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**EXAMINATION OF THE EUROPEAN UNION VAT SYSTEM
AND ITS EFFECTS**

Bachelor's Thesis

European Union and International Law

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ABSTRACT

Digitalisation, which appears to have enabled the expanding growth of globalisation and is the most valuable aspect in technological development, has created a digital economy, “an economy which functions primarily by means of digital technology, especially electronic transactions made using the Internet.”¹ The European Union (EU) tax system which has not majorly changed in the past decade, is deficient to the current economic situation. This deficiency has led to significant revenue losses in consumption taxes like value added tax (VAT). Also, the actual legal categories concerning businesses e.g. Amazon are challenged by new concepts created by the digital economy. The increased role of online marketplaces and platforms have created uncertainties among services providers, IT companies and in general any intermediaries.² This Bachelor’s thesis examines the history, current state, characteristics, and problems relating to EU intra-Community trade in the area of VAT. The European Commission has set out an Action Plan which intends to provide a pathway to modernise the current VAT rules in EU, by including key takeaways for a future single European VAT system. The aim is to simplify VAT rules for electronic commerce in the context of the Digital Single Market Strategy by introducing a comprehensive VAT package to make life easier for micro, small and medium sized enterprises.³ Therefore, the purpose of this paper is to determine how will the proposals included in this Action Plan on amending the VAT Directive impact the VAT system in EU.

Keywords: Electronic commerce, Joint and several liability, Special Scheme, Value added-tax, Value added-tax fraud

¹ Digital economy, The Oxford English Dictionary; https://en.oxforddictionaries.com/definition/digital_economy

² For an historic perspective see, e.g. Marella E., “Le categorie tradizionali del diritto tributario ed il commercio elettronico”, I Riv. Dir. Trib. 595 (1999).

³ European Commission - Press release, VAT Action Plan: Commission presents measures to modernize VAT in the EU, Brussels, 7 April 2016

INTRODUCTION

The European Union's (EU) internal trade is an interesting area from the point of view of tax fraud since the fundamental principles of the EU include the free movement of goods, services, capital and workers. In this sense, the EU largely resembles federal states. The difference is, however, that the EU is a confederacy and lacks federal authorities that are competent in all states.⁴ The increased cross-border grey economy may be considered to have gained significant additional space by the combination the freedoms of the EU and the lack of a centralised authority along with other issues. The abolition of customs frontiers as a result of the 1993 reforms, coupled with shortcomings in the value-added tax (VAT) control systems, has created a huge source of financial income for organized financial crime, funded directly from the MS VAT collections.

Lešnik and Jagrič have considered the best-known abusive practice to be the nonpayment of tax obligations based on tax returns filed as arising tax debt.⁵ The latter, however, can be considered a relatively restricted form of tax non-compliance volume-wise, as, in the EU as a whole, the revenue loss occurring from the VAT gap is on the latest estimate of 147.1 billion EUR.⁶ The largest focus of internal trade abuses has been the Missing Trader intra-Community (MTIC)⁷ practice, which is based on the sale of real or non-existent goods from one country to another and the making of unjustified VAT refund applications or deductions based on these acquisitions. In the past, in a situation where a principal company is selling his goods online directly or via a platform, e.g. Amazon and declares VAT included in the purchase price, even if failed to show a VAT number the customer and intermediary may have assumed upon purchase that VAT is included and declared. As the platform only withholds its portion of VAT claiming commission costs,⁸ the rest is paid out to the principal

⁴ Börzel, T., Thomas R., "Who is Afraid of a European Federation. How to Constitutionalize a Multi-Level Governance System." What kind of constitution for what kind of polity, Harvard Jean Monnet Working Paper (Symposium) (2000), p. 45 - 59.

⁵ Lešnik T., Jagrič, T., Jagrič, V., "VAT Gap Dependence and Fiscal Administration Measures", *Naše gospodarstvo, Our Economy*, *Naše gospodarstvo/Our Economy*, 64 (2) (2018), p. 43 - 51.

⁶ Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report, TAXUD/2015/CC/131 (2018)

⁷ MTIC; <https://www.europol.europa.eu/crime-areas-and-trends/crime-areas/economic-crime/mtic-missing-trader-intra-community-fraud>

⁸ Article 9(a) "...provider is explicitly indicated as the supplier by that taxable person and that is reflected in the contractual arrangements between the parties." Council Regulation 1042/2013

company. The latter practice may be seen increasing the risk of non-payments, as the EU VAT system is deficient to deal with increasingly digital nature of the economy.⁹

The issue of the future implementation of VAT in the EU is topical as the European Commission (EC) has in 2016 introduced an Action Plan¹⁰ which intends to provide a pathway to modernise the current EU VAT, by including proposals for a future single European VAT system, simplifying VAT rules for electronic commerce (e-commerce) in the context of the Digital Single Market Strategy (DSM) by introducing comprehensive changes to current VAT system in order to make life easier for micro, small and medium-sized enterprises (SMEs)¹¹ while at the same time addressing the increased VAT gap.¹² The Action Plan contains proposals and serves as an opening for the implementation on the future of VAT. This Bachelor's thesis deals with the shortcomings of the current EU VAT system and empirically analyses, with the appropriate methodological framework, two proposals presented by the EC which in consideration may be connected to the Action Plan.

The research question is whether the COM/2016/0757 and COM/2018/819 proposals are sufficient and proportional for the collection of VAT in EU, and should additional measures be adopted? The thesis analyses the proposals focusing on specific changes further described in from the point of view that they would fulfil as far as possible the objectives set by the EC in its DSM and at the same time minimising the VAT gap. Therefore, this thesis hypothesizes that the current VAT system in place in the EU is not compatible with the objectives of DSM.

