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HARMONIZATION OF INDIRECT TAXATION AND THE CREATION OF THE INTERNAL MARKET

TILL MÜLLER-IBOLD*

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I. IMPORTANCE OF INDIRECT TAXES FOR EUROPE

Matters of taxation seem to be an important issue with respect to any state. The right to tax and the question of who determines the right to tax have always been at the center of the political debate. For example, in England the Crown and Parliament have struggled over the control of taxes¹ and in the U.S. it took much debate and a constitutional amendment² to enable the federation to levy meaningful taxes.

1. See O. HOOD PHILLIPS, *THE PRINCIPLES OF ENGLISH LAW AND THE CONSTITUTION* 256-259 (London 1939); E.C.S. Wade, G. Godfrey Philips, *CONSTITUTIONAL LAW* 36-38 (7th ed. 1965) (citing *Bates' Case*, 2 St. Tr. 371, K. L. 48 (1606); *The King v. Hampden*, 3 St.Tr. 825, K.& L. 50 (1637)).

2. U.S. CONST. amend. XVI; see *Springer v. United States*, 102 U.S. 568 (1880), *Pollock v. Farmers Loan Trust Co.*, 158 U.S. 601 (1895), *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911); see generally LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW*, at 318 (2d. ed. 1988).

Similar controversies and developments are taking place in the Member States of the European Community.³ The Treaty of Rome⁴ (the "Treaty") devotes a whole subchapter to the problems of taxation.⁵ However, the subchapter does not permit the EC to levy taxes.⁶ The rules are designed to avoid distortion of competition caused by the tax rules of the Member States. It was clear from the beginning that a harmonization, especially of indirect taxes, was necessary because of the trade and competition distortions created by the existing differences between the Member States. Such distortion was incompatible with the basic principles and major goals of the Common Market.⁷

The European Economic Community (EEC) enacted several directives⁸ to harmonize indirect taxes, especially the Value Added Tax (VAT). The implementation of these measures led to a series of questions which concern fundamental constitutional principles of community law. The notion of supremacy of EEC law, the immediate applicability of both "primary" and "secondary" EEC law,⁹ including Directives, and related questions gave rise to a series of disputes which began in the early 1960's¹⁰ and are still ongoing.¹¹ At the same time, VAT-related cases raised issues concerning the power and competence of the European Court of Justice.¹²

The intense discussion and great attention devoted to all these

3. For a very detailed discussion of the recent political and technical arguments by Member States and the academic world with respect to the harmonization of the rules on taxation, see *Fédération Internationale pour le droit européen*, 14e Congrès, Madrid, Vol. II, *L'harmonisation fiscale: le Défi de 1993*, Madrid, 1990 [*hereinafter* FIDE 1990] (in particular, the general report of Chairman Prout, p. 283).

4. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY]; see also T.M.C. ASSER INSTITUUT, *GUIDE TO EEC LEGISLATION*, Suppl. 1987.

5. EEC TREATY, Art. 95.

6. EC resources are levied on the basis of a decision pursuant to EEC TREATY, Art. 201.

7. *Id.* at Arts. 2-3.

8. See, K.R. SIMMONDS, *ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW*, Vol. B., 10-228 (1974).

9. Primary EEC Law is the law of the Treaties themselves, secondary legislation comprises all the enactments created by the community institutions themselves, based on the Treaties.

10. See, e.g., Case 26/62, *Van Gend & Loos v. Nederlandse administratie der belastingen*, 1962 E.C.R. 1; Case 6/64, *Costa v. ENEL*, 1964 E.C.R. 585, 593.

11. See Case 148/78, *Ministero Publico v. Ratti*, 1979 E.C.R. 1629; Case 8/81, *Becker v. Finanzamt Münster Innenstadt*, 1982 E.C.R. 53 (decision of the court at 70 record 17, 74 record 41).

12. A decision of the German Bundesfinanzhof (BFH) is a good example, see *Rijkele Betten and Servaas Van Thiel, Direct Effect of Sixth VAT Directive Denied*, 26 *European Taxation* 22 (1986); The Bundesverfassungsgericht has explicitly overruled this decision (Judgement of Oct. 22, 1986, 73 BVerfGE 339, 366) See 25 *COMMON MKT. L. REV.* 201 (1988).

issues reflects the fact that the fiscal borders were a major¹³ obstacle to the creation of the internal market. For many Member States indirect taxes were a major source of revenue. Any European Community (EC) interference with those taxes was, therefore, a substantial limitation on their sovereignty. On the other hand, up to 1.4% (originally 1.0%) of the taxable basis of the VAT is part of the "own resources" which finances the EC.¹⁴ Therefore, the EC had a vital budgetary interest in the matter as well.

The following analysis of the development of harmonization of indirect taxes in the EC will include six steps. First, the general powers and the legislative history of the EC with respect to indirect taxes will be considered. In a second part, the pre-1993 VAT system will be described, and the incompatibility of that system with the notion of an internal market will be analyzed. The third part will describe how the intended definitive and the adopted transitional VAT system will deal with these issues as of January 1, 1993 and discuss proposals (including the original proposals of the Commission)¹⁵ in this respect. Then, in a fourth part, problems and proposals with respect to the harmonization of excise duties will be discussed. The adopted new rules will be discussed in a fifth part. The sixth part contains the final evaluation and puts the total package on indirect taxes into perspective with respect to the developments relating to the establishment of the internal market as a whole.

13. A decision of the German Bundesfinanzhof is a good example, see Judgement of 25.4.1985, 26 [1986] *European Taxation* 22. The Bundesverfassungsgericht has explicitly overruled this decision (Judgement of 22.10.1986, 73 BV34fGE 339 (366 et seq.) See 25 [1988] *CMLRev* 201.

14. 1985 O.J. (L 128) 15, art. 3(2) (council decision 85/257/EEC, EURATOM, on the Communities' system of own resources May 7, 1985); 1970 O.J. (L 94) 19 (the own resources were originally introduced by council decision 70/243/ECSC/EEC/EURATOM on the Communities' own resources).

15. Completing the Internal Market: White Paper from the Commission to the European Council, COM(85)310 final; Completion of the Internal Market: approximation of indirect tax rates and harmonization of indirect tax structures, COM(87)320 final; Proposal for a Council directive supplementing the common system of VAT and amending Directive 77/388/EEC: Approximation of VAT rates, COM (87)321 final; The introduction of a VAT clearing mechanism for intra-community sales, COM(87)323 final; Proposal for a Council Directive instituting a process of convergence of rates of value added tax and excise duties, COM(87)324 final.

