Electronic Commerce and its Challenges to the European Union System of Value Added Tax

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Chapter 1: Introduction

The relentless advance of Globalization and its economic, social, political and technological innovations and developments long since determines day-to-day business around the globe and seeks to facilitate the burdens of our modern world. The most revolutionary product of the globalizing process is the World Wide Web which forms an essential part of daily life for millions of people worldwide twenty-four-seven. In an official communication of the European Commission, it describes the role and development of the internet as important and fundamental as the ‘industrial revolutions of the previous centuries’. The Internet establishes a perfect symbol for Globalization since it represents a proceeding technical evolution and, furthermore, ignores geographical as well as economic frontiers by connecting individuals worldwide within seconds. Following the economic perspective of the internet, the main features of the Internet are electronic commerce and online services. They are regarded as one of the core drivers in the globalized world economy and it is claimed that rejecting electronic commerce may have noticeable competitive disadvantages.

The Organization for Economic Cooperation and Development (hereinafter referred to as the OECD) offers a closer description of the role electronic commerce plays today. In its ‘Ottawa Framework’, electronic commerce and online services are praised for their multifaceted advantages. In effect, electronic commerce opens up manifold ways to render business transactions over far distance, leads to essential social and economic developments and helps to create new markets for new consumer products and services.

However, new developments in a breath introduce new challenges and the evolution of electronic commerce does not form an exemption to that fact. As a reason, international organizations and their institutions as, for instance, the OECD or the United Nations Commission on International Trade Law (hereinafter referred to as UNCITRAL) regard electronic commerce as a priority task and seek international cooperation as well as legal guidance in this field. The UNCITRAL introduced an international model law framework with implementation guidance already in 1996 with the aim to support national legislations around the globe to overcome legal impediments and to provide for legal certainty, simplification as well as harmonization of ‘international economic relations’
dependent on electronic commerce.\(^5\) The OECD published the above mentioned ‘Ottawa Framework’ in 2001 following the official Ottawa Conference in 1998. Next to political and economic challenges, legal difficulties and possible solutions to them stand in the foreground. Since the enactment of the framework, regular reports and investigations regarding the process, implementation as well as potential improving amendments are published.

Also the European Union accepts and considers the importance but also the challenges of electronic commerce. Next to the overarching European internal market\(^6\), the EU authorities seek electronic commerce as the nexus of a European wide ‘digital single market’ which shall be based by the same premise of a level playing field. To fulfill the desired target, especially the consumer must have unambiguous trust in electronic commerce. In effect, privacy has to be respected, legal certainty to be guaranteed, transactions to be secured and the utilization has to be simple as well as of reasonable costs.\(^7\)

The existence of various challenges to a sufficient functioning of electronic commerce was already mentioned above. One of the main fields where such challenges are especially intensive is the area of taxation, respectively taxation of consumption (e.g. Value added tax).\(^8\) The European Commission in its Communication regarding the ‘Single Market Act’ requires improvement and revision of the European VAT system, essentially in cross-border trade - in general as well as in electronic form.\(^9\)

The main question remains what impediments electronic commerce establishes regarding value added taxation. From a European Union perspective - the internal market in the back of the mind - the distortion of competition by 28 different VAT rates as well as electronic services provided by third countries is primarily considered.\(^10\) The OECD seems to focus more on a practical issue by asking from whom the VAT due has to be charged and collected in an electronic transaction which are in many cases of cross-border nature. The obvious problem at hand is to identify the appropriate tax jurisdiction.\(^11\) Several authors also attempt to categorize the challenges electronic commerce

\(^8\) See OECD, Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions, p.9.
\(^9\) See European Commission, Communication from the Commission the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions: Single Market Act - Twelve levers to boost growth and strengthen confidence, p.16.
provides. In their work they hint to the ‘blurring of geographical categories’ and the ‘blurring of income categories’ which renders correct and effective taxation a challenging task.\(^\text{12}\)

Since these issues just form partial elements of the challenges to electronic commerce in the European VAT system, this evaluation will dig deeper by dealing with the preliminary research question whether the existing as well as future EU legal framework for VAT levied in electronic commerce (electronic services) is compatible with the fundamental principles of VAT, respectively the taxation of final consumption, tax neutrality as well as the practical implications of the VAT reforms 2010-2015.

To answer the research question, a step by step elaboration of the topic is required. In chapter 2, Value added Taxation is described in general terms. In essence, the actual meaning of VAT, how VAT works in effect and how VAT is regulated in the European Union will be clarified. Furthermore, the essential VAT principals of taxing final consumption and tax neutrality - next to the occurring practical issues - will be discussed.

Since electronic commerce is a very far reaching term, Chapter 3 aims to provide a general definition of the term and its entire meaning for the world economy as well as the European Single Market. In addition, the manifold facets and forms of electronic commerce will be determined and explained.

Value added taxes are commonly charged for the provision of goods on the one hand or services on the other hand. This evaluation will concentrate on electronic/online services mainly. After defining the term in Chapter 3, Chapter 4 will clarify the existing EU legal framework for electronic services in general (as well as in the area of VAT).

The task of Chapter five is to merge both elements and to crystalize the legal relationship between online services and the charging of VAT while concentrating on the above indicated challenges.

Chapter 6 will round up this work with a general conclusion which will finally answer the research question through summarizing the findings of the previous chapters.

Chapter 2: Value Added Tax in the European Union

2.1. General Remarks

Before we turn to the actual topic concerning the existing challenges to the European Union VAT system by electronic commerce in the form of online services, the following subparagraphs will elaborate on the relevant aspects of VAT.

2.1.1. Direct vs. Indirect Taxes

Value added tax is concerned to be an indirect tax. The question remains what conditions differentiate it from direct taxes. Referring to economic principles, direct taxes decrease the income of a taxable person by paying the tax to the relevant tax authority. In effect, the tax burden as well as the actual payment of the tax remains on the same person. In the case of indirect taxes, the tax burden and the actual payment of the tax are shifted and, thus, lay on different individuals. 13

Simplified formulated direct taxes are levied on persons who are the tax subject as well as the final taxpayer whereas indirect taxes are transferred from the actual tax payer to another person through the prices for the purchase of goods or services. 14 The concerned author uses the actually purposes of both types of taxation to establish a reasonable distinction. In short, the purpose of direct taxation is often justified by the ability-to-pay principle as well as the direct-benefit-principle.

According to the ability to pay, direct taxes on income are levied based on the ‘individual taxpaying capacity’ of the concerned taxable person calculated on his/her actual regular income. 15 Referring to the direct-benefit-principle, the purpose of direct income taxes is to provide for a consideration for the benefits the taxpayer enjoys by governmental legislation as well as public services or infrastructure of a country. 16

The overarching principles of indirect taxes such as VAT are often concerned to be tax fairness and tax neutrality dealt with in more detail below.

The World Trade Organization provides interested individuals with a sustainable list of explicit examples for direct and indirect taxes in one of its agreements. Accordingly, direct taxes are taxes on income in the form of ‘wages, profits, interests, rents, royalties’ and on real estate. Correspondingly

15 Ibid., p.9.
16 Ibid., p.10.
indirect taxes are referred to as taxes on ‘sales, excise, turnover, value added [...] and all taxes other than direct taxes’.17

2.1.2. VAT as an Indirect Tax on Final Consumption

There are manifold types of indirect/consumption taxes but as opposed to retail sales taxes where the tax is levied only once, VAT has prevailed as the most commonly used indirect/consumption tax in the world (Since the 1960s established in over 150 countries worldwide) what unambiguously underlines its intensive significance.18

The status of VAT as an indirect tax is determined by its purpose. Relying on the guidelines of the OECD, the encompassing purpose of VAT is to establish a far reaching/ broad-based taxation of overall final consumption.19 Normally, only private individuals are regarded as final consumers bearing the tax burden whereas businesses are the actual tax subject. Nevertheless, also legal persons will become final consumers if they use goods or services for non-business activities.20 For further clarification, VAT on consumption shall entail the charging of a proportional tax on consumable goods and services.21 The definition of the term consumption always leads to discrepancies of its exact meaning. On the one hand there is short-term consumption like smoking a cigarette or enjoying something to drink. On the other hand there is long-term consumption as buying and wearing clothes for instance. Since VAT seeks to establish a broad-based tax on overall consumption, the differentiation between short – and long-term is inappropriate. For the purpose of VAT, consumption shall be simply reduced to the actual ‘expenditure’ made in consideration for this consumption.22

The OECD provides its audiences with a ‘pure definition of consumption’ according to which the actual consuming of a service determines the place of consumption and referring to their Ottawa Framework to the place where VAT actually should be charged. Hence, the OECD remarks that such a pure definition of consumption is rather difficult to apply to electronic services because of the

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20 Ibid.
complexion of the digital world. This fact constitutes a further challenge of electronic services to the EU VAT system and will be discussed in detail below (Chapter 4.3.).