As the EU internal market mostly consists of SMEs,¹³ the proposed measures should not increase the administrative burdens of these actors.¹⁴ If administrative burdens were to increase, for example, as an increase in reporting obligations, administrative costs should be reduced accordingly. The

⁹ Schippers, M., Verhaeren, C., "Taxation in a Digitizing World: Solutions for Corporate Income Tax and Value Added Tax" EC Tax Review, Issue 1, (2018), p. 61 - 66.

¹⁰ European Commission - Press release, VAT Action Plan: Commission presents measures to modernize VAT in the EU, Brussels, 7 April 2016

¹¹ Small and medium-sized enterprises (SMEs) are defined in the EU recommendation 2003/361

¹² Report on the VAT Gap; https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/vat-gap_en

¹³ SMEs represent 99% of all businesses in the EU, European Commission - What is an SME?; https://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en

¹⁴ European Commission - Press release Digital Taxation: Commission proposes new measures to ensure that all companies pay fair tax in the EU Brussels, 21 March 2018

objectives set out for the modernisation of the VAT system should provide for fewer administrative responsibilities for businesses, no reductions in the MS tax revenues, no increases in the risk of tax fraud and maintain the neutral impact of VAT on the competition.¹⁵ This is based on the harmonisation of indirect taxes, explicitly established in Article 113 of Treaty on the Functioning of the European Union (TFEU).¹⁶

This thesis has five chapters including introductory and conclusions. The first chapter briefly introduces the history of VAT, the basic principle of operation, and the reasons for favouring VAT as a consumption tax. Second chapter deals with the current situation, specificities and goals for modernising the intra-Community trade. In addition, it reviews the legal means of combating the tax frauds and problems associated with VAT in the current system. Both, third and fourth chapter show the proposals and discuss the proposed amendments that try to solve the problems related to the current situation in intra-Community trade. Third chapter explicitly deals with the administrative means and analyses their proportionality in reforming the VAT. The conclusions summarise the options presented in the previous chapters, compares them, and analyses their strengths and weaknesses. Regarding the methodology of the research in this thesis, the qualitative legal method has been used.¹⁷ The latter is used to examine problems relating to law within appropriate methodological framework to answer the research questions presented.¹⁸

¹⁵ Modernising VAT for cross-border e-commerce; https://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en

¹⁶ In so far as necessary for the establishment and functioning for the internal market.

¹⁷ Douma, S., *Legal Research in International and EU Tax Law*, Kluwer-Deventer (2014)

¹⁸ For analysis on principles, theories, process and historical development see Kharel, Amrit, *Doctrinal Legal Research* Juris Nepal Law Associates; Tribhuvan University, Faculty of Law, Nepal Law Campus (2018)

1. BACKGROUND OF VAT

1.1. The history of VAT

When the European Community was established, the original six MS had different forms of indirect taxation. The tax was added to the price of the product when the product was transferred to the next company in the production chain, and the previous production tax could not be reduced.¹⁹ This type of taxation caused the tax to be multiplied, making it impossible to determine the final amount of the tax on the final price of the product. The taxation favoured conceptual production processes within a single company, whereby the tax was added to the price only once, and taxation was not cumulated. Due to the tax multiplication and the difficulty of calculating the actual amount of tax, there was a risk that MS would either intentionally or inadvertently give the exporting company a refund too high when assessing tax. This refund thus created an export subsidy which would have distorted competition. In order to make the European internal trade area effective, the MS needed a neutral and transparent tax system.²⁰ The First and Second VAT Directives (67/227/EEC and 67/228/EEC), which replaced the former system in place to a common system of tax on value added, were introduced in 1967. According to Farmer and Lyal these Directives only set out the essential characteristics of a theoretical model to which the actual Community system aspires.²¹ The Third, Fourth and Fifth contained minor alterations regarding implementation e.g. extensions of time limits. It was only in 1977 did the Sixth Directive (77/38/EEC) determine the scope of the tax.²²

1.2. The internal trade before the Single Market

Until 1993, border controls on trade between MS allowed a straightforward control mechanism for VAT on intra-Community trade. The export products were treated at a zero rate, i.e. the exporter of

¹⁹ John, F., "SALES TAXATION IN WESTERN EUROPE: Part II The Multiple-Stage Sales Taxes", *National Tax Journal* 8.3 (1955), p. 300 - 321

²⁰ Promoting the internal market and economic growth, European Commission; https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/taxation_internal_market_en.pdf

²¹ Farmer, P., Lyal, R., "EC Tax Law", Oxford Clarendon Press (1994), p. 85

²² Article 2, The Sixth Directive 77/38 /EEC

the goods did not charge VAT on the sale and applied for a refundable VAT on the goods.²³ Thus, the price of the export product was not subject to VAT. In most MS, the price was added to the import immediately upon importation. Under that system, the effect of VAT on each Member State ended at the state border, the system being similar as the one currently traded outside the EU.²⁴ This system did not leave room for tax fraud, as a tax on the acquisition was levied at the border of the importing company. Although the former system of internal trade with border formalities provided protection against fraud, its weakness was bureaucracy and, in part, favoring domestic production, as national rules varied considerably.²⁵

The aim of the Sixth Directive was to further harmonise the various national laws.²⁶ In the beginning of 1993, internal border controls in the EU Member States were abolished.²⁷ The aim was to create a single and free internal market while removing the costs of border formalities and barriers to trade. The present system differs from the system prior to 1993, as now VAT is no longer increased on the price of the imported product at the border. The current system reduced the burden of the customs procedure, but at the same time increased the potential for VAT fraud.²⁸

One of the aims of the 1993 reform was to encourage companies from different MS to treat the internal market area in the same way. However, the measures and requirements imposed on businesses to combat the risk of tax fraud made compliance costs even higher. This will be further explained in the following chapter.

²³ Keuschnigg, C., Loretz S., Winner H., “Tax competition and tax coordination in the European Union: A survey”, Working Papers in Economics and Finance, No. 2014 - 04, University of Salzburg, Department of Social Sciences and Economics (2014)

²⁴ See e.g. GST and how it functions in the United States of America

²⁵ See e.g. Freedom of Movement, which is the cornerstone of Union citizenship, established by the Treaty of Maastricht in 1992

²⁶ Terra B., Wattel P. “European Tax Law”, 6th edition, Chapter 4.1.3., Kluwer Law International (2012)

²⁷ Ibid. Chapter 4.1.7.