II. LEGAL BASIS AND POLITICAL IMPORTANCE

1. The Goals of the Common Market

The EEC is not an omnipotent state, but a supranational organization, whose powers are limited.¹⁶ The Treaty must authorize the exercise of lawmaking powers. According to Art. 2, the main goal of the Treaty is the creation of the common market. This common market should have all the characteristics of a national market.¹⁷ The activities which in the eyes of the drafters of the Treaty would lead to the establishment of such a market are spelled out in Art. 3 of the Treaty:

For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein

- a) the elimination, as between Member States, of customs duties and of quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect;
- f) the institution of a system ensuring that competition in the Common Market is not distorted;
- h) the approximation of the laws of Member States to the extent required for the proper functioning of the Common Market;

2. Taxation-related Problems for the Creation of an Internal Market

The necessity for the EC to act is a result of the possible effect that taxation - particularly indirect taxation - has on the creation of the internal market. The goal is to create conditions which will allow the movement of goods, persons, and capital as if there were no boundaries among the Member States. The first main step towards the creation of such conditions was the creation of the customs union.¹⁸ Among the Member States no duties, tariffs or quantitative restrictions are to be applied. However, the Member States remained free in principle to regulate taxation. Therefore, border controls did not disappear. At all times since the creation of the EC, the Member States have used the old borders for the purpose

16. Gert Nicolaysen, *Principe de Competence d'Attribution*, *Europaisches Gemeinschaftsrecht* 43 (Stuttgart 1979); Beutler, Bieber, Pipkorn, Streil, *Europaisch Gemeinschaft-Rechtsordnung und Politik* 75 (Baden-Baden 3rd.ed. 1987).

17. *See*, EEC TREATY, Art. 8(a).

18. *Id.*, at Arts. 3, 9, 12.

of tax clearance and tax adjustments.¹⁹

Originally, the Member States used a variety of turnover and excise taxes.²⁰ In most cases these were only applicable to national consumption. In case of export, any tax levied would be reimbursed. At the same time a wide variety of turnover tax systems were used. All were based on the idea that only national consumption would be burdened. Many of the systems operated on the basis of a cascade-type turnover tax.²¹ Any particular transaction would be burdened with a specific tax rate. On the next production stage, the price would already include some tax. But again, the tax would be levied on the product without discount, yet the particular tax burden of a product would be compensated upon export. Similar rules applied to excise duties, but the duties would not become due if the goods were exported or until the goods were removed from bond.

The tax compensation systems created a certain dilemma. On the one hand, they were necessary to avoid distortion of competition. The tax burden a particular product would carry depended, to a great extent, on the tax structure of the particular Member State. It also depended on the structure of the company, since highly vertically integrated corporations created less taxable commercial turnover than several independent companies operating one after the other.²² In order to limit the impact of the tax differential, it was considered better to allow each country to reimburse the product-related (indirect) taxes upon export and to permit the country of importation to levy the same indirect tax upon import at rates similar to the burden sustained by a national product of the same kind.

On the other hand, the inherent danger of the tax compensation is that export subsidies are hidden or that tax compensation upon imports turns out to be a hidden import duty or import restriction. The difficult problems of establishing the exact tax burden of a particular product, which had on previous production stages been subject to the cascade-type turnover tax, made just

19. The borders are also used for immigration and health control (phytosanitary checks).

20. See S. Van Thiel, *Harmonization of Turnover Taxes in the European Communities: Towards the Internal Market without frontiers*, 28 *EUROPEAN TAXATION* 77 (1988) (Footnote 4).

21. France had already introduced a certain kind of VAT, which was, however, different from the system now in effect. See, *Id.* at footnote 4.

22. *Id.*

compensation even more difficult.

These difficulties are reflected in Articles 95 - 99 of the Treaty. Article 95 prohibits levying taxes on products originating in other EEC Member States which are higher than the taxes on comparable domestic products and taxes designed to protect competing domestic production.²³ Articles 96 and 98 prohibit the refund of domestic direct taxes and of indirect taxes insofar as the refund is greater than the actual tax burden for a particular product. Special consideration was given to the formerly existing cascade turnover tax systems. Since it is difficult to determine which tax burden is placed on any particular product, Member States were permitted by virtue of Article 97 to refund cascade turnover taxes on the basis of the burden of average products.

This system assured a certain tax neutrality. Yet, the neutrality was achieved at the expense of using border adjustments. Therefore, the borders were a necessary element of the system and could not disappear. It was understood that further steps would be necessary to create a system which would be more adequate with respect to the general goal of creating a common market (now more commonly referred to as "internal market"). Such a new system would have to be based on a harmonization of the Member States' substantive tax laws.

Article 99, in its original version, permitted the Commission to "consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation, including countervailing measures applicable to trade between Member States, can be harmonized."²⁴

Later, when political forces decided to reinforce their efforts towards a single market, it was believed that the mere reference to possible "considerations" of the Commission was perhaps insufficient. The Single European Act²⁵ - a comprehensive amendment of the Treaty - had as its overall goal the establishment of a single

23. Case 27/67, *Fink Frucht v. Hauptzollamt München*, 1968 E.C.R. 223; Case 170/78, *Commission v. United Kingdom*, 1980 E.C.R. 417; Case 169/78, *Commission v. Italy*, 1980 E.C.R. 385; SMIT, HERZOG, *THE LAW OF THE EUROPEAN ECONOMIC COMMUNITY - A COMMENTARY ON THE EEC TREATY*, ART. 95.03.

24. The question whether a harmonization of direct taxes is excluded by the wording of Art. 99 cannot be discussed here. Most authors believe that a harmonization is possible on the basis of Arts. 100, 101 or 235; *See also*, Smit, Herzog at 3- 460.23.

25. Single European Act of 28 February 1986, *Bulletin of the European Communities*, Suppl. 2/1986. *See also*, T.M.C. Asser, *Guide to EEC Legislation*, Suppl. p. xxxi (1987).

internal market by the end of 1992. Apart from institutional and other policy reforms, the Act replaced the old Article 99 by a new, more forceful version:

The Council shall, acting unanimously²⁶ on a proposal from the Commission and after consulting the European Parliament, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market within the time limit laid down in Art. 8A.²⁷

It is important to realize that the legislative tool used for the harmonization is and has always been the directive.²⁸ Directives are a form of enactment which are not directed to the individual, but to the Member States. The Member States, in turn, have the obligation to adapt their legislation to the contents of the particular directive.²⁹

3. The Historic Development of the Harmonization

Since the Treaty provisions by themselves created a workable customs union and limited the distorting effects of fiscal differences between the Member States, the EC was able to live with the situation for some time. Once the EC was established, intensive negotiations began in order to solve the problems created by the fiscal differences.³⁰

26. The Commission's original proposal called for a qualified majority (Bulletin of The European Communities, 9/85 p. 10-14); however, the intergovernmental conference insisted on unanimity, which had been necessary under the original version of ART. 99 EEC TREATY as well. See, G. Montagnier, *Fiscalité*, 24 REVUE TRIMESTRIELLE DE DROIT EUROPEEN [RtDE] 518, 531 (1988).

27. The reference to Art. 8A EEC Treaty is of particular importance. Art. 8A EEC Treaty, also introduced by the Single European Act, contains the famous 1992 time limit: "The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992, in accordance with the provisions of . . . this Treaty.