Turning to the functionality of VAT, it has been clarified that an indirect tax shifts the actual tax burden from the tax subject to another individual, respectively the final consumer. Though how does it actually work? The OECD categorizes the charging of VAT as the ‘staged collection process’. In other words, VAT is charged and collected at the multiple stages of a production chain with the final consumer bearing the actual tax burden. To guarantee that the interim links of the production chain does not bear the actual tax burden of VAT, the tax paid by them is returned through deductions. Although there are two methods of relief in existence, only one method attained acceptance in the economic world. By the ‘invoice credit method’ the VAT paid by the one trader is added as an input tax to the price and offset by the output tax paid by the other trade.

The element which renders governments so interested in the VAT system is its large potential of high revenue. From a financial perspective, the broad base of VAT as a consumption tax reaches every purse in a State so that tax returns are guaranteed. Furthermore, VAT is a flexible tax since rates can be adjusted quite easily. Another advantageous character of VAT is its relative simple administration compared to direct income taxes for instance. Referring to the economic perspective, VAT is always honored for its neutrality which will be discussed in detail below. The only negative predicate dimming the overall positive view of the VAT system consists of the claim that the tax is regressive. In effect, the tax burden is considered to be higher for individuals with low income than compared to individuals with a higher income (‘ratio of consumption to income’). This abstract shall only demonstrate a short list of advantages and disadvantages of the VAT system but shall not be of further concern since it is not part of the essentials elaborated in this work.

2.1.3. The Principle of Tax Neutrality in VAT

Next to the overarching principle/purpose of VAT to tax final consumption, tax neutrality is a very important element to be considered. Again, the OECD guidelines for consumption taxes provides us with a list of guidelines for tax neutrality as well as other important principles emphasizing VAT as an indirect tax as explained in Chapter 2.1.1.

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24 See OECD, OECD International VAT/GST Guidelines, Chapter 1, Paragraph 1.4.
25 Ibid., Chapter 1 Paragraph 1.4f.
27 Ibid., p.437f.
28 Ibid., p.440f.
Essential for VAT is efficiency, flexibility, certainty, simplicity, effectiveness as well as proportionality establishing the overall framework of a functioning tax system.\textsuperscript{29} Next to these elements, tax neutrality is the most fundamental principle relevant for VAT as well as for the research question of this work. Although tax neutrality is deemed to be achieved by the stage-collection-process, it is a multifaceted principle. For VAT purposes, it requires that the tax burden of VAT shall only lay on taxable persons if explicitly provided by legislation.\textsuperscript{30} Secondly, neutrality shall be guaranteed by ensuring that taxable persons of equal or similar characteristics operating equal or similar business activities shall be subject to equal or same tax.\textsuperscript{31} Official guideline 2.3 concerning tax neutrality requests a VAT system to be legally formed in a way not influencing or distorting business decisions like investments for instance. Regarding cross-border trade, a VAT system shall safeguard neutrality by eliminating any advantages as well as disadvantages occurring for foreign businesses compared to domestic businesses. In other words, VAT legislation shall establish a level-playing-field enhancing fair competition – an essential element of the European internal market.\textsuperscript{32} The last important guideline for tax neutrality with its emphasis on non-discrimination is the justification of specific administrative measures only applicable to foreign businesses if they do not establish any ‘inappropriate compliance burden[s]’\textsuperscript{33}

One principle may collide with the principle of tax neutrality. According to the principle of origin, VAT is charged in the State of production of goods or provision of the service ignoring the actual location of consumption.\textsuperscript{34} Hereby, tax neutrality is distorted because consumers get the incentive to choose a country with a lower VAT rate instead of purchasing goods and services in their domestic market due to a higher rate. Correspondingly, a further principle has been introduced to simplify cross-border trade and to ensure tax neutrality. According to the destination principle, the supply of goods or services is taxed at the place of their destination/final consumption.\textsuperscript{35} This principle is realized by the ‘reverse charge mechanism’ we found for instance in the EU VAT directive concerning Business-to-Business transactions within the European Union.\textsuperscript{36}

Also the ECJ widely concerns tax neutrality and its importance for the EU VAT framework. Various cases reemphasize those elements available in the OECD Guidelines. For instance in Dornier, the court states that tax neutrality - often referred to as fiscal neutrality - is ‘inherent’ in the existing VAT

\textsuperscript{29} See OECD, \textit{OECD International VAT/GST Guidelines}, Chapter 1, Paragraph 1.16.
\textsuperscript{30} Ibid., Guideline 2.1.
\textsuperscript{31} Ibid., Guideline 2.2.
\textsuperscript{32} Ibid., Guideline 2.4.
\textsuperscript{33} Ibid., Guideline 2.6.
\textsuperscript{35} Ibid.
\textsuperscript{36} See VAT Directive, Article 196.
system and full compliance is required. In \textit{Gregg}, the court confirms that tax neutrality shall preclude equal or similar business operators to be treated differently for tax purposes. Not only equal or similar business operators shall enjoy tax neutrality but also similar and thus competing goods and services shall be precluded from unequal treatment. These case are only some examples in a wide pool of case law concerning tax neutrality what actually emphasize the importance of this principle.

Both tax neutrality as well as the place of actual taxation (origin/destination) relating to the purpose to tax final consumption will be dealt with later on in connection to electronic commerce/online services.

2.2. VAT in the European Union

The European Union authorities quite early realized the importance of a functioning consumption tax system in the form of VAT. Therefore, the main task is to establish a VAT system respecting the level-playing-field and fair competition to become a fundamental pillar of the European internal market. Therefore an EU wide harmonization of VAT is required to form a simply and neutral tax system even if exemptions and varying rates still might exist. Though how does the VAT as a consumption tax gain acceptance throughout Europe?

The European authorities agreed that a harmonization of the several existing taxes on consumption is necessary and essential for the functioning of the desired internal market. In the sixties, several committees advising the European Commission elaborated some drafts which were different in their entire content but which all unanimously preferred a value added tax system for the European community. The final outcomes of these early efforts were the first and second directives installing a value added tax among all Member States. Nevertheless, these were only first steps in a long harmonization process. The essential contribution to the VAT system we find in presence today is the simplified and unified tax basis established by the sixth directive in 1977 which also attempts to answer the questions of for whom, for what, where and when taxation is actually due.

\begin{itemize}
\item \textsuperscript{37} Court of Justice, C-45/01, \textit{Christoph-Dornier-Stiftung für Klinische Psychologie v Finanzamt Gießen}, (2003), paragraph 42.
\item \textsuperscript{38} Court of Justice, C-216/97, \textit{Jennifer Gregg and Mervyn Gregg v Commissioners of Customs and Excise}, (1999), paragraph 20.
\item \textsuperscript{39} Court of Justice, Case C-363/05, \textit{JP Morgan Fleming Claverhouse Investment Trust plc The Association of Investment Trust Companies v Commissioners of HM Revenue and Customs}, (2007), paragraph 43.
\item \textsuperscript{40} \textit{Ibid.}, Preamble Paragraph 4ff.
\item \textsuperscript{41} A. van Doesum, H. van Kesteren, G.J. van Norden, \textit{Draft: Fundamentals of EU VAT Law}, Tilburg University (2013), Chapter 1, p.11.
\item \textsuperscript{42} \textit{Ibid.}
\end{itemize}
The VAT directive in force (Directive 2006/112 EU) is the result of long-term fine-tuning since the enactment of the above mentioned sixth directive and for this work of essential concern. It is quite obvious that the older directives are withdrawn by the VAT directive which entails important amendments and reconciliations fitting in the internal market of – nowadays – 28 Member States.\footnote{Ibid., Chapter 1, p.12f.}

Next to the VAT directive and clarifying regulation exists which supports a correct and reasonable use of the provisions of the directive. It is an additional legal measure to the VAT Directive requiring the Member States to adopt the implicated rules in order to guarantee a functioning VAT system in a functioning internal market.\footnote{Council of the European Union, Council Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, Official Journal of the European Union L77/1 (2011), Preamble Paragraph 2.}

The relevance of this short historical summary is the continuous development of VAT legislation promoting tax neutrality along the development of the internal market in the European Union. Each piece of legislation until the enactment of the VAT Directive but also its essential amendments discussed below helped to improve the single market by enhancing a fair and neutral VAT system step by step. Whether these targets are achieved will be answered in Chapter 5.
Chapter 3: Electronic Commerce

Much ink has been spilled on the question what electronic commerce actually consists of and entails. Thus, a widespread bunch of literature has been published examining the characteristics of electronic commerce – either in its technological, economical or even legal terms. The following chapter will summarize the most essential elements of electronic commerce attending in the mentioned literature in order to provide for a reasonable and focused view of this diversified topic relevant for this work.

