COMMISSION OF THE EUROPEAN COMMUNITIES

COM(94) 515 final

Brussels, 23.11.1994

REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

ON

THE OPERATION OF THE TRANSITIONAL ARRANGEMENTS FOR CHARGING VAT IN INTRA-COMMUNITY TRADE

(presented in accordance with Article 28l of Directive 77/388/EEC)

SUMMARY

I. THE ACHIEVEMENTS OF THE TRANSITIONAL ARRANGEMENTS

The elimination of procedures on the crossing of an internal border

The implementation on the 1st January 1993 of the principle of freedom of movement inside the Community pre-supposed that intra-Community trade ceased to be treated for fiscal purposes as imports and exports. It is on this condition that the procedures on the crossing of an internal border and controls hitherto imposed, in particular for the purposes of application of VAT, could be completely abolished.

With the adoption of the transitional arrangements, one of the objectives set by the 1st Directive was achieved: the abolition, for intra-Community trade, of tax on importation and the remission of tax on exportation. This important achievement made it possible to ensure that inside the Community, only commercial transactions are now taxable: the procedures previously imposed on private individuals (e.g. on removal of home) therefore finally disappeared. Travellers have now the opportunity to shop in the market conditions of the Member State of their choice, without having to satisfy obligations of declaration and of payment of tax in their own Member State.

Taxation at destination in respect of operations between taxable persons entitled to deduction

For operations between different Member States carried out by taxable persons entitled to deduction, the Council wished to maintain, for a transitional period, the general rule of taxation at the rate and conditions of the Member State of destination.

The mechanisms set up for this purpose (exemption of the supplies of goods destined for another Member State / taxation of intra-Community acquisitions) were well accepted by the operators and function in a generally satisfactory manner.

However, so that the principle of taxation at destination retained by the Council is rigorously applied, special provisions had to be introduced in order to ensure the monitoring of certain intra-Community movements of goods (transfers of goods between Member States; movements of goods connected with the carrying out of work on these goods), as well as for the treatment of some of the supplies of services

carried out between Member States (transport services; supplies of intermediaries; etc. etc.). The application of these specific provisions is particularly complex and a source of difficulty for the traders concerned.

In order to remedy these difficulties, the Commission quickly proposed measures aimed at simplifying the treatment of a number of operations. This exercise has nevertheless reached its limits; except basically to challenge the principles retained by the Council regarding the place of taxation of transactions and the place of deduction of the tax.

The special arrangements for taxation at destination

Supplies to final consumers (operators without right to deduction) are normally taxable in the Member State from which they are made. However, taking account of the risks of distortions of competition due to an insufficient approximation of tax rates, three special arrangements for taxation at destination were put in place (purchases made in other Member States by totally exempt taxable persons, or by non-taxable legal entities; distance sales; sales of new means of transport).

Each of the three special arrangements for taxation at destination imposes heavy obligations either on the suppliers (distance sale procedure), or on the purchasers (purchases made by exempt taxable persons and by non-taxable legal entities; purchases of new means of transport).

The complexity of the applicable provisions led certain operators, in particular the small and medium-sized enterprises, to cease buying or selling in other Member States: the single market cannot be achieved with such obstacles to trade.

The establishment of the internal market: a challenge partially tackled

Today, after 22 months of operation, one can state that the measures adopted within the framework of the transitional arrangements have enabled the Community to take up the challenge that maintenance of taxation at destination represented, while ensuring the effective abolition of fiscal controls on the crossing of internal borders. Within this framework it needs to be said that data on the VAT revenues of Member States, although still provisional, reveals an evolution which in general is consistent with the economic trends which characterised the year of 1993 and the first months

of 1994. It does not indicate changes in the level of receipts directly attributable to the new provisions introduced by the transitional arrangements.

However, the real difficulties encountered by the traders are a daily reminder that businesses and consumers do not benefit yet from all the expected advantages of a single market; the justification of the intra-Community character of their operations, the weight of the identification and declaration obligations and, the dissuasive effect of certain provisions are some of the remaining obstacles to the development of trade between Member States.

These difficulties, combined with the multiplicity of provisions applicable, are reflected in complex mechanisms of application of the common system of VAT, thus challenging the simplicity of its conception.

II. FROM THE TRANSITIONAL ARRANGEMENTS TO THE DEFINITIVE SYSTEM

The constraints now imposed by the 6th Directive

In its implementation of the principle of taxation at destination, retained by the Council, the transitional arrangements had necessarily to draw conclusions not only from features retained by the 6th Directive on the place of taxation of operations, but also from the options exercised by the Member States in the definition of some of the elements of taxation.

This situation confronts European businesses with two series of difficulties:

- either they have to satisfy identification and declaration obligations in each Member State from which they carry out operations;
- or they have to make use of long and expensive procedures for obtaining refunds of tax borne in Member States where they do not carry out operations.

These difficulties do not result at all from the mechanisms retained during the transitional period: they are a direct consequence of the rules retained by the 6th Directive, as regards place of taxation of the operations and place of deduction of the tax. These rules are reflected in the maintaining of constraints which are not easily compatible with the correct operation of the internal market.

The challenge to be accepted in the preparation of the definitive system

The provisions which apply during the transitional period allow the abolition of controls at internal frontiers, however, the development of the common system of VAT is part of a wider context extending far beyond this single achievement. The actual process of harmonizing Member States' legislation governing turnover taxes is inseparable from two other objectives:

- to guarantee the neutrality of taxation in trade within and between Member States, and this in parallel with the general process of building the Community;
- in this way, and in accordance with the Treaty, "to establish, within the framework of an economic union, a common market within which there is healthy competition and whose characteristics are similar to those of a domestic market".

The very pursuit of each of these objectives undoubtedly constitutes the fundamental challenge to which the Community must now respond in the context of the work on setting up a definitive VAT system which will ensure that the internal market functions smoothly.

CONTENTS

PAGE

INTRODUCTION 9

1. ACHIEVEMENTS OF THE TRANSITIONAL ARRANGEMENTS 11

1.1. ABOLITION OF CONTROLS AT INTERNAL BORDERS 11

1.1.1. Situation prior to 1 January 1993 11

1.1.2. Situation since 1 January 1993 12

1.2. GENERAL STRUCTURE OF THE TRANSITIONAL ARRANGEMENTS 13

1.2.1. General structure of transitional arrangements 13

1.2.2. New taxable transaction: intra-Community acquisition of goods 16

1.2.3. Special arrangements for taxation at the place of destination 18

1.2.4. Intra-Community supplies of services 20

1.3. IMPACT OF NEW ARRANGEMENTS: BROADLY POSITIVE OVERALL ASSESSMENT 22

1.3.1. Surveys conducted among consumers 23

1.3.2. Surveys conducted among traders 23

1.3.3. Consequences for the Member States of the new arrangements 27

1.3.4. Broadly positive overall assessment 28

2. NEW RULES ON TAXATION OF INTRA-COMMUNITY TRANSACTIONS 29

2.1. PROOF OF THE RIGHT TO EXEMPT INTRA-COMMUNITY SUPPLIES OF GOODS 29

2.1.1. Proof of transport of goods outside the Member State of departure 29

2.1.2. Proof of purchaser's status 30

2.1.3. Purchaser fails to notify status 32

2.2. SPECIAL TAXATION SCHEMES IN THE MEMBER STATE OF DESTINATION 32

2.2.1. Purchases made by taxable persons not entitled to deduct input tax and by non-taxable legal persons 33

2.2.2. Distance selling 34

2.2.3. New means of transport 35

2.3. INTRA-COMMUNITY SUPPLY OF SERVICES........ 37

2.3.1. Intra-Community transport of goods and ancillary transport services, including services supplied by intermediaries....37

2.3.2. Other services rendered by intermediaries....38

2.4. DIVERSITY OF TAXATION ARRANGEMENTS IN FORCE....38

2.4.1. Concept of intra-Community trade....38

2.4.2. Multiplicity of taxation arrangements....39

2.4.3. National rules implementing Community provisions....40

2.5. EVALUATION OF THE TRANSITIONAL PROVISIONS....42

3. COMPLIANCE WITH THE PRINCIPLES OF TAXATION LAID DOWN IN THE SIXTH DIRECTIVE....45

3.1. GENERAL MECHANISMS OF THE COMMON SYSTEM OF VAT....45

3.1.1. Place of taxation of transactions....45

3.1.2. Place at which the right to deduct input tax may be exercised and rules governing the exercise of that right....47

3.1.3. Scope and consequences of these basic options....48

3.2. TAXATION OF INTRA-COMMUNITY TRANSFERS OF GOODS....49

3.2.1. Mechanisms introduced....49

3.2.2. Situations covered....50

3.2.3. Provisions very broadly applied on account of stock management practices....51

3.2.4. Consequences for traders....53

3.3. TAX TREATMENT OF WORK ON MOVABLE TANGIBLE PROPERTY....55

3.3.1. Classification for tax purposes of work on movable tangible property....55

3.3.2. Treatment of transactions between Member States....56

3.4. TRANSACTIONS CARRIED OUT BY NON-ESTABLISHED TAXABLE PERSONS....58

3.4.1. Supplies of transport services....58

3.4.2. Triangular transactions....61

3.4.3. Chain transactions....63

3.5. PERSON LIABLE FOR PAYMENT OF THE TAX....66

3.5.1. Person liable for payment of the tax: general problem....66

3.5.2. Guidelines laid down by the Commission....67

3.6. SMALL BUSINESSES ("UNDERTAKINGS") QUALIFYING FOR EXEMPTION 68

3.6.1. Provisions applicable 68

3.6.2. Difficulties encountered 69

3.7. ASSESSMENT OF THE PRINCIPLES OF TAXATION LAID DOWN IN THE SIXTH DIRECTIVE 69

CONCLUSION 71

I. INTRODUCTION OF NEW TAX RULES 71

II. ADAPTATION TO PRE-EXISTING TAX RULES 71

III. THREATS TO MECHANISM WHEREBY PAYMENTS ARE MADE AT EACH STAGE 72

IV. LESSONS TO BE DRAWN FROM EXPERIENCE GAINED SINCE 1 JANUARY 1993 73

ANNEX 1: **THRESHOLDS IN THE MEMBER STATES** 75

ANNEX 2: **HARMONISATION OF LEGISLATION OF MEMBER STATES CONCERNING TURNOVER TAXES**

- References - 77

INTRODUCTION

(1) The launching of the internal market on 1 January 1993 posed four problems for the value added tax (VAT) and excise duty systems in force in the Community:

- implementation of the principle of freedom of movement on Community territory necessarily presupposed the disappearance of all customs procedures and formalities associated with the crossing of internal borders: it was therefore possible only if the tax concept of importation was first abandoned for good in trade between Member States;
- since the Council had decided that intra-Community trade between traders was, however, to continue to be taxed in the Member State of destination, new tax mechanisms had to be introduced, both for VAT and for excise duties;
- at the same time, the level and structure of tax rates in the Community had to be aligned sufficiently to ensure that the freedom of individuals to purchase goods on a tax-paid basis (VAT and excise duty) in the Member State of their choice became the rule;
- finally, the instruments and procedures of administrative cooperation between Member States had to be adapted to the new circumstances of the internal market and to the new tax mechanisms introduced.

(2) These four problems were tackled: the new mechanisms were in place by 1 January 1993 and, while a number of teething troubles arose, they were of a temporary nature.

(3) - Article 281 of the Sixth Directive requires the Commission to report to the Council, before 31 December 1994, on the operation of the transitional arrangements for charging VAT in trade between Member States.

(4) This report examines and assesses the operation of the transitional arrangements for taxing intra-Community trade from the following three angles:

- the achievements of the transitional arrangements (Part 1);
- the new rules on taxation of intra-Community transactions (Part 2);
- compliance with the principles of taxation laid down in the Sixth Directive (Part 3).

(5) The aim of this report is, of course, to review the transitional arrangements after eighteen months of operation. Without claiming to be exhaustive, this assessment is designed principally to describe the problems encountered both by traders and by the authorities in the Member States. It thus attempts to respond to the questions and concerns raised in connection with the operation of the transitional arrangements. Faced with the many and complex arrangements in force, businesses are concerned about the way in which authorities responsible for control will evaluate, subject to confirmation by the Courts, the practical implementation of the new regimes. In this respect it should be noted that the European Court of Justice has not yet been required to pass judgement on any of these new requirements.

(6) The report also seeks to identify the causes of the difficulties or malfunctions encountered in order to enable an analysis to be made of likely remedies. It has also to be viewed against the background of the proposals which the Commission is required to present to the Council on the changeover to the definitive system for taxing intra-Community trade.

(7) This report concerns itself only with the mechanism for taxing intra-Community trade: it does not address questions of liability or rates; neither does it deal with the issue of administrative cooperation[13] and mutual assistance between Member States.

1. ACHIEVEMENTS OF THE TRANSITIONAL ARRANGEMENTS

1.1. ABOLITION OF CONTROLS AT INTERNAL BORDERS

(8) The launching of the internal market on 1 January 1993 necessitated the disappearance of administrative procedures preliminary to or associated with the crossing of internal Community borders: a swift comparison of the situations before and after 1 January 1993 shows the magnitude of the step taken with the adoption of the transitional arrangements.

1.1.1. Situation prior to 1 January 1993

(9) Prior to 1 January 1993 any movement of goods within the Community led to systematic tax monitoring since any entry of goods into the territory of a Member State was taxable as an importation. For that reason alone, any movement of goods gave rise to VAT declaration and payment obligations:

- whatever the origin (Community or not) of the goods imported into the territory of a Member State;
- whatever the destination of those goods (whether intended to remain within the territory of the country or to be sent to another destination);
- whatever the "VAT status" of the goods (already taxed or not).

(10) However, in view of the consequences which strict application of this principle would have had for traders and individuals, programmes were implemented for simplifying the administrative procedures and formalities involved in charging VAT:

- the *various import allowances* obviated the need for certain imports carried out by individuals to be taxed (travellers' allowances, exemptions in the case of removal, etc.);
- the *tax exemptions* applied by Member States in the case of goods placed under duty-suspension arrangements also obviated the need for such goods to be taxed throughout the duration of those arrangements;

- in a number of cases (e.g. the SCHUL judgments), the Court of Justice, having been asked for a preliminary ruling, put an end to double taxation between Member States, invoking in particular Article 95 of the Treaty establishing the European Community.

(11) Nevertheless, the general principle of taxation on importation was maintained and undoubtedly constituted a major cost of non-Europe. The obligation to complete administrative formalities and to pay the tax or to guarantee its payment on importation entailed appreciable costs for firms and dissuaded individuals from making purchases in other Member States.

(12) In addition, the work carried out in connection with the Cecchini report on the costs of non-Europe had clearly demonstrated that, with the abolition of frontier checks, adaptation of the common system of VAT in a manner which ensured that only sales were taxed was crucially important for reinforcing intra-Community competition and for putting an end to market segmentation.

(13) Consequently, the definitive abolition in trade between Member States of importation as the chargeable event was an essential precondition for achieving the objectives underlying the single market.

1.1.2. Situation since 1 January 1993

(14) With the adoption, on 16 December 1991, of Directive 91/680/EEC amending the Sixth VAT Directive with a view to the abolition of tax frontiers[8], Member States took a major step towards completing the internal market.

(15) Now that intra-Community trade in goods has ceased to be treated as importations the free circulation of goods within the Community has become a reality. Therefore, between Member States, commercial supplies of goods or services are now, in principle, the only events giving rise to tax.

(16) It is for these two reasons that the system introduced on 1 January 1993 was entered into with a view to "progress to a unified system of taxation in the country of origin, the favourable conditions for which will be created by the dynamic effect of the abolition of frontiers" (Conclusions of the ECOFIN Council of 13 November 1989[7]).