The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

28. See, K.R. SIMMONDS, *ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW*, Vol B. 10-228 (1989) (Looseleaf).

29. ART. 189 EEC TREATY states:

"A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. . ."

30. See, Chr. Prout, *Federation Internationale pour le Droit Europeen* [FIDE] p. 283,

The first objective was to eliminate the remaining lack of precision associated with the average border adjustments. The idea was to find a common turnover tax system that would leave the "average" adjustment procedure of Article 97 inapplicable. The system, ideally, would allow export refunds which would correspond precisely to the tax burden of the particular product and taxation upon import which would burden the imported product with the same tax as would be levied on a similar national product.

The Member States agreed that the VAT System would be the most appropriate solution to the problem. As a result, the First and Second VAT Directives were adopted.³¹ They provided for the abolition of the cascade-type turnover tax and for the introduction of a common "value added tax" system. The basic features of a VAT system were laid down.³² Any taxable person would have the duty of charging and collecting the tax on his customers while being able to offset any VAT he had paid to his suppliers.

Ten years after the introduction of the VAT, a second major step was taken. The Sixth Directive³³ harmonized the taxable basis, leaving only the tax rate to the discretion of the Member States. This step was not only important for the own resources of the European Community Revenues, part of which were from then on to be calculated on the basis of the VAT,³⁴ but it also eliminated most of the remaining actual tax differences between the economic operators in the different Member States. In addition, this step prepared the ground for a possible tax rate harmonization which was seen as a prerequisite to the relinquishing of tax borders.

A further step towards harmonization concerned different administrative procedures. Certain import/export documents were standardized,³⁵ which allowed the usage of the documents in any

287 (Madrid 1990); see also, P. Guieu, *L'élimination des barrières fiscales et l'harmonisation de la TVA*, REVUE DU MARCHÉ UNIQUE EUROPÉEN [RMU], 11, 13 (1992).

31. Council Directive 67/227 of 11 April 1967 Harmonizing the Legislation on Turnover Taxes, 1967 J.O. 1301; Council Directive 67/228 of 11 April 1967 on the Harmonization of the Turnover Tax Laws of the Member States (application of common system of VAT), J.O. 1967, 1303.

32. For a detailed analysis of the functioning of the VAT, see *infra*, Section III.

33. Council Directive 77/388 of 17 May 1977 Harmonizing Turnover Taxes in the Member States, O.J. (L 145) 1.

34. See *infra*, Section II(4).

35. The T1 and T2 documents were created first, and later the single administrative document was established. See Council Directives 85/678 and 85/679/ of 18 February 1985, O.J. (L 79) 1; see also, P. Guieu, C. Bonnet, *Completion of the Internal Market and Indi-*

language throughout the Community. This made it possible to reduce the border to only a checkpoint with respect to the actual export of the goods, allowing for an adjustment procedure at the place of destination (inland customs).

Excise taxes posed less of a problem in a system of border adjustments because it was relatively easy to determine what the tax burden was for a particular product. Unlike turnover taxes, which are charged several times during the process of production and distribution, excise duties are generally levied only once, at the time the goods are released from bond.

As long as tax neutrality was based upon border adjustments, the system worked well. However, the Commission began to propose harmonization of excise taxes as early as 1967. Like the approach followed for the VAT harmonization, the Commission first planned on harmonizing the tax structure. It planned to abolish most excise taxes, concentrating harmonization efforts on:

- tobacco products
- alcoholic beverages, and
- mineral oils

Little progress was made at first. Only recently, and just in time to meet the 1993 deadline, have the necessary measures been adopted, including an agreement on certain minimum tax rates.³⁶

4. The VAT and the Communities' Own Resources

The EC revenue consisted originally of mandatory contributions of the Member States. This system of financing the EC was completely modified by the "Decision on the Replacement of Financial Contributions from Member States by the Communities own Resources."³⁷ The Decision created a set of own resources of the EC. Those resources consisted mainly of the revenues created by the common external customs duties and a share of the taxable basis of the VAT. The VAT was used for this purpose because it was considered to be an adequate measure of the economic activity in each Member State. It was also the only existing tax which was

rect Taxation, 25 JOURNAL OF COMMON MARKET STUDIES [JCMSt] 209, 212 (1987).

36. See *infra*, Section VI.

37. Council Decision 85/257 of 21 April 1970, 1970 O.J. (L 94) 1; now replaced by Council Decision 70/243 of 7 May 1985, 1985 O.J. (L 128) 15.

widely harmonized throughout the EEC.³⁸ The Decision was in fact a formal amendment of the EEC Treaty.³⁹ It is noteworthy that this amendment has elevated the existence and the need for the existence of the VAT throughout the Common Market to the Communities' constitutional level.⁴⁰ It is hardly a surprise that the Communities have since considered the VAT to be of particular importance for the continuation of the integration process.

5. Summary

The development of the VAT within the Common Market can be summarized as follows: Originally the Member States of the Common Market applied a variety of cascade turnover tax systems. Their trade-diverting and competition-distorting effect could only roughly be corrected by the original Treaty provisions themselves.

In order to achieve a more equal treatment of traders and consumers, the common VAT system was created. The harmonization efforts have gone through four steps, with one additional step yet to come. In the beginning, a general system was created leaving many details to the Member States as to which transactions were to be included in the system. In the second major step, the tax structure was harmonized on the Community level to the extent that the taxable basis of the VAT was basically identical throughout the EEC. This became especially important once own resources of the Community were derived from this common taxable basis. The third step was the implementation of certain administrative measures which reduced the paperwork for all involved and made the operation of the system more suitable for the needs of businesses. Step four (the introduction of the transitional system) has

38. See, the second to last recital of the preamble of Decision 70/243, 1970 O.J. (L 94) 1.

39. Note that it is not a decision in the sense of Art. 189 (II) EEC Treaty, but is by reference to Art. 201 para. 3 EEC Treaty, which requires ratification by the member states (creating a special amendment procedure to the Treaties, deviating from the normal Art. 236 EEC Treaty procedure).

40. The laws of the treaties including the particular amendments are generally considered to be the Constitution of the EC. This has some implications for the interpretation of the treaties, which are not to be treated as simple international treaties as commonly known in public international law. For further reference see, Eric Stein, *Lawyers, Judges, and the Making of a Transnational Constitution*, 75 AJIL 1 (1981); Lord Mackenzie Stuart, *The European Communities and the Rule of Law*, The Hamlyn Lectures, p. 63 (London 1977); Gert Nicolaysen, *Ansichten zur Gemeinschaftsverfassung*, EUROPARECHT 299 (1987).

just been completed and step five (the introduction of the definitive system) is still to follow.