3.1. General Aspects

Electronic commerce is one of the milestones since the innovation and unstoppable evolution of the information technology. This evolution entirely morphs the state of art business is done today. One author phrases it as a ‘tsunami’ because the consistently rapid changes of the information technology and thus of the electronic business are ‘overwhelming [and] irresistible’.

The term ‘electronic commerce’ got its first attention when smaller networks of computers facilitated several transactions (e.g. electronic funds transfers, electronic settlements of securities trade, electronic contracting). Although these processes ran nearly automatically, they were integrated in administrative frameworks supervised and performed by individuals. During the 90s, electronic commerce ultimately emerged to a solid constant in day-to-day business. Due to the manifest the internet became in these days and due to its commercialization and the widely accepted view to exploit this commercial utility, business transactions turned away from ‘paper-based processes’ to their digital counterpart. Behind the scene stood and always stands the concept of a public tool connecting businesses and consumers around the world. In due process, electronic commerce developed to a simple but widespread transaction system and spawned the complex construct of electronic business entailing tools as resource management systems or customer relationship management systems providing for an effective and competitive level-playing field.

People always praise the internet as such for the upcoming of useful concepts as electronic commerce but their view is often too superficial and limited. Of course the World Wide Web is the nexus of today’s information technology but one of the most fundamental processes going along the line is digitalization. Rather banally formulated, ‘if information could not be digitized, the internet

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45 Exact information to the literature can be found in the subsequent footnotes (footnotes 43ff.)
47 Ibid., p.3.
48 Ibid.
49 Ibid., p.4.
Hence, digitalization transforms information into a perfectly flexible and fast medium ignoring any boundaries or limits the exchange of information on the pure interpersonal level might have – especially in the terms of electronic commerce.\(^5\)

To branch off the historical and technical development of electronic commerce, we shall focus on its essential characteristics. Simply formulated, the internet – as a tool for exchanging information – enables businesses and individuals to contract with each other for the purchase of goods and services by electronic means. This is only one and rather poor definition among thousands.\(^5\)

Actually no one-fits-all definition of electronic commerce is already in existence. A frequently emerging term to determine the essence of electronic commerce is the application of digital networks to enable transactions of goods and services and their correlated production, distribution, purchase and delivery in local and global markets.\(^5\) The OECD appears to conclude similarly but additionally indicates that the trade of goods and services via computer networks in its essence only set a digital order whereas the final processes of payment or delivery do not need to be conducted digitally. Furthermore, the OECD definition offers a wider spectrum of involved players as ‘enterprises, households, individuals, governments and other public or private organizations’.\(^5\) The definition of electronic commerce by the institutions of the European Union predominantly focus on the term ‘Information Society Services’ which entails services provided for consideration ‘at distance’, by ‘electronic means’ and upon an individual request by the consumer of the service.\(^5\) For the reader it does not become quite clear whether information society services also contains the distribution of goods by electronic means. The above mentioned proclamation of the digital internal market in the European Union and its correlations to the OECD let logically conclude that electronic commerce in the European Union refers to goods and services traded over distance by electronic means alike.

After the attempt to offer a sufficient definition of electronic commerce, a next step to further concretize the picture of this concept is to categorize it. The first categorization has been indicated above by differentiating between electronic commerce and electronic business. Whereas electronic


\(^{5}\) Ibid., p.12.


commerce adapts the actual process of business transactions via the World Wide Web, electronic business on the other hand represents a complete rearrangement of a business to transform it into an ‘Internet based network enterprise’.\(^{56}\)

Contemporary concentrating on the concept of electronic commerce, it can be categorized based on the nature of the transaction at hand. The very first category is business-to-business electronic commerce where two different businesses trade with each other in an electronic marketplace.\(^{57}\) The logical second constellation is the classic business-to-consumer transaction which is the most relevant for daily life business activities and for this evaluation. Simplified illustrated, business-to-consumer transactions by electronic means refer to purchasing goods or services by public consumers via digital catalogs. The obviously biggest player in electronic business-to-consumer transactions is ‘Amazon’.\(^{58}\) There are several more categories in existence as business-to-government, consumer-to-business as well as consumer-to-consumer transactions (e.g. ‘ebay’). Also remarkable is intra-business e-commerce establishing a transaction framework not leaving the inside of an organization and non-business e-commerce (e.g. by universities or religious organizations etc.)\(^{59}\)

To keep it reasonably short, the most essential category for the purpose of this paper shall be the business-to-consumer transaction by electronic means.

Another important factor to be mentioned is the basic interrelation between electronic commerce and electronic payment systems. Online payment providers as ‘PayPal’ or ‘Paysafe’ unambiguously determined the destiny of electronic commerce and its success since they are faster than traditional payment methods. Despite the outcry concerning the security of this system, it perfectly fit in the electronic commerce framework nowadays due to technological expansion regarding security.\(^{60}\)

\(^{57}\) Ibid., p.5.
\(^{58}\) Ibid., p.6.
\(^{59}\) Ibid., p.6ff.
\(^{60}\) See R.L. Doernberg, L. Hinnekens, W. Hellerstein, J.Li, Electronic Commerce and multijurisdictionalTaxation, p.55f.
3.2. Benefits and Challenges of Electronic Commerce

3.2.1. Benefits

The following subparagraph shall determine the general benefits and challenges electronic commerce establishes absent from a legal perspective which will be discussed below.

Electronic commerce is inextricably connected to the internet and thus may enjoy it profits but also suffers from its downsides. As the World Wide Web in general, electronic commerce is available and in action all over the world 24/7. Ignoring geographical boundaries, electronic commerce opens a new global market everybody has access to. In the patterns of competition, all traders in the internet may be in a level playing field regarding market access and market availability, although remarkable pressures may rise since already digitally established big players as ‘Amazon’ are not easy to defend.\(^6^1\) However big players may dominate the market, small players achieve acknowledgement and a visible presence in digital markets, thereby enhancing their overall chances.\(^6^2\) Moreover, electronic commerce is much cheaper regarding advertisement, merchandising and the presentation of the stocks of goods or services offered. Whereas big warehouses spend a lot of their assets to publish paper-print catalogs etc., electronic warehouses just need one click to furnish their digital shop windows. The saved assets can be redistributed to enhance the digital business by other means than expensive advertisement.\(^6^3\) Another important aspect of electronic commerce is its flexibility and the correlated capability to immediately answer to new consumer behavior and requests as well as to new market developments.\(^6^4\) The access to information relating to the business (‘FAQ’) is also quite remarkable and much easier to access than in non-digital businesses.

The European Union materially relies on electronic commerce to realize the overarching target of a digital internal market. The expected benefits of an effective online market consist of the potential to foster economic growth and employment as well as in the education sector. Again, its availability, flexibility and efficiency are the core features rendering electronic commerce that essential.\(^6^5\)

In summary, electronic commerce offers a simple and cheap way to access global markets and to compete with big players. Furthermore, it is a flexible and consumer-friendly tool which enables quick and easy shopping.

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\(^6^2\) Ibid.

\(^6^3\) Ibid.

\(^6^4\) Ibid. p.7.

