



EUROPEAN
COURT
OF AUDITORS

Background paper



Collection of VAT and customs duties on cross-border e-commerce

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The European Union encourages e-commerce: its goal is to ensure that businesses and consumers can buy and sell internationally on the internet as they do on their local markets.

However, e-commerce is prone to irregularities concerning VAT (Value Added Tax) and customs duties. Such irregularities directly affect the Member States' budgets and, indirectly, the European Union's (by reducing the Member States' customs duties and VAT-based contributions).

While the single market abolished border controls for intra-EU trade between Member States, customs controls are still applied at the Union's external borders, and all non-EU goods entering each Member State are subject to these. Services provided digitally from outside the EU represent a particular risk in this regard: such services do not physically cross any border and are not subject to the same controls as goods entering the EU.

The ECA is currently conducting an audit on whether the EU is addressing effectively the challenges posed by e-commerce in terms of VAT and customs duties. In particular, we will examine the Commission's regulatory and control framework for e-commerce and the cooperation between Member States to ensure the completeness of the collection of VAT and customs duties on e-commerce transactions.

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CHALLENGES OF E-COMMERCE IN TERMS OF VAT AND CUSTOMS DUTIES' COLLECTION

The European Union (EU) encourages e-commerce: its goal is to ensure that businesses and consumers can buy and sell internationally on the internet as they do on their local markets. Up to now, however, the collection of VAT and customs duties in cross-border e-commerce has been prone to irregularities. In particular, e-commerce is open to abuse by non-EU suppliers, putting EU traders at a disadvantage.

The EU's new 'e-commerce package', proposed by the European Commission on 1 December 2016 and adopted by the European Council at the end of 2017, is aimed at addressing these issues. The package of legislation was drawn up within the framework of the Strategy for the EU Digital Single Market. On the VAT e-commerce proposal, first reforms will come into effect on 1 January 2019. Other measures will come into place in 2021.

Collection of VAT and customs duties in e-commerce: the EU's current arrangements

The EU's current arrangements for collecting e-commerce VAT and customs duties differ between goods and services.

For **EU-registered traders** supplying goods from one Member State to a consumer in another, the '*distance-selling scheme*' applies. This means that, up to a certain sales threshold (usually €35 000, but €100 000 in some Member States), the trader applies the VAT rate of the Member State where it is registered. Above this threshold, the trader must register for VAT in, and apply the VAT rate of, the destination Member State (thereby incurring also all the reporting and compliance obligations).

In the case of **non-EU traders** selling to EU consumers, goods are imported into the EU and are subject to custom clearance. There is a low-value customs relief for goods worth €150 or less (small value consignments), meaning that no customs duties are due on import. There is also a VAT relief for goods of negligible value – those not exceeding €22 in value (or €10 in certain Member States) are not subject to import VAT.

E-commerce services supplied by a business to private consumers ('B2C supply') are subject to the '*destination principle*', meaning they are subject to VAT at the rate applicable in the consumer's country of residence. The destination principle has applied to B2C supplies of digital services from a non-EU country to EU consumers since 2003. As of the beginning of 2015, the same principle applies to e-commerce services provided by an EU supplier to a consumer in another Member State. Previously, such services had been subject to the VAT rate of the supplier's country of residence.

ISSUES WITH THE CURRENT ARRANGEMENTS FOR COLLECTING VAT AND CUSTOMS REVENUE ON E-COMMERCE

There are a number of issues with the current arrangements for collecting VAT and customs duties on e-commerce for both goods and services.

Reliance on traders cooperating voluntarily

One general issue – for both goods and services supplied by both EU and non-EU traders – is that the existing set-up essentially relies on traders' willingness to voluntarily register and pay the due VAT. A 2014 report by Germany's Supreme Audit Institution highlighted this issue and found that there are a large number of non-EU traders who do not pay VAT on the internet services which they provide¹.

Risks in legal framework and cooperation arrangements

Member States have no enforcement powers outside their own jurisdiction, especially in relation to non-EU traders. This makes it difficult for them to ensure the completeness of the collection of VAT/customs duties in the Member State where the goods and services are ultimately consumed (the 'Member State of consumption').

Moreover, there is the risk that tax and customs authorities in the Member State of consumption will not use the administrative cooperation arrangements to request information from the country or countries where the supplier is registered or identified. Without such information exchanges, tax/customs authorities in the Member State of

consumption cannot be aware of the untaxed transactions. Moreover, business-to-customer transactions are not covered by the VAT information exchange system (VIES), an electronic network for transmitting VAT information both on valid VAT identification numbers of companies registered in the Member States, and on tax-exempt intra-EU supplies.

