
Chapter 3

The Current EU VAT System: Practical Problems

1. The current EU VAT system: General overview

Thirty-eight years after the approval of the First Directive and the introduction of a common VAT system, the current EU VAT system can be broadly characterised as vast, complex, and extremely detailed.³³⁵ Until recently, the principal legislative instrument since 1977 was undoubtedly the Sixth Directive, which was the source of the majority of EU VAT law's substantive provisions; from 2007 onwards that role belongs to the CVSD. However, during the last 30 years, other VAT related legislation has been approved by Community institutions, either with the objective of regulating specific aspects of the system, or in order to establish procedural law provisions which assist the effective functioning of the system. Overall, the EU VAT system can be divided into five principal areas, as follows:

- Basis of assessment – which CVSD and all related legislation (amendments, derogations, ancillary legislation);
- Intra-community and international VAT refund system – VAT refund system for taxable persons not established in the territory of the country/Community, which includes the soon to be repealed Eighth Directive, the new Council Directive 2008/9/EC, and the Thirteenth Directive;
- Statistical system – which includes legislation regarding statistics in relation to the trade in goods between Member States, i.e., all Intrastat related legislation;
- Administrative cooperation – including not only the recently approved administrative cooperation Regulation, but also all *Fiscalis* related legislation;
- Own resources – which includes all legislation in relation to the use of domestically raised VAT as one of the Community's own resources (i.e., for EU budgetary purposes).

335. For a compilation of all EU VAT legislation to date see R. de la Feria, *A Handbook of EU VAT Legislation*, Volumes 1, 2 and 3, Loose-leaf (The Hague/London/New York: Kluwer Law International, 2004 onwards).

1.1. Basis of assessment: Common VAT System Directive (CVSD)

The most significant and recognised area of the EU VAT system, is the “basis of assessment”, which until recently included the First Directive, and most importantly, the Sixth Directive, and since 2007 includes the CVSD and all related legislation.³³⁶ It represents the bulk of the EU VAT system, and for that reason, it is a common misconception to regard the “basis of assessment” as synonymous with the EU VAT system. It is possible to identify four stages in the evolution of the common VAT basis of assessment:

- Adoption of a common VAT system (First Directive);
- Introduction of a uniform basis of assessment (Sixth Directive);
- Introduction of the transitional VAT system (Abolition of Fiscal Frontiers Directive, Approximation of VAT Rates Directive and First Nettoyage Directive),³³⁷ and,
- Rationalisation of the basis of assessment through recast of the Sixth Directive (CVSD).

The CVSD now compiles all the provisions, which used to be included in the First and Sixth Directives. The First Directive set out the basic principles of the common VAT system, which remain an important ancillary instrument to the interpretation of the substantive rules, formerly included within the Sixth Directive. It was in the Sixth Directive that the substantive legal provisions of the EU VAT system were predominantly situated, forming what is broadly known as the “uniform basis of assessment”. Moreover, it has been the amendments introduced to the Sixth Directive which have largely determined the evolution of the entire EU VAT system. Although, an ideal VAT system is a simple VAT system, several factors have conspired to create an EU VAT basis of assessment under the CVSD which is not only extremely complex, but increasingly so.³³⁸ In fact, if the VAT system under the original version of the Sixth Directive was elaborate, the amendments and derogations which have been subsequently introduced have transformed it into an enigma.³³⁹ It was precisely acknowledgement of this fact that prompted the

336. The Second Directive would also have been included in this area, before ceasing to be in force.

337. Council Directive 91/680/EEC of 19 December 1991, OJ L376, 31/12/1991, 1; Council Directive 92/77/EEC of 19 October 1992, OJ L316, 31/10/1992, 1; and Council Directive 92/111/EEC of 14 December 1992, OJ L384, 30/12/1992, 47.

338. As J. Swinkels comments “the European VAT system is developing, but in the wrong direction”, in “Combating VAT avoidance” (2005) *International VAT Monitor* 4, 235–246, at 246.

339. See COM(2004) 246 final, 15 April 2004, n. 323 above, at 3–4.

Commission to present a proposal for the recast of the Sixth Directive, in a clear attempt to minimise the complexities of the system.