3.2.2. Challenges

Next to the challenges electronic commerce establish for legal scholars, there are some aspects which dim the alleged perfect image of electronic commerce. Whereas electronic commerce let businesses save assets for advertisement or merchandising, they have to face rather high costs to establish a competitive and successful electronic commerce platform. Costly licenses, expensive adjustments of new technological innovations and cost intensive maintenance are just some examples of heavy burdens a business successfully digitally trading has to carry.\(^66\)

Although easy access and stable presence in digitally run markets is frequently proclaimed, it is actually rather difficult to gain and defend a sufficient stand in the online world. In effect, the main task of achieving certain credibility and to ensure consumer confidence and reliance is as much as costly as reacting immediately to market changes imposing undeniable competitive pressures.\(^67\) In other words, the internet is the perfectly competitive field for a business but only following the first-wins-all principle.

One of the most striking negative concerns regarding electronic commerce are security lacks in the internet. The naïve believe of millions of consumers in their online sanctity and their negligent conduct towards their own private data and, finally, the possibility to steal data as passwords, bank account details etc. invites criminals to illicitly exploit this system. Internet security has become a market itself also based on legal and political influence but still fraud and theft are on the daily online agenda.\(^68\)

Disregarding the alleged benefits of electronic commerce, we conclude that might be indeed rather cost intensive to establish a successfully functioning business in the digital world. Furthermore, competition might be rather harsh and also cost intensive. Finally, severe security lacks always throws a negative light on electronic commerce forcing consumers to return to old fashion style shopping.

3.3 Online/Electronic Services

Since this work deals with the VAT regulations of electronic commerce in the form of services provided online, it is of essential necessity to clarify this term. In effect, one may turn to the above indicated definitions. In the pattern of the ‘Information Society Services’ online services are provided for to the consumer by electronic means. Essentially for VAT purposes is that these services are provided for consideration/remuneration.


\(^{67}\) Ibid., p.8.

\(^{68}\) Ibid., p.14f.
A non-exclusive but unambiguously most relevant list of examples of electronic services is provided by Annex II of the VAT Directive. The annex entails ‘website supply, website hosting, distance maintenance of programs and equipment, supply of software and updating thereof, supply of images, text and information and making available of databases, supply of music, films and games [... and the supply of distance teaching].’\(^{69}\) This list is additionally clarified by the corresponding Council Implementing Regulation 282/2011. In essence, electronic services qualify as electronic when they are supplied rather ‘automated’ via the internet or any other electronic network with ‘minimal human intervention’ in the sphere of modern information society.\(^{70}\) Article 7(2) concretize the elements of the list presented in Annex II of the VAT Directive with some explanatory remarks but also adds new features. For instance, the allocation, administration and maintenance of a digital market place such as ‘ebay’ may qualify as an electronic service.\(^{71}\) The list of electronic services relevant for the legal purposes of the VAT Directive is finally amended by a quite detailed and explicit accumulation of examples in the Implementing Regulation 282/2011.\(^{72}\) For the purpose of this work, we will primarily focus on these electronic services to describe the according VAT arrangements as well as to answer the basic research question.

After the clarification of the term, the next chapter will consider the exact VAT framework in the European Union from a present and future perspective.

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\(^{69}\) See VAT Directive Annex II.

\(^{70}\) See Council Implementing Regulation (EU) No 282/2011, Article 7(1).

\(^{71}\) Ibid., Article 7(2)(d).

\(^{72}\) Ibid., Annex I.
Chapter 4: Taxation of Electronic Services

The subsequent paragraphs concern the existing VAT framework of electronic services in the European Union on the one hand and upcoming new rules applicable from January 2015 onwards on the other hand. For the purpose of this chapter, I will primarily concentrate on Business-to-Consumer transactions/supply of electronically provided services and correspondingly filter out the relevant present as well as future rules and conditions for such transactions in the sphere of EU VAT legislation. The alleged focus on Business-to-Consumer transactions and its relevance root in the essence of this work as well as in the question whether the EU VAT system for electronic services respects the principle to tax final consumption. In other words, this elaboration shall concentrate on the relation between the service provider and the final consumer of electronically supplied services since it is actually this relation which renders the investigation of the present and future VAT legislation for electronic services interesting. In further essence - without the intention to anticipate - the alleged reforms of 2015 will substitute the origin principle enrooted in Art. 45 VAT Directive applying to B2C transactions in the European Union for the destination principle implemented in the amended Art. 58 VAT Directive. Thus the 2015 reform just addresses the relation between the service provider and the final consumer (B2C) since the destination principle already applies to all available Business-to-Business transactions under the reverse-charge mechanism.73

4.1. General Remarks

Before turning to the substance, respectively where VAT for electronically provided services is exactly levied, the general framework of the VAT directive is compactly summarized.

In its essence, the VAT Directive installs a mutual framework for VAT in the European Union to further stabilize the functioning of the internal market. To achieve such target, a comprehensive tax on EU wide consumption is fostered and applied to goods and services in proportion to their price.74

For the purpose of this paper, the main subject of such an overall tax on consumption shall be the provision of services for consideration in the European Union by a taxable person.75 A taxable person under the Directive is determined as such by sovereignly carrying out an economic activity what also comprises the supply of services and the interrelated use of intangible property - as listed in Annex II of the Directive - to generate income.76 The most remarkable examples of Annex II in this regard are

74 See VAT Directive, Article 1(1),(2).
75 Ibid., Article 2(1c).
76 Ibid., Article 9(1).
the supply of technical web-maintenance, the supply of software as well as the supply of music, films and other medial tools.

Articles 24 and its successors clarify under which circumstances the supply of services in general qualifies as a taxable transaction. It is just logical that a supply of services does not contain a supply of goods as it is simply formulated in Article 24. Along the lines, Article 25(1) of the VAT Directive confirms the above rendered statement that the allocation of intangible property constitutes a supply of services.

The last general but nevertheless remarkable point is that a supply of services provided complimentary and for private or any other use not relating to the business of a taxable person, shall be treated as a taxable transaction.77

This small subparagraph shall only present a short insight in the general framework of the VAT directive which is also relevant for the comprehension of this system regarding the taxation of electronic commerce. After determining what constitutes a taxable person and a related taxable transaction, we now turn to the fundamental question where VAT on electronic services is actually due. Thus, the following subparagraph will discuss the place of supply rules and their application to electronically provided services.

4.2. EU Place of Supply Legislation until 2015

4.2.1. The actual/current Place of Supply Rules

The place of supply rules have always been the nexus of discussions and arguments, especially in the field of electronic commerce. In the sphere of taxation, the continual debate roots in the above mentioned expansion of the digital market and the corresponding conversion from physically to electronically supplied services and the related fact that such a digital market requires a ‘comprehensive broad-based VAT system’ with reasonable place of supply rules.78 To understand the complete picture of the existing legal framework for electronic services, first the generally applicable place of supply rules for services will be discussed.

The importance of place of supply rules is that they determine where the taxable transaction ultimately takes place or in other words where VAT has to be levied finally. The general rule for services supplied to taxable persons is the place where such a person has his/her place of

77 Ibid., Article 26(1b).
establishment or where he/she has his/her fixed establishment in the event the services are supplied to it.\textsuperscript{79}

On the other hand, if services are supplied to a non-taxable person (in other words the (final) consumer), the place of supply shall be the location where the supplier has his/her place of establishment or has his/her fixed establishment if concerned services are provided by it.\textsuperscript{80} Much criticism is spent on this provision since it establishes a competitive disadvantage. Due to different VAT rates in- and outside the European Union, final consumers tend to purchase services as well as goods in Member States/ non-EU countries with a lower VAT rate since the supply takes place where the supplier is established and not where the services are finally consumed.\textsuperscript{81} Following this line of thought, domestic service provider in countries with a higher VAT rate are disadvantaged by this provision compared to service providers in low-rate countries. Concerning the trade between EU Member States and non-EU countries complicated registration rules additionally exacerbate the situation.\textsuperscript{82}

A first mitigating measure has been the introduction of the reverse-charge mechanism. By referring to the services mentioned in Article 44, VAT on services provided to taxable persons and non-taxable legal persons identified for VAT purposes (B2B transactions) shall be charged at the place of the recipients, if the service provider is established in another Member State of the EU.\textsuperscript{83}

In my point of view, this mechanism is a sufficient starting point but it refers only to taxable and non-taxable legal persons identified for VAT purposes, in other words to Business-to-Business transactions. The consumer/natural person is not affected by this provision but by Article 45 VAT Directive.