Another risk might be that the tax authorities of the country of registration (or the Member State of identification) have little incentive to carry out proper checks on suppliers because any VAT discovered belongs to the Member State of consumption. In 2015, the Lithuanian National Audit Office (SAI) conducted an audit on e-commerce, covering the changes introduced by the 'Mini One Stop Shop'² (MOSS) for traders supplying e-commerce services since the beginning of the year. The main problem the Lithuanian SAI identified is that the VAT owed to the Member State of consumption is not checked in the Member State of identification, whereas the Member State of consumption has limited opportunities to carry out such checks³.

Risk of non-compliance

This reliance on traders' cooperation leaves the system open to various forms of non-compliance. In the case of the distance-selling scheme, one risk is that suppliers might not register in the destination Member State if their sales there are above the relevant threshold. Another risk, given that differences in VAT rates between Member States potentially make fraud on distance sales advantageous, is of suppliers underreporting sales VAT in order to remain under the threshold and avoid charging the higher VAT applicable in the destination Member State. This would allow suppliers based in Member States with lower VAT rates to unfairly undercut those in Member States with higher VAT and lead to lost revenue for the national budgets.

Because enforcing the registration in MOSS is difficult, the risk likewise exists of non-EU suppliers not registering for VAT in any Member State in order to avoid charging and paying VAT on the services they provide. Even if they do register in a Member State of identification, there is still a risk of them under-declaring VAT or not declaring it at all. This reduces national budget revenue and allows non-EU suppliers to undercut EU-registered suppliers.

The VAT and customs exemptions for low-value consignments potentially encourage another form of non-compliance: the systematic undervaluation of goods on import declarations for the purposes of evasion. In a special report last year⁴, we pointed to evidence from one Member State, suggesting that imports from the Far East were being massively undervalued by a factor between 10-100 times the correct valuation.

Lost VAT revenue

In terms of the EU as a whole, a 2016 study by a Danish consultancy firm likewise points to gaps in the system⁵. According to the study, VAT is levied on only 35 % of postal imports, and these gaps translate directly into a loss of VAT revenue of approximately €1.05 billion. It estimates additional losses of €0.25 billion from gaps in the collection of import duties. The European Commission, meanwhile, estimates the overall VAT losses in cross-border e-commerce resulting from the exemption of low-value consignments to be as high as €5 billion per year⁶.

EU POLICY AND LEGAL FRAMEWORK

Legal framework

In general terms, EU customs law is laid down in the Union Customs Code⁷, while VAT is governed by the EU VAT Directive⁸.

A new package of specific EU legal provisions governing VAT in e-commerce, the 'e-commerce package', was adopted at the end of 2017. This represents the first attempt to address directly in legislation the issue of VAT and customs duties in e-commerce. The package consists of three legal acts⁹ and introduces the following changes:

- It allows micro-businesses and start-ups to tax their supplies of e-commerce services not exceeding the threshold of €10 000 according to the 'origin principle', i.e. at the rate of the Member State of origin, not the Member State of destination.

- It allows e-sellers to apply the invoicing rules of their Member State of identification instead of the rules in force in the Member State of destination, as they currently do.
- It extends the MOSS system to all cross-border B2C supplies of services and to online B2C sales of goods, whether from an EU or non-EU country.
- It abolishes the VAT relief for items not exceeding a total value of €22 (or €10) purchased online and imported from a non-EU country.

Some of these changes will come into effect from 1 January 2019, while the rest will only apply from 1 January 2021.

Relevant EU policies and strategies

The most relevant strategic document is the action plan on VAT¹⁰ published by the Commission in 2016, aimed at creating a single EU VAT area. The action plan recognises that the boom in e-commerce requires a new approach to collecting VAT, and it comprises several urgent and medium-term measures to this end, including setting up a definitive VAT regime for intra-EU trade in order to tackle 'missing trader fraud'¹¹.

The plan forms part of the Commission's Digital Single Market strategy¹². Its main aim is to make the EU's VAT system simpler, more fraud-proof and more business-friendly, providing for the following improvements in respect of VAT on e-commerce:

- strengthening cooperation in the fight against fraud within the EU and with non-EU countries;
- introducing a common EU-wide simplification measure (VAT threshold) to help small e-commerce start-up businesses;
- allowing for home-country checks, including a single audit of cross-border businesses;
- removing the VAT exemption for imports of small consignments from non-EU suppliers.

- extending the One Stop Shop mechanism to EU and non-EU countries online sales of tangible goods to final consumers;
- a definitive VAT regime for intra-EU trade based on the destination principle

ROLES AND RESPONSIBILITIES

European Commission

DG TAXUD

The Directorate General for Taxation and the Customs Union (DG TAXUD) is responsible at a strategic and legislative level for customs and taxation policy, including in relation to e-commerce. Its remit includes developing and managing the Customs Union, and developing and implementing tax policy across the EU. It prepares legislative and strategic initiatives and coordinates cooperation and information sharing between Member States.