1.1.1. Amendments

The several amendments introduced to the Sixth Directive have basically been designed either to eliminate inconsistencies within the original version of the Directive,³⁴⁰ or to deal with new emerging situations, such as the development of telecommunications or e-commerce. These amendments have been largely successful in achieving this objective; however, this success came at a cost: the increased complexity of the system. This is a direct result of the legislative procedure applicable to the area of VAT: the unanimity requirement means in practice that in order to arrive to a consensus amongst Member States (which more often than not have diverging interests) exceptions, derogations and options have to be introduced into the text of each amending Directive, the most paradigmatic example of this phenomenon being the VAT transitional system.³⁴¹ As recognised by the European Parliament's Directorate General for Research:

“One of the most serious defects of the transitional VAT system is its complexity: the scope it allows for varying national interpretations of VAT law. The basic system established under the Sixth Directive is riddled with derogations, exemptions, options and special regimes.”³⁴²

1.1.2. Derogations

The possibility of introducing measures derogating from the CVSD, and prior to 2007 from the Sixth Directive, pending Council's authorisation has further complicated the functioning of the EU VAT system.³⁴³ The requirements to obtain an authorisation of this type are extremely broad,

340. In many cases, these inconsistencies were known at the time of the approval of the Sixth Directive, but political consensus had been impossible to reach and decisions were postponed until after the entry into force of the Directive. In other cases, the inconsistencies only emerged once the Directive came into force.

341. As discussed in Chapter 2 from the Council discussions on the Commission's simple (albeit controversial) proposals, emerged a complex set of rules which gave rise to a system with many types of derogating measures, most of these being “permanently temporary”, i.e., theoretically temporary, permanent in practice.

342. In *Tax coordination in the European Union*, European Parliament, Directorate-General for Research, ECON 125 EN, 12–2000, at 29.

343. See Article 395 of the CVSD (formerly Article 27 of the Sixth Directive).

and in most cases, once the request is made by a Member State to introduce a derogating measure, the Council grants the authorisation without debate. Although these derogations do not affect the common system under the CVSD directly, indirectly the overall functioning of the EU VAT system is affected. In fact, these derogations can potentially distort competition within the Community, increase legal uncertainty, and increase compliance costs, making it increasingly difficult for a trader established in a Member State to determine the VAT rules applicable in another Member State.³⁴⁴ Moreover, it is not only the complexity of the system that has increased, but also the impact that this complexity has had upon traders. Globalisation and the increased levels of international and intra-community trade amplify the negative consequences of a deficient EU VAT system, as the Commission itself has acknowledged:

“By dint of the manner in which the common system was set up (Directives leave the Member States with a lot of powers and options), divergences in its application have existed from the outset. However, the impact of these divergences has been reinforced by the fact that operators are now affected to a greater degree by legislation – and above all the manner in which it is applied – of Member States other than the one in which they are established or pursue their usual activities.”³⁴⁵

1.2. Intra-Community and international VAT refund system

The establishment of intra-community and international VAT refund arrangements is a natural corollary of the principle of the right to deduct VAT, as set out in the CVSD. These arrangements are currently set out in two legislative instruments:³⁴⁶

- the Eighth Directive for taxable persons not established in the territory of the Member State of refund, soon to be replaced by Council Directive 2008/9/EC from 2010 onwards – for intra-community VAT refunds;³⁴⁷ and,
- the Thirteenth Directive for taxable persons not established in the territory of the Community – for international VAT refunds.³⁴⁸

344. As G. de Witt rightly points out “a complicated VAT system is good for lawyers and other advisers, but is bad for business”, in “The European VAT Experience” (1995) *Tax Notes International* 10(2), 49–54, at 49.

345. In COM (96) 328 final, 22 July 1996, n. 4 above.

346. Although Article 171 of the CVSD sets out a few extra rules, namely regarding the concept of taxable person for the purposes of these Directives.

347. Eighth Council Directive 79/1072/EEC of 6 December 1979, OJ L331, 27/12/1979, 11; and Council Directive 2008/9/EC of 12 February 2008, OJ L44, 20/02/2008, 23–28.