Articles 44 and 45 of the VAT Directive are part of the VAT reform package 2010-2015 and are generally held statutes extended by several specifying provisions defining rules of supply for special types of services as those electronically provided. The reform package will be complete in 2015 with new rules for telecommunications, broadcasting and electronic services.\textsuperscript{84}

\textsuperscript{79} Ibid., Article 44.
\textsuperscript{80} Ibid., Article 45.
\textsuperscript{81} P. Wille, New EU VAT Rules for Telecommunications Services from 2015, International VAT Monitor January/February 2012, p.6.;
\textsuperscript{82} Ibid., p.6f.
\textsuperscript{83} See VAT Directive, Article 196.
\textsuperscript{84} Commission of the European Union, Directorate – General Taxation and Customs Union, Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015, Brussels (2014), p.10f.
It is quite remarkable that the above mentioned competitive disadvantages as well as the administrative burdens for non-EU suppliers have already been considered in the late 90’s regarding the taxation of telecommunication services and later in the field of electronic services by the institutions of the European Union.\footnote{L. Hinnekens, \textit{An updated overview of the European Union VAT Rules concerning electronic commerce}, EC Tax Review Volume 2 (2002), p.67f.} The second remarkable aspect is that new place of supply rules for telecommunication services based on the destination principle has been enacted to tackle these competitive disadvantages.\footnote{Ibid.}

In 2002, an amending Directive explicitly considered the problematic place of supply rules for electronic services. It reads that the existing legal framework at that time was ‘\textit{inadequate for taxing [electronically supplied] services consumed within the Community and for preventing distortions of competition’}.\footnote{Council Directive 2002/38/EC, amending and amending temporarily Directive 77/388/ECC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, Official Journal of the European Communities L128/41 (2002), Preamble Paragraphs 1.} Thus, an enduring harmonization was required. The only twist consisted of the fact that these considerations only dealt with the electronic provision of services between an EU Member State and a non-EU country. Nevertheless it was a remarkable step in the right direction since in essence the document officially required taxation in the place of consumption following the destination principle. In other words, the place of supply of electronic services provided to a non-taxable person having his/her place of establishment in the European Union by a taxable person established outside the European Union is the place of the recipient of these services.\footnote{Council Directive 2002/38, Art. 1b.} Hinnekens admits in his article that the reforms of 2002 represent a first improvement but additionally cautions against upcoming practical challenges like the correct determination of the place of final consumption and the correct mechanisms to charge and collect VAT. Already in 2002, the present as well as future problems have been obvious and let Hinnekens demand prudence as well as essential reforms resulting in simplification and efficiency of a functioning VAT system for electronic services.\footnote{See L. Hinnekens, \textit{An updated overview of the European Union VAT Rules concerning electronic commerce}, p.69.}

In due process, Directive 2002/38 as well as the directive it amended shall be later implemented in a modified form in the present VAT Directive. As from 2010 until 2015 and according to the rules of Directive 2002/38/EC integrated in the VAT Directive, the place of supply of electronically provided services listed in Annex II of the VAT Directive to non-taxable EU citizens by a taxable person from outside the EU and - vice versa - to a non-EU non-taxable person by a taxable EU citizen shall be the

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\footnote{See L. Hinnekens, \textit{An updated overview of the European Union VAT Rules concerning electronic commerce}, p. 70f.}
\end{flushleft}
place where the recipient is located/residing. These provisions actually concern Business-to-Consumer transactions and are effectively in line with the premise to achieve taxation at the place of final consumption. As an additional and small hint beside, it is remarkable that whereas the Council Implementing Regulation 282/2011 indicates additional conditions and information for most of the various types of services, it remains silent about electronic commerce. This picture has changed with the introduction of an amended implementing regulation discussed below.

In summary, by the above elaborated place of supply rules the disadvantageous competitive situation established by different VAT rates as well as complex registration rules are eliminated at least for trade with non-EU countries. The question remains how to deal with the situation of inner EU cross-border trade where the place of supply of services to non-taxable persons - including electronically provided ones – is still the location where the supplier has his/her place of establishment or has his/her fixed establishment.

4.2.2. The special regime for Non-EU Suppliers

Before answering this question in the next subparagraph, first a correlated substitute question shall be considered, respectively why especially the trade with non-EU countries is regulated by the destination principle according to Articles 58 and 59(k) of the VAT Directive. In this line we already considered complex registration rules and procedures as well as differences of VAT rates. However, before the reforms by Directive 2002/38/EC, EU taxable persons had to charge VAT while electronically providing services outside the EU and, on the other hand, non-EU electronic service providers had to levy VAT ‘as EU-Suppliers’ if they sold services to non-taxable EU citizen. This scheme established administrative burdens for non-EU service providers as well as a further disadvantageous competitive situation for EU traders since non-EU customers could be deterred of the VAT due in the EU. In essence, the main problem has always been the fact that the reverse-charge mechanism applying to B2B transactions does not apply to non-taxable persons. Thus, service suppliers from outside the territory of the European Union had to register for VAT purposes in the EU Member State where the customer resided. With 28 Member States the above mentioned administrative burdens become obvious.

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90 See VAT Directive Articles 58 and 59(k).
92 Ibid.
93 M. Lamensch, Proposal for Implementing the EU One-Stop-Shop Scheme from 2015, International VAT Monitor September/October 2012, p. 313f.
The previous mentioned reforms therefore required additional practical developments and improvements. Articles 358 until 369 of the VAT Directive concern a special regime for non-EU taxable persons providing electronic services to non-taxable persons established or residing in one of the Member States. This scheme – achieving notoriety as the one-stop shop scheme – has been necessary to guarantee a correct charge of VAT. Put it as much simple as possible, the non-EU taxable person has to be registered/identified in the Member State of Identification as a sort of contact point and where he/she actually initiates his/her business activities in the EU. Next to the Member State of Identification is the Member State of Consumption where the electronic service is finally consumed. Upon registration/identification, the non-EU taxable persons has to submit his/her VAT returns to the authorities of the Member State of Identification, stating the VAT payable for electronic services supplied to non-taxable persons in each Member State of Consumption. Based on those returns, the non-EU taxable person has finally to pay the VAT due. If the non-EU taxable person leaves the EU and thus ceases his/her business activities in the EU he/she is officially deregistered in the Member State of Identification.

The idea behind the one-stop shop scheme presented by Articles 358ff. is to simplify the due process for non-EU taxable persons, since they have to be only once registered to be charged of VAT of all provided electronic services among the EU in the Member State of Identification instead of an official registration in all Member States of Consumption. Nevertheless, the expedient simplification in the form of the one-stop-shop scheme has gone hand in hand with the intention of the EU legislators to attract and to convince non-EU service providers to continue their business relations with non-taxable EU citizens.

This subchapter has demonstrated that the applicable VAT rules for electronically supplied services within the European Union - as far as B2C transactions are concerned - still rely on the origin principle whereas B2C transactions involving non-EU service providers as well as non-EU customers are handled based on the destination principle. The introduction of essential reforms has already been indicated several times in this work. Thus, the subsequent subchapter will now illustrate these fundamental changes applicable from January 2015 onwards.

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94 See VAT Directive Article 358(3),(4).
95 Ibid., Articles 360, 362,363, 364 and 367.
96 See M. Lamensch, Proposal for Implementing the EU One-Stop-Shop Scheme from 2015, p. 313.
4.3. The 2015 Place of Supply Rules

4.3.1. The new place of supply rules

Alleged amendments of existing legislation are invariably attended by ambitious targets the concerned legislator wants to achieve. The aims of the place of supply framework reform have been already explained as a measure to eradicate competitive distortions by installing a level playing field for charging and collecting VAT for electronic services. On the other hand, the intention of the reforms can be formulated more diversified. In effect, the present situation of transforming business types, enhancing cross-border transactions, rapidly evolving technology as well as arrant deception demand a VAT system which is more resilient, cheaper and less vulnerable to fraud. One approach seems to be the switch from the origin principle to the destination principle but in a more extensive scope than that of the existing legislation hitherto. The supposed alternatives consist of a general reverse-charge mechanism on the one hand or the introduction of a general destination principle for intra-community trade on the other hand. Inherent to the reform plans are always the technical challenges which probably could occur. Thus, not only the legal framework requires improvement but also the ‘VAT Information Exchange System’ as well as the above mentioned one-stop-shop system. The question remains which options have been chosen and which reforms have actually succeeded the initiative pre-legislation phase.