1.2. GENERAL STRUCTURE OF THE TRANSITIONAL ARRANGEMENTS

(17) The adaptation of the common system of VAT to permit the effective abolition of controls at tax frontiers was designed to be consistent with the general principles of the VAT system arising from the Sixth Directive and from the rules applicable to domestic transactions.

(18) Nevertheless, this proved particularly hazardous and difficult to achieve in view of the guidelines adopted by the Ecofin Council. The Ecofin Council's conclusions of 13 November 1989[7] included the following:

- "the smooth operation of VAT arrangements in the case of transactions between different Member States carried out by taxable persons must be ensured by taxing the recipient in the country of destination at the rate and under the conditions obtaining in that country";
- "exempt or non-taxable bodies making purchases of a certain value in other Member States will be treated in the same way";
- through "differential treatment", purchases of vehicles and distance supplies of a certain value will be taxed in the country of destination;
- at the same time, "the present burden on undertakings and administrations will be lightened" and "distortions of competition are avoided without hampering the free movement of goods".

(19) At all events, any restrictions, in terms of quantity or value, on purchases made on a tax-paid basis in other Member States by travellers moving within the Community were to be definitively abolished.

(20) Under these circumstances, only a hybrid tax system combining taxation in principle in the country of origin and derogations from taxation in the country of destination was such as to allow all the objectives laid down by the Council to be met.

1.2.1. General structure of transitional arrangements

(21) The transitional system is based on three principles governing the notion of taxable transactions, the place of fiscal origin of these transactions and the place of fiscal destination of the goods or services on which these transactions are carried out:

- all transactions consisting of supplies of goods or services carried out for consideration are subject to VAT. Each of these transactions is treated as a sale by the provider and a purchase by his customer;

- a place of taxation is associated with each supply, regarded as being the place of their fiscal origin. This place of fiscal origin is taken to be in the Member State from which the goods are sold or from which the services are rendered;
- the place of destination of supplies of goods or services is the place where the client uses these goods or services. In the case of commercial traders this place of destination merges with the place of fiscal origin of the transactions carried out with those goods and services.

(22) Thus, contrary to the impression sometimes created, the transitional regime is based exclusively on the principles, used to define taxable transactions and their place of taxation, which have been in force since the adoption of the EC Sixth VAT Directive in 1977.

An unchanged principle: taxation in the Member State of origin

(23) The rules governing in principle the place of supply for goods and services set out in the Sixth Directive have been retained under the transitional arrangements; the principle that supplies of goods and services are taxed in the Member State from which they are supplied is thus reaffirmed.

(24) The transitional arrangements ensure therefore that sales to final consumers are taxed in the Member State of origin. Even though travellers have not always assimilated the real extent of the changes that have occurred, it is nevertheless a fact that they are now able to acquire goods under the market conditions obtaining in other Member States without having to satisfy VAT declaration and payment obligations in their own Member State.

Derogations maintained for a transitional period: taxation at the place of destination

(25) Given the objectives laid down by the Ecofin Council, it was necessary for a number of transactions carried out between Member States to be taxed at the place of destination. To that end, two measures were taken:

- the creation of a new taxable transaction: the intra-Community acquisition of goods;
- the change in the place of taxation of certain transactions: distance sales and certain intra-Community supplies of services.

(26) The choice of these methods of taxing at destination and the defining of the circumstances to which they apply answered two concerns: to capture the transaction which gives rise to tax at destination (purchase or sale) and to impose on the businesses concerned (buyers or sellers) the obligations relating to declaration. These two elements are implemented in the following way:

- in all cases where it is possible to guarantee taxation at the place of destination in the hands of the purchaser, the general arrangements for taxing intra-Community acquisitions of goods have been introduced. Similar rules have been brought in for the taxation of intra-Community supplies of services to taxable persons;
- however, where turnover of a given level is achieved in a Member State other than the Member State of destination of the goods (i.e. on account of the conduct of the seller), taxation must take place in the hands of the seller. This is achieved by the special arrangements for taxing distance sales. As a result, no obligation is imposed on the purchaser (generally an individual), who could under no circumstances be considered as having to fulfil VAT declaration and payment obligations.

Autonomy of Member States in the control of transactions

(27) Not only the originality but also the difficulties of constructing the transitional system stemmed from the fact that taxation under the destination principle, adopted by the Council, had to be implemented without affecting the autonomy of each Member State in exercising control over transactions.

(28) Each Member State must in fact be able to exert its own competence in taxation independently of events in other countries (other Member State or third country). In the framework of a system of taxation common to all Member States, the respect for this principle relies entirely on the rules of territoriality applicable to the taxation of transactions. The place of taxation is consequently of primary importance and this is further emphasised by the fact that Member States have options to derogate from the common rules of taxation (sales or purchases giving rise to no right of deduction, optional exemptions, etc).

(29) This preoccupation, related to independence of competence in taxation, is not only the concern of Member States: it also has important consequences for traders themselves. In the application of the tax, traders cannot be made responsible because of fiscal behaviour of their partners. The conditions for taxation or exemption of a transaction must therefore be evaluated in regard of the operator who makes the supply, whatever the fiscal behavior of his commercial partner.

(30) Within the framework of the transitional system, close attention was paid to these principles This explains in large measure why the destination principle was adopted together with the complementary arrangements for administration. Without doubt the paradox is that certain national measures, implementing the transitional regime reduced its scope, giving rise to concern regarding respective responsibilities of suppliers and their customers.

1.2.2. New taxable transaction: intra-Community acquisition of goods

Description of the mechanism

(31) It soon became clear that, where goods were transported between two Member States and the situation was one where the Ecofin Council wished to maintain taxation in the country of destination, the independence of Member States was best guaranteed through the definition - for the same economic transaction - of one taxable transaction in the Member State of departure of the goods (the supply of goods) and of another taxable transaction in the Member State of arrival of the goods (the intra-Community acquisition of goods).

(32) The fact that the two tax transactions - the supply of goods effected by the vendor in the Member State of departure and the intra-Community acquisition of goods effected by the purchaser in the Member State of arrival - are quite separate enables each of the Member States in question to satisfy itself about the conditions for taxing or exempting the transaction carried out on its territory, independently of events in the other Member State. Furthermore, by ensuring complementarity, both spatially and over time, of the responsibilities for charging tax, this method guarantees continuity in the general principle of taxation of transactions within the Community:

- at the time when conditions of non-taxation of a transaction are met in the Member State of origin, the conditions of taxation are met in the receiving Member State (definition of the transactions concerned);

- any transaction satisfying the conditions of non-taxation in the Member State of origin comes within the tax jurisdiction of another Member State (definition of the place of taxation of transactions).

(33) Thus, any sale of goods between taxable persons involving the transport of those goods between two Member States gives rise to two taxable transactions:

- a *supply* of goods which is taxable in the Member State of departure and liable to qualify for an exemption where the following two conditions are met:
  - the goods are dispatched or transported by or on behalf of the vendor or the purchaser outside the territory of the Member State of departure but within the Community;
  - the supply of goods is effected for another taxable person acting as such in a Member State other than that of the departure of the goods;
- an *intra-Community acquisition of goods* on which tax is payable by the acquirer in the Member State of their arrival and which, being the counterpart of the supply of the goods, is defined as the "acquisition of the right to dispose as owner of movable tangible property dispatched or transported to the person acquiring the goods by or on behalf of the vendor or the person acquiring the goods to a Member State other than that from which the goods are dispatched or transported".

(34) A mechanism for treating certain intra-Community transfers of goods as taxable transactions (intra-Community supply and acquisition) has been introduced in all cases where goods are moved by a taxable person in the Community prior to any subsequent supply.

(35) In the context of the special schemes, intra-Community acquisitions made by farmers subject to the flat-rate scheme, by taxable persons not entitled to deduct input tax and by non-taxable legal persons are also subject to VAT in the Member State of destination of the goods once their total annual amount exceeds a threshold which Member States have to determine but which may not be less than ECU 10 000 (see the table in Annex 1 showing the amounts set by the different Member States).

Accompanying measures

(36) For traders and tax administrations to be able to ascertain the tax status of the purchasers concerned, a new mechanism central to the entire system has been introduced: that of identification for VAT purposes.

(37) Each Member State has had to take the measures necessary to identify, by means of an individual number, every taxable person capable of carrying out intra-Community transactions, i.e. "every taxable person who within the territory of the country effects supplies of goods or of services giving him the right of deduction".

(38) This obligation on Member States was extended to non-taxable legal persons and to taxable persons not entitled to deduct input tax whose intra-Community acquisitions are subject to tax (see special arrangements referred to above).

(39) Firms are required to submit a recapitulative statement listing the acquirers identified for VAT purposes in another Member State to whom they have supplied goods exempt from VAT. For each of these customers, who has his own VAT identification number, the supplier indicates the value of goods supplied. On the basis of this information, which can be obtained direct from traders' accounting records, the tax administration in the Member State of departure is able to transmit to the other Member States the list of traders to whom goods have been supplied exempt from VAT.

(40) In the control of transactions taking place within its territory each receiving Member State can therefore make use of the information transmitted to it by the VIES system.

1.2.3. Special arrangements for taxation at the place of destination

(41) The general arrangements for taxing intra-Community acquisitions of goods are reserved for taxable persons entitled to deduct input tax and, provided that a given annual threshold is reached, for acquisitions of goods effected by other taxable persons and non-taxable legal persons. The right to opt for taxation at destination was available to these last two categories of businesses: they could have all their intra-Community purchases subject to VAT in their own Member States thus avoiding having to monitor whether the threshold has been exceeded.

(42) The arrangements for taxing intra-Community acquisitions of goods have also been extended to purchases of new means of transport effected by any person excluded from the general arrangements: taxable persons not entitled to deduct input tax, non-taxable legal persons whose other acquisitions are below the taxation threshold, and individuals.

(43) The arrangements governing distance selling have for their part ensured that turnover of a given level achieved by vendors from Member States other than that of consumption is taxed in the Member State of destination.

Intra-Community sales of new means of transport

(44) The arrangements for taxing intra-Community acquisitions of new means of transport have ensured that such acquisitions are taxed in the Member State of destination as stipulated by the Ecofin Council at its meeting on 13 November 1989[7]. Sales of cars in particular have always been regarded by Member States as an extremely sensitive issue on account of all the taxes associated with them and the risks of distortions of competition connected with insufficient approximation of VAT rates.

(45) Member States determine the measures needed to ensure, first, that the vendor transmits the information necessary for the tax to be applied and monitored and, second, that purchasers declare and pay the tax due on these intra-Community acquisitions of means of transport.

Change of place of taxation: the case of distance selling

(46) Since it was concerned that systems of distance selling - mail order or other sales - would develop from Member States other than the Member State of destination and consumption of the goods, the Council decided to lay down arrangements for taxing this type of sale at the place of destination. Its concern was heightened all the more by the fact that insufficient approximation of rates threatened to cause a shift in sales to those Member States applying lower rates and thus to create distortions of competition between Member States that would be detrimental to firms selling goods from Member States applying higher rates (whether domestic supplies or distance sales to Member States applying low rates).

(47) Provided the conditions for applying them are met, the special arrangements adopted involve switching the place of the supply effected by the vendor to the Member State of arrival of the transport of the goods to the purchaser.

(48) This technique was adopted since it was felt that the vendor's turnover should be taxed at the place of destination and also in the light of the status of the purchasers affected by the special arrangements, namely:

- taxable persons not entitled to deduct input tax or non-taxable legal persons not identified for VAT purposes and not having exceeded the threshold beyond which their intra-Community acquisitions of goods are subject to tax;
- individuals.

(49) A distance sale is defined as any supply of goods for which the transport operation is effected by the vendor or on his behalf. Conversely, therefore, it is sufficient for the transport to be provided by the purchaser or on his behalf for the special arrangements not to apply. Taxation in the country of origin is confined, therefore, to sales to purchasers who take supply of the goods on the premises of their supplier. The tax rules applicable thus vary according to the terms of the sales contracts.

(50) These special arrangements also apply only where the taxable vendor effects supplies to a particular Member State which exceed an annual threshold set in principle at ECU 100 000, although Member States were authorized to reduce this to ECU 35 000 (see in Annex 1 the summary table of the thresholds adopted by the various Member States).

(51) Like all the other special schemes, these arrangements have created many difficulties which are dealt with as part of the analysis of the problems encountered in applying the transitional arrangements (see Part 2).

1.2.4. Intra-Community supplies of services

(52) The place of supply of services was altered under the transitional arrangements only to the extent strictly necessary to ensure that they functioned smoothly. As a result, only the place of supply of services connected with an intra-Community movement of goods was changed so as to avoid complicating the way in which they were treated. Prior to 1 January 1993, the value of such services was, as a rule, incorporated in the taxable amount on importation of the goods to which they related. This allowed the supplier to invoice the services exempt from VAT.

(53) With the abolition of tax on importation between Member States, all supplies of services between Member States are subject to tax as such and at the rate where they originated (no longer included in import value). In this context the place of supply rules for services had to be modified in such a way as to ensure their taxation at destination, as called for by the Council:

- supplies of services in the intra-Community transport of goods;
- supplies of services ancillary to such transport;
- certain supplies provided by intermediaries acting in the name and for the account of other persons.

Supplies of services in the intra-Community transport of goods

(54) Intra-Community transport of goods is defined as any transport of goods where the place of departure and the place of arrival are in two different Member States. During the transitional period these services are in principle taxable in the Member State of departure of the transport.

(55) Where, however, the customer is identified for VAT purposes in a Member State other than the Member State of departure, the transport is taxable at the place where the customer is identified for tax purposes (see Article 28b(C)).

(56) In a way comparable to that which applies to goods these provisions implement the principle of taxation at origin (place of departure) and the derogation providing for taxation at destination (place of arrival) according to the VAT status of the purchaser.

(57) Additionally, and in order to avoid suppliers having to apply - and purchasers having to bear - tax in a Member State where they are not established, special measures were added relating to the person liable for the tax. The tax is due from the supplier only in the two following cases:

- he is established in the member State of taxation,

or

- the purchaser of the supply is not identified for VAT purposes.

(58) In all other cases the customer is liable to account for the tax due on supplies of transport.

Services ancillary to the intra-Community transport of goods

(59) The principles of taxation for these services are constructed along the same lines as those for the taxation of the intra-Community transport of goods:

- the ancillary service is normally taxable at the place where it is physically performed;
- where, however, the customer is identified for VAT purposes in a Member State other than that in which the service is physically performed, the ancillary service is taxable where the customer is identified for tax purposes.

(60) The person liable for payment of tax is determined in the same way as for the intra-Community transport of goods (see § 57).

Services supplied by intermediaries

(61) With regard to supplies of services rendered by intermediaries, the guiding principle for the transitional regime was to ensure tax treatment parallel with that applicable to the principal transaction. For VAT purposes, intermediaries are regarded as persons who act in the name and for the account of others. Consequently, the rules applied correspond to the particular nature of the commercial relationship between the principal, the intermediary and the third party concerned in the transaction in which the intermediary has intervened (principal transaction).

(62) Such taxation arrangements, which already applied to intermediaries involved in the supply of intangible services, have therefore been extended:

- services rendered by intermediaries involved in supplying services in the intra-Community transport of goods and services ancillary to such transport are governed by the tax rules described above in points 54 to 60;
- services rendered by intermediaries involved in other transactions - this concerns in particular intermediaries involved in intra-Community supplies and/or acquisitions of goods - are taxable at the place where the principal transaction is located. Here again, however, where the customer is identified for VAT purposes in another Member State, the intermediary's supply is located and taxable in that other Member State.