²⁸ Keen, M., Smith, S., “The future of value added tax in the European Union”, Economic Policy, Volume 11, Issue 23 (1996), p. 373

1.2. The principle of VAT

It has been described by theories of taxation in economics, that the ideal tax system should maximise the welfare of society with the given restrictions.²⁹ The VAT is a large-scale consumption tax levied by a company on all goods or services it provides, whether it be purchased by the final consumer or another company. The VAT may be seen with a wide range of societal and economic advantages³⁰ i.e. it is self-policing, has a clear audit-trail and in addition, it may be used as an instrument to influence production or consumption therefore as a tool in improving the trade balance.³¹ A VAT, which does not include exceptions has the broadest possible tax base, implements all of these features. When designing the structure of consumption taxation, one interesting question is whether more tax should be levied on certain commodities compared to others. This option will be considered in the light of the current VAT Directive³² (2006/112/EC) in subsection 2.1.2.

The implementation of VAT is relatively simple within a state. The situation becomes much more difficult, however, in the context of international trade. As far as international trade is concerned, the first and foremost concern is the tax burden, which means deciding whether the tax rate depends on the country of purchase or sale. Second, the administration, that is, which state collects the VAT and if an intermediate party collects the VAT, but does not receive a final return, is in its interest to collect tax. The thesis aims to cover the latter in the following chapters.

²⁹ See e.g. Smith, A., “The Wealth of Nations”, William Straham (1776)

³⁰ Ebrill, L., “The modern VAT”, International Monetary Fund (2001)

³¹ de la Feria, R., “The EU VAT System and the Internal Market”, IBFD (2009)

³² Council Directive 2006/112/EC on the common system of value added tax

Hereinafter referred to as the VAT Directive throughout this thesis.

2. CURRENT STATE

2.1. The current state of internal trade and the VAT Directive

When the internal market was adopted, the need of a suitable system increased. The system in place contained limitations i.e. the divergence interpretation of common provisions created legal uncertainty. Currently, VAT is levied by the company on all the goods or services it supplies, whether it be the final consumer or another company. As VAT is based on value added at different stages of production,³³ VAT registered businesses have the option of deducting input VAT if the purchased item is for business use. The deduction of input VAT is fundamental to the system of VAT. In fact, the right to deduct is what gives VAT its character as a tax on the value-added.³⁴

All companies in distance sales with exceeding turnovers in particular MS are obliged to register for VAT purposes in those MS if they desire to benefit from input deductions in where they carry out trade.³⁵ Companies supplying with a turnover below given thresholds may also register for VAT.³⁶ However, this special scheme does not come without issues, as this is a mere derogation from the VAT Directive and not all MS have implemented it.³⁷ Also, as current thresholds may be considered relatively low, the implication seems to be that for many, the registration becomes an administrative burden, as registered companies have to e.g. comply with national legislation. Increasing the minimum thresholds could constitute as an easing solution. However, as MS impose different rates, the lower rates could be seen more attractive which could further lead to disruption of revenue allocation. This would raise a political discussion as well, as it may be assumed that an MS has a

³³ Tanzi, V., and Parthasarathi S., "A primer on tax evasion" Staff Papers 40.4 (1993), p. 807 - 828.

³⁴ Eleonor K., "EU VAT: Adjustment of Input VAT", INTERTAX, Volume 46, Issue 8 and 9, Kluwer Law International BV (2018)

³⁵ VAT Thresholds;
https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf

³⁶ Except in the field of reverse charge, a taxable person shall pay VAT on his sales of goods and deduct the tax on goods purchased by him. Under reverse charge, the tax is payable by the buyer.

³⁷ See Articles 284 to 287 of Council Directive 2006/112/EC, as amended. This scheme is reserved for taxable persons established within the territory of the Member State in which the VAT is due.

desire to allocate as much tax revenue as possible, and by restricting the freedoms provided by the VAT Directive would impose as restrictions to national autonomy.

2.1.1. The VAT Directive - place of taxation

In intra-Community trade, the common application is mainly the country of destination principle. It means the taxation of goods is in their country of acquisition or consumption.³⁸ In practice, it is implemented by setting a “zero rate” on export products and levying a tax on imported products. Although the “zero rate” of export refers to the fact that the exporter receives deductible refunds on the inputs, it cannot be calculated as an export subsidy but merely 'clears' the exported product from the previous VAT.³⁹ The “zero rate” on exports ensures that the exported product does not contain any hidden VAT. The VAT on imported products puts it on the same line as the domestic commodity.

An alternative to the country of destination principle is the country of origin principle, whereby goods are taxed in the country in which they are produced. As regards services, the treatment of intra-Community trade has been differentiated from the treatment of goods.⁴⁰ Intangible services have previously been and are subject to the country of origin principle.⁴¹ The country of origin principle has also been considered for wider intra-Community purpose,⁴² however, as the EC has concluded, the earlier systems in place have caused significant restraints.⁴³ Therefore, consumption taxation at the destination is, considered to be more beneficial in terms of international competitiveness and revenue allocation.⁴⁴ The country of destination principle, also, addresses the issues mentioned in section 1.2. In applying the country of destination principle, there occurs no conflicts between collection and distribution of income.

³⁸ OECD, *International Guidelines for VAT/GST*, OECD Publishing (2015)

³⁹ See Article 111 Treaty on the Functioning of the European Union (TFEU), Terra B., Wattel P., “European Tax Law”, 6th edition, Chapter 2.2., Kluwer Law International (2012)

⁴⁰ Except for companies falling below the thresholds of the special scheme, which are still in principle based on the country of origin principle.