In a first step, Directive 2002/38/EC referred to above is essentially amended itself by another EU measure explicitly reforming the place of supply rules in order to eliminate competitive disadvantages distorting the EU internal markets in an extensive manner.

On January 2010, EU Member States were required to implement the new legislation into their national laws. The reason behind the requirement of an exact implementation was and still is the necessity of a coherent adaption of VAT rules to guarantee a simple system establishing a level playing field without distortions within the community.

The concerned Directive 2008/8/EC entirely promotes the taxation of the provision of services in the place of the actual consumption but reserves for itself several restrictions to this general rule. As already indicated above, services provided to taxable persons and non-taxable legal persons

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97 See e.g. supra note 85.
99 Ibid. p.260f.
100 Ibid., p.261.
identified for VAT purposes shall be taxed at the place of the recipient whereas services provided to non-taxable persons shall still be taxed at the place of the supplier.\textsuperscript{103} These suggestions stated in the Preamble create a disillusioning view on the taxation of electronic services at the place of actual consumption/destination.

A further decisive approach in this directive is the reintroduction of the effective-use-and-enjoyment principle (place of real consumption) for services emphasizing the intention to broaden the destination principle and to prevent double taxation/non-taxation in addition to distortive competition.\textsuperscript{104} Under this principle, Member States may levy VAT where the concerned service is actually used and enjoyed. However, the application of this principle excludes electronically provided services and refers only to individual transactions between EU and non-EU countries. Furthermore, this approach is subject to intensive criticism which will be recaptured in Chapter 5.\textsuperscript{105}

In its further substance, Directive 2008/8/EC confirms the place of supply rules between 2010 and 2015 but more importantly indicates the extended framework from January 2015 onwards. The most fundamental change will be the new Article 58 of the VAT Directive. It reads that the place of supply of services listed in Annex II of the VAT Directive to a non-taxable person shall be the place where this person resides/is established or has his/her fixed establishment if the service is provided to him/her.\textsuperscript{106}

Formulated differently, the place of supply for electronically provided services shall be the place of actual consumption. The essential element is that this rule will apply not only to the trade with third countries but also to the trade between the Member States of the European Union itself. Hence, the destination principle (emphasized by the place of final consumption) becomes established as the premise for EU cross-border trade of electronic services while simultaneously abolishing the existing competitive distortions inherent to the former legislation.\textsuperscript{107} For instance, cross-border shopping in Luxembourg with a VAT rate of 15% is no beneficial option anymore while applying the principle of destination.\textsuperscript{108}

\textsuperscript{103} Ibid., Preamble Paragraphs 1-4.
\textsuperscript{105} Ibid., p.407f.
\textsuperscript{107} See P. Wille, New EU VAT Rules for Telecommunications Services from 2015, p.6.
\textsuperscript{108} Ibid, p.7.
Nevertheless, Wille - like Hinnekens cited above - indicates the probably occurring problems the new system will bring, especially at a practical stage by correctly applying the new place of supply rules.¹⁰⁹ This issue will be discussed in detail below.

One intention of Chapter 4 consists of the demonstration of the existing as well as future place of supply rules applicable in the VAT system for electronic services until and beyond 2015. As we have seen, the idea of a general reverse-charge mechanism was abandoned in favor of a far reaching application of the destination principle.

Finally, an illustration (Annex) presented in an official article provides for a last summarizing overview of the legislation until and after the reforms become legally valid.¹¹⁰

4.3.2. The Mini One Stop Shop System

The second substantial reform is the extension of the one-stop shop system to taxable EU citizens. In this light, enhanced cooperation regarding the exchange of information relating to VAT purposes such as its measurement, charging and collection on the one hand and the combat against tax fraud on the other hand are fiercely requested by EU secondary legislation.¹¹¹

Next to the encouragement of enhanced cooperation among Member States, the one-stop shop model available for non-EU taxable persons shall also be an option for taxable EU citizens in order to prevent complex multiple registrations.¹¹² The EU authorities refer to it as the ‘mini one-stop shop model’ which in its essence offers the usage of a web-portal in the Member State of Identification where taxable EU citizens as well as non-EU taxable persons may register for VAT purposes. Through this web-portal, the taxable person refers all his/her VAT returns/receipts on electronically provided services in the Member States of Consumption to the Member State of Identification and is finally charged afterwards. Once again, the alleged simplification of this model is the missing necessity to register for VAT purposes in each single Member State of Consumption. It has to be added, that this system will be optional but due to the new place of supply rules based on the principle of the place of actual consumption it will become indispensable for practical reasons.¹¹³

¹⁰⁹ Ibid.
In summary, the 2015 amendments will not only extend the place of supply rules based on the destination principle (emphasizing taxation at the place of final consumption) to inner EU cross-border supply of electronic services but additionally the availability of the one-stop shop scheme to taxable EU citizens providing electronic services in other Member States.

4.3.3. Additional Practical Implications under the New Implementing Regulation

The amended VAT Directive and the correlated extended one-stop shop system require a simultaneously extended implementing Regulation. The present implementing regulation (EU NO 282/2011) already contains several explanatory provisions for the existing one-stop shop system, for instance regarding the exclusion of specific services from registration, the exact determination of return periods as well as the necessity to instantly report any changes of the relevant information of registration.\(^\text{114}\)

Although Regulation 282/2011 shall clarify and primarily provide for a simplified and efficient functioning of the VAT Directive regarding the existing place of supply rules, these tasks are just partly fulfilled since the regulation incompletely covers the VAT Directive by leaving out a few chapters (e.g. Title VI about the chargeable event).\(^\text{115}\)

In this light, Council Regulation 1042/2013\(^\text{116}\) and its explanatory notes shall introduce several new practical implications to provide for a sufficient functioning of the new place of supply rules (especially for electronic services). However, the question remains whether these amendments are able to fill the gaps left open by the current Regulation and whether the new instrument de facto provides for the desirable simplicity and functionality.

The alleged essence of a previous proposed implementing regulation has been to create a ‘common understanding […] necessary for the design of an appropriate […] system for the functioning of the [new] special regime’.\(^\text{117}\) Unambiguously correlated and even more important are nevertheless the provisions offering detailed definitions for the main characteristics of the new place of supply rules,

\(^\text{114}\) See M. Lamensch, *Proposal for Implementing the EU One-Stop-Shop Scheme from 2015*, p.314f.
\(^\text{117}\) See M. Lamensch, *Proposal for Implementing the EU One-Stop-Shop Scheme from 2015*, p.315.
respectively concerning the exact status of the non-taxable consumer, the determination of his/her exact location as well as further technical details in the new implementing regulation.\textsuperscript{118}

Although the place of supply rules will change in the way that VAT is charged in the place where the customer resides or is established, the actual status of the customer is still of importance for the service provider but to a lesser extent.\textsuperscript{119} In essence, the status of the customer determines the actual VAT liability of the supplier. If a service is supplied to the non-taxable final consumer or to a taxable person in the same Member State, the supplier is liable for VAT. On the other hand, if the service is supplied to a taxable person in another Member State, the reverse-charge mechanism applies.\textsuperscript{120} The status of a customer is specified by the communication of the relevant identification number for VAT purposes of the customer. If a customer officially communicates his/her identification number, he/she will be regarded as a taxable person by the concerned service supplier.\textsuperscript{121} The amended Article 18(2) reads that irrespective of contrary information, a supplier of electronically provided services may regard his/her customer (EU citizen) as a non-taxable person if that person has not communicated his/her identification number to the authorities.\textsuperscript{122} The new place of supply rules do not leave any reason/incentive for non-taxable persons to hide their identification number since any possible benefits are eradicated by the new legislation.\textsuperscript{123}

The continual importance of the determination of the correct status of the customer is mirrored by complex cross-border constructs. For instance, in the case of self-employed customers carrying on his/her business in one Member State but residing in another Member State a precise demarcation between B2C (private use) and B2B transactions is required to determine the exact VAT liability of the concerned parties.\textsuperscript{124}

Despite the fact that the importance of the actual status of the customer is undisputed, the exact stipulation of the location of non-taxable consumers is of even greater necessity. According to the current implementing regulation, two decisive factors fix the place of a general taxable transaction to a natural person, respectively his/her permanent address as well as the usual place of residence (as