III. THE VAT SYSTEM UNTIL DECEMBER 31, 1992⁴¹

1. The Basic Characteristics

The basic features and the working mechanism of the pre-1993 VAT system are best explained using an example. Please refer to Example I of the Annex, which contemplates a series of transactions leading from the importation of goods by the manufacturer to the ultimate sale of the goods produced to the consumer. In the somewhat limited world of this example only two things are supplied to the seller at each stage of the commercial transaction: office supplies and accounting services. In Example I, all transactions are carried out in Country A of the EEC, whose tax rate is 14%.

The first transaction concerns the importation of the raw material, worth 1.000,- (fourth column). Import transactions were always taxable events;⁴² therefore, the producer paid an Import VAT of 140,-. In order to process his goods, he only needs office supplies (second column) and the services of an accountant (third column). Both charge 100,- for their supply or service, each adding 14% (= 14,-) VAT.

These three transactions represent the basic taxable events of the pre-1993 VAT system. Importation, supply of goods, and supply of services are the events which are taxable. While imports are taxable in any case, the supply of goods or services is only taxable if a "taxable person" (*i.e.*, an entrepreneur acting in his business capacity) is supplying the goods or services.⁴³

The manufacturer sells his product in turn to the wholesaler for 2.000,-. This sale (supply of goods) is a taxable event and the producer requires his customer to pay 14% (= 280,-) as VAT on top of the 2.000,-. The seller receives the VAT (280,-) on behalf of the tax authorities. Before turning the money over to the government, another important VAT feature comes into play - the right

41. References to the Sixth Council Directive in this section are references to the Directive in the form applicable before December 31, 1992.

42. Council Directive 77/388 on the Harmonization of Turnover Taxes among the Member States, art. 2, para 2, 1977 O.J. (L 145) 1 ["Sixth Directive"]; *See also*, Section III(4) for the special treatment of certain intra-community transactions of non-taxable persons after the Gaston Schul decision of the European Court of Justice (ECJ).

43. *Id.*

of deduction. The taxable person may, before it pays any VAT proceeds to the government, deduct all business-related VAT expenses. The calculation of the manufacturer is as follows:

280,-	[received from wholesaler]
./140,-	[VAT paid upon import]
./ 14,-	[VAT paid to office supply]
./ 14,-	[VAT paid to Accountant]
=112,-	[Amount to be paid to the Government]

Note, that the manufacturer bought his raw material for 1.000,-. His costs in this limited world consisted only of the 200,- paid for the office supply and for the accountant. Since he sells his product for 2.000,-, the manufacturer added 800,- in value to the product. If one applies the tax rate of 14% to this value added, the result is also 112,-. This demonstrates why the tax is called value added tax. The tax is designed to be a tax on the value that is added to a product throughout the entire production and distribution process.⁴⁴

The wholesaler sells the good to the retailer for 3.000,- + 420,- (= 14%) VAT. He too spends 200,- + 28,- VAT for his supplies. Deducting his VAT expenses, he pays 112,- to the government coinciding with the 800,- added value. The retailer acts in a similar manner. He sells for 4.000,- + 560,- to the consumer, deducts his VAT expenses, and pays 112,- to the government.

The consumer is not a taxable person. He cannot offset anything against the VAT nor does he have any way of claiming a refund from the government if he exports the product bought. It is this factor that makes the VAT an indirect tax, the taxable person (entrepreneur) being distinct from the person economically burdened by the tax (consumer). In order to establish that the dealers are not economically burdened, but do not profit from the tax either, consider the amount finally received by the government:

44. The term value added must be distinguished from notions of profit because labor cost and social security payments incurred by the taxable person are not deducted from the "value added" but obviously influence profit.

	140,-	Import VAT
	112,-	Producer
	112,-	Wholesaler
	112,-	Retailer
	42,-	Office Supply
+	42,-	Accountant
	<u>560,-</u>	

The amount paid by the consumer to the last taxable person coincides with the amount received by the government from all the taxable persons who were part of the production and distribution process.

2. The Legal Framework

a. Generalities

As previously mentioned, the VAT system is harmonized by the EC. Two separate sets of legal rules overlap. On one side, the EC Directives set the basic principles and detailed rules, which the VAT systems in the various Member States must follow. Yet, each Member State has to incorporate the particular EC rules into its own legal system.⁴⁵ Therefore, all Member States have enacted VAT Laws which will repeat and incorporate the EC rules laid down in the directives. The Member States have the power to add certain rules, fix the tax rate, and generally adapt the VAT rules to their administrative structure.

The Court of Justice has firmly established that in case of conflict between the Community Directives and the national VAT legislation, the Community rules prevail. If the particular rule is sufficiently clear and unconditional, even a private individual can invoke the directive against the Member State⁴⁶ who has failed to adapt its own legal system properly, even though a directive seemingly binds the Member States only vis à vis the Community.

The two main directives which control the VAT system are the First⁴⁷ and Sixth⁴⁸ Council Directives on the VAT. While the

45. See, ART. 189 (III) EEC TREATY.

46. See, Case 148/78, *Ministero Publico v. Ratti*, 1979 E.C.R. 1629, 1 C.M.L.R. 96 (1980); Case 8/81, *U. Becker v. Finanzamt Münster Innenstadt*, E.C.R. 53 (1982); Case 70/83, *G. Kloppenburg v. Finanzamt Leer*, E.C.R. 1075 (1984).

47. Council Directive 67/227 of 11 April 1967 on the Harmonization of Legislation Concerning Turnover Taxes, 1967 J.O. 1301.

48. Sixth Council Directive, *supra*, at note 32.

First Directive compels the Member States to introduce a VAT system, the Sixth Directive contains all the detailed regulations necessary to establish the taxable basis in any particular case. The analysis of the VAT system can therefore be based primarily on the Sixth Directive.

b. The taxable person

The VAT is an indirect tax. Therefore, the definition of the taxable person is of particular importance since the taxable person is responsible for collecting the tax on behalf of the government, but is not economically burdened by it.

Article 4 of the Sixth Directive defines a taxable person as anyone who independently carries out certain economic activities, which in turn are defined to include "all activities of producers, traders, and persons supplying services" including mining and agriculture. It is the entrepreneur who is intended to be defined (whether a private individual or a corporation), as opposed to the consumer, who in turn is the one to be economically burdened by the VAT. Public authorities are also excluded from the definition of taxable persons.⁴⁹

c. The taxable event

Basically, all acts of supplying goods (*i.e.*, transactions conveying ownership of tangible property)⁵⁰ or services (all other transactions⁵¹ carried out against consideration by a taxable person) are taxable events.⁵² The consumption or use of business assets for private purposes also constitutes a taxable event. In addition, all imports are subject to VAT.⁵³

d. The location of a taxable transaction

Only transactions that take place within the territory of a particular Member State are taxable in that state.⁵⁴ The Sixth Directive contains elaborate rules defining where a particular transac-

49. Art. 4 para. 5 Sixth Directive, *supra*, at note 32.

50. Art. 5 para. 1 Sixth Directive, *supra*, at note 32.

51. Art. 6 para. 1 Sixth Directive, *supra*, at note 32.

52. *See also*, Smit, Herzog, *supra*, at note 23.