⁴¹ In the case of business-to-business supplies. Article 43, Council Directive 2006/112/EC

⁴² de Bruijn, R., Kox, H., Lejour, H., ”THE TRADE-INDUCED EFFECTS OF THE SERVICES DIRECTIVE AND THE COUNTRY-OF-ORIGIN PRINCIPLE”, EUROPEAN NETWORK OF ECONOMIC POLICY RESEARCH INSTITUTES WORKING PAPER NO. 44 / APRIL (2006)

⁴³ Terra B., Wattel Peter J. “European Tax Law”, 6th edition, Chapter 2.2., Kluwer Law International (2012)

⁴⁴ OECD, *Consumption Tax Trends 2012: VAT/GST and Exercise Rates, Trends and Administration issues*, OECD Publishing, (2012), p. 70, OECD, *International VAT/GST Guidelines*, OECD Publishing, (2017), p. 15

2.1.2. The VAT Directive - rates and exemptions

Most of the VAT registered businesses are subject to the general VAT rate, but the VAT Directive provides for the possibility to also use two reduced categories.⁴⁵ The reduced categories may include i.e. food, books, medicine, cultural and sporting events, movies and amusement parks etc. In addition to the general and reduced rates of VAT, there is an exemption. The value of the exempt goods in Articles 132-135 of the VAT Directive includes VAT on inputs.⁴⁶ The term exempt from VAT is, therefore, misleading in a sense, as the exemption from VAT means that sales do not include VAT, but VAT cannot be deducted from the inputs used. Therefore, the supplying company does not, as a rule, pay taxes on the sale of goods transported to a VAT exempt business or consumer in another MS. An exemption for intra-Community supplies is, however, subject to the condition that the supplying company has established that the intra-Community acquirer is registered for VAT in another MS and that the goods are transported from one MS to another.

Even as the proposals do not contain any alterations to the rates, regard should be noted to the impact on the several rates currently applied by the MS, as evasion may also depend on other factors, e.g. the taxable rates.⁴⁷ An interesting question regarding the policies of consumer taxation in EU is whether certain goods should be taxed more than other. It may be suggested, that a tool which could affect harmonisation and as a decrease in fraud, would be a generally applicable rate. This would also provide a solution for the revenue disruption presented in the previous subsection, where the increase of thresholds presented as measure. In addition, an important measure which could have a considerable impact on decreasing the VAT gap, is the general reduction of the tax rate. A lower tax rate may reduce the risk of tax fraud considerably.⁴⁸ Although it is not realistic to have the tax rate so low that the attractiveness of tax evasion is minimised, even a small deduction would have a positive impact on tax fraud prevention.⁴⁹ This could be approached by lowering the standard rate and abandoning VAT exemptions. As suggested by several academics, the abandonment of the exemption i.e. the inclusion of financial services in the field of VAT, the abandonment of reduced rates and other

⁴⁵ Article 98, Council Directive 2006/112/EC

⁴⁶ Exemptions; https://ec.europa.eu/taxation_customs/business/vat/eu-vat-rules-topic/exemptions_en

⁴⁷ Vasilev, A., "Is consumption-Laffer curve hump-shaped? The VAT evasion channel", *Journal of Economic Studies*, Volume 45, Issue 3, (2018)

⁴⁸ Clotfelter, C., "Tax Evasion and Tax Rates: An Analysis of Individual Returns." *The Review of Economics and Statistics*, Volume 65, Issue 3, JSTOR (1983), p. 363 - 373

⁴⁹ *Ibid.* 48

exceptions could present as a good solution for achieving harmonisation⁵⁰ and a significant reduction in the attractiveness of tax fraud.⁵¹

2.1.2. The VAT Directive - Taxable transaction

The country of taxation depends on where the service is provided. The articles determining the taxable transactions may be found from Articles 14-23 of the VAT Directive. However, it is not always easy to determine the place of supply e.g. in the case of intangible services. The place of supply is affected by the nature of the service, the nature of the supplier and the acquiring business or consumer of the service. A service trade distinguishes between a company that purchases a service for business use and a service sold to the end consumer, as seen from subsection 2.1.1. Once the status of the acquiring business or consumer has been determined, the place of performance for the service can be determined. Business-to-business (B2B) trade in services is generally taxed in the country of establishment of the acquirer. By contrast, services provided to the final consumer (B2C) are generally taxed in the MS of establishment of the supplier. However, there are a number of exceptions to the general rule, such as intermediary services, electronically produced services and many other types of service.⁵²

2.5. Intermediaries in distance sales

As seen from the previous subsection, the intermediaries provide an exception to main rule regards to the taxable person. Similar rules apply to importers and intra-Community intermediaries. The importer has to appoint an EU established intermediary. The proposals presented in the following chapter contains amendments imposing joint and several liability to intermediaries, depending if they

⁵⁰ Exemptions in VAT, as seen from CJEU case law, create an interpretational difficulty. The CJEU has to balance the strict interpretation, which is an interpretational principle and fiscal neutrality, which is a general EU principle. See e.g. de la Feria, R., “EU VAT Principles as Interpretative Aids to EU VAT Rules: The Inherent Paradox”, Working paper 16/03, Oxford University for Centre for Business Taxation (2016)

⁵¹ Walpole M., “Tackling VAT Fraud”, International VAT Monitor, IBFD (2014)

⁵² European Commission, Where to tax?; https://ec.europa.eu/taxation_customs/business/vat/eu-vat-rules-topic/where-tax_en

conduct as service providers⁵³ or undisclosed agents⁵⁴. For that reason, it should be taken into consideration at what point does one cease being a passive and technical support and begin to be an intermediary. As seen from CJEU case law,⁵⁵ if an online platform takes any active steps in the principal supplier's business, but without acting in its own name, it is likely to be classified as an intermediary and must, therefore, be taxed accordingly. This may have a considerable impact on the VAT treatment, as the new legislation only applies to sales that are made on the online marketplaces.⁵⁶