(63) The person liable for payment of tax is determined in the same way as for the intra-Community transport of goods (see § 57 and 58).

1.3. IMPACT OF NEW ARRANGEMENTS: BROADLY POSITIVE OVERALL ASSESSMENT

(64) Since the introduction of the transitional arrangements, the Commission has consulted firms and Member States about their operation with a view to putting forward proposals for simplification measures capable of rapidly overcoming the difficulties encountered. In particular, the Commission took the initiative of setting up at the beginning of 1993 an Enterprise Consultation Committee for sounding out the views of firms directly.

(65) A number of studies have also been carried out to gauge the views of the various parties involved on the new VAT arrangements. The findings of those studies are set out below.

1.3.1. Surveys conducted among consumers

(66) Unlike traders, whose views on the rules applicable since 1 January 1993 have been canvassed on numerous occasions, consumers have not often been consulted about the benefits they believe they have derived from the abolition of customs controls and from the freedom to purchase goods on a tax-paid basis in the Member State of their choice.

(67) Nevertheless, a recent survey carried out by Eurobarometer (published in issue No 41 of 5 July 1994) points to a fairly poor level of awareness among consumers of the opportunities available to them since 1 January 1993:

- the survey shows first of all that two thirds of respondents have not crossed an internal Community border since 1 January 1993 and that two thirds of those who have visited other Member States consider it took them less time to cross the borders in question.
- a total of 43% of respondents are unaware that they are free to purchase goods in other Member States without having to regularize the tax position or complete formalities in their own countries. Of those consumers who are aware of these possibilities, only 20% have actually made use of them.
- finally, barely 52% of those consulted feel that the abolition of customs controls is likely to reduce product prices. However, 75% take the view that it is likely to increase the range of products on offer.

(68) In view of these findings, information relating to the destinations of European citizens should be updated and relayed to ensure a better knowledge of the opportunities available to them.

1.3.2. Surveys conducted among traders

(69) Since the transitional VAT arrangements came into force, a number of surveys have been conducted among traders to ascertain their views on the new VAT system applicable since 1 January 1993.

(70) Those surveys have been carried out on the initiative both of private bodies (e.g. Deloitte Touche Tohmatsu study, KPMG Peat Marwick, Federal Association of German Industry (BDI)) and of certain Member States (e.g. HM Customs and Excise in the United Kingdom, the Economic Institute for Small and Medium-Sized Enterprises in the Netherlands). The Euro-Info-Centres have also reported their experiences of the operation of the new VAT arrangements through the Enterprise Consultation Committee set up by the Commission.

(71) A comparison of the findings of those studies points up a number of constants in traders' assessments - both positive and negative - of the transitional arrangements and confirms the main aspects of the stocktaking report presented by the Commission in October 1993, and in particular the fact that difficulties have been confined to certain limited areas.

(72) In addition, the wish of traders to see these arrangements replaced by a definitive system on 1 January 1997 has also been examined in some of those studies.

Reduction in the costs connected with intra-Community transactions

(73) Generally speaking, traders report a substantial reduction in costs. The reasons most frequently given for this include the following:

- *the elimination of expenses connected with customs formalities*, such as the payment of customs agents entrusted with the task of carrying out formalities and import or export procedures;
- *the abolition of customs guarantees and of the prefinancing of the VAT due on importation*, which has improved firms' cash-flow positions;
- *the reduction in transport costs* associated with the substantial reduction in journey times (two days or more) following the abolition of all formalities at internal Community borders;
- *the general easing of administrative burdens*: despite the imposition of new obligations on taxable persons (the introduction of two additional headings on the regular return, the recapitulative statement), such obligations are regarded by many traders as being less onerous than was previously the case;

- *the increased opportunities for obtaining supplies in other Member States* as a result of the new arrangements has undeniably reduced costs. A number of the traders surveyed mentioned the benefits they derived from the increased opportunities for obtaining supplies in other Member States and thus for benefiting from the most competitive prices on the market.

(74) This general reduction in costs is reflected, albeit in varying degrees, in all the studies carried out. One of the most recent studies - carried out by the Economic Institute for Small and Medium-Sized Enterprises in the Netherlands - is very clear on this point: after one year, the new arrangements are reported as having resulted in a structural reduction in the costs incurred by firms.

(75) This reduction in costs has improved firms' cash-flow positions appreciably and has enabled them to allocate financial resources to other activities.

Difficulties encountered

(76) Among the problems most often mentioned by the operators questioned are the following points:

- the considerable *costs involved in adapting* to the new arrangements. Occurring at the beginning of 1993, these costs are regarded as having been cancelled out by the benefits accruing from the removal of frontier formalities;
- nevertheless, certain operators considered that their costs, due to the new *obligations*, exceeded their savings. These criticisms are largely due to the fact that businesses were not generally undertaking direct management and processing of information, especially statistics, relating to their intra-Community trade. These tasks were effectively entrusted to third parties specialising in declaration and customs formalities, and therefore became part of the overhead costs of the businesses;
- *insufficient or late information* regarding the detailed application, in each Member State, of the new tax rules concerning in particular: the arrangements for distance selling, the new headings on the periodic returns, the recapitulative statements. The treatment of *triangular transactions* within the meaning of Directive 92/111/EEC, is also not sufficiently known and understood. Consequently the traders did not benefit from the simplification measures open to them;

- the difficulties being increasingly perceived by the operators who carry out transactions *in Member States where they are not established*: establishing who is the liable person; the treatment of chain transactions; knowledge of the legislation of the various Member States concerned;
- the *awareness of the divergences* stemming from the differences in transposing Community rules into national legislation.

(77) More generally, many traders take the view that VAT has become highly complicated and are concerned that faulty application of the rules due to misunderstandings will lead to tax rectifications being made.

Arrangements welcomed

(78) A comparison of the positive and negative aspects shows on balance a favourable reaction to the new VAT arrangements in the vast majority of the studies carried out.

(79) Admittedly, the assessment sometimes varies according to the departments concerned within a firm: the logistics departments frequently give a more favourable assessment than the accounts departments, whose tax obligations have increased. An overall assessment should take account of the information gathered from stock managers, transport managers and accounts departments.

(80) However, this mostly positive assessment must be qualified when we look beyond what are standard intra-Community transactions involving two taxable persons from different Member States carrying out intra-Community supplies of goods which are to be transported between those two Member States.

(81) Even so, the abolition of the prefinancing of VAT due on importation is an improvement for operators although it is essentially noticeable only in the sectors or in the Member States where there was previously no provision for postponed payment (eg approved operators, internal trade in the Benelux countries).

(82) In view of the tangible and severe nature of some of the difficulties encountered by traders, a number of studies have also asked them whether they are in favour of the move to the definitive system in 1997. The Deloitte Touche Tohmatsu study indicates that 75% of traders replying are in favour of switching to the definitive system provided that it guarantees equal treatment for domestic and intra-Community transactions.

(83) This general tendency on the part of the business community was confirmed at the conference organized by the Commission in Brussels on 27 and 28 June 1994 with the aim of achieving as wide an exchange of views as possible on the objectives to be set for the definitive VAT system.

1.3.3. Consequences for the Member States of the new arrangements

(84) From the first months of operation of the transitional scheme, the Commission undertook consultation with the Member States to ascertain their views. These consultations confirmed the general satisfactory working of the new arrangements. At the same time, Member States took up the concerns expressed by traders. In this connection, they confirmed in particular, the Commission's evaluation of the first six months of the application of the transitional scheme and have paid particular attention to the search for measures likely to improve it and to solve the difficulties encountered.

(85) Member States also indicated that they had not noted, since the introduction of the transitional VAT scheme, fluctuations in their tax income which would have been attributable to the new rules. Indeed, in 1993, all noted a fall in funds as a result of the abolition of the payment of VAT on importation, and its replacement by a payment on intra-Community acquisition in the periodic return. However, all the Member States emphasised the need to reserve final appraisal until such time when complete and reliable data is available. Such appraisal by each individual Member State still stands as at the time of drafting of this report.

(86) Comparison of the data relating to 1992 and 1993 faces difficulties related to the methods to be used, to the absence of absolutely complete and reliable data, to the number of factors likely to influence it (e.g. a change in rates, in the time of statement and the payment of the tax), and to the difficulty of evaluating their relative importance in the explanation of these fluctuations. Moreover, 1993 is, in many respects, a year of transition. In these circumstances, final conclusions cannot yet be drawn. The Commission will continue to examine these questions carefully in close cooperation with the Member States.

(87) It could however already be said that VAT receipts follow to a large extent the macroeconomic trends relating to inflation, consumption and imports. If, on the whole, the VAT yield was moderated in 1993, the major cause was the weakness of domestic demand and the favourable development, in numerous cases, of the commercial trade balance. Moreover, the suppression of the luxury rates, one of the achievements of the transitional scheme, and the elimination of the delay connected with the collection of

VAT at import, decreased the collected revenues. On the basis of the monthly results, improvement in the economic situation was reflected only in certain Member States and only at the end of the year.

(88) The evaluations, in terms of income, mentioned above bears no relation to the other savings the transitional scheme has produced in terms of administrative costs borne by the Member States: the complete abolition of the frontier controls on all Community internal trade certainly made it possible to reallocate ressources to other tasks, such as the control of domestic transactions or of trade with third countries. The incidence of these modifications often cannot be quantified but also constitutes one of the profits induced by the removal of the tax frontiers.

1.3.4. Broadly positive overall assessment

(89) The transitional VAT arrangements have generally been welcomed by traders. The new concepts of intra-Community supply and intra-Community acquisition of goods, which are simply the tax counterparts of commercial transactions, have been assimilated without particular difficulty. In the same way, the key elements of the new system, such as the communication of VAT identification numbers between traders and the retention of the proof of transport outside the Member State of departure, have been rapidly incorporated into the system, thanks, it is true, to swift adaptation on the part of firms.

(90) Nevertheless, the difficulties which have emerged since 1 January 1993 and have been reported both by traders and by Member States can under no circumstances be disregarded. They fall into two categories:

- the difficulties connected with the new rules for taxing intra-Community transactions are examined in Part 2 of this report;
- the difficulties which have become apparent since 1 January 1993 and which actually stem from the rules inherent in the common VAT system as derived from the Sixth Directive are examined in Part 3 of this report.

(91) It is essential to identify and analyse the real causes of the difficulties encountered. Only if this is done will it be possible to devise appropriate solutions and to ensure that the common VAT system develops along satisfactory lines.

2. NEW RULES ON TAXATION OF INTRA-COMMUNITY TRANSACTIONS

(92) The main difficulties encountered in applying the new rules for taxing intra-Community transactions introduced under the transitional arrangements relate to:

- proof of the right to exempt intra-Community supplies of goods;
- special taxation schemes in the Member State of destination;
- intra-Community supply of services;
- diversity of taxation arrangements in force.

2.1. PROOF OF THE RIGHT TO EXEMPT INTRA-COMMUNITY SUPPLIES OF GOODS

(93) Examination of complaints from Community traders suggests that they are encountering some difficulties in gathering evidence to show that the conditions for exempting an intra-Community supply of goods are met.

2.1.1. Proof of transport of goods outside the Member State of departure

(94) First, traders must be able to establish that the goods supplied have actually left the Member State of departure. Where the transport is carried out by the vendor himself or by an independent carrier acting on behalf of the vendor or the purchaser, the supplier is in possession of commercial documents, such as goods dispatch and delivery notes, which can form the basis of this evidence.

(95) When the purchaser himself undertakes the transport by his own means, the vendor can only rely on indication that the goods are going to be transported to another Member State. A freight bill or a document serving as such, presented at the time of the removal of goods, or a formal engagement subscribed by the purchaser, does not establish that the transport has taken place. Under these conditions, suppliers often express concern that their responsibility is challenged and the exemption of supplies rejected, on inspection.

(96) The above difficulties may also be encountered by purchasers; some suppliers refuse to exempt their supplies where the purchaser carries out the transport himself. One Member State even seems to have made this practice the norm. The only solution then available to the purchaser is to become identified for VAT purposes in that Member State in order to transfer the goods to the Member State of destination; this operation has to be shown on a periodic return on which the right to deduct the VAT invoiced by the supplier can be exercised.

(97) Such practices seriously prejudice the decisions taken by the Council when it adopted Directive 91/680/EEC. It is unacceptable that the exemption or taxation of an intra-Community supply of goods should depend on the person assuming responsibility for the transport of the goods supplied: this runs counter to the equality of treatment for sales transactions made under identical conditions and limits considerably the traders' choice of their place of supply.

2.1.2. Proof of purchaser's status

(98) The only intra-Community supplies of goods eligible for exemption are those made to a taxable person or a non-taxable legal person acting as such in a Member State other than the Member State of departure of the dispatch or transport of the goods, and as such liable to charge VAT, in the Member State of destination on their intra-Community acquisitions of goods.

(99) In order to avoid, between traders, any movement of documents justifying their "VAT status", the transitional scheme obliged the Member States to identify their operators by means of an individual VAT identification number. This identification obligation concerns two categories of operators:

- taxable persons being entitled to deduction, whether or not taking part in intra-Community trade, had automatically to receive a VAT identification number in the Member States where they carry out their transactions giving them the right to deduction;
- taxable persons without right to deduction, and non-taxable legal entities, for which VAT identification is only necessary for acquisitions where the amount exceeds the threshold, or where they opt for taxation at destination.

(100) Thus, any supplier can presume that his customer is an intra-Community acquirer from the VAT identification number communicated to him by that customer. In order to enable the vendors to verify the validity of the numbers advised by their customers, a powerful tool is at their disposal: the VIES network allows, both traders and administrations of the Member States, to obtain this confirmation. Each Member State had indeed the obligation to constitute as a data base the information concerning traders it identified for the VAT purposes.

(101) However, regarding the conditions of exemption for intra-Community supplies of goods, it should be noted that such verification is neither necessary nor sufficient to justify exemption of the supply transaction in question. In addition, such verification is merely a "snapshot" of a purchaser's position at a particular moment and does not allow any conclusions to be drawn about his position before or after that moment.

(102) In the event of a dispute concerning an exemption granted by the supplier, written confirmation that the supplier consulted the data base does not constitute proof in itself: it is merely an indication of the supplier's efforts to verify the validity of the VAT identification number notified by the purchaser. On the contrary, failure to consult the database cannot be held against the supplier if he was in possession of information giving him no reason to doubt the purchaser's status or the validity of the identification number notified to him.

(103) Some traders nevertheless thought it useful to verify at the beginning of 1993 the validity of the VAT identification numbers of all their customers. It should be stressed that such a check gives only a "snapshot", at a given moment, of the identifications issued to traders whose "VAT status" may, subsequently, have changed (activity cessation; change in the tax nature of the transactions carried out; etc).

(104) Even though the status of an intra-Community acquirer may be presumed from the VAT identification (cf § 100), certain Member States, in their legislative provisions, test the exemption for intra-Community supplies of goods by applying additional requirements such as the proof of taxation on acquisition in the Member State of arrival of transport. Confronted with such surprising provisions, businesses were very concerned about being able to keep good faith with the tax authorities when they risked having the exemption of their intra-Community supplies call into question: with such measures their fiscal responsability could, in effect, be triggered as a result of an omission or irregularity on the part of their trading partner, this being altogether contrary to the principles laid down for proper control of the tax (cf § 29).

2.1.3. Purchaser fails to notify status

(105) In all cases where the purchaser does not notify the vendor of his status as a taxable person or non-taxable legal person identified for VAT purposes, the vendor has to tax his supply in the Member State of departure even though an intra-Community acquisition is taxable in the Member State of arrival.

