Application of the EU Value Added Tax to E-Commerce Transactions

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Introduction

While income tax issues and in particular the application of double tax treaties are at the center of the academic debate on electronic commerce, in practice tax attorneys are more often confronted with consumption tax issues raised by Internet based business models. The reasons for this are very simple: Income tax returns are filed annually, and a tax audit may take place several years later - if at all. By contrast, VAT returns are filed on a monthly basis, and, pursuant to the European self assessment system, businesses are required to compute VAT tax liabilities at the time they account for their e-commerce transactions. As a result, VAT attorneys found themselves at the forefront of electronic commerce taxation and it was their task to devise solutions before other tax lawyers had even begun to understand the issues. In addition, Internet start-ups are rarely profitable so the fiscal authorities focus on VAT compliance issues, whereas income tax aspects are less important.

The rapid expansion of the "New Economy" left not much time for an in-depth discussion of tax issues. Meanwhile, the situation has changed. We now understand the issues more clearly, and a consensus is emerging on how to apply the existing rules and how to amend them so as to reflect the changes brought about by the implementation of Internet based business models. The objective of this article is to reflect the current VAT discussion within the EU. Part one deals with the political compromise reached by the US and the EU. Part two explains a few basic concepts of the EU VAT in order to lay the ground for the more advanced issues of electronic commerce. In part three, the different VAT rules applying to B٢B transactions and B٢C transactions are discussed. Finally, part four is dedicated to the proposed amendments to the EU VAT Directive,[١] which were adopted by the EU Council of Ministers on February ١٢, ٢٠٠٢, and are scheduled for implementation by July ١, ٢٠٠٣.

I. Dissent and Consensus within the OECD

When the OECD first started examining the subject of electronic commerce about four and a half years ago,[٢] it soon became clear that the US and the EU had opposing economic interests and therefore opposing views on the taxation of electronic commerce: The US, being a net exporter of digital products, demanded a "tax moratorium" for electronic commerce transactions.[٣] The rationale of that policy was obvious: The Clinton administration planned to maximize worldwide US business opportunities by taking advantage of the US's technological and economic lead. The EU, on the other hand, found itself in the uncomfortable position of being a net importer of digital goods and services. It quickly realized that foreign taxpayers no longer had to maintain a physical presence in the EU to do business on European markets. Not surprisingly, several member states of the EU voiced serious concerns about dwindling tax revenues. Ironically, it seemed that the very tax treaty mechanism that had been designed to limit the source taxation of developing countries now turned against its European inventors who had to protect their shrinking tax bases against the economic power of the US.

For a while, it seemd that some European countries would tighten their source taxation rules in an attempt limit future revenue losses to a minimum. Some even considered repealing or reducing tax treaty benefits for e-commerce income. In the end, however, the US prevailed, and the OECD decided unanimously to keep the current treaty system of reduced source taxation under Articles ٧ and ١٢ OECD Model Convention. Fortunately, the EU did not leave the negotiating table with empty hands: It reasserted its right to impose VAT on US.