DG TAXUD also chairs the Customs Policy Group (CPG), which supports the implementation of the Customs Union and is composed of the Directors-General of the 28 national customs authorities.

DG BUDG

The Directorate General Budget (DG BUDG) is responsible for conducting inspections in relation to 'own resources', a form of revenue made available to the EU budget by the Member States, which includes VAT and customs duties on imports from outside the EU.

The European anti-fraud office (OLAF)

The European anti-fraud office, OLAF, is responsible for investigating fraud, corruption and other offences against the EU's financial interests in relation to some areas of EU revenue, mainly customs duties.

Member States

Member States are primarily responsible for implementing the control system to ensure the registration of EU and non-EU traders in the MOSS system. In addition, each Member State is responsible for putting in place its own risk management framework for controls on distance-selling and low-value imports. Since there is no common framework at EU level, different approaches in the various Member States may lead to different results.

Member States are also responsible for collecting the VAT paid by traders registered in the MOSS system and transferring the collected amounts to other Member States where they are due.

MAIN ISSUES IDENTIFIED WHEN PREPARING THE AUDIT

When preparing our audits, we carry out an issue analysis of the policy area or programmes that we intend to examine. Since these issues are identified before the audit work commences, they should not be regarded as audit observations, conclusions or recommendations.

In the course of our audit on VAT and custom duties in e-commerce, we will look at a number of areas related to these issues. In particular, we will examine whether:

- the Commission has established a sound regulatory and control framework on e-commerce with regard to the collection of VAT and customs duties;
- the Member States' control measures help ensure the complete collection of VAT and customs duties in respect of e-commerce.

ABOUT ECA SPECIAL REPORTS AND BACKGROUND PAPERS

The ECA's special reports set out the results of its audits of EU policies and programmes or management topics related to specific budgetary areas.

Background papers provide information in relation to an ongoing audit task. They are based on preparatory work undertaken before the start of the audit and are intended as a source of information for those interested in the policy and/or programme being audited.

If you wish to contact the team in charge of this audit, please do so through the following e-mail address: ECA-e-commerce-VAT-audit@eca.europa.eu.

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- ¹ Bundesrechnungshof, Spring report 2014 on federal financial management in 2013.
<https://www.bundesrechnungshof.de/en/veroeffentlichungen/bemerkungen-jahresberichte-en>
 - ² Under the 'Mini One Stop Shop' (MOSS) system, traders supplying e-commerce services charge VAT at the rates applied in the Member States where their customers actually consume their services (the 'Member State of consumption'). However, they can register to pay VAT in any Member State of their choice (the 'Member State of identification') and submit a single VAT return there, listing all services supplied to each Member State of consumption and paying the relevant VAT on these. The Member State of identification then transfers the VAT owed to each Member State of consumption. The MOSS applies to both EU-registered and non-EU traders.
 - ³ Lithuanian National Audit Office (SAI), Executive summary of the public audit report Electronic commerce control, 30 April 2015 No. VA-P-60-12-:
http://www.vkontrolė.lt/audito_ataskaitos_en.aspx?tipas=15
 - ⁴ European Court of Auditors, Special Report 19/2017: "Import procedures: shortcomings in the legal framework and an ineffective implementation impact the financial interests of the EU", paragraph 137.
 - ⁵ Copenhagen Economics, *E-commerce imports into Europe: VAT and customs treatment*, 2016.
 - ⁶ European Commission, 'Proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods', COM (2016) 757 final, 1.12.2016.
 - ⁷ Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code; amended by Regulation (EU) 2016/2339 of the European Parliament and of the Council of 14 December 2016 amending Regulation (EU) No 952/2013 laying down the Union Customs Code, as regards goods that have temporarily left the customs territory of the Union by sea or air.
 - ⁸ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.
 - ⁹ Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods (OJ L 348 of 29.12.2017, p. 7); Council Implementing Regulation (EU) 2017/2459 of 5 December 2017 amending Implementing Regulation (EU) No 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax (OJ L 348 of 29.12.2017, p. 32); Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax (OJ L 348 of 29.12.2017, p. 1).
 - ¹⁰ European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT: Towards a single EU VAT area - Time to decide, COM(2016) 148 final, 7.4.2016.

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- ¹¹ 'Missing trader fraud' refers to a system whereby a trader is registered for VAT purposes who, potentially with a fraudulent intent, acquires or purports to acquire goods or services without paying VAT, and supplies these goods or services with VAT, but does not remit the VAT collected to the national tax authority.
- ¹² European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A Digital Single Market Strategy for Europe COM (2015) 192 final, 6.5.2016.