(106) There are signs that such practices occur in certain economic sectors where the rate differential between the Member States is important: by not communicating his status as an intra-Community acquirer, the purchaser bears the tax at the reduced rate in force in the Member State of departure. Not declaring his acquisition and his resale, the purchaser loses any right to deduction on his purchase. However this is more than compensated by the fact that he intends to pay no tax on his sale: the creation of parallel circuits of resale enables him to avoid, in the Member State of destination, direct and indirect taxes to which his turnover should be subjected.

(107) It should be remembered that this situation involves no risk for the vendor since the responsibility lies entirely with the purchaser as a result of his not having notified his status to the vendor. In any event, when it comes to taxing the intra-Community acquisition thus made in its territory, the competence of the Member State of arrival is absolute and independent of the taxation of the supply transaction carried out in the Member State of departure.

(108) Detection of unrecorded purchases is a difficult exercise, whether those purchases have been carried out inside the country, in another Member State or in a third country: in addition to the checks covering the "stock-account", the information necessary to establish the infringement can be sought from the various suppliers, via the administrative cooperation procedures, when traders of other Member States are involved. Controls of overall coherence of the transactions carried out by a same trader, whatever the nature and the place of these transactions, takes on a special importance in the detection of such practices.

2.2. SPECIAL TAXATION SCHEMES IN THE MEMBER STATE OF DESTINATION

(109) The three special schemes providing for taxation in the Member State of destination undeniably infringe the freedom to make tax-paid purchases within the single market. The prospect of VAT rates not being brought sufficiently into line to eliminate the risks of trade being deflected to Member States with lower rates of VAT is therefore the reason for these schemes. However, it should be noted that the consequences of these arrangements seem to go way beyond the safeguarding of tax receipts.

2.2.1. Purchases made by taxable persons not entitled to deduct input tax and by non-taxable legal persons

(110) The bodies concerned are required to charge tax in the Member State of arrival of the goods on their intra-Community acquisitions where the total annual amount of these purchases exceeds a certain threshold set at not less than ECU 10 000 by the Member State concerned. A table giving the thresholds applicable in the Member States is enclosed at Annex 1.

(111) As soon as they exceed the threshold fixed by their Member State, these bodies are required to become identified for VAT purposes so that the purchases they make in other Member States may be exempted there and taxed in their own Member State as intra-Community acquisitions of goods. In respect of their intra-Community purchases they are therefore treated as taxable persons entitled to deduct input tax. They may also opt for taxation in the Member State of destination of all their intra-Community acquisitions of goods, even if the threshold fixed by their Member State is not exceeded.

(112) The above arrangements ensure identical taxation of purchases made within the territory of the country or in another Member State.

(113) To differing degrees, the bodies concerned will be encouraged to make purchases in other Member States in cases where the differences in VAT rates are pronounced and onerous obligations are placed on them by their Member State should their acquisitions be subject to VAT there.

(114) If the obligations were unduly onerous, they might decide to refrain from making purchases in other Member States, to the detriment of the development of intra-Community trade. The arrangements are also open to question in that, in particular, they hamper free access by European firms to public contracts in all the Member States.

(115) In view of the fact that bodies concerned benefit in the majority of the Member States from a release from all VAT obligations, the monitoring of the tax threshold on their acquisitions seems to be a particularly heavy burden for the operators concerned and is particularly difficult for the tax authorities to control.

2.2.2. Distance selling

(116) The special scheme of taxation in the Member State of arrival of the dispatch or transport operation applies to supplies of goods to persons whose intra-Community acquisitions of goods are not subject to VAT (whether they are taxable persons or non-taxable legal persons who have not exceeded the threshold referred to at point 2.2.1 or the threshold for individuals) in cases where the goods are transported outside the Member State of departure to another Member State by the vendor or on his behalf. It therefore covers situations where a trader targets a large number of purchasers in a Member State other than that from which he supplies goods.

(117) This special scheme applies to all sales of products subject to excise duties. It applies to sales of other products only if the vendor exceeds the threshold set by the Member State of destination (ECU 100 000 or ECU 35 000: see the table in Annex 1 giving the amounts applicable in the Member States). It means that the VAT which the vendor has to invoice is that of the Member State of arrival of the goods.

(118) It should be stressed that the scheme does not, contrary to the impression given in some quarters, increase the risks of sales not being taxed. Sales could be taxed - wrongly - in the Member State of departure when it is the Member State of arrival that is responsible for charging the tax, but the existing mechanism excludes the possibility of goods not being taxed.

(119) By way of consequence of the taxation at destination for distance selling, the vendor is required to become identified for VAT purposes in the Member State of arrival of the goods - where necessary, a tax representative will have to be appointed - in order to satisfy all the obligations, in particular relating to declarations, associated with the carrying-on of taxable transactions in that Member State. There is no doubt that the diveristy of taxation arrangements in force in the Member States (thresholds, extent of obligations, determination of the rate applicable) discourages this modern form of distribution, and traders often refrain from selling products so as not to exceed the turnover threshold in a particular Member State of arrival, especially if it is more difficult to satisfy the obligations applicable there.

(120) In the present situation, the dissuasive effect of the complex mechanisms introduced to ensure the proper functioning of this special scheme is such that it is regarded in many business sectors as a real barrier to intra-Community trade. In the final analysis, the scheme's objective is not met since its cost and complexity discourage operators from selling under the tax conditions prevailing in the Member State of destination.

(121) If one adds to that the fact that no threshold applies to products subject to excise duties (alcoholic drinks, for example), the barrier to intra-Community trade in these products where the vendor assumes responsibility for the transport operation is almost insurmountable. This scheme discourages direct selling to the final consumer and, in general, encourages recourse to an intermediary in the Member State of destination. As a result, selling prices to the consumer are higher because of the extra cost involved in using the services of an intermediary.

(122) The difficulties encountered in the publishing trade since 1 January 1993 provide a good example of this. It is not uncommon for a publisher to distribute periodicals throughout the Community from a single Member State. Sales of subscription periodicals give rise to dispatch or transport by the vendor or on his behalf. Accordingly, where the subscriber is not identified for VAT purposes in a Member State other than that from which the periodical is dispatched or transported, such supplies are covered by the special scheme for distance selling and taxation takes place automatically in the Member State of arrival of the goods. Publishers therefore face the aforementioned difficulties associated with the carrying-on of taxable transactions in that Member State.

(123) Although the difficulties encountered in applying the special scheme for distance selling are simply the consequences of the choices made by the Council, the Community as a whole cannot be content, even for a transitional period, with this aspect of the indirect taxation arrangements.

(124) In the short term, revision of the arrangements concerning tax representatives would make life easier for traders (see point 3.6 below).

(125) A harmonization of the thresholds of taxation at destination would also be likely to simplify the application of the distance selling arrangements. The Commission will re-examine this possibility as soon as the data related to the turnover concerned is available.

2.2.3. New means of transport

(126) The special scheme ensures that new means of transport are taxed in the Member State of destination, whoever the purchaser is.

(127) The following are considered as new:

- means of transport supplied not more than three months after the date of first entry into service, and
- means of transport which have travelled not more than 3 000 kilometres in the case of land vehicles, sailed for not more than 100 hours in the case of vessels or flown for not more than 40 hours in the case of aircraft.

(128) Following the adoption of Directive 94/5/EC of 14 February 1994[8], the limits of three months and 3 000 kilometres laid down for land vehicles were raised to six months and 6 000 kilometres. The Member States are required to adapt to the Directive by 1 January 1995 at the latest.

(129) Since 1 January 1993, the Member States had to take specific measures necessary to identify intra-Community acquisitions of new means of transport made on their territory and to ensure monitoring of the proper application of VAT payable in the Member State of arrival, particularly when due by individuals and other persons not a priori registered with the tax authorities responsible.

(130) Even though the scope of the special scheme is very broad (48cc, six months and 6 000 km), a number of Member States have reported difficulties in ensuring that means of transport exempt from registration, for example, are taxed in the Member State of arrival.

(131) Since the tax treatment applicable in the Member State of departure is quite independent of taxation of the acquisition in the Member State of arrival, the risks of the acquisition not being taxed or being taxed twice are not negligible and particular attention must be paid to monitoring these transactions.

(132) However, where the vendor himself has acquired the good from an individual and within the territory of the country, one of the essential means of monitoring taxation - deduction by the vendor of the tax paid on the purchase - is lacking in the Member States which refuse to allow any deduction in these situations. The same monitoring problem arises where information on sales of new means of transport to purchasers who are not identified for VAT purposes is sought only from vendors who are identified for VAT purposes. These Member States are unable to provide any information whatsoever to the Member State of arrival, either on their own initiative or after receiving a request for such information.

(133) In any case, it seems to have had a strongly dissuasive effect, in particular for individuals; and, in view of the onerous and complex formalities to be completed, some consumer associations are even advising their members not to buy new means of transport in other Member States. Of course, such a situation is at odds with the objectives of the internal market and contributes to the continued existence of segmentation of distribution networks.

(134) Each of these elements would, as such, justify a restriction in the scope of the special arrangements applicable to new means of transport. The Council however took an opposite route by revising, on the occasion of the adoption of the directive 94/5/CE(8), the criteria applicable to the means of land transport. The Commission will carefully examine the consequences of that choice.

2.3. INTRA-COMMUNITY SUPPLY OF SERVICES

(135) This section deals only with those supplies of services in respect of which new provisions were introduced on 1 January 1993. The specific difficulties associated with applying the general principles of the Sixth Directive are analysed below in Section 3.4.

2.3.1. Intra-Community transport of goods and ancillary transport services, including services supplied by intermediaries

(136) The principles of territoriality applicable to the supply of services in the intra-Community transport of goods and to the supply of services ancillary to the intra-Community transport of goods, whether loading or unloading services or services provided by intermediaries involved in the supply of these transport services or ancillary transport services, are functioning in a satisfactory manner where both traders and national administrations are concerned.

(137) This situation is explained by the simplicity of the taxation rules introduced, which may be summarized in three questions which traders supplying the services in question must ask themselves:

- Is my customer identified for VAT purposes?
- If so, is he identified in the same Member State as I am?
- Am I established in the Member State in which my customer is identified for VAT purposes?

(138) By asking himself just these three questions, the service provider is able to ascertain whether he is liable to pay the tax and, if so, where. However, the fact that these rules are applicable only to certain very specific situations - intra-Community transport of goods and ancillary transport services - does not mean that traders can easily establish that they are actually in such a situation.

(139) Thus, some traders, in particular those carrying out loading and unloading operations, have reported difficulties in ascertaining whether their service is ancillary to an intra-Community transport of goods and in providing the requisite evidence.

(140) However, this is an integral part of the rules adopted and is not likely to be amended unless there is a comprehensive review of the rules for identifying the place of supply of services in the intra-Community transport of goods.

2.3.2. Other services rendered by intermediaries

(141) For all services rendered by intermediaries acting in the name and for the account of other persons, there is, during the transitional period, a derogation from the principle that the place where a service is supplied is the place where the supplier is established.

(142) The place of supply of all the services rendered by intermediaries in transactions other than those referred to above (see § 136 to 140) is deemed to be the place where the transactions are carried out, except where the recipient is identified for VAT purposes in another Member State, in which case the place of supply of the service is the Member State which issued an identification number to the recipient.

(143) Given the complexity of these taxation rules, the interested parties do not yet seem to appreciate fully their implications.

2.4. DIVERSITY OF TAXATION ARRANGEMENTS IN FORCE

(144) Traders are faced with a wide range of taxation arrangements depending on whether the transactions they carry out are domestic or intra-Community transactions: the difficulties they encounter are associated both with the lack of a clear concept of intra-Community trade and with the wide diversity of national measures implementing Community rules.

2.4.1. Concept of intra-Community trade

(145) When it comes to defining intra-Community trade, there are many criteria available.

(146) First, intra-Community trade presupposes the existence of a transport operation between two Member States. Second, it is linked to the VAT status of the purchaser:

- where the purchaser is identified for VAT purposes in a Member State other than that from which the goods are transported, the supply is exempt from VAT in the Member State of departure and the purchaser is liable to pay tax on an acquisition in the Member State of arrival;
- where the purchaser is identified for VAT purposes in the Member State from which the goods are transported, the vendor is liable, in principle, to pay tax on the supply in the Member State of departure;
- where the purchaser is not identified for VAT purposes, the vendor is liable to pay tax on the supply in the Member State of departure or arrival of the transport operation.

(147) In the same way, the intra-Community nature of the provision of services depends on the combination of numerous criteria, including:

- the existence of a transport operation between two Member States;
- the VAT status of the purchaser (taxable person or non-taxable person);
- whether the purchaser is identified for VAT purposes;
- whether the service provider and the purchaser are established or identified for VAT purposes in two different Member States.

(148) These criteria do not reflect trader's preferred method of defining for intra-Community trade: for businesses, the "intra-Community" nature of their transactions should be more related to the place of establishment of their customer or supplier.

2.4.2. Multiplicity of taxation arrangements

(149) Transactions are also taxed under arrangements that differ according to the nature of the transaction and the place where the supplier of the goods and services is established in relation to the place where the purchaser or recipient is established. Thus, depending on the circumstances, the supplier or his customer will be liable to pay the tax due on a particular transaction involving the sale of goods or services.

(150) The multiplicity of taxation arrangements is particularly evident in the special schemes: whereas the scheme for distance selling, by shifting the place of supply, renders suppliers liable to pay the tax in Member States in which they are not established, the other two special schemes render purchasers liable to pay the tax on their purchases even though they would face no such obligation under a normal scheme. It is also reflected in the rules for taxing services.

(151) This represents a fundamental derogation from the principles that have always underpinned the functioning of this tax, namely that, as a general rule, only a taxable person who is a vendor of goods or services has duties and obligations with regard to the application of VAT.

(152) With regard to traders acting in their own name but on behalf of somebody else, it is advisable to remember that they are deemed to be buying and reselling the goods or services concerned themselves (in particular agents to whom a commission is paid on sale or on purchase). The place of supply and arrangements for taxation of their interventions are therefore functions of the tax nature of the transactions in which they intervene: domestic supply, intra-Community supply, distance sales, subcontracting transport services, etc . These rules are applicable in the case of successive transactions covering a same goods or services. Although they have been in force since the adoption of the 6th directive, these provisions seem far from beeing effectively applied in conformity with the Community principles.

2.4.3. National rules implementing Community provisions

(153) Traders doing business at Community level are continually faced with differences between the taxation arrangements introduced by the Member States pursuant to the Sixth Directive. These differences relate not only to the provisions applicable but also to the obligations to be satisfied by taxable persons.

Differences in the provisions applicable

(154) The Sixth Directive contains a large number of options which have been unaffected by the transitional arrangements. This is reflected in rules that differ between Member States in areas as fundamental as:

- the moment the tax becomes chargeable;
- the scope of the right to deduct, determination of the expenses excluded from this right, and the conditions for exercising it;

- transactions exempt from the tax;
- determination of the rate applicable.

(155) Consequently, firms operating in several Member States need to know which laws are applicable, and the costs involved in obtaining such information are quite significant.

Diversity of declaration obligations

(156) The obligations to be satisfied by a person liable to pay VAT in a particular Member State also differ considerably: even though the Sixth Directive imposes a certain number of obligations on all persons liable to pay VAT, it still allows Member States to exempt certain taxable persons from their fundamental obligations as well as to impose additional obligations.

(157) Moreover, the definition of the scope of a particular obligation varies a great deal from one Member State to another. With regard to periodic VAT returns, for example, these differences concern:

- the tax period in respect of which the return is submitted (month, quarter, year);
- the varying degree of detail to be included on the return;
- the date for payment of the net tax due and shown on the return.