53. Art. 2 no. 2 Sixth Directive, *supra*, at note 32.

54. Art. 2 no. 1 Sixth Directive, *supra*, at note 32.

tion is considered to take place. These definitions serve three purposes:

- to determine the territorial scope of the Community legislation,
- to assure that all taxable events of international character are taxed in the state of consumption (destination principle),⁵⁵ and
- to assure that the transaction is only taxed in one Member State (avoidance of double taxation (*i.e.*, distortion of competition).

Generally speaking, goods are considered to be supplied at the point where they are located when they were sold. Services are usually considered to be supplied at the place of business of the supplier.⁵⁶

e. VAT Exemption

Certain transactions are exempt from VAT even though they constitute a supply of goods or services or an import. Two major groups of exemptions should be differentiated. The first group relates to exports. The exporter beneficiary is exempt from its obligation to collect the VAT but may still exercise its right of deduction of the VAT paid to its suppliers, even if the state, in effect, has to reimburse the exporter for the VAT.⁵⁷ This assures that the exported good is not burdened with any internal VAT of the exporting country.

Other exemptions remove the transaction entirely from the VAT system. The exempt transaction is treated as if it were carried out between non-taxable persons. Therefore, no tax credit can be claimed for VAT paid by the supplier of the exempt transaction to its own suppliers. One set of exemptions of this kind involves transactions carried out by public or private organizations in the public interest, in the medical profession, or by charities.⁵⁸ Another set of such exemptions involves major parts of the banking, insurance, or reinsurance business⁵⁹ which in several states is subject to special indirect taxes. It is not a coincidence that these industries

55. See, *infra*, Section III (4).

56. Art. 9 para. 1 Sixth Directive, *supra*, at note 32.

57. Art. 15, 17 Sixth Directive, *supra* at note 32; See also, *infra*, Section III (3), dealing with the international aspect of the pre-1993 VAT system.

58. Art. 13 part A Sixth Directive, *supra*, at note 32.

59. Art. 13 part B Sixth Directive, *supra*, at note 32.

are also the least liberalized as far as their business operations in the Common Market are concerned. Yet another set of exemptions involves certain imports.⁶⁰ Apart from exceptions for diplomatic and other representatives of foreign countries and international organizations, the exemptions refer primarily to temporary imports, imports in duty-free zones, and imports of goods in the context of certain inward processing schemes.

f. The taxable basis and gross VAT

The taxable basis for the calculation of the VAT is, in most cases, the consideration received in exchange for the supply of goods or services.⁶¹ If such consideration is, for certain specified reasons, not an adequate measure, then the open market value (or the costs for the supplier) is the taxable basis⁶² (e.g., when a taxable person consumes a good supplied to him in his business capacity for private purposes).

The particular tax rate is applied to this taxable basis. The rate is left to the Member States to determine.⁶³ However, the Member States have to adhere to the general rules laid down in Article 95 et seq. of the Treaty. The Court of Justice has ruled on several occasions that it is incompatible with the Treaty to use the right to fix the VAT rates to discriminate against products from other Member States. One of the better known line of cases refers to discriminatory tax rates for (nationally produced) beer and (imported and highly taxed) wine.⁶⁴ The Court stated that Article 95 is intended to "guarantee the complete neutrality of internal taxation as regards competition between domestic products and imported products."⁶⁵

Most Member States have more than one tax rate depending on the kind of transaction. The sale of basic necessities, such as

60. Art. 14 Sixth Directive, *supra*, at note 32.

61. Art. 11 part A para. 1(a); Art. 11 part B para. 1(a) Sixth Directive, *supra*, at note 32.

62. Art. 11 part A para. 1(b-d); Art. 11 part B para. 1(b) Sixth Directive, *supra*, at note 32.

63. Art. 12 Sixth Directive (Art. 12 contains some general rules concerning changes of rates by the Member States), *supra*, at note 32.

64. Case 170/78, *Commission v. United Kingdom*, 1980 E.C.R. 417 (438, Rec. 24) and (same case) 1983 E.C.R. 2265 (2292, Rec. 27).

65. Case 106/84, *Commission v. Denmark*, 1986 E.C.R. 833 (para. 10), cited with approval by Advocate General Luis da Cruz Vilaça, Opinion, Case 365/85, *Commission v. Belgium*, 1987 E.C.R. 3299, 3307.

food, is usually taxed at a reduced rate. In 1987, after the publication of the White Paper, but before the first voluntary alignment steps were taken, the rates were as follows:⁶⁶

<u>Country/Tax rate</u>	<u>Reduced</u>	<u>Standard</u>	<u>Increased</u>
Belgium	1&6*	19	25&33
Denmark	.*	22	-
France	2.1-7	18.6	33.33
Germany (F.R.)	7	14	-
Greece	6	18	36
Ireland	2.4&10*	25	-
Italy	2&9*	18	38
Luxembourg	3&6	12	-
Netherlands	6	20	-
Portugal	8*	16	30
Spain	6	12	33
<u>United Kingdom</u>	<u>.*</u>	<u>15</u>	<u>-</u>

* A zero% tax rate applies in certain cases of domestic production, particularly in the United Kingdom and Ireland.

Zero tax rates may be used by the Member States only to a limited extent. According to Article 28 (2) Sixth Directive and Article 17 last indent of the Second Directive,⁶⁷ they may be maintained (insofar as they existed on 31. Dec. 1975) if they are justified by "clearly defined social reasons and for the benefit of the final consumer." Because zero rating interferes with the proper functioning of the VAT system and its self policing nature, maintenance of zero rates was permitted in specific fields as a basis for a gradual phase-out.

When the British and Irish governments seemed very reluctant to give up any zero rating during the present negotiations,⁶⁸ the Commission took the initiative by challenging a large number of both countries' zero rating schemes in Court. The Court held that the term "clearly defined social reasons" left the Member States a broad spectrum of discretion, allowing only limited Com-

66. Completion of the Internal Market: Approximation of Indirect Tax Rates and Harmonization of Indirect Tax Structures, Global Communication from the Commission of the European Communities, COM(87)320 final/2 at 9 [Completing the Internal Market].

67. Council Directive 67/228 of 11 April 1967 Structure and Procedures for Application of the Common System of Value Added Tax, 1966-1967 O.J. SPEC. ED. 16. (Euratom).