348. Thirteenth Council Directive 86/560/EEC of 17 November 1986, OJ L 326, 21/11/1986, 40.

Although the existence of the Thirteenth Directive procedure is fundamental for the integrity of the right to deduct principle, in practice, the procedure has a restricted application, and thus, has not given rise to serious practical problems. However, the same could not be said of the Eighth Directive procedure, as the Commission recognises:

“In practice, the operation of the Eighth Directive refund procedure poses considerable problems for both traders and the national administrations of the Member States.”³⁴⁹

From the perspective of business, the Eighth Directive procedure constitutes a serious obstacle to intra-community trade.³⁵⁰ The main complaints relate to the administrative complexity and consequent costs of filling in a refund request, as well as the overall effectiveness of the system. From the perspective of national administrations, the refund procedure has proved more difficult, and thus, more costly to operate than initially expected. In this context, the inclusion of recommendations regarding the Eighth Directive procedure within the results of the second phase of the SLIM initiative did not come as a surprise.³⁵¹ As the recommendations had the support of both representatives of the national

349. In *Proposal for a Council Directive amending Directive 77/388/EEC as regards the rules governing the right to deduct Value Added Tax and Proposal for a Council Regulation (EC) on verification measures, measures relating to the refund system and administrative cooperation measures necessary for the application of Directive 98/xxx/EC*, COM(98) 377 final, 17 June 1998, at 3.

350. In fact, business surveys organised by the European Commission's Internal Market Scoreboard show that the difficulties caused by the VAT system and the VAT procedures (which include the Eighth Directive procedure) have consistently been regarded by traders as one of the main trade barriers to the Internal Market. In November 1997, VAT rules and procedures were the most mentioned obstacle to intra-community trade (*Single Market: business survey reveals cautions optimism*, Internal Market Scoreboard, 19 November 1997); in November 1998, the VAT system and procedures was still perceived as a source of concern with 28% of participating businesses considering it a barrier to intra-community trade (*Single Market: business survey reveals positive effects feeding through to companies*, Internal Market Scoreboard, 3 November 1998); similar numbers resulted from the 1999 and 2000 business surveys, with 27% and 26% respectively, considering VAT system and procedures as a barrier to intra-community trade (*Internal Market: business satisfaction grows, EU enlargement largely seen as a positive perspective*, Internal Market Scoreboard, 24 November 2000).

351. The SLIM initiative (Simpler Legislation for the Internal Market) was launched by the Commission in 1996 aimed at identifying ways in which Community and national legislation could be simplified. The second phase of SLIM, concluded at the end of 1997, dealt with EU VAT legislation. The results of this second phase were published in the *Report from the Commission to the Council and the European Parliament on the results of the second phase of SLIM and the follow-up of the implementation of the first phase recommendations*, COM(97) 618, 24 November 1997. For a more detailed analysis of the SLIM initiative, see H. Xanthaki, “The SLIM initiative”, (2001) *Statute Law Review* 22(2), 108–118.

administrations and businesses, the Commission decided to follow-up on them, and in 1998 presented two complementary proposals aimed at reforming the rules governing the right to deduct VAT.³⁵² These proposals, amongst other measures, advocated the abolition of the Eighth Directive procedure and its substitution by a new scheme under which taxable persons established in the Community could deduct the VAT paid in a Member State where they are not established from their periodical VAT returns. However, the Council was unable to reach an agreement regarding these proposals, and six years later, the Eighth Directive procedure was still the applicable method for the deduction of VAT incurred by a taxable person in a Member State other than the one where it is established. In this context, the Commission has put forward in 2004 an alternative proposal with a view to modernising the current refund system laid down in the Eighth Directive without changing its fundamental principles.³⁵³ This proposal, which was part of the VAT package, was finally approved in February 2008, and the new legislation is due to come into force in January 2010. Amongst the most important innovations introduced by Directive 2008/9/EC are the facts that the refund applications should now be submitted in electronic form, and although addressed to Member State of refund, submitted to the Member State of establishment.³⁵⁴

1.3. The statistical system, administrative cooperation, and training measures: Intrastat, VIES, and fiscalis

The third and fourth areas of the EU VAT system are, respectively, the statistical system, which basically includes all Intrastat related legislation, and the administrative cooperation, which includes not only the administrative cooperation legislation *stricto sensu*, but also the legislation regarding training programmes such as Fiscalis.

1.3.1. Intrastat

As discussed in Chapter 2, the system of collecting statistics on the trading of goods between Member States of the European Union, known

352. See COM(98) 377 final, 17 June 1998, n. 306 above.

353. COM(2004) 728 final, 19 October 2004, n. 95 above.

354. Articles 7, 8, and 9 of the Directive.