(158) Similarly, with regard to the obligation to issue an invoice, traders are faced with differing national provisions concerning:

- the time by which the invoice must be issued;
- the information to be shown on the invoice;
- the consequences for the conditions governing the right to deduct.

(159) These very differences are clearly reflected in difficulties for businesses concerned and impose on them additional costs. Generally induced by the facilities and options already provided for in the 6th directive itself, this situation nevertheless surprised traders: they perceived the implementation of the internal market not only as to ensure the abolition of controls and formalities at the internal borders, but also to accomplish the harmonized treatment of all transactions carried out within the Community. This second objective, contained in the logic of construction of the common VAT system, was however not achieved with the transitional arrangements. The lesson of this will have to be taken into account in the preparation of the definitive VAT system.

2.5. EVALUATION OF THE TRANSITIONAL PROVISIONS

(160) In general, the difficulties referred to above arise because of the specific rules introduced in order to ensure the taxation of intra-Community trade during the transitional period. However, it should be noted that they are the inevitable consequence of the choices made by the Council.

(161) Although the problem of proving the right to an exemption in the case of supplies of goods is not new - it already existed before 1993, in particular whenever an export transaction was carried out by the purchaser of the goods - there can be no denying that the dual system established by the transitional arrangements has complicated matters by linking the taxation or exemption of supplies of goods carried out by a taxable person to two cumulative criteria: knowledge of the purchaser's tax status, and movement of the goods to another Member State.

(162) The combination of these two concepts is inevitably complex and goes some way towards explaining the difficulties currently being experienced, in particular in proving the intra-Community nature of a transaction, its place of taxation and the right to exemption. In addition, by charging the tax on the intra-Community acquisition of goods made by a taxable person or a non-taxable legal person and by making the purchaser liable for payment of the tax due on the transaction, the transitional arrangements have increased the number of cases in which the purchaser - and not the vendor - is the person liable to pay the tax.

(163) The situation is no different for the provision of services: the purchaser's status will be decisive provided that the service is regarded as an "intra-Community" service. Traders face considerable difficulties in checking that they do indeed find themselves in one of these cases.

(164) The manner in which Community provisions have been implemented in some cases undermines the principles on which the transitional arrangements have been based. After having discussed these questions many times with the administrations of the Member States, the Commission continues to keep these issues under close examination, within the framework of its ongoing review of the implementation of Community provisions.

(165) Independently of the difficulties encountered in the application of the transitional arrangements, it should be noted that, based on information available at present, the new rules for taxation of intra-Community trade have not given rise to new types of fraud. Furthermore, reinforcement of administrative cooperation between administrations of the Member States has provided the competent authorities with both adequate instruments and information. The Commission will continue to look carefully at these issues, in close cooperation with the Member States.

3. COMPLIANCE WITH THE PRINCIPLES OF TAXATION LAID DOWN IN THE SIXTH DIRECTIVE

(166) Some of the difficulties most frequently reported by traders can be traced back to the fundamental choices that arise directly out of the Sixth Directive itself, choices with implications that have had to be recognized in the transitional arrangements by introducing mechanisms for taxation at the place of destination.

(167) Before tackling these problems in detail, a brief summary of the general mechanisms of the common system of VAT is called for.

3.1. GENERAL MECHANISMS OF THE COMMON SYSTEM OF VAT

3.1.1. Place of taxation of transactions

Place of taxation of supplies of goods

(168) The place of supplies of goods other than sales on board is deemed to be:

- in the case of goods dispatched or transported by the supplier, by the person to whom they are being supplied or by a third person: the place where the goods are at the time when dispatch or transport to the person to whom they are being supplied begins;
- where the goods are installed or assembled, with or without a trial run, by or on behalf of the supplier, the place of supply is deemed to be the place where the goods are installed or assembled;
- in the case of goods not dispatched or transported: the place where the goods are when the supply takes place.

(169) Consequently, where they rank as supplies of goods, transactions are always located by reference to the physical situation of the goods in question. At no time during the negotiations on the transitional arrangements was this principle, which has been applicable since the Second Directive(2) was adopted and confirmed by the Sixth Directive, called into question. No other locational criterion - e.g. the place where the vendor is established - was envisaged by the Council. On the contrary, the rule locating supplies of goods by reference to the place where the goods are physically situated was reaffirmed.

(170) The opening-up of markets to firms from other Member States has been a major factor prompting traders to expand their commercial activities throughout the Community. Given the rules determining the place where VAT is charged on supplies of goods, traders are still required, however, to apply the tax at the rate and under the conditions obtaining in each of the Member States from which they supply goods, including in those cases where they have not established any legal or commercial structure in that Member State.

Place of taxation of supplies of services

(171) Supplies of services are, in principle, located at the place of establishment of the supplier, defined as "the place where the supplier has established his business or has a fixed establishment from which the service is supplied". There are numerous exceptions to this principle, however, which are also determined by the service supplied: the place where the property is situated, the place of departure of a transport operation or the place where transport takes place, having regard to the distances covered, the place where services relating to movable tangible property are physically carried out or the place of establishment of the customer of an "intangible" service.

(172) The result of all these exceptions is to reduce the scope of the principle of taxation at the supplier's place of establishment to such an extent that it remains applicable only in residual cases, thereby increasing the number of cases in which a firm has to apply the tax at the rate and under the conditions obtaining in Member States where it is not established. These basic options, in force since the Sixth Directive was adopted in 1977, have only been partially revised by the transitional arrangements (see Section 2.3 above).

(173) These rules on the location of services have considerable implications for traders: being liable for payment of the tax in Member States on whose territory they are not established, they are faced with the difficulties involved in applying provisions with which they are not conversant and must bear the additional costs of satisfying their declaration obligations in other Member States. These difficulties arise in particular in connection with tourism and construction work, albeit two areas where the free movement of services within the Community has become a reality.

3.1.2. Place at which the right to deduct input tax may be exercised and rules governing the exercise of that right

(174) Any taxable person carrying out taxable transactions is entitled to deduct the tax borne by the expenditure which he incurs in that connection provided, however, that such transactions are either taxed or exempted on account of their being sent to another Member State or exported to a third country.

(175) The right to deduct is exercised, at all events, in the Member State which taxed the goods or services purchased By maintaining the principle of taxation at the place of destination for all goods and services intended for taxable persons, the transitional arrangements by definition remove any possibility of deduction in a Member State other than that of taxation.

(176) Accordingly, taxable persons have to exercise their right to deduct in accordance with rules which differ according to whether or not they are established or liable for payment of the tax in the Member State where their purchases or imports have been taxed:

- a taxable person who is established or liable for payment of the tax in the Member State where he is invoiced for VAT may recover the amount of tax by direct imputation on his periodic returns;
- a taxable person who is neither established nor liable for payment of the tax in the Member State where he is invoiced for VAT may recover the amount of tax only by applying for a refund under the conditions and in accordance with the procedures laid down in the Eighth and Thirteenth Directives. Given the time it takes for refunds to be paid, these procedures are cumbersome and costly.

(177) Irrespective of the procedures for its exercise (imputation or refund), the right to deduct available to any taxable person may be subjected to certain restrictions the scope of which is determined by each Member State within the limits laid down by the Sixth Directive (e.g. in the case of travel and subsistence expenses or expenses relating to the purchase or maintenance of means of transport). As with the determination of the place of taxation of transactions, the provisions relating to the right to deduct apply therefore in accordance with strict rules on territoriality.

3.1.3. Scope and consequences of these basic options

(178) The common system of VAT is constructed on the principle of the definitive taxation of all final consumption occurring in the Community. With intra-Community trade being taxed at the place of destination, the yield from the tax accrues directly to the Member State on whose territory the final consumption is deemed to take place.

(179) The arrangements for implementing these principles have remained unchanged since the Second Directive was adopted in 1967: they are based entirely on the rules determining territoriality in the case of the sale of goods or services. The place where VAT is charged on supplies of goods and services is basically defined by reference to the presumed place of consumption of those goods or services: since the consumption of movable tangible property is deemed to occur at the place from which the goods are removed with a view to being handed over to the purchaser, the place of taxation of the supply of the goods and of the services relating to those goods is determined according to the same criterion; in the case of transactions involving immovable property, since the place of consumption is a function of the place where the property is situated, it is this criterion which determines the place of taxation of the transactions in question, and so on.

Neutrality of taxation rules

(180) In view of the principles governing the place of taxation, the very concept of neutrality of taxation in the case of VAT can be assessed only for each individual Member State and thus concerns only the tax treatment of transactions falling within the tax competence of each of them.

(181) This concept requires first that all consumption, final or intermediate, occurring in a given Member State should be subject to the tax at the same rate and under the same conditions of taxation, irrespective of the origin of the goods or service in question (purchase or production within the territory of the country, in another Member State or in a third country). Under the transitional arrangements, this objective is basically achieved by taxing intra-Community sales at the place of destination, except however for certain sales to individuals or traders ranking as individuals. Additional measures have nevertheless had to be introduced to cover the case of goods being transferred between Member States (see Section 3.2) and of transactions consisting in work on movable tangible property effected between Member States (see Section 3.3).

(182) Compliance with the principle of VAT neutrality also requires that all sales transactions should receive the same tax treatment, whether they are carried out by a national trader, by a firm in another Member State or by a trader in a third country. It is precisely in applying this principle, which is unaffected by the transitional arrangements, that traders are having most difficulty: they are experiencing problems in particular with all taxable transactions carried out by them in Member States on whose territory they are not established (see Section 3.4).

(183) These difficulties, which derive from the application of the rules on the territoriality of transactions, assume their full proportions when it comes to determining the person liable for payment of the tax (see Section 3.5) and in the case of transactions carried out by small firms (see Section 3.6).

3.2. TAXATION OF INTRA-COMMUNITY TRANSFERS OF GOODS

(184) To supplement the rules applicable to transactions taking place between Member States, and in order to realize fully the objective - laid down by the Council - of taxation at the place of destination, special provisions for monitoring certain intra-Community movements of goods have been introduced under the transitional arrangements: these provisions relate to transfers effected between Member States by taxable persons.

3.2.1. Mechanisms introduced

(185) Any taxable person who dispatches goods from his firm to another Member State is deemed to carry out a supply which is taxable in the Member State from which the goods are dispatched or transported. Through this assimilation, he is regarded as supplying himself with the goods and must therefore treat such "sale" as he would in any transaction concluded with a third party.

(186) In the Member State of arrival of the transport, the taxable person makes an intra-Community acquisition of goods: since he is deemed to have purchased the goods from himself, he must consequently apply the tax as he would for any purchase from a third party. Taxation of this acquisition is therefore a function of the transactions for whose performance the goods are used (transactions conferring the right to deduct or not).

(187) Once the taxable person is identified for VAT purposes in each Member State, the supply made in the Member State of departure of the transport meets the conditions for the exemption of intra-Community trade and, as such, will be entered in the recapitulative statement listing purchasers identified for VAT purposes.

(188) The provisions thus introduced by the transitional arrangements are designed to ensure that all goods used in the performance of taxable transactions in a given Member State are taxed at the rate and under the conditions obtaining in that Member State. Failing this, the rate of taxation and any tax which may be deducted would be determined in accordance with the legislation in force in the Member State from which the goods are transferred, contrary to the principle of the neutrality of the origin of goods in regard to the conditions of taxation.

3.2.2. Situations covered

(189) Not all intra-Community movements of goods give rise to taxation in respect of a transfer: only those cases are covered where the goods transported are applied for the purposes of carrying out transactions located in the Member State of arrival of the transport and where, consequently, any right to deduct must be monitored in that Member State.

(190) The mechanism for transfers is thus neutralized every time the intra-Community movement of goods is temporary: dispatch of a crane to a construction site, dispatch of goods for repair, etc.

(191) The dispatch of goods to another Member State is temporary if, at the time the transport is carried out, the goods are intended to be returned to the Member State of departure. Nevertheless, if over time this condition ceases to be met, the trader must regularize his situation retroactively and declare a taxable transfer. These provisions are modelled largely on the temporary duty-free admission procedures applicable to goods from third countries.

(192) If transfers other than temporary transfers are classified as taxable transactions, irrespective of the "nature" of the goods in question (goods for resale or capital goods), it is basically in the case of movements of stocks that firms have had to apply these arrangements.

3.2.3. Provisions very broadly applied on account of stock management practices

(193) As suppliers, traders decide on the location of their stocks in such a way as to be able to meet their customers' expectations as fully and as quickly as possible: the choice of the place of storage is dictated by factors such as the facilities available in terms of transport infrastructure and the reduction in the costs of storing or transporting the goods.

(194) As customers, traders determine the threshold at which their stocks will be built up or replenished in the light of the seasonal nature of their turnover or sales forecasts, the aim being to avoid their cash being tied up for too long (just-in-time management, for example). Suppliers meet these concerns through special procedures for supplying their customers: call-off stock, sales on consignment, etc.

(195) In each of these situations, which nowadays are commonplace in the way firms organize their business, irrespective of their activity and size of turnover, the mechanism for transfers is applied.

Intra-Community call-off stock

(196) *Specific case*: To meet his firm's needs in Member State 2, trader B often uses goods supplied to him by trader A, who is established in Member State 1. To speed up supplies to his customer, A builds up in B's Member State - generally on the premises of B's firm or in warehouses designated by B - a stock of goods from which B takes the quantities he needs as and when. To this end, A moves part of his stock from Member State 1 to Member State 2.

(197) The goods remain the outright property of A until they are effectively removed by B. It should be pointed out here that, in the VAT field, it is the transfer of the power to dispose of the goods which determines the existence of a supply:

- if this right is transferred as soon as the stock is constituted, the transaction is deemed to be a sale by A;
- if it is not transferred, the transfer operation is taxable. The special rules on the transfers of goods adopted by the Council are intended to avoid a situation in which goods move within the Community without their movement being assigned any "tax status".

(198) Consequently, in the case in point, a taxable transfer of goods occurs when the stock is built up in A's Member State: since the place of the supply/sale effected by A is situated in Member State 2, the goods cease to be applied for the purposes of carrying out taxable transactions in Member State 1, and the change of territorial application thus has to be recorded as an intra-Community transfer.

Sales on consignment and dispatch of goods on approval

(199) *Specific case*: A taxable person A dispatches goods intended for resale by a trader B in another Member State. B, however, becomes the owner of the goods only once he has found a customer for them (sale on consignment) or if they come up to the customer's expectations (sale on approval).

(200) The feature common to such dispatches of goods is that they are intended for a potential buyer who will become the purchaser only under certain conditions, i.e. if he finds a customer (sale on consignment) or if the goods which he has agreed to receive match his expectations (purchase on approval).

(201) Where goods are sent on consignment, taxable person A carries out a taxable transfer of goods. As soon as they are sent, therefore, he must identify himself for VAT purposes in the Member State of arrival, declare the transfer giving rise to an intra-Community acquisition of goods and tax his supplies to B as and when B sells the goods.

(202) Where goods are sent on approval, they may be placed under a temporary admission procedure if they come from a third country. When the goods are sent, the mechanism for taxable transfers is therefore neutralized. Nevertheless, the transfer will have to be taxed once the dispatch is no longer temporary but is followed by an effective sale. Consequently, if the potential purchaser wishes to acquire the goods thus received, the taxable supplier must be identified for VAT purposes in the Member State of arrival in order to be able to carry out the intra-Community acquisition of the goods and declare the subsequent supply taxable within the territory of the country.

Sale of goods at markets, fairs or exhibitions

(203) *Specific case*: A publisher in one Member State transports a stock of books for display at a book fair organized in another Member State. Some of the books are sold at the fair, while the others return to the Member State of departure.