68. See, the statement of Lord Young ("we are not going to harmonize"- said with respect to zero rating), quoted by G. Montagnier, *Fiscalité*, 24 RtDE 518,548 (1988).

munity control. However, the zero rating must only benefit the final consumer.⁶⁹ Defining the term "benefit to the final consumer" narrowly, the Court struck down many of the zero rating provisions which were applicable to previous production stages.⁷⁰ The remaining zero rates will be maintained even under the new transitional VAT system.⁷¹

A calculatory gross VAT figure is computed by applying the tax rate to the taxable basis.

g. Deductions

A taxable person can deduct from the gross amount any VAT that was charged to it by its suppliers in its business capacity. It can also deduct any VAT on imports paid for goods that are used for business purposes.⁷² This right to claim a deduction ensures that any VAT expense is not a real cost factor for a taxable person. For such a person, the VAT is a transient figure to be recorded for tax purposes, but without influencing the cost structure. A special problem arises with respect to tax exempt activities for which a tax deduction is not available.⁷³ If a particular business engages solely in exempt activities, no deduction is possible at all. If the business is not involved in any exempted transactions, all the VAT paid to suppliers can be deducted.

The deduction requires the taxable person to have certain proof of its expenses.⁷⁴ Usually a commercial invoice stating the good or service supplied, the amount, and the VAT paid is required. In the case of imports, the import document stating the VAT must be kept.

Deductions in any given taxable period may exceed the gross VAT which has been incurred. In this case, the net VAT is negative, representing a refund obligation by the State. The Sixth Directive leaves it up to the State⁷⁵ to meet that obligation by refunding the excess, or by carrying forward the balance into future taxable periods.

69. Case 415/85, *Commission v. Ireland*, 1988 E.C.R. 3097; Case 416/85, *Commission v. United Kingdom*, 1988 E.C.R. 3127.

70. *Id.*

71. *See, infra*, Section IV(4).

72. Art. 17 para. 2, Sixth Council Directive, *supra*, at note 32.

73. *See*, Art. 17 para 2 Sixth Directive, *supra*, at note 32.

74. Art. 18 Sixth Directive, *supra*, at note 32.

75. Art. 18 para. 4 Sixth Directive, *supra*, at note 32.

3. Administrative Advantages of the VAT

Two major advantages led the Member States to adopt the VAT system rather than any other turnover sales tax model.

The system allows to differentiate very clearly between taxable and non-taxable persons (consumers) without the necessity of intensive controls. The system also ensures that the turnover tax paid at one production stage does not become an element of the price for the following production stages.

The administrative advantage is due to the fact that the determination whether a certain person is taxable and eligible to deduct his VAT expenses is made in connection with the tax return of that person. Unlike some forms of sales taxes, where the seller must determine whether he is permitted to sell a particular product tax-free to a commercial user, under the VAT system the tax authorities themselves make that decision. The second advantage in this context concerns the chances and risks for tax evasion. Customers must be in possession of a proper invoice specifying the amount of VAT paid, if they want to deduct the VAT paid from the VAT they owe the State. The seller does not necessarily know whether his customer is taxable or not, and whether he will make an offset for VAT purposes. The tax authorities are confronted with the VAT invoices on both ends, through the taxable person presenting the VAT return and the customers claiming the deduction. This enables the authorities to check the correctness of tax returns without outside controls. This self-policing device⁷⁶ made the VAT very attractive, especially for those European countries where tax evasion has traditionally been a problem.

4. The VAT in Intra-Community Trade

The basic difference between national and international trade for the application of the VAT has already been mentioned: All exports of goods are tax exempt,⁷⁷ and all imports of goods, whether or not carried out by a taxable person, are a taxable event.⁷⁸

The principle underlying this structure is the so called "desti-

76. Zero rating interferes with this advantage because if no VAT is charged, the recipient will not supply any information to tax authorities.

77. See, Art. 15 para. 3(b) Sixth Directive, *supra*, at note 32.

78. See, Art. 2(b), Sixth Directive, *supra*, at note 32.

nation principle".⁷⁹ This principle presumes that indirect taxes burdening the consumer should benefit the consumer's country of residence in order to avoid double taxation. Goods are to be taxed where consumed rather than where produced.⁸⁰

Example II of the Annex shall illustrate the basic mechanism. Suppose, as in Example I, raw material is being imported into Country A of the EEC. The price paid for the Import is 1,000,-. The tax rate in Country A is again 14%.

The importing producer has to pay 140,- VAT. To each of his suppliers he pays 100,- plus the 14,- VAT for the supply of services and goods. He, in turn, sells his new product for 2,000,-, charging the wholesaler 280,- VAT. After he offsets his VAT payment, he pays 112,- to the Government. So far there is no difference from Example I.

His customer, the wholesaler, exports the product to Country B, also a Member State of the EEC (tax rate 20%). The wholesaler had to incur expenses for office supplies and accounting, including 28,- for VAT. His sale for 3,000,- to the retailer in Country B is tax exempt. Since the tax exemption for exports does not limit the right to deduction of VAT paid to suppliers, the wholesaler can claim from the government of Country A a 308,- reimbursement (280,- paid to the producer, 14,- to each of his suppliers).

For Country A the transaction has been a zero sum game, because no revenues were generated and no expenses were incurred. The repayment of the VAT granted to the wholesaler corresponds exactly with the tax burden; no hidden export subsidy is involved.

The situation for Country B is different. Upon import, the retailer has to pay the import VAT. He bought the products for 3,000,-, and since the tax rate in Country B is 20%, his VAT-payment amounts to 600,-. He then needs the service of the accountant and office supplies and pays for each 100,- plus 20,- VAT. He then sells the product to the consumer who in turn pays 4,000,- plus 800,- VAT. The retailer will therefore deduct 600,- and 40,- from the VAT received from the consumer and pay the remaining 160,- to the Treasury. In total, Country B receives 800,-, which

79. P. Guieu, C. Bonnet, *Completion of the Internal Market and Indirect Taxation*, 25 JCMSt 209 (1987); Van Thiel, *Harmonization of Turnover Taxes in the European Communities*, 27 EUROPEAN TAXATION 77, 80 (1988).

80. S. Cnossen, *Harmonization of indirect taxes in the EEC*, BRITISH TAX REVIEW 232, 235 (1983).

again is equivalent to the VAT burden on the final consumers.

It is important to realize that in order for this system to work the act of exportation and the act of importation must be policed by the tax authorities. Therefore, the pre-1993 regulations required that the exporter must have in his possession some proof of export in order to claim the tax exemption while the importer must have an import document stating the amount of import VAT paid⁸¹ in order to deduct the import VAT from the VAT received from his customers. Many of the former administrative difficulties were reduced when the measures directed to simplify export/import were put into effect, yet, the necessity to obtain at least a visa on the paper accompanying the goods at the border control remained.

Unlike the internal VAT, the export/import rules have no built-in self-policing device.⁸² Since the person buying in Country B is not necessarily the importer and since the transactions are reported to tax authorities in different Member States, the question whether import VAT has been paid corresponding to the tax exemption requested cannot be checked simply by comparing the VAT declaration of the two parties involved in the sale. Some form of import/export certification is therefore necessary at the moment the goods cross the border between Member States.

A major problem of the system involves intra-Community transactions between private (non-taxable) persons. It is a special feature of the VAT system that once the product has reached the consumer, no tax deductions or export refunds are made. The consumer is intended to be economically burdened by the tax, and it would therefore not be acceptable to permit any refunds to him.