\textsuperscript{119} \textit{Ibid.}, p.223.
\textsuperscript{120} See Commission of the European Union, Directorate – General Taxation and Customs Union, \textit{Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015}, p.47.
\textsuperscript{121} Council Implementing Regulation (EU) No 282/2011, Art. 18(1).
\textsuperscript{122} Council Implementing Regulation (EU) No 1042/2013, new Art. 18(2).
\textsuperscript{124} \textit{Ibid.}
of 2015 decisive for electronic services.\textsuperscript{125} Electronic services supplied to (non-taxable) legal persons are deemed to take place where they are established (also from 2015 onwards).\textsuperscript{127}

To provide for clarification, the permanent address shall be the address officially recorded at the population register, whereas the place of usual residence is the location where a natural person ‘lives as a result of personal or occupational ties’.\textsuperscript{128} Furthermore, new Article 13a reads that the place of central administration (place of business) or any other suitable fixed establishment is alleged to be the place of supply of electronic services to non-taxable legal persons.\textsuperscript{129}

Before 2015, non-taxable persons with multiple residences or multiple establishments shall be taxed in that Member State where the highest guarantee to tax final consumption exists.\textsuperscript{130} From 2015 onwards, Article 24 reads differently for priority is given either to the place of business unless adversatively proven or to the place of actual residence unless proven to the contrary.\textsuperscript{131}

To provide further guidance for situations in which the exact place of supply is rather difficult to determine, new Articles 24 (a) and (b) introduce several presumption clauses. If electronic services are supplied to non-taxable person whose presence is required at ‘a location such as a telephone box, a telephone kiosk, a wi-fi hot spot, an internet café, a restaurant or a hotel lobby’, this location is alleged to be the place of supply mentioned in articles 12,13 and new 13(a) of the implementing regulation.\textsuperscript{132} Electronic services supplied through a fixed land line or through mobile networks are presume to be supplied where the fixed land line is installed or where the SIM card code is registered (country code of the SIM).\textsuperscript{133}

These elements form the substance of the new implementing regulation. Additional provisions deal with issues such as intermediaries or different payment methods such as vouchers. The fact remains that the new implementing regulation attempts to provide for guidance but nevertheless is subject to several weaknesses as ambiguities and exceptions.\textsuperscript{134}

\textsuperscript{125} See Commission of the European Union, Directorate – General Taxation and Customs Union, \textit{Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015}, p.45.
\textsuperscript{127} Council Implementing Regulation (EU) No 1042/2013, new Art.13a.
\textsuperscript{128} See Commission of the European Union, Directorate – General Taxation and Customs Union, \textit{Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015}, p.45.
\textsuperscript{130} Council Implementing Regulation (EU) No 1042/2013, new Art.13a.
\textsuperscript{132} Council Implementing Regulation (EU) No 1042/2013, new Art.24(a).
\textsuperscript{133} Ibid., new Art. 24(b).
The following chapter will show how the existing as well as the 2015 reforms and its practical implications correlate to the essential VAT principles. In this light, the question shall be ask whether the reforms are blessing or curse.
Chapter 5: The VAT Framework 2014/2015 and its applicability to the basic principles of VAT

As already indicated, the final chapter of this elaboration will discuss the applicability of the 2014/2015 VAT framework for electronic services to the basic principles of VAT and further practical implications. In essence, the VAT framework 2014/2015 for electronic services will be tested against tax neutrality, the principle to tax final consumption as well as against the practicability of the rules.

5.1. Tax Neutrality

To reassemble the facts stated in Chapter 2.1.3 above, the OECD suggests tax neutrality for VAT purposes to establish a level-playing field of fair competition for domestic as well as foreign suppliers of electronic services, to establish a framework where business decisions are rendered independently from existing taxation legislation as well as to establish a system where similar taxable persons are due to similar taxation. The same pattern is required by the European Union authorities via the VAT Directive where overall tax neutrality connected to simplicity are promoted.

Applying this principle to the present VAT place of supply rule for electronic services under Article 58 VAT Directive (and Article 59 (k)) valid until end of December 2014, it may be concluded that overall tax neutrality is only provided for the trade of electronic services between non-EU taxable persons and non-taxable EU citizens and vice versa. Referring to the elaboration above, Articles 58 and 59 (k) allow VAT to be charged in the place of actual consumption if cross-EU border trade is concerned. Since the VAT is charged where the consumer officially is established/resides, the competitive distortion based on different VAT rates is eliminated. Put it differently, consumers are not influenced by VAT rates in the decision to purchase services abroad or at home and domestic as well as foreign service suppliers are on an equal footing. Unfortunately this neutral situation only applies to trade with third countries. Electronic services provided from one Member State to another are taxed for VAT purposes at the place where the supplier is established. In this scenario, different VAT rates may give incentives to deny domestic suppliers for the more price effective foreign supplier. It has to be added that these situations mirror Business-to-Consumer transactions and that the 2015 legislation establish stronger tax neutrality at their level. Business-to-Business transactions are covered by the neutrality promoting reverse charge mechanism mentioned above.

However, as from January 2015, Article 58 of the VAT Directive will be rewritten and apply also to business transactions in the field of electronic services as well as telecommunication and broadcasting services between Member States of the EU. From there on, VAT is charged at the place

135 See OECD, OECD International VAT/GST Guidelines, Chapter 1.
136 See VAT Directive, Preamble Paragraphs 4f.
of consumption, respectively where the consumer officially resides. In effect, the same neutral situation will appear as in the cross-EU border example. In essence, non-taxable persons will not have any advantages and benefits rooting in different VAT rates and correlated cross-border shopping.\textsuperscript{137}

The European Union confirms and applies with its 2015 VAT legislation the OECD Ottawa Framework from 1998 and officially states that based on the principle of neutrality and based on the fact that VAT is a tax on final consumption, the place of supply of electronically provided services shall be the place of its actual consumption – or based on a different perspective, the Member State of actual consumption shall profit from VAT revenues earned by the provision of electronic services.\textsuperscript{138}

Finally, as referred to in Chapter 2.2, the European Union has passed a long way to the realization of the internal market. It has been stated that the development of a neutral VAT system as one of many core elements of this internal market co-exists and co-develops. Under the 2015 VAT legislation on electronically provided services and its maximized neutrality a further important step leading to the stabilization of the internal market has been done.

5.2 VAT as a Tax on Final Consumption

Referring again to the Explanatory Note of the European Commission\textsuperscript{139}, VAT as a tax on final consumption shall logically be levied in the place of that final consumption. Previously it has been illustrated that a pure definition of consumption and the related location is difficult for electronic services. Thus OECD and the EU simultaneously apply the principle that the place of actual consumption - where the VAT reasonably should be due - is the place where the consumer is officially established, resides or has his/her fixed establishment.\textsuperscript{140}

The EU legislation recognizes this principle but the current legislation regarding the place of supply rules for electronically provided services - respectively Articles 58 and 59(k) of the VAT Directive - applies only to Business-to-Consumer transactions at a cross-EU border level. As with the principle of neutrality, the principle that VAT as a tax on final consumption has been only realized for outer EU situations yet.

Nevertheless, in 2015 the new Article 58 of the VAT Directive applies and attempts to guarantee that VAT is charged at the place of actual consumption in Business-to-Consumer transactions in the field


\textsuperscript{138} See Commission of the European Union, Directorate – General Taxation and Customs Union, \textit{Explanatory notes on the EU VAT changes to the place of supply of telecommunications, broadcasting and electronic services that enter into force in 2015}.

\textsuperscript{139} See supra note 81 for complete citation.

\textsuperscript{140} See supra note 23 and VAT Directive Art. 58/59(k).
of electronic services between EU Member States themself as well as in relation to non-EU countries as its nature and characteristics of a consumption tax request.

As mentioned above, the principle to tax final consumption/ to tax at the place of final consumption can be expressed by the actual use and enjoyment of the service concerned. To tax a service where it is actually consumed is an ideal circumstance and desirable for the principle to tax final consumption. Unfortunately, it is not always possible to determine the exact place of final consumption what in substance constitutes the downside of the destination principle.\(^{141}\) In this line of argumentation, especially electronic services might be problematic since the service can be used by another person than that who actually bought it. In addition, electronic services might not be consumed immediately after the purchase and the delivery.\(^{142}\)

Opposite to the principle of tax neutrality, the principle of taxing final consumption is partly realized for electronic services in the EU but not without technical difficulties concerning an exact determination of the place of final consumption. Subchapter 5.3 will further discuss the several practical problems arising under the new system of 2015.