(204) The dispatch of the goods will not give rise to a taxable transfer since they may be placed under the temporary admission procedure if they come from a third country: nevertheless, the transfer will have to be taxed once the dispatch is no longer temporary but is followed by an effective sale.

(205) In the case of an exhibition, when a book is sold in the Member State of exhibition, the transfer becomes taxable since the conditions under which it is not taxed are no longer met. From that moment, the trader must be identified in that Member State in order to be able to carry out the transfer and declare the supplies taxable within the territory of the country as and when the goods are sold to the different purchasers.

3.2.4. Consequences for traders

(206) This situation created a certain amount of disappointment among traders, who had expected that the new arrangements would, in the case of intra-Community and domestic transactions alike, relieve them of the need to treat movements of their stocks or capital goods as taxable transactions. However, it should be pointed out that, independently of the mechanism for transfers, taxable persons are in any event obliged to justify the application and use of goods forming part of the assets of their firms.

(207) In the Member State where the trader has exercised his right to deduct, the mechanism introduced permits monitoring of the application of the goods which form part of the firms' assets (stocks or capital goods) and which conferred the right to deduct: in particular, it is possible to check application for the purposes of the taxable activity and continued application, within the context of that taxable activity, to the performance of taxable transactions giving rise to the right to deduct. Where the goods are not present within the firm, proof will consist of:

- either the register in which the goods sent temporarily to another Member State are recorded,
- or the inventory of capital goods, stocks, etc.,
- or evidence that the transfer has been carried out and entered in the accounts as a taxable transaction.

(208) In each of the situations described above, the obligation on the supplier to identify himself for VAT purposes in the Member State of arrival of the transport is often presented as an additional obligation imposed by the transitional arrangements and attributable simply to the mechanism for taxing transfers. However, the transfer is perceived as an intra-Community acquisition of goods only because taxable transactions, whether occasional or not, are carried out in the Member State of arrival of the transport.

(209) The taxable transfer, therefore, is only the means introduced by the transitional arrangements for showing that transactions carried out with the aid of goods thus transported fall within the tax competence of the Member State of destination.

(210) Consequently, if transfers were no longer treated as supplies and intra-Community acquisitions of goods, this would not resolve the difficulties encountered by traders, who would in any case find themselves subject to the same obligations as at present, the purpose being to ensure that supplies of goods on its territory are taxed in the Member State of destination of the movement of the goods: any subsequent supply is regarded as being carried out from that Member State and so is taxable there.

(211) Some Member States have tried to ease the consequences of the provisions relating to intra-Community transfers of goods. To this end, they have agreed - under conditions and in accordance with procedures which vary considerably - to treat the transaction as an intra-Community sale, thereby frustrating the territoriality rules on the charging of VAT: the sale, in fact, becomes taxable in the Member State of departure of the transport even though the transaction takes place within the Member State of destination. Depending on the case and circumstances, the "sale" is regarded as having been made either when the goods are dispatched with a view to building up stocks or when they are removed by the purchaser. Moreover, some administrations have shown no hesitation in subjecting the application of these measures to "conditions of reciprocity" whose nature and scope they have not, however, defined.

(212) Introduced without consultations between Member States, measures of this kind have only added to traders' lack of understanding of the purpose of the transfers mechanism and have imposed more constraints than if the provisions laid down in the transitional arrangements had been strictly applied. In addition, they call into question the very principle of monitoring goods, which was adopted by the Council and has been confirmed on numerous occasions by Member States' administrations at meetings of the working parties convened by the Commission.

3.3. TAX TREATMENT OF WORK ON MOVABLE TANGIBLE PROPERTY

3.3.1. Classification for tax purposes of work on movable tangible property

(213) In the negotiations on the transitional arrangements, it did not prove possible to harmonize the tax treatment of transactions consisting of work on movable tangible property. Consequently, the distinctions made between contract work and other work, and in particular the tax treatment of such transactions, vary considerably from one Member State to another. This has the following unfortunate consequences as far as the single market is concerned:

- inequalities of treatment and distortions of competition;
- extra charges for traders who arrange for work described as supplies of services in another Member State to be carried out in that other Member State, where the VAT paid by them cannot be deducted but can be refunded in accordance with the procedure laid down in the Eighth (or Thirteenth) Directive.

Principle: work on movable tangible property constitutes a supply of services

(214) As a general rule, all work on movable tangible property (repairs, working, processing, etc.) constitutes a supply of services. Such supplies of services are taxable at the place where they are physically carried out and qualify for exemption only if the goods in question are exported outside the Community. Given the place and procedures for exercising the right to deduct, a customer who has work carried out in another Member State must normally comply with the procedures for refunding the VAT invoiced to him.

Exception: contract work

(215) The Sixth Directive allows Member States to treat as supplies of goods work which meets the definition of contract work. However, since not all the Member States exercise this option, differential treatment would have resulted in non-taxation or double taxation in the case of transactions carried out between Member States. This is why special provisions were introduced under the transitional arrangements.

3.3.2. Treatment of transactions between Member States

Contract work under the bilateral intra-Community arrangements

(216) Intra-Community contract work ranks as a supply of goods where the product on which the work has been done is sent back to the Member State of provenance of the raw materials. Where his customer is identified for VAT purposes, the contract processor is thus able to exempt the work which he has carried out, with the transaction giving rise to the taxation of an intra-Community acquisition in the Member State of the principal. Lastly, while it may not be covered by the mechanism for monitoring taxable transfers, the dispatch of materials on which contract work is to be done must nevertheless be mentioned separately on the recapitulative statement of transactions with traders in other Member States.

(217) This provision applies only to "bilateral" transactions. In other circumstances, the principal is charged tax under the conditions obtaining in the Member State of the contract processor in respect of a supply of services or goods, depending on the legislation in force in that Member State. He must also regard the dispatch of the raw materials as a taxable intra-Community transfer.

(218) In much the same way as with transfers, the special measures relating to contract work have imposed very tight constraints on traders, with experience having confirmed that there were relatively few instances of "bilateral" contract work.

(219) By way of illustration, reference can be made to all those cases where the principal resells the goods - either as raw materials or as finished products - while they are being worked under contract in another Member State. Given the place of taxation of the supplies of goods, the current system of VAT does not allow the principal to avoid identification in the Member State of the contract processor: he carries out supplies of goods there and is subject there to the ensuing obligations, especially with regard to declarations.

(220) Patient analysis has nevertheless made it possible, on the Commission's initiative, to devise within Working Party No 1 practical arrangements that will simplify many transactions.

Measures exempting supplies of services under the bilateral intra-Community arrangements

(221) Under the transitional arrangements there is no way of ensuring that the taxation of work on movable tangible property, other than bilateral contract work, takes place in a Member State where the customer can deduct the tax direct. The considerable difficulties this creates have led the Council to grant the request made by eleven Member States to exempt such supplies of services temporarily, provided that they are made to non-established taxable persons who would at all events be entitled to a refund of the VAT invoiced in accordance with the procedures laid down in the Eighth and Thirteenth Directives.

(222) These exemptions are not applicable therefore where the principal resells the goods from the Member State where they are worked, irrespective of the circumstances of the sale: before or after completion of the processing work; sale under domestic arrangements, to another Member State or for export.

Search for additional simplification measures

(223) Any simplification of the tax treatment of work on movable tangible property presupposes prior harmonization of the way in which such work is classified: the most effective measure in this respect would be to dispense with the special rules governing contract work.

(224) At the same time, the location of these transactions should be re-examined so that traders' requirements can be better met and the objectives of the single market more fully achieved. In this connection, taxation of such supplies of services as a function of the place where the principal is identified for VAT purposes could be considered, along the lines of the provisions governing services ancillary to an intra-Community transport of goods (see § 59).

(225) Regardless of the fact that they fundamentally call into question the principle that tax is applied by the supplier of the services, provisions of this nature would resolve only some of the difficulties now being encountered. For principals who resell goods from the Member State where the work is carried out, such provisions do not affect:

- the obligation to apply the tax at the rate and under the conditions obtaining in that Member State;
- the subsequent application of the mechanisms for taxing a transaction as an intra-Community transfer of goods.

3.4. TRANSACTIONS CARRIED OUT BY NON-ESTABLISHED TAXABLE PERSONS

(226) The territoriality rules for supplies of goods and services lead firms to apply the tax in Member States on whose territory they are not established. It is primarily in the field of transport services, triangular transactions and chain transactions that the main difficulties have arisen. In response to these difficulties, the Commission has put forward simplification proposals some of which are still under discussion in the Council at the time of writing.

3.4.1. Supplies of transport services

(227) In principle, the place of taxation of transport services is the place where the transport is carried out, account being taken of the distances covered. The abolition of all checks when an internal Community border is crossed means, however, that it is no longer possible to monitor the respective distances covered in the different territories concerned. Another criterion had therefore to be found, at least for intra-Community transport operations.

Intra-Community passenger transport

(228) The current situation as regards the taxation of passenger transport is fairly chaotic: the rule that tax is charged according to the distance covered is particularly difficult to apply, and all the Member States continue, to a greater or lesser extent, to exempt such services by exercising one of the options available to them under the Sixth Directive.

(229) Consequently, while national transport is taxed in a large majority of Member States whatever the means of transport used, international transport (or, to be more precise, the national section of an international transport operation) is exempt in a majority of Member States: transport by sea and by air is exempt throughout the Community, while transport by inland waterway, rail and road is taxed only in some Member States.

(230) This situation is bound to create difficulties, particularly for road transport operators, who are obliged to know the rules applicable in the different Member States they travel through when carrying out an intra-Community passenger transport operation and to apportion the cost of the journey on the basis of the distance covered in each of them. The difficulty is particularly great when the tax position (actual taxation or exemption) and the rates applicable vary from one Member State to another. It is a moot point, therefore, whether these rules as to location are effectively applied, given that the

Member States, following the abolition of checks at internal borders, have little means of verifying whether the distances covered on their territory have been taxed.

(231) Faced with these difficulties, the Commission on 5 November 1992 transmitted to the Council a proposal for a Directive as regards the value added tax arrangements applicable to passenger transport (COM(92) 416 final of 30 September 1992, OJ No C 307 of 25 November 1992, p. 11).

(232) For passenger transport operations by road or inland waterway, the proposal incorporates the rule that they are to be taxed at the place of departure of the transport, without however calling into question the exemptions currently applied.

(233) While this criterion of the place of departure is easier for traders to apply than the principle of taxation according to the distances covered, it nevertheless requires the trader to be identified for VAT purposes in each of the Member States where he starts a transport operation and to satisfy obligations there, especially with regard to declarations.

Transport of goods

Intra-Community transport of goods on behalf of individuals

(234) All intra-Community transport operations involving the supply of goods to customers who are not identified for VAT purposes are taxable in the Member State of departure of the transport, irrespective of the place of establishment of the carrier.

(235) International removal firms in particular are therefore subject to identification and declaration obligations in each of the Member States from which they operate. The cost of meeting these obligations has dissuaded some firms from responding to removal requests from Member States where they are not established.

Transport within Member States

(236) Transport of goods beginning and ending in the same Member State is taxable there, irrespective of the place of establishment of the supplier. In the case of cabotage within a Member State where he is not established, the carrier is obliged to become identified for VAT purposes with each of the competent tax administrations and to fulfil all the declaration and payment obligations, where necessary after designating a tax representative.

(237) A customer for these services who is neither established nor liable for payment of the tax in the Member State of departure of the transport operation is required to apply the procedures for refunding the tax invoiced.

(238) These rules apply in particular to "feeder" operations in intra-Community transport, i.e. transport operations whose place of departure and place of arrival are situated in a Member State but which take place "upstream" or "downstream" of the intra-Community transport proper. Such situations are often the result of a principal carrier subcontracting parts of an intra-Community transport operation or of a customer using several successive carriers to transport the goods from one Member State to another.

(239) The Council has decided to grant the request of eleven Member States to take temporary measures exempting such supplies of services provided that the customer is a taxable person identified for VAT purposes in another Member State who could qualify for a refund of VAT under the Eighth and Thirteenth Directives.

(240) In the proposal for a Directive which it presented on 9 March 1994[10], the Commission opted to apply to feeder transport operations the provisions in force for intra-Community transport. The proposal also covers ancillary services and the services of intermediaries involved in supplying such services.

(241) The difficulties currently being encountered both by transport suppliers and by their customers are therefore in the process of being resolved, although the proposed solution leaves open the problem of establishing and verifying the ancillary nature of an intra-Community transport operation.

Transport operations associated with the importation of goods

(242) If included in the taxable amount on importation, transport operations associated with the importation of goods qualify for exemption in the Member State where they are carried out. Since 1 January 1993 it has become clear that, as a result of the conditions in which they were carried out, some of these operations were not included in the taxable amount and had to be taxed therefore on the basis of the distances covered.

(243) In order to remedy this situation and thereby simplify the procedures for taxing the services associated with the importation of goods, the proposal for a Directive presented by the Commission on 9 March 1994[10] provides that all ancillary expenditure should be included in the taxable amount for any import operation, irrespective of the Member State into which the goods are imported and irrespective of the place of destination of any subsequent transport operation.

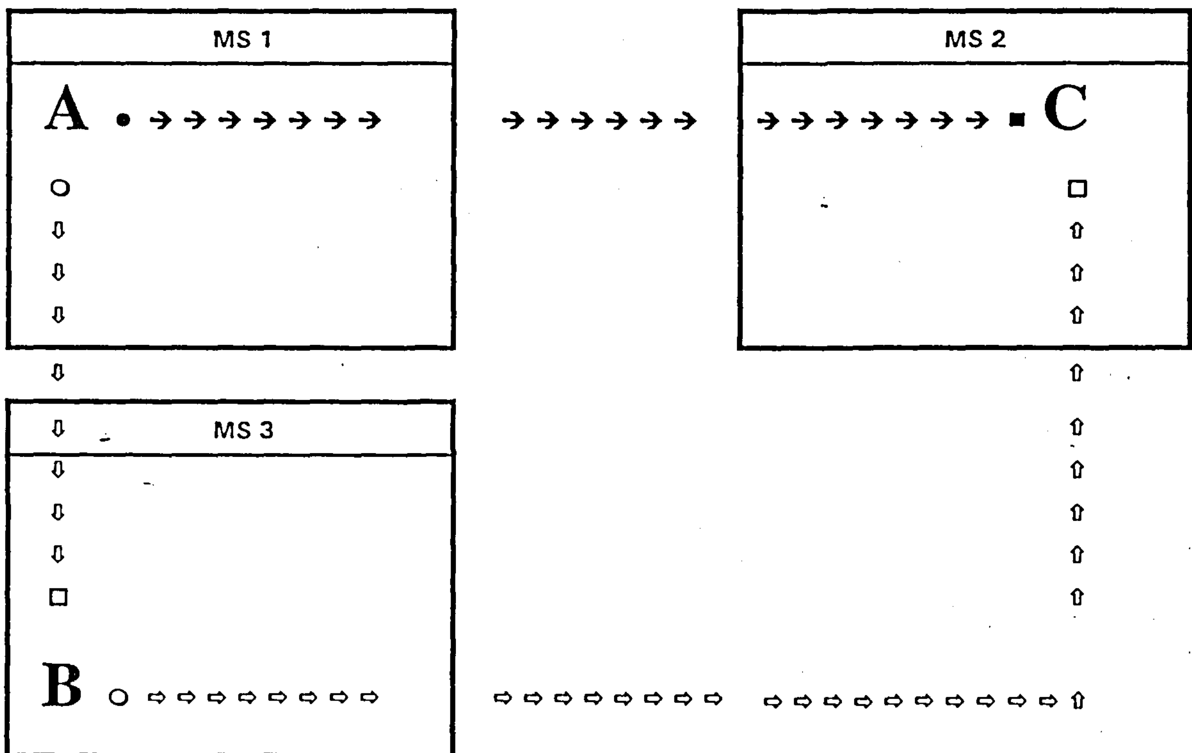
3.4.2. Triangular transactions

(244) It is a major source of satisfaction for the Commission that, despite its belated adoption, the "simplification" Directive of December 1992 had been implemented, at least by way of administrative action, in most of the Member States by 1 January 1993. As a result of the efforts thus made and the speed with which the Member States enacted the Directive, the problem was settled to the satisfaction of both the firms involved and the administrations responsible for applying and monitoring the tax.