On the other hand, any import is a taxable event even if carried out by a non-taxable (private) person. The idea behind this is the assumption that products bought outside the Common Market are not burdened by the tax and that the country of destination should have the benefit of the proceeds of the tax.

Consequently, there are distinct obstacles to private sales across intra-Community borders. While a private sale within one Member State is not subject to the VAT,⁸³ the same sale across the

81. Art. 18 I(b) Sixth Directive requires that the person claiming the deduction for import VAT must hold an import document, specifying him as the consignee or the importer, and stating or permitting calculation of the amount of tax due, *see, supra* at note 32.

82. *See infra*, Section III(3).

83. The supply of goods and services is only taxable if carried out by a taxable person,

Community fiscal borders is taxable by virtue of the import VAT.

This situation was considered to be acceptable in the beginning because of the relative commercial insignificance of such private sales. However, the discrepancy of the tax rates in the various Member States was thought to make import VAT for non-taxable persons inevitable. Those differences would have caused enormous artificial trade diversion because an individual could have shopped for the lowest tax rate in Europe by going there and bringing back the goods personally. Only the extension of the import VAT to (generally) non-taxable persons could avoid such trade diversion.

The realization of the problems that the import VAT created began soon after the system was introduced. As a result, certain exceptions were made. Since the EEC Treaty calls for the free movement of workers and the freedom of establishment,⁸⁴ arrangements were made to permit a person exercising these rights to take personal belongings (including cars, furniture, professional tools) across borders, without being subject to the import VAT.⁸⁵ Other examples of these exceptions include certain goods bought by a tourist throughout his trip within the EEC or to other foreign countries.⁸⁶

Unfortunately, the two areas in which second-hand sales had some real commercial importance were left without special concessions, however. These being the markets for used cars and used boats. It took a judgment of the Court of Justice of the European Communities (the famous Gaston Schul cases⁸⁷) to initiate some changes in this context. A private individual in the Netherlands had bought a pleasure boat in France from a non-taxable private person for 365.000,- FF. Through his customs forwarding agent, Gaston Schul BV (plaintiff on behalf of importer), he had the boat

Art. 2(a) Sixth Directive, *supra* at note 32.

84. ART. 48 EEC TREATY; ART. 52 EEC TREATY.

85. *E.g.*, Council Directive 83/183 of 23 March 1983 on Tax Exemptions Applicable to Permanent Imports from a Member State of the Personal Property of Individuals, 1983 O.J. (L 105) 64.

86. Council Directive 78/1035 of 28 December 1978 on the Exemption from Taxes of Imports of Small Consignments of Goods of a Non-Commercial Character from Third Countries, 1978 O.J. (L 366) 34; *see also*, Council Directive 69/169 on the Harmonization of Provisions Laid Down by Law, Regulation or Administrative Action Relating to Exemption from Turnover Tax and Excise Duty on Imports in International Travel, 1969 O.J. (L 133) 6; these imports may only be of rather limited value.

87. Case 15/81, *Gaston Schul Douane Expeditie BV v. Inspecteur der Invoerrechten en Accijnzen, Roosendaal*, 1982 E.C.R. 1409 [G. Schul I]; Case 47/84, *Staatssecretaris van Financien v. Gaston Schul Douane Expeditie BV*, 1985 E.C.R. 1491 [G. Schul II].

imported into the Netherlands. The boat had been imported into France by the seller only one year earlier at a price of 269.571,- FF, and at that time 17,6% Import VAT had been paid to the French customs agency. The Netherlands charged an 18% Import VAT on the importation of the boat claiming that it did not matter whether or not the importer was a taxable person. On appeal the matter was referred to the European Court of Justice⁸⁸ (ECJ, the Court).

In its judgment, the Court notes that Article 95 of the treaty prohibits the taxation of foreign products in excess of what is levied on national products.⁸⁹ The Court accepted the argument that it would constitute unequal treatment if a specific transaction, which would not be taxable internally, was taxed only because it involved a seller abroad. It held that such a differentiation is justified insofar as it *compensates* for the VAT difference between two countries. Only such compensation puts the national and the foreign product on an equal footing. The Court pointed out that for commercial sales the (taxable) seller, in effect, receives a refund of the VAT accumulated in the product through the exemption provisions.⁹⁰ It is therefore generally adequate to levy the full VAT rate upon the importation of a product.

This is not true in the case of private sales. The ECJ has deduced from its interpretation of Article 95 of the Treaty that the Import VAT, as a form of border tax adjustment, may be levied on private sales only insofar as is necessary to burden the imported good with the same VAT burden that is accumulated in a similar domestic product.⁹¹

It, therefore, held that the Import VAT charged had to be reduced by the residual VAT (adjusted to reflect the depreciation of the goods) originally paid in the country of exportation.

88. See, ART. 177 EEC TREATY, A national Court may request the ECJ to issue a preliminary ruling on any question of EEC Law relevant to a case before it. This ruling is then binding upon the Court requesting it. Courts of last instance have the obligation to request a ruling if there is doubt as to the Rule of EEC Law; see also, Case 283/81, *Slr. CILFIT v. Ministry of Health*, 1982 E.C.R. 3415.

89. See, Case 169/78, *Commission v. Italy*, 1980 E.C.R. 385.

90. See *infra*, Example II.

91. Case 15/81, *Gaston Schul Douane Expeditie BV v. Inspecteur der Invoerrechten en Accijnzen, Roosendaal*, 1982 E.C.R. 1409; see also, the second ruling in this case, Case 47/84, 1985 E.C.R. 1491. Similar problems exist in purely national settings, where a taxable person buys goods from a private consumer for resale, see, Case C-165/88, *ORO v. Inspecteur der Omzetbelasting*, 1989 E.C.R. 4081.

Since Article 95 is immediately applicable in all Member States,⁹² and Community Law takes preference over national law,⁹³ this interpretation was required to be immediately applied by the Member States. The decision created significant technical problems since it was difficult to determine when and at what value the country of exportation had last charged VAT on a particular product.⁹⁴

5. Summary

The European Communities have created a customs union. The treaty and subsequent secondary legislation established tax neutrality and a considerable amount of harmonization. The VAT system in its pre-1993 form and the desire to create an internal market without frontiers are, however, to a certain extent, incompatible. The pre-1993 VAT system was based on the existence of borders because a taxable event (import) was linked to their existence. Border controls are needed in order to police the imports and exports. The very aim of the creation of an internal market is the abolition of such borders. The fact that imports of non-taxable persons (the average citizen) are taxable events means that all individuals are in principle subject to border controls. In the eyes of an average European, it makes little difference whether he has to open his suitcase because "real" customs duties are to be enforced or "only" import VAT. The lack of progress made in this respect was one of the political forces behind the Single European Act and the 1992 target. The political fear was that people would associate Europe only with the large amounts spent on agricultural subsidies and not with any meaningful progress for them.