5.3 Practical Issues

It was written that general harmonization of the European VAT system shall provide for simplicity, clarity and transparency.\(^ {143}\) The harmonizing process contains also the VAT Reform Package 2010-2015 with the above elaborated place of supply rules and their implementing measures. The subsequent part will display several technical problems which will question the actual efficiency as well as simplicity of the 2015 reforms.

In this light, Subject related literature offers a critical perspective and states that the new rules of 2015 are essentially ‘unsuitable’.\(^ {144}\) Lamensch admits that the EU follows the pattern of the OECD and its Ottawa Conditions but both institutions fail to enact a stable legal framework to deal with distorting practical implications. Elements necessary for a correct VAT assessment as correct identification of the consumer and his/her place of establishment/residence put a heavy burden on the shoulders of the supplier who has to guarantee a correct charge and collection of VAT.\(^ {145}\)

Articles 12, 13 and new 13(a) of the implementing regulation determine the place of supply where the customer has his/her permanent address, usually resides or has his/her place of business.

\(^{141}\) T. Ecker, *Place of Effective Use and Enjoyment of Services – EU History Repeats Itself*, p.408.

\(^{142}\) Ibid.


\(^{145}\) Ibid.
Apparently, the new legal framework is ‘based on the unrealistic assumption’ that the providers of electronic services have unlimited information and precise knowledge of the personal characteristics of their customers such as where they are officially registered or which status they have for VAT purposes.\(^{146}\) Multiple establishments as well as residences in several Member States or an unclear differentiation between economic and private use of electronic services by one customer\(^{147}\) even exacerbate the anyway complex system. Concerning business customers, the supplier must determine which establishment in which Member State actually uses the service. The existence of fixed establishments - famous for the varying definitions of this term - fuels the uncertainty on the suppliers’ side.\(^{148}\) Simultaneously, several addresses and residences of natural consumers lead to the same practical burdens as multiple establishments of business consumers. The above mentioned new Article 24 as well as the presumptions of new Article 24a does not provide for sufficient guidance to overcome these difficulties.\(^{149}\)

These technical problems establish the second downside of the destination principle. On the one hand it is difficult to determine where the services are actually consumed. It is alleged that the place of final consumption shall be the place of supply which is alleged to be the location where the customer resides or is established. The determination of this location (as well as the status) is in itself rather complicated. Thus, a correct application of the destination principle proves to be impractical.\(^{150}\)

Lamensch indicates that a correct identification (status/location) of the customer of electronic services is approximately impossible because it is unreasonably expensive due to the ‘scarcity’ and complicated verification of information.\(^{151}\) Additionally, the correct identification of the customer does not only determine his/her status and location but also the nature of the transaction, respectively whether it is domestic or cross-border.\(^{152}\)

In essence, these statements recapitulate the fact that the 2015 framework for electronic services representing the destination principle establishes fierce practical challenges. The whole framework stands and falls with the correct identification of the customer, primarily of his/her exact location - also regarding the application of the new mini one-stop-shop system. Hence, without an exact identification of the customer, no correct VAT return in the Member State, where the supplier is

\(^{146}\) See P. Wille, New EU VAT Rules for Telecommunications Services from 2015, p.7.
\(^{147}\) See M. Merkx, New Implementing Measures for EU Place-of-Supply Change 2015, p.223ff.
\(^{148}\) See M. Lamensch, Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach, p.84.
\(^{149}\) Ibid.
\(^{150}\) Ibid., p.81.
\(^{151}\) Ibid.
\(^{152}\) Ibid., p.82.
registered according to the special regime, is possible.\textsuperscript{153} The special regime notoriously exists for non-EU suppliers and already consists of these ‘\textit{substantial compliance burdens}’ which will be extended to EU-suppliers in 2015.\textsuperscript{154}

Another aspect to be respected is the menace of fraud which is connected to the ‘\textit{intangibility of the supply}’ and the reliance on the good faith of the service provider to remit the VAT due. Indeed, electronic services are intricate to track/trace and provide for multiple security gaps.\textsuperscript{155}

Last but not least, most electronic services are cheap and the quantity of daily transactions is much higher than that of non-electronic services, so that the costs of the actual verification of these transactions for VAT purposes might extend the alleged profit of the concerned services.\textsuperscript{156}

Facts like these allow for the question whether enhanced tax neutrality and the partly compliance with the principle to tax final consumption are worth the manifold practical difficulties the new system provides. In this light, supposed improvements by the EU authorities unfortunately prove to be rather vague, uncertain and on the basis of voluntary compliance which is definitely not able to decline the substantial compliance burdens.\textsuperscript{157}

\textsuperscript{153} See M. Lamensch, \textit{Proposal for Implementing the EU One-Stop-Shop Scheme from 2015}, p.315.
\textsuperscript{155} Ibid.
\textsuperscript{156} Ibid., p.84.
\textsuperscript{157} Ibid., p.86; The EU suggested higher cooperation of involved tax authorities regarding VAT on the international stage. Moreover, VAT shall be collected from private consumers by checking online payments. Both suggestions are uncertain, too broad as well as based on voluntary compliance. Especially the checking of online payments would require self-assessment of the online consumer as well as extensive administration which in essence would partly transfer and even increase the compliance burden for all related parties.
Chapter 6: Conclusion

The final conclusion will summarize my findings - especially those of Chapter 5 - in order to answer the research question of this elaboration whether the existing as well as future EU legal framework for VAT levied on electronic services is compatible with the fundamental principles of VAT, respectively the taxation of final consumption, tax neutrality as well as the practical implications of the VAT reforms 2010-2015.

Starting with tax neutrality, one has to admit that the existing VAT framework for electronic services is less neutral than the system used for transactions between EU and non-EU parties as well as the system applicable from 2015 onwards. The reason roots in the current application of the origin principle, respectively to levy VAT where the supplier is established/resides. Notoriously, this might lead to distortion of competition due to 28 different VAT rates among the European Union. Non-taxable consumers tend to purchase electronic services in countries with a lower VAT rate what in essence disadvantages the domestic market. Hence, full tax neutrality is not guaranteed since it is the VAT rate which sets incentives and influences the business decisions of the final consumers.

The existing place of supply rules for transactions between EU and non-EU parties, as well as the amended system of 2015 provide for a higher degree of tax neutrality since they are based on the destination principle. Hence, VAT for electronic services shall be levied where the customer is established/resides. The advantages and benefits of the application of 28 different VAT rates and the correlated distorted competition are abolished by this framework.

Observed from the perspective of tax neutrality, the new place of supply rules are a definite improvement because they help to stabilize the digital internal market by decreasing distortive competition.

This view might slightly change if we look at the principle to tax final consumption. This principle mirrors the essential aim of VAT to levy a broad-based tax. I already indicated that the principle to tax final consumption is unambiguously related to the place of final consumption as well as the actual use and enjoy of the service concerned. The existing legislation - except that one applicable to transactions between EU and non-EU parties - does not represent the principle to tax final consumption since VAT is levied where the supplier is established. As with tax neutrality, the 2015 legislation for electronic services will closer adhere to the principle to tax final consumption. Unfortunately the obvious practical problems of the destination principle applicable from 2015 onwards, in particular the complexity to determine the correct place of final consumption, render the new legislation ineffective. The observation of the other existing practical implications confirms this assumption.
Although the new place of supply rules for electronic services support tax neutrality and come rather close to the principle to tax final consumption, various practical implications blurs the positive opinion one might have about the reforms.

As listed in Chapter 5.3., difficulties to determine the correct location and status of the consumer as well as the correlated huge verification costs establish a substantial compliance burden for service providers. Also the extended one-stop shop system suffers from these complexities. In addition, potential frauds aggravate the overall framework. As indicated in footnote 154, suggested practical improvements are rather poor, uncertain and additionally complex.

Finally concluding, the present system for inner European transactions of electronic services is lesser neutral, does not entirely represent the principle to tax final consumption but does not load a substantial compliance burden on the supplier. On the other hand, the existing legislation for transactions between EU and non-EU parties as well as the reformed legislation of 2015 based on the destination principle is more neutral, partly applies to the principle to tax final consumption but is unfortunately almost impractical due to the above mentioned complexities and uncertainties related to the exact determination/identification of the concerned customer and his/her circumstances relevant for VAT purposes.
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