2.5.1. Determining the place of supply and applicable scope for intermediaries

For intermediaries taking part in a supply of goods in their own name and on behalf of someone else suggests that there occur two supplies.⁵⁷ The first, between the principal and intermediary and second, between the intermediary and the customer. Therefore, the place of supply plays a considerable role as to VAT liability, as the B2C relationship would point towards the undisclosed agent rather than the principal.⁵⁸ This creates a situation similar to the current supply of goods with the intermediaries falling under the scope of Article 14 VAT Directive. In comparison to regular sales concerning intermediaries under this type of arrangement, and with the straightforward application of Article 14, could create an administrative burden if VAT were first and foremost collected on behalf of the undisclosed agents, as online marketplaces e.g. Amazon tend to have large customer bases.⁵⁹ For intermediaries, this means, that for one to fall out of the applicable scope, the sales contract must be concluded directly on the platform, as the rules do not apply to sales where goods are offered through a platform but where the supplier and consumer agree on the details of the sale outside the

⁵³ Article 2(c), Council Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce')

⁵⁴ Articles 28, Council Directive 2006/112/EC

⁵⁵ CJEU, Judgement of 11 May 2006, Case C-384/04 - Federation of Technological Industries and Others, ECLI:EU:C:2006:309, In addition see e.g. commentary on footnotes p. 1210, Fabiola, A., "EU VAT Compass 2018/2019", IBFD (2018)

⁵⁶ Internet Marketplaces: Effects of the New German Law regarding VAT and Online Trading, 2018 Greenberg Traurig; <https://www.gtlaw.com/en/insights/2018/12/internet-marketplaces-effects-of-the-new-law-regarding-vat-and-online-trading>

⁵⁷ Article 14, Council Directive 2006/112/EC

⁵⁸ Article 28, the one facilitating supplies is deemed to have 'received goods himself', Council Directive 2006/112/EC

⁵⁹ Application of Article 14 Paragraph 2 (c), Council Directive 2006/112/EC

marketplace,⁶⁰ as is, e.g. the case with some used car platforms.⁶¹ For many online platforms this will not be the case, however for those who fall under the scope, this arises the question wheatear proposed measures are aligned with principles of EU law.⁶² This will further be examined and analysed in detail in chapter 3.

⁶⁰ In particular the purchase price.

⁶¹ Internet Marketplaces: Effects of the New German Law regarding VAT and Online Trading, 2018 Greenberg Traurig; <https://www.gtlaw.com/en/insights/2018/12/internet-marketplaces-effects-of-the-new-law-regarding-vat-and-online-trading>

⁶² However, the situation is interesting regarding alternative warehousing options. As the “supply of goods” means the transfer of the right to dispose of tangible property as owner, the type of warehousing may alter the latter right regarding ownership. See e.g. Terra B., Wattel P., “European Tax Law”, 6th edition, Kluwer Law International (2012)

3. MEASURES FOR RENEWAL

3.1. Objectives set for the new mechanism in Commission's proposals

A properly functioning VAT system should in the EU allow for national tax autonomy, provide compatibility with administrative incentives, avoid creating tax loopholes in the EU internal market and distribute VAT revenues according to consumption.⁶³ The current strategy for implementing VAT in the EU is based on the simplification and harmonisation of existing rules. The EC has declared that EU is moving towards a significant reform which should account for a major reform in the field of VAT.⁶⁴ Therefore, I have chosen two proposals, which I find to contain interesting amendments for the VAT in EU. These amendments are presented in the following sections. They consist of amendments found from COM/2016/0757 (Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods) and COM/2018/819 (Proposal for a COUNCIL DIRECTIVE amending Council Directive 2006/221/EC of November 2006 as regards provisions relating to distance sales of goods and certain domestic supplies of goods). The proposals are presented to achieve a modernised system with the objectives set by the DSM, bearing in mind that in order to fully grasp the implications of this proposal, it is not sufficient to merely look at their content.⁶⁵

3.2. Special Scheme – From MOSS to OSS

The amendments, as seen from the detailed explanation of the specific provisions of the proposal,⁶⁶ implies that purchases taking place in a MS of consumption from an exempt company were imposed on the basis of the country of destination principle by obliging such companies to register for VAT

⁶³ Terra B., Wattel P., "European Tax Law", 6th edition, Kluwer Law International (2012)

⁶⁴ Francesco C., Calogero V., Davide P., "A New Legal Framework Towards a Definitive EU VAT System: Online Hosting Platforms and E-Books Reveal Unsolved Problems on the Horizon", INTERTAX, Volume 46, Issue 8 and 9, Kluwer Law International BV (2018)

⁶⁵ Peeters M., "Rating the European Commission's Proposal on VAT Rates", IBFD Publishing BV (2018)

⁶⁶ European Commission proposal COM/2016/0757

in the same way as in the case of distance selling. In 2015, a special scheme was introduced in order to prevent differences in tax systems between MS.⁶⁷ It prompted, e.g. providers of telecommunications, broadcasting and television services who by electronic means deliver services to non-taxable persons,⁶⁸ to register and collect VAT in all of the MS where consumption occurred. In order to avoid registration to all 28 MS and ease the administrative burden, a simplification measure called mini one stop shop (MOSS) was introduced.⁶⁹ There are two MOSS mechanisms currently in place in the EU: (1) the Union scheme, which applies to businesses established in the EU; and (2) the non-Union scheme, which applies to non-EU companies.⁷⁰ From a procedural point of view, the two schemes differ, but the main features remain broadly similar for both. In practice, a taxable person who is registered through the MOSS in an MS, submits VAT returns detailing the services rendered to non-taxable persons in other MS of consumption, and the amount of VAT due. These statements, together with the VAT paid, are then transmitted by the MS of origin to the MS of consumption concerned.⁷¹