Transactions concerned

(245) The simplification measures adopted concern transactions involving:

- three Member States: MS1, MS2 and MS3
- three traders: A, identified for VAT purposes in MS1
  B, identified for VAT purposes in MS3
  C, identified for VAT purposes in MS2
- two sales: ⇨⇨⇨⇨⇨
  ○ vendor
  □ purchaser
- a transport operation: → → → →
  ● place of departure of the transport
  ■ place of arrival of the transport



Principles of taxation

(246) Since the supply from A to B gives rise to the dispatch or transport of the goods to a place of destination in Member State 2, taxable person B effects in that Member State an intra-Community acquisition of goods, the goods being in Member State 2 when the dispatch or transport arrives. The subsequent supply from B to C is, therefore, a transaction within Member State 2 and attracts VAT there in accordance with the normal rules applicable in that Member State.

(247) Conversely, where B takes delivery of the goods in Member State 1 or if his purchaser C undertakes, on his own behalf and for his own account, to transport the goods to a place of destination in Member State of arrival 2, B makes a purchase within Member State 1 followed by an intra-Community supply from that Member State.

Simplification measures

(248) The object of the simplification measures is to avoid trader B having to satisfy identification and declaration obligations in Member State 2: they therefore apply only in the situation described above at § 246.

(249) The mechanism introduced for this purpose consists in nullifying taxation of the intra-Community acquisition, which is in principle taxable in Member State 2, and in shifting to subpurchaser C taxation of the sale made to him by B.

(250) The simplification thus consists essentially in the introduction of a common solution as regards the person liable for payment of the tax due on the supply effected by B in Member State 2.

(251) For his intra-Community acquisition of goods, B uses therefore the VAT identification number issued to him by a Member State other than the Member State of arrival of the transport (identification number issued by Member State 3). In the circumstances, the arrangements for taxing in that Member State any acquisition not subject to tax at the place of arrival of the transport would in principle apply. The necessary measures have also been taken to nullify such taxation in Member State 3.

Conditions relating to the place of identification for VAT purposes

(252) The objective of the measures taken was to avoid B being identified for VAT purposes in the Member State of arrival of the transport. Consequently, Member States may exclude from these simplified arrangements traders already identified in the Member State of arrival since they have appointed a tax representative there. No simplification is possible if B is not identified for VAT purposes or identified only in the Member State of departure of the transport.

(253) The simplification measures do not apply to a trader from a third country who takes part in a triangular transaction without yet having a VAT identification number: depending on the conditions under which he takes part (see § 246 and 247), the trader will consequently have to obtain such identification either from the Member State of departure or from the Member State of arrival of the goods.

(254) It should be borne in mind, however, that the performance of a single taxable transaction in a Member State may not serve as a pretext for obtaining a VAT identification number that would subsequently be used exclusively for participation in triangular transactions.

(255) A problem of this type arose in Ireland, where the High Court held that a VAT identification number must be issued as soon as a firm carries out even a one-off purchasing/reselling transaction on Irish territory. While this principle cannot be questioned, there are grounds for asking how long such an identification number should remain valid: if no other taxable transaction is carried out in that Member State and the number is used by a firm only so that it can participate in triangular transactions and avoid identification for VAT purposes in other Member States where it actually purchases and resells goods, deletion or withdrawal of the identification number should be considered.

3.4.3. Chain transactions

(256) Where goods are the subject of successive transactions, each of these sales is taxable in the Member State where it is deemed to take place. Although the rules on the location of supplies of goods have not been altered in any way by the transitional VAT arrangements, the difficulties encountered in the treatment of chain transactions have taken on a new dimension since 1 January 1993. It is probably in this area that the constraints imposed by the definition of the place of taxation have been least welcomed by traders.

(257) To gain a better understanding of the difficulties which they encounter, it is necessary first to find out why the problem has been so acute since 1993 and then to examine possible simplification procedures in the light of the principles established by the Sixth Directive.

Chain transactions involving goods placed under customs supervision

(258) Until 31 December 1992 most of the products which were the subject of chain transactions qualified for VAT-suspension arrangements, irrespective of their origin (Community goods already located within the territory of the country or coming from other Member States, or non-Community goods) and irrespective of their destination (products intended for consumption or use within the territory of the country, products intended for another Member State or a third country). These provisions basically related to goods placed under customs or like warehousing procedures, pending clarification of their definitive use and destination. As a general rule, supervision of the conditions for applying these procedures was entrusted to Member States' customs administrations.

(259) For traders, these procedures have the advantage that they are accompanied by an exemption for all transactions carried out in connection with the goods in question, the Member States having largely implemented the options provided for in this field by the Sixth Directive. In most Member States the exemption arrangements are supplemented by a dispensation from any identification or declaration obligation. Thus, these measures meant that traders did not have to satisfy obligations in Member States other than that in which they were established and that third-country firms whose transactions related only to goods placed under suspension arrangements need not satisfy any obligation in the Community. Payment of the charges due (VAT and, where appropriate, customs duties and excise duties) took place only when the goods were removed from such arrangements, the basis for calculating such charges having to be determined by the transaction giving rise to the effective release of the goods.

(260) Since 1 January 1993, only non-Community goods have been admitted to customs procedures involving suspension of import duties. The scope of the previous measures, for which all goods qualified irrespective of whether they had Community status or not, has thus been considerably reduced. Since Member States have not introduced for Community goods warehousing procedures other than customs

procedures proper, the principles that all sales of goods should be taxed at the rate and under the conditions obtaining in the Member State where the goods are located has applied in its entirety: traders have therefore had to apply the tax to transactions which they exempted prior to 1 January 1993.

Other chain transactions

(261) The ordinary arrangements have always applied in full to chain transactions carried out outside these suspension arrangements. In particular, where taxable persons are involved in chain transactions in Member States in which they are not established, they must charge the tax at the rate and under the conditions obtaining in each of the Member States concerned and must fulfil the requirements laid down by each of them (see Section 3.5.)

(262) These provisions, which have major implications for traders, are none the less essential for ensuring tax neutrality in respect of the place of establishment of firms.

Measures proposed by the Commission

(263) Since the beginning of 1992 attempts have been made to alleviate the difficulties encountered by traders. Even though simplification measures for triangular transactions were quickly devised (see Section 3.4.2.), it proved impossible to find a general solution for all types of chain transaction (futures transactions, commodities transactions, transactions on open markets, etc.) since the different measures considered in turn fundamentally prejudice the rules on the location of supplies of goods set out in the Sixth Directive.

(264) The Commission's concern in this difficult exercise was to ensure that the tax treatment of transactions involving goods that can be placed under customs warehousing procedures could also apply to the same transactions carried out under similar conditions but involving Community goods. With this in mind, it proposed[10] the introduction of tax warehousing arrangements in Member States where transactions involving goods in customs warehouses are exempt. If the Council were to accept this proposal, such an approach would constitute an important step in the direction of simplification since it would resolve many of the difficulties faced by traders, in particular those who buy and sell raw materials. In addition, it is entirely consistent with the choices made by the Council concerning the principles of taxation in the VAT field. At the time of writing, the proposal presented by the Council is still before the Council.

3.5. PERSON LIABLE FOR PAYMENT OF THE TAX

3.5.1. Person liable for payment of the tax: general problem

(265) The rules governing the place of taxation of transactions require traders to satisfy identification, declaration and payment obligations in every Member State in which they operate.

(266) Where traders buy and sell goods or provide services in a Member State other than that in which they are established, they are very often required, in their capacity as taxable persons, to avail themselves of the services of a tax representative. They frequently complain that this requirement is extremely onerous, costly and disproportionate.

(267) In addition, national law varies considerably: as a result, the trader is faced with the problem of obtaining information about his obligations in each Member State in which he carries out transactions.

(268) During the negotiations on Directive 92/111/EEC, the Commission proposed that the provisions concerning the person liable for payment of the tax should be completely rewritten since they had emerged as one of the main causes of the difficulties encountered by traders in satisfying their obligations in a Member State in which they are not established.

(269) The Council did not take up the Commission's proposal and decided to amend the provisions concerning the person liable for payment of the tax only with regard to the treatment of triangular transactions, keeping intact the other provisions in force since the adoption of the Sixth Directive.

(270) However, in December 1992 the Commission undertook to present to the Council a report on tax representation. A detailed review of the provisions implemented in the Member States confirmed the very wide variety of taxation arrangements in force, not only with regard to tax representation but more generally in the designation of the person liable to pay the tax.

(271) The main difficulties encountered by taxable persons in carrying out transactions in a Member State in which they are not established involve the following:

- determination of the person liable for payment of the tax. Any one category of transactions is governed by provisions which differ between Member States: in addition, even for transactions carried out in the same Member State, the person liable for payment varies according to the nature of the transaction;
- the nature and extent of the obligations imposed on the person liable for payment. For any one person liable for payment, these obligations differ from one Member State to another or, where only one Member State is concerned, according to the nature of the taxable transaction;
- the considerable differences in the interpretation of the concept of tax representative, whose role and obligations vary significantly from one Member State to another;
- the burden and cost of these obligations, particularly for small and medium-sized firms;
- the substantial drain on liquidity resulting from the time it takes for Member States to refund VAT under the Eighth and Thirteenth Directives.

3.5.2. Guidelines laid down by the Commission

(272) In its communication to the Council and the European Parliament of 3 November 1994(14), the Commission laid down the following guidelines in order better to respond to these difficulties:

- ensuring that there is only one person liable for payment per taxable transaction;
- applying as widely as possible the principle that the tax is payable by the taxable person who carries out the taxable transaction and, consequently, refraining from the systematic use of the option, available under the Sixth Directive, of designating the tax representative or the recipient as the person liable for payment of the tax in place of the non-established taxable person;
- permitting non-established taxable persons to use the services of a tax agent under the same conditions as those laid down for established taxable persons;
- lastly, ensuring that Community legal instruments on administrative cooperation and mutual assistance are applied as effectively as possible.

(273) If these guidelines were applied by all the Member States, it would be possible to simplify considerably the difficulties currently faced by taxable persons, in particular with regard to the nature of the obligations to be met by non-established taxable persons. However, traders' expectations go beyond the simple question of the person liable for payment of the tax: they take the view that the internal market should ensure uniform tax treatment for all their transactions in the Community. This expectation cannot be met, however, because of the principles currently laid down by the common system of VAT regarding the location of taxable transactions. Only fundamental changes to those rules would be likely to provide a complete answer to the problems currently encountered by traders: this matter is central to the work to be carried out in preparing for the definitive VAT system.

3.6. SMALL BUSINESSES ("UNDERTAKINGS") QUALIFYING FOR EXEMPTION

(274) In the field of VAT, the concept of "small undertaking" is reserved for traders with a very low turnover (see the table in Annex 1 setting out the turnover thresholds applied by the Member States under the exemption arrangements). For these businesses, the difficulties generally encountered in applying the rules for charging VAT become real barriers.

3.6.1. Provisions applicable

(275) Small businesses qualifying for the exemption arrangements do not charge VAT on sales of goods or services that are taxable in the Member State in which they are established. Since this exemption also applies to intra-Community supplies of goods to purchasers identified for VAT purposes in another Member State, the small businesses concerned do not have to satisfy any of the declaration obligations associated with such transactions.

(276) On the other hand, like any other taxable person without the right to deduct input tax, they are required to charge VAT on their intra-Community acquisitions of goods where they exceed the taxation threshold laid down by their Member State (see Section 2.2.1). Under this scenario, they have to obtain from their tax administration a VAT identification number and are required to declare and tax the acquisitions in question. However, in view of the thresholds laid down by the Member States, few businesses eligible for exemption on their turnover have to tax their intra-Community acquisitions of goods, except perhaps when renewing their fixed assets.

(277) It is thus essentially when carrying out taxable transactions outside the Member State in which they are established that these businesses encounter difficulties.

3.6.2. Difficulties encountered

(278) Application of the exemption arrangements is an option available to the Member States under the Sixth Directive. Its scope is therefore necessarily limited to transactions carried out within the territory of the Member State which chooses to apply it.

(279) Thus, small businesses face the same difficulties as other traders when carrying out transactions in the territory of another Member State. They are required to satisfy the general obligations to become identified for VAT purposes and to submit periodic returns - if necessary, after appointing a tax representative - in respect of the transactions which they carry out in another Member State, whereas in general they are exempt from any obligation in their place of establishment.

(280) It is essentially when applying the special scheme for taxation of distance selling involving products subject to excise duties that small businesses have to satisfy these very onerous obligations.

(281) These difficulties could be resolved only if non-established traders qualified for exemption in every Member State in which they operate. However, the present definition concerning the territoriality of transactions prevents this: the status of a small business can be properly assessed only in the Member State in which the trader is established. In any other Member State the number of transactions carried out by a non-established business does not provide any indication of its total turnover.

(282) Consequently, only a fundamental change in the territoriality rules governing transactions would be likely to resolve this difficulty without jeopardizing the essential principle of tax neutrality in the VAT field. No satisfactory solution is available under the transitional arrangements.

3.7. ASSESSMENT OF THE PRINCIPLES OF TAXATION LAID DOWN IN THE SIXTH DIRECTIVE

(283) The present configuration of the common VAT system is based on taxation in the place of origin of goods and services. This place is defined so as to ensure identical tax treatment for sales, regardless of the provenance of the goods (imported goods, intra-Community acquisitions, goods bought within the territory of the country) and irrespective of the trader making the sale (whether or not established in the Member State of taxation). In addition, the definition of the place of taxation ensures that the tax is charged in and by the Member State in which the final consumption of goods and services is likely to take place. This fiscal place of origin does not necessarily

correspond to the interpretation of a more economic nature preferred by traders, which more often than not equates to the place where the trader selling the goods or providing the services is situated. The consequences of these choices of principle are well known and are reflected in the difficulties referred to throughout this section.

(284) These difficulties become more serious when the rules on VAT have to be combined with those on excise duties, customs duties or statistics. Thus, whenever goods are imported into the Community through a Member State other than the Member State of destination of the goods, consistency with the customs rules has been ensured only by suspension of the chargeable event of the tax due on importation or by the technique of transfer subsequent to importation, both of which impose onerous obligations on traders. In the same way, although there is a large degree of consistency with the rules on the provision of statistical information, full consistency is lacking because monitoring of commercial transactions does not always match the movement in the Community of goods covered by the statistics. Lastly, the rules on excise duties do not always mirror those on VAT, which means that traders face major difficulties when marketing products subject to excise duties at Community level. However, despite a constant search for greater consistency in the application of the provisions on customs, taxation (VAT and excise duties) and statistics, the different structures used in each of these fields mean that this objective is not always fully attained.

(285) All these difficulties are inherent in the current principles governing the location of sales transactions: they would arise in the same way and to the same extent if the rules applicable during the transitional period were abolished without changing the present definition of the place of taxation for sales of goods or services.

CONCLUSION

(286) Without claiming to be exhaustive, this report seeks to analyse the operation of the transitional arrangements, to set out their main achievements and to assess the principal problems which have bedevilled application of the common system of VAT since internal border controls were abolished. A number of broad conclusions can now be drawn from this analysis.