In order to avoid high administrative costs, the allocation of multiple VAT registrations and knowledge of complex national VAT legislation, the EU has, with its proposal, decided to bring all distance sales within the extended one stop shop scheme (OSS).⁷² This implies that the provider of online goods to non-taxable persons will no longer require multiple VAT numbers. Instead, the supplier may use the special scheme to charge local VAT in the MS where the acquiring business or consumer resides. However, a taxable supplier may declare VAT in his MS of an establishment if his

⁶⁷ European Commission, Guide to the VAT mini one stop shop; https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf

⁶⁸ Council Regulation (EU) No 967/2012 as regards the special schemes for non-established taxable persons supplying telecommunications services, broadcasting services or electronic services to non-taxable persons

⁶⁹ The Mini One Stop Shop; https://ec.europa.eu/taxation_customs/business/vat/telecommunications-broadcasting-electronic-services/content/mini-one-stop-shop_en

⁷⁰ Pfeiffer, S., Ursprung-Steindl, M., "Global Trends in VAT/GST and Direct Taxes", Schriftenreihe IStR Band 93, Hrsg, (2015)

⁷¹ European Commission, Guide to the VAT mini one stop shop; https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf

⁷² "Extends the scope of the special schemes for non-established taxable persons supplying telecommunications, broadcasting or electronic services to non-taxable persons, as defined in Articles 358 to 369k of the VAT Directive", European Commission proposal COM/2018/819

distance sales within the EU and services to consumers in MS other than the MS in which he is established do not exceed the annual threshold. The VAT treatment on distance sales of goods and services are based on the national legislation of the MS of consumption, which hold all the powers of the courts, e.g. applicable tax rates, invoicing, accounting, reporting, etc. and also, receives the revenue generated by the service. The MOSS only deals with a part of the compliance task faced by a company, and it has to know and apply in its transactions the rules of all the other MS where services are provided.

As established in section 2.1., the thresholds in MS vary and, in some MS, the annual thresholds can be considered relatively low.⁷³ Therefore, as already discussed in the second chapter, an aspect to consider could be increasing the VAT threshold. For example, setting a minimum threshold requirement for the Special Schemes in the VAT Directive would not, in my opinion, impose as measures which would be considered too intrusive. It could present as a prerequisite for other proposed measures as they will, in any case, increase the administrative burden on businesses, especially as the proposed measure concerning joint and several liability is to tighten controls.

3.3. Import scheme

Due to the increased imports and large-scale occurrence of fraud, it is suggested for the exemption on importation of low-value goods to be cancelled.⁷⁴ As seen from the Article 325 TFEU, the EU obliges its MS to encounter illegal activities affecting the financial interests.⁷⁵ This may be also, as according to Terra, be seen straightforwardly from the VAT Directive.⁷⁶ The new proposals suggest that VAT must be paid for any import of goods, irrespective of its value.⁷⁷ Also, where the transportation of goods takes place by or on behalf of the supplier or if the supplier intervenes indirectly in transport, the supply is subject to VAT in the MS of dispatch of the goods, that is to say,

⁷³ See chapter 2 on thresholds

⁷⁴ European Commission, VAT e-commerce package of 5 December 2017, The Import scheme, 26 February 2018, VAT Expert Group

⁷⁵ CJEU, Judgement of 26. February 2003, Case C-617/10, Åkerberg Fransson, ECLI:EU:C:2013:105

⁷⁶ See. Article 131, Terra, B., Kajus, J., “A guide to the European VAT Directives”, Integrated Texts of the VAT Directives (including the implementing Regulations) and of the former Sixth VAT Directive, Volume 2, IBFD (2019)

⁷⁷ European Commission, VAT e-commerce package of 5 December 2017, The Import scheme, 26 February 2018, VAT Expert Group

in the MS where the consumer resides. The supplier may choose to declare distance sales of goods outside the EU in a similar type of MOSS VAT return, but which will be named the one stop shop for import (IOSS).⁷⁸ The scheme, however, applies only to goods with an intrinsic value of up to EUR 150.⁷⁹ Both EU and non-EU suppliers are eligible to apply the scheme; therefore, companies established outside the EU that do not have a permanent establishment in the EU will also be able to use the MOSS scheme to report VAT on services rendered to non-taxable persons in the EU. Non-EU suppliers, however, have to appoint an intermediary in the EU, unless the EU has concluded a Mutual Assistance Agreement (MAA) on VAT.⁸⁰⁸¹

⁷⁸ Ibid. 77

⁷⁹ Ibid. 77

⁸⁰ See e.g. Proposal for a COUNCIL REGULATION amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in order to combat VAT fraud

⁸¹ For sections 3.1. - 3.3. see also, Kerschner, I., Somare, M., “Taxation in a Global Digital Economy” Chapter, “EU OSS and MOSS: A Solution for the Challenges of the Digital Economy?”, Schriftenreihe IStR Band 107, Linde Verlag (2017)

3. JOINT AND SEVERAL LIABILITY - DOES IT UNDERMINE THE GENERAL PRINCIPLES OF EU LAW?

3.1. The principle of proportionality

The CJEU has developed a number of doctrinal strategies, one which is the interaction between general principles and directives.⁸²⁸³ The principle of proportionality is a substantial principle of EU law, meaning it needs to be implemented into national legislation. Therefore, in measures rectifying the VAT Directive, there should be done a proportionality test, which establishes a relation between means and purpose. Measures should not go beyond what is necessary to meet the objectives,⁸⁴ in this case of the amending proposals to the VAT Directive nor the national implementations of it. The EC, in its legislative process, has to set a balance between joint and several liability and the role of a fiscal administrative authority with the requirement to ensure collection of VAT and that regular trade is not rendered unreasonably difficult by a threat of liability for non-payment. The appropriations must, also, be necessary and reasonable in relation to the pursued purposes of the administrative practical and effective combating of fraud.

3.2. Joint and several liability for online marketplaces – the German example

Third party's joint and several liability arises from the VAT Directive, which implies that MS may provide that a person other than the person liable for payment of VAT, i.e. an intermediary party, is to be held jointly and severally liable for payment of the unpaid VAT.⁸⁵ The applicability of this has raised concern, as the straightforward application of Article 14 Paragraph (2), as seen from subsection 2.5.1., may raise uncertainties in its application, in the light of the proposal COM/2018/819. This section will take into consideration some relevant Articles of the German VAT Act (Umsatzsteuergesetz), as the Federal Republic of Germany provides for a rich field of study, due to

⁸² Craig, P., Burca, G., "Eu Law: Texts, Cases, Materials", Chapter 1, 6th, edition, OUP Oxford (2015)

⁸³ Ibid. For this chapter see also interaction between directives and regulations.

⁸⁴ Article 5 (4), Treaty on European Union (TEU)

⁸⁵ Article 205, referring to situations under Article 193 - 204, with the exception of Article 201, See chapter 10.4., Fabiola, A., "EU VAT Compass 2018/2019", IBFD (2018)

German Constitutional Court being particularly active in testing tax legislation against constitutional principles.⁸⁶ Also, the Federal Republic of Germany has from 1st of January 2019 drafted the proposals concerning joint and several liability into its national legislation.

In general, it has been⁸⁷ a standard practice for VAT collection to fall under the obligations of national tax administrations or the customs. In the Federal Republic of Germany, the responsible authority for assessing and collecting VAT is the Federal Central Tax Office (Bundeszentralamt für Steuern).⁸⁸ The German Federal Fiscal Court (Bundesfinanzhof) and the CJEU consider in its case law⁸⁹ that the principal supplier would need to be primarily liable in account of the indirect excise duty or VAT, but the intermediary, may be imposed by joint and several liability. However, the imposed measure must comply with the general principles of law which form part of the Community legal order and which include, in particular, the principles of legal certainty and proportionality.⁹⁰

Here, the issue arises if an undisclosed agent is considered to be included in the VAT collection process and to be acting "in the interest of the public".⁹¹ This may be interpreted as the online platform or marketplace acting as an administrative officer of the fiscal authority, which in obvious consideration is interference with its occupational freedom. It would particularly increase administrative burdens by creating additional expenses, which also interfere with the area of freedom provided by Article 12 Paragraph (1) of the German Constitutional Law (Grundgesetz).

In further consideration of national law, if there occur legal requirements concerning business with the exercise of an additional profession, linking activity outside of the actual profession,⁹² it may be considered in this purpose that the undisclosed agents are first and foremost intermediaries; agents who merely establish pre-contractual obligations for direct actions of other parties. The accumulation

⁸⁶ Thuronyi, V., "Tax Law Design and Drafting", Volume 1, Chapter 2, International Monetary Fund (1996)

⁸⁷ With emphasis added.

⁸⁸ Fact sheet on VAT obligations for foreign operators not established in the European Union, Bundesfinanzministerium, 2017

⁸⁹ CJEU, Judgement of 11 May 2006, Case C-384/04 - Federation of Technological Industries and Others, ECLI:EU:C:2006:309

⁹⁰ CJEU, Judgement of 11 May 2006, Case C-384/04 - Federation of Technological Industries and Others, ECLI:EU:C:2006:309

⁹¹ CJEU, Judgement on 21 February 2008, Case C-271/06 Netto Supermarkt, ECLI:EU:C:2008:105

⁹² Bundesverfassungsgericht (BVerfG), 29.11.1967 - 1 BvR 175/66, Decision, II.

of risks imposed by the amendments on the part of the online platform weighs heavily on the overall picture, as they not only have to guarantee the success of marketplace supervision, as regulators or default guarantors, but also have to deal with an uncertain scope of engagement and liability. In a concept of joint and several liability as a rule⁹³ and discharge as an exception⁹⁴, the intermediary is dependent on the accuracy of the discharge rules. If the intermediary, as a mere service provider, is imposed with tax liability despite the correct exercise of his obligations, e.g. burden of proof regarding documents, the disproportionality seems noticeable. As regarding the proof, the German legislation suggests that the intermediary would be liable in the case it fails to submit a certificate⁹⁵ or an electronic confirmation.⁹⁶ In the light of the presented facts, the submitted documents, however, may not be sufficient if the intermediary, in general, is acting negligently towards its obligation to act as an administrative officer. In my opinion, the discharge exception cannot determine a reasonable, proportionate and thus constitutional application itself. Therefore, the national tax administrations should not, in general, impose on the taxable person, to monitor whether the issuer of the invoice relating to the goods or services, for which the exercise of that right is claimed, possesses and was in a position to supply them if it has fulfilled its obligations to declare and pay VAT to ensure that there are no irregularities or fraud at the level of the principal suppliers or, to have documents in that regard.

The taxable persons facilitating certain taxable supplies in the Community through the use of an electronic interface it should be considered appropriate to release them from the burden of having to prove the status of the seller and customer.⁹⁷ Therefore, the responsibility of the undisclosed agents should be limited, and MS required not to impose general obligations on service providers to actively investigate circumstances indicative of unlawful activity. The national tax legislations are not entitled to undermine the EU's fundamental evaluation, which is also a guarantee of the supremacy of the EU law.⁹⁸ In all assumptions of joint and several liability, as regards to the burden of proof, the case law of the CJEU is consistent with the fact that proof of involvement in fraud lies with the national criminal body, which must demonstrate the subjective nature of the involvement in evasion.⁹⁹

⁹³ Section 25 e (1) UStG-E

⁹⁴ Section 25 e (2) UStG-E

⁹⁵ 22 f (1) Sentence 2 UstG

⁹⁶ 22 f (1) Sentence 6 UstG

⁹⁷ The Directive on e-commerce, does not have direct application to the field of taxation. See, Article 1 Paragraph 5 (a), Council Directive 2000/31/EC

⁹⁸ CJEU, Judgement of 27 March 2012, Case C-314/12 – UPC Telekabel Wien, ECLI:EU:C:2014:192

⁹⁹ CJEU, Judgement of 22 October 2015, Case C-277/14, PPUH Stehcomp, ECLI:EU:C:2015:719, Paragraph 50

Therefore, it should be the responsibility of the national fiscal administration to find frauds or irregularities committed by the person who issued the invoice to establish, in relation to objective elements and without requiring from the vendor of the invoice the task of which he is not responsible.