I. INTRODUCTION OF NEW TAX RULES

(287) The measures brought in on 1 January 1993 made it possible for the checks carried out at the Community's internal borders to be abolished and thus for the conditions necessary for establishing the internal market to be created by the deadlines set. Admittedly, the belated adoption of the new arrangements raised difficulties for Member States in implementing them, in some cases impairing the supply of information to traders and consumers.

(288) Generally speaking, as the surveys conducted among the various interested parties have shown and as the Commission has noted at its regular meetings with traders and Member States' administrations, the new arrangements are viewed positively. The measures adopted have indeed made it possible for the controls imposed for tax reasons at internal borders to be permanently abolished and for taxation to be effectively applied at the place of destination as decided by the Council.

II. ADAPTATION TO PRE-EXISTING TAX RULES

(289) While the transitional arrangements are functioning in a generally satisfactory manner, the Commission's assessment of the overall operation of the common system of VAT cannot be so narrowly circumscribed. The difficulties encountered by traders show, day after day, that firms and consumers are not yet reaping all the benefits expected of a single market. In particular, traders' expectations that they should be able to treat in the same way all the transactions they carry out in the Community are still far from being realized.

(290) This situation stems from the very principles of taxation on which the common system of VAT is built, the measures implemented under the transitional arrangements being simply an adaptation of those principles to the particular case of intra-Community trade. The place of taxation of transactions is still defined by reference to the place of consumption of goods and services, thereby maintaining the need for physical monitoring of the goods and services involved in commercial transactions.

(291) As a result, traders still have to identify separately supplies to other Member States. Since the intra-Community nature of a transaction is determined by reference to a host of criteria which vary depending on the type of transaction carried out, the arrangements in force during the transitional period are especially complex to apply. These difficulties, which have led some traders, particularly small and medium-sized firms, to refrain from buying or selling in other Member States, also affect individuals when it comes to the arrangements applicable to new means of transport.

(292) While the maintenance, during the transitional period, of rules providing for taxation at the place of destination ensures that both Member States and traders are protected against possible distortion of competition arising from insufficient approximation of the arrangements relating to rates, this entails complex machinery.

III. THREATS TO MECHANISM WHEREBY PAYMENTS ARE MADE AT EACH STAGE

(293) The recent development of the common system of VAT is characterized by an enormous increase in the number of transactions on which the tax is payable by the purchaser or customer. This affects not only intra-Community acquisitions of goods but also many services supplied by non-established taxable persons. Particularly in cases where taxation depends on the place where customers are identified for VAT purposes, the neutrality of the arrangements for applying tax is no longer guaranteed, all the less so as traders can choose whether or not to divulge their VAT identification number and, in the case of multiple identifications, can also select the number under which the service is to be supplied to them.

(294) This trend is especially disturbing in that it is undermining one of the essential characteristics of VAT. Of the advantages afforded by VAT as compared with other

consumption tax systems, the simplicity of taxation conditions and mechanisms is undoubtedly the most significant: the taxation of a given transaction depends purely on the supplier's status as a taxable person and on the tax nature of the transaction he carries out.

(295) This "objectivity" in the conditions for applying the tax relieves suppliers entirely of the need to check the VAT status of their customers and is necessarily accompanied by a clear division of responsibilities between the parties: the responsibility for taxing a sale lies exclusively with the vendor; the purchaser's responsibility is confined to justifying his possible entitlement to deduct the tax invoiced to him. These arrangements ensure that traders cannot be held responsible as result of the tax behaviour of their customers or suppliers.

(296) Difficulties arise whenever this general framework comes under threat: the questions relating to proof that the conditions for exempting an intra-Community supply of goods have been met are only one illustration of this; the same is true of supplies of services that are taxable at the place where customers are identified for VAT purposes.

(297) Mainly because VAT invoiced in another Member State cannot at the moment be deducted, such a trend, if it were to be reinforced, would fundamentally alter the intrinsic nature of value added tax, turning it into a purchase tax. Under those circumstances, the level of rates and the arrangements for monitoring application of the tax would have to be revised accordingly. While the current principle of taxation by the supplier and deduction by the purchaser ensures that Member States collect their tax revenue at each stage of the economic process and allows high rates to be applied, no single taxation system applied solely at the stage of sale to a final consumer guarantees the same results.

IV. LESSONS TO BE DRAWN FROM EXPERIENCE GAINED SINCE 1 JANUARY 1993

(298) The objective of eliminating controls at internal Community borders, laid down by the Single European Act, dovetails with "the aim of abolishing the imposition of tax on importation and the remission of tax on exportation in trade between Member States" - an aim set by the First Directive and achieved with the adoption of the transitional arrangements.

(299) However, the setting-up and development of the common system of VAT are part of a wider context extending far beyond this single achievement. The actual process of harmonizing Member States' legislation governing turnover taxes is inseparable from two other objectives:

- to guarantee the neutrality of taxation in trade within and between Member States, and this in parallel with the general process of building the Community;
- in this way, and in accordance with the Treaty, "to establish, within the framework of an economic union, a common market within which there is healthy competition and whose characteristics are similar to those of a domestic market"(1).

(300) The very pursuit of each of these objectives undoubtedly constitutes the fundamental challenge to which the Community must now respond in the context of the work on setting up a definitive VAT system which will ensure that the internal market functions smoothly.

THRESHOLDS IN THE MEMBER STATES

(amounts in ECU)

	THRESHOLD FOR TAXATION ON ACQUISITIONS	THRESHOLD FOR TAXATION ON DISTANCE SALES	LIMIT OF APPLICATION OF THE TAX EXEMPTION (in base)
BELGIQUE/BELGIE	10 000	35 000	5 000
DANEMARK	10 000	35 000	1 200
DEUTSCHLAND	12 255	100 000	12 255
ELLAS	10 000	35 000	6 000 2 000
ESPAÑA	10 000	35 000	---
FRANCE	10 000	100 000	10 000
IRELAND	41 600	35 000	50 000
ITALIA	10 000	35 000	---
LUXEMBOURG	10 000	100 000	10 000
NEDERLAND	10 000	100 000	---
PORTUGAL	10 000	35 000	6 600 9 445
UNITED KINGDOM	59 000	100 000	59 000

HARMONISATION OF LEGISLATION OF MEMBER STATES CONCERNING TURNOVER TAXES

- References -

I. HARMONISATION OF LEGISLATION OF MEMBER STATES CONCERNING TURNOVER TAXES

(1) **FIRST COUNCIL DIRECTIVE** of 11 April 1967 on the harmonisation of legislation Member States concerning turnover taxes (67/227/CEE) - O.J. N° 71, 14.4.67, p. 1301/67

(2) **SECOND COUNCIL DIRECTIVE** of 11 April 1967 concerning turnover taxes - Structure and procedures for application of the common system of value added tax (68/227/CEE) - O.J. N° 71, 14.4.67, p. 1303/67

(3) **SIXTH COUNCIL DIRECTIVE** of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (77/388/CEE) - O.J. N° L 145, 13.6.77, p. 1, as amended by:

- Council Directives:
  - Ninth Council Directive of 26 June 1978 on the harmonisation of the laws of the Member States relating to turnover taxes (78/583/CEE) - O.J. N° L 194, 19.7.78, p. 16
  - Tenth Council Directive of 31 July 1984 on the harmonisation of the laws of the Member States relating to turnover taxes, amending Directive 77/388/EEC - Application of value added tax to the hiring out of movable tangible property (84/386/CEE) - O.J. N° L 208, 3.8.84, p. 58
  - Eleventh Council Directive of 26 March 1980 on the harmonisation of the laws of the Member States relating to turnover taxes - exclusion of the French overseas departments from the scope of Directive 77/388/EEC 80/368/CEE) - O.J. N° L 90, 3.4.80, p. 41
  - Fifteenth Council Directive of 19 December 1983 on the harmonisation of the laws of the Member States relating to turnover taxes - derment of the introduction of the common system of value added tax in the Hellenic Republic (83/648/CEE) - O.J. N° L 360, 23.12.83, p. 49

- Eighteenth Council Directive of 18 July 1989 on the harmonisation of the laws of the Member States relating to turnover taxes - Abolition of certain derogations provided for in Article 28(3) of the Sixth Directive, 77/388/CEE (89/465/CEE) - O.J. N° L 226, 3.8.89, p. 21

- Twenthy-first Council Directive of 16 June 1986 on the harmonisation of the laws of the Member States relating to turnover taxes - Deferment of the introduction of the common system of value added tax in the Hellenic Republic (86/247/CEE) - O.J. N° L 164, 20.6.86, p. 27

♦ the Acts of Accession:

- of the Kingdom of Denmark, of Ireland, of the Kingdom of Norway and of the United Kingdom (O.J. n° L 73, 27.3.72, p. 93, 138, 156)
- of the Hellenic Republic (O.J. n° L 291, 19.11.79, p. 95, 163, 169)
- of Spain and Portugal (O.J. n° L 302, 15.11.85, p. 167, et 168)

(4) **EIGHTH COUNCIL DIRECTIVE** of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in the territory of the country - (79/1072/CEE) - O.J. N° L 331, 27.12.79, p. 11

(5) **THIRTEENTH COUNCIL DIRECTIVE** of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover taxes - Arrangements for the refund of value added tax to taxable persons not established in Community territory - (86/560/CEE) - O.J. N° L 326, 21.11.86, p. 40

II. THE OBJECTIVE OF REMOVAL OF FISCAL FRONTIERS BETWEEN MEMBER STATES

(6) **PROPOSALS FOR COUNCIL DIRECTIVES PRESENTED BY THE COMMISSION:**

- Completion of the internal market: approximation of indirect tax rates and harmonisation of indirect tax structure - Global communication from the Commission - COM (87) 320

- Supplementing the common system of value added tax and amending directive 77/388/EEC - Approximation of vat rates - Proposal present by the Commission to the Council on 7.8.87 - COM (87) 321 final/2 - (O.J. N° C 250, 18.9.87, p. 2)

- Proposal for a Council Directive completing and amending Directive 77/388/EEC - Removal of fiscal frontiers - Proposal presented by the Commission to the Council on 7.38.87 - COM (87) 322 final, 4.8.87 corrected by COM (87) 322 final/2 - (O.J. N° C 252, 22.9.87, p. 2)

- Working document from the Commission completing the internal market - The introduction of a VAT clearing mechanism for intra-Community sales - Transmitted to the Council on 7.8.87 and to the European Parliament on 19.7.88 - COM (87) 323 final, 4.8.87 corrected by COM (87) 323 final/2

- Instituting a process of convergence of rates of value-added tax and excise duties - Proposal presented by the Commission to the Council on 7.8.1987 - COM (87) 324 final, 4.8.87 corrected by COM (87) 324 final/3 - (O.J. N° C 250, 18.9.87, p. 3)

(7) **ECOFIN COUNCIL'S CONCLUSIONS**: General Secretariat of the Council - Press release 9850/89 (Press 206 - G)

III. ARRANGEMENTS IN FORCE SINCE 1 JANUARY 1993

(8) **TRANSITIONAL ARRANGEMENTS FOR THE TAXATION OF TRADE BETWEEN MEMBER STATES:**

- Amendment to the proposal for a Council Directive supplementing the common system of value added tax and amending Directive 77/388/EEC - Transitional arrangements for taxation with a view to establishment of the internal market presented by the Commission to the Council on 17.5.90 and to the European Parliament on 10.7.90 - COM (90) 182 final - SYN 274, 19.6.90 corrected by COM (90) 182 final/2 - O.J. N° C 176, 17.7.90, p. 8

- Amendment to the proposal for Council Directive supplementing the common system of value added tax (VAT) and amending Directive 77/388/EEC - Abolition of tax frontiers (COM (87) 322/final) and transitional arrangements for taxation (COM (90) 182/final) with a view to establishment of the internal market presented by the Commission to the Council on 2.5.91 and to the European Parliament on 14.5.91 - COM (91) 157 final, 2.5.91 (O.J. N° C 131, 22.5.91, p. 3)

- Council Directive of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers - 91/680/CEE - O.J. N° L 376, 31.12.91, p. 1

- Council Directive of 14 February 1994 amending Directives 69/169/EEC and 77/388/EEC and increasing th elevel of allowances for travellers from third countries and th elimits on tax-free purchases in intra-Community traval - 94/4/CEE - O.J. N° L 60, 3.3.94, p. 14

- Council Directive of 14 February 1994 supplementing the common system of value added tax and amending Directive 77/388/EEC - Special arrangements applicable to second-hand goods, works of art, collectors' items and antiques - 94/5/CEE - O.J. N° L 60, 3.3.94, p. 16

(9) VAT RATES

- COM (87) 321 (see point (7) above)

- Amendment to the proposal for a Council Directive supplementing the common system of value added tax and amending Directive 77/388/EEC, presented by the Commission to the Council on 24.1.92 and to the European Parliament on 28.1.92 - Approximation of VAT rates - COM (92) 005 final, 23.1.92 - (O.J. N° C 44, 19.2.92, p. 21)

- Council Directive of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC - Approximation of VAT rates - 92/77/CEE - O.J. N° L 316, 31.10.92, p. 1

(10) SIMPLIFICATION MEASURES TO THE OPERATION OF THE TRANSITIONAL ARRANGEMENTS:

- Proposal for a Council Directive presented by the Commission to the Council on 4.11.92 and to the European Parliament on 5.11.92 amending Directive 77/388/EEC and introducing simplification measures with regard to value added tax - COM (92) 448 final, 4.11.92 - (O.J. N° C 335, 18.12.92, p. 10)

- Council Directive of 14 Directive 1992 amending Directive 77/388/EEC and introducing simplification measures with regard to value added tax - 92/111/CEE - O.J. N° L 384, 30.12.92, p. 47)

- Proposal for a Council Directive amending directive 77/388EEC and introducing new simplification measures with regard to value added tax - scope of certain exemptions and practical arrangements for implementing them - presented by the Commissionto the Council on 2.3.94 - COM (94) 58 - (O.J. N° C 107, 15.4.94, p. 7)

(11) ADMINISTRATIVE COOPERATION IN THE FIELD OF INDIRECT TAXATION:

- Proposal for a Council Regulation (EEC) concerning administrative cooperation in the field of indirect taxation (VAT), presented by the Commission to the Council on 17.5.90 and to the European Parliament on 10.7.90 - COM (90) 183 final - SYN 275, 19.6.90 - (O.J. N° C 187, 27.7.90, p.23)

- Modification to the proposal for a Council Regulation (EEC) concerning administrative cooperation in the field of indirect taxation (VAT), presented by the Commission to the Council on 7.5.91 and to the European Parliament on 21.5.91 - COM (91) 115 final - SYN 275, 30.4.91 - (O.J. N° C 131, 22.5.91, p. 112)

- Council Regulation (EEC) N° 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation (VAT) - O.J. N° L 24, 1.2.92, p. 1

IV. REPORTS AND COMMUNICATIONS PRESENTED BY THE COMMISSION ABOUT THE OPERATION OF THE TRANSITIONAL ARRANGEMENTS FOR CHARGING VAT IN INTRA-COMMUNITY TRADE

(12) Mrs Scrivener's speech to ECOFIN Council of 25.10.93 - Six month's operation of the new indirect tax regime: a broadly positive initial assessment

(13) Report from the Commission to the Council and the European Parliament - Application of Council Regulation (EEC) N° 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation (VAT) - COM (94) 262 final, 23.6.94

(14) Communication and report from the Commission to the Council and the European Parliament - Common system of value added tax: arragements for taxing transactions carried out by non-established taxable persons - COM (94) 471 final, 3.11.94