The discussion may clearly be regarded as an issue of implementation of EU law into national legislation. Therefore, some other alternatives should be taken into consideration. As the EU may impose regulations to protect its finances,¹⁰⁰ the replacement of a directive with a regulation and the removal of flexibility within the national courts could serve as an effective mean by which to further harmonise VAT tax law across the EU's 28 tax jurisdictions.¹⁰¹ A regulation might also foreclose the problem of EU legislatures creating a legal regime that ends much of the MS discretion threatening harmonisation.¹⁰² This may be seen as the EC has in proposal COM/2018/821 introduced the type of information which should be kept in the records of taxable persons facilitating taxable supplies in the Community through an online marketplace.¹⁰³

The tightening of control, and the German implementation of it under this chapter can, in principle, be seen as an effective way to prevent tax fraud. However, the problem of tightening controls is the negative costs to businesses and the increasing administrative burden. As the proposed means of monitoring in reducing the risk of VAT fraud may be diverse, it creates enormous uncertainty, which increases the risk of compatibility with EU law.

¹⁰⁰ Note that regulations cannot undermine the EU's requirement that there exist a common VAT tax system or fundamental requirement of that common VAT tax system.

¹⁰¹ Tudor, J., "Making Sense of the European Union's Vat Tax System: Does the European Court of Justice's Jurisprudence Support Harmonization", 7 *Global Business Law Review* 76 (2018)

¹⁰² CJEU, Judgement of 13 March 2014, Case C-599/12 *Jetair*, ECLI:EU:C:2014:144

¹⁰³ Proposal for a COUNCIL IMPLEMENTING REGULATION amending Implementing Regulation (EU) No 282/2011 as regards supplies of goods or services facilitated by electronic interfaces and the special schemes for taxable persons supplying services to non-taxable persons, making distance sales of goods and certain domestic supplies of goods

CONCLUSIONS

One of the great challenges of VAT in the future, but also of opportunities, is the increase globalization and digitalisation. The VAT system is in need of a reform. How the reform is done presents a complex problem. A problem with the current system is that it requires companies to treat differently domestic and intra-Community companies, which in turn increases compliance costs for companies. One of the explicit objectives of the 1993 reform was to allow companies from different MS to treat the internal trade area in the same way. The current system interrupts the accumulation of VAT revenue whenever the production chain crosses the frontier between MS and thus makes the chain vulnerable to fraud. At the beginning of the study, the impressions were that a system that would change the structure of VAT would be sufficient enough to remedy at least some of the weaknesses of the current system. However, the transfer to the destination principle in the current system reduced the issues of allocating revenues, but at the same time increasing the chances of VAT fraud.¹⁰⁴

One of the main weaknesses of the current EU internal trade system is that it creates problems in the implementation of VAT. In the light of the proposals, as the intention was to increase harmonisation of the rules across MS on the subject of allowable interpretation, the regulation would provide as a balancing tool to decrease the uncertainty of interpretation. The vulnerability for fraud lies generally within co-operation between the MS. Therefore, in order to ensure the uniform application, the new VAT system should be amended in such a way that the procedure has to be implemented in all MS.¹⁰⁵ Therefore, as suggested in section 3.2. even as the intended aim of this thesis may not be accomplished by the proposal COM/2018/819, a regulation should still be adopted due to its general positive effect on decreasing legal uncertainty.

Also, as VAT fraud is also increasingly involved in activities outside the EU. In this case, it is not possible to prevent fraud solely by changing the internal structures in the EU, however, canceling the exemption of importation of low-value goods can, in my opinion, be seen as an effective measure. However, the problem does not disappear with this proposed amendment, as it is the responsibility

¹⁰⁴ Study on the review of the VAT Special Scheme for travel agents and options for reform; https://ec.europa.eu/taxation_customs/sites/taxation/files/travel_agents_special_vat_scheme_en.pdf

¹⁰⁵ Submission XVIII.2.a by German Chambers of Commerce and Industry (DIHK), EUROPEAN COMMISSION, REFIT Platform, STAKEHOLDER SUGGESTIONS, XVIII - TAXATION AND CUSTOMS UNION

of the supplier to correctly mark the goods for customs purposes.¹⁰⁶ If the basic principles of the current VAT system were to be maintained, it would require a review of the system and its application in terms of legal certainty and administrative burdens for intra-Community transactions. The presented options in section 2.1. and subsection 2.1.2. would constitute better options regards the overall picture, as both, the administrative burdens and attractiveness could decrease.

In conclusion, the options presented in this thesis present a few opinions to solve the problems of the current system. All of the presented measures have strengths, but none of them serves as a universal tool for solving any problem. Based on the brief overview presented in this thesis, it is impossible to say which solutions would be the most viable to strike a balance between easing administrative burdens of SMEs while efficiently combating tax evasion. The purpose was to present the basics of some possible alternatives. In the light of societal benefits and the vulnerability to fraud, the implementation of the Regulation presented in 3.2. is an aspect worth considering as it would at least close out the need for broad legal interpretation. None of the proposed solutions represent an absolute fix for the shortcomings nor do they come without problems, but all the proposed solutions have good advantages.

¹⁰⁶ The suppliers may mark goods as gifts. Taxable gifts: “On the basis of preferential tariff agreements, a gift consignment exceeding the value limit of 45 euros can be granted preferential tariff treatment, i.e. exemption from customs duty or a reduced rate of duty, without documentary proof of origin.”; <https://tulli.fi/en/private-persons/receiving-gifts/taxable-gifts>

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