Therefore, two basic problems with the pre-1993 system can be isolated. First, as far as intra-Community trade is concerned, many delays and substantial costs are caused by the necessity of providing the export/import documentation. The speed and effectiveness of the actual delivery are reduced because all goods have

92. See, Case 57/65, *Lütticke v. Hauptzollamt Saarlouis*, 12 E.C.R. 205 (1966); Case 45/75, *Rewe-Zentrale v. Hauptzollamt Landau*, 1976 E.C.R. 181; Case 74/76, *Iannelli & Volpi v. D.P.Meroni*, 1977 E.C.R. 557.

93. See, e.g., Case 26/62, *Van Gend & Loos v. Nederlandse administratie der belastingen*, 1962 E.C.R. 1; Case 6/64, *Costa v. ENEL*, 1964 E.C.R. 585; Case 106/77 *Amministrazione delle Finanze v. Simmenthal [II]*, 1978 E.C.R. 629.

94. The Court of Justice put the burden of proof in this context on the person requesting a limitation of the Import VAT.

to be presented to customs. Traders bear finance costs because they have to pay import VAT immediately upon import and can claim a deduction only in their next periodic tax return.

Second, trade between private persons is effectively hindered because a private individual's goods are burdened twice with the VAT if the sale is across the border of any Member State. Retailers in the border regions are effectively prevented from selling products to private customers from an adjacent country because the products would be burdened twice.⁹⁵

IV. THE VAT AS OF JANUARY 1, 1993⁹⁶

1. Introduction

The proposals for the new 1993 structure of the VAT have changed substantially if one compares the original proposals with the recently enacted rules. The change, however, is much smaller if one compares original proposals with what the Council of Ministers has envisaged as the "definitive" system.

This seemingly contradictory statement summarizes the unusual course the negotiations took. For technical and political reasons (described below), Finance Ministers could not agree for the immediate future on the system the Commission proposed, but they agreed that the definitive VAT system, to be implemented in 1997, would be based on such proposals.⁹⁷

The difference between the original proposal and the definitive system, on the one hand, and the pre-1993 and the transitional system on the other, can be expressed as the difference between the principle of "taxation at origin" and "taxation at destination".⁹⁸

To explain the difference perhaps it is best to describe the basic features of the original proposal and the envisaged definitive system first, before turning to "hard law" and describing how the

95. At the time of sale and at the time of importation it is not entirely clear whether the Gaston Schul rule would apply to such a transaction, since that rule deals with used goods and application of it would cause a deviation from the destination principle.

96. References to the Sixth Directive in this and subsequent chapters refer to the Sixth Directive as amended to implement the transitional VAT system.

97. For a more detailed description of the development of the negotiations see, G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtdE 79, 106 (1991).

98. See, *Chr. Prout, FIDE 1990*, p. 283, 289; G. Montagnier, *Fiscalité*, 24 RtdE 518, 524 (1988); G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtdE 79, 110 (1991).

transitional system will work.

2. The Definitive VAT System

During the EC Council of Ministers meeting of June 24, 1991, the Finance Ministers agreed on basic principles of a transitional VAT system. They also agreed to implement by January 1, 1997 a definitive VAT system based on the principle of taxation in the country of origin.⁹⁹ This is in-line with the Commission's original proposals,¹⁰⁰ although both the Commission's original proposal and the Council of Ministers refer to a modified origin taxation.

How would a pure system based on the principle of taxation at the point of origin work at the outset and what would be the economic impact? Please consider Example III of the Annex which sets out the basic features of such a system. Instead of allocating the benefit of the VAT to the consumer's country, the idea is to let each country collect the VAT insofar as the value added was generated in that country.¹⁰¹ This could be done by simply treating the intra-community sale the same way as a national sale, forcing the receiving country to permit deduction of the VAT charged by and paid to the seller in the country of origin.

This creates certain technical problems both with respect to currency compensation and shipments to third countries. But, more importantly, some general arguments make it difficult to accept this solution without adjustments. The VAT is an indirect tax. The party that is economically burdened is the consumer. It is this feature that led to the acceptance of the destination principle, according to which that country should receive the proceeds of the tax whose citizens were burdened by it.¹⁰² Any other solution

99. The text of the agreement was published in a Commission Memorandum MEMO/92/13 of 19 February 1992, where the Council agreement is summarized as follows: "il a été convenu de remplacer le régime transitoire, en principe le 1er janvier 1997, par un régime de taxation définitif reposant sur le principe de la taxation dans le pays d'origine. . .".

100. See, Michael Langer, *Umsatzsteuer und Binnenmarkt*, 44 *DER BETRIEB* 462 (1991); P. Guieu, *L'élimination des barrières fiscales et l'harmonisation de la TVA*, *REVUE DU MARCHÉ UNIQUE EUROPÉEN*, 11, 37 (1992); G. Montagnier, *Fiscalité*, 24 *RtDE* 518, 520, 524 (1988).

101. See, S. Van Thiel, *Harmonization of the Turnover Taxes in the European Communities: Towards the Internal Market without frontiers*, 28 *EUROPEAN TAXATION* 77, 83 (1988); P.P.S.C. Tielemans, *Towards a European Community without Borders: Utopia or Reality?* 27 *EUROPEAN TAXATION* 207, 208; Chr. Prout, *FIDE* 1990, p. 283, 289.

102. See, *Completing the Internal Market - the Introduction of a VAT Clearing Mechanism for Intra-Community Sales*, COM (87)323 final/2, para 1.1.

would imply a transfer of funds from the citizens of one country to the treasury of another.

Such a transfer might be acceptable, if it were to involve a transfer from the more prosperous regions to the poorer regions of the EC, thereby aiding the regional policy of the EC.¹⁰³ Yet the probable effects would be to the contrary. The net-exporting countries (e.g. Germany, Benelux countries)¹⁰⁴ would likely benefit from giving up the destination principle, while the countries with less developed regions are likely to lose out (Ireland, Greece, Portugal, Spain).¹⁰⁵

The shift in benefits would be threefold. On one side, the balance of payments between the less developed regions and the industrialized regions is already unfavorable to the less developed regions. Under the present system, the VAT paid by the consumers stays in the country. Giving up the destination principle would give an additional advantage to the net-exporting regions.

But even if the balance of payments were equal, abandoning the destination principle would be an advantage for the industrialized countries. This is because the goods and services supplied in the less developed areas of the Communities center around agriculture. In almost all Member States, the tax rate for agriculture-related products is significantly lower than the tax rate for industrial products and services.¹⁰⁶ To give up the destination principle would seriously change the distribution of the tax revenue. So far, in the less favored regions, tax revenues are created on the basis of consumption. Therefore, the tax revenue is based on a mixture of revenues from industrial and agricultural products. Without the destination principle, the tax revenues would be created according to production, and since the less favored regions deal predominantly in agriculture, revenues would be created predominantly on the basis of agricultural products. Given the lower tax rates for these products, the revenue created would be lower in the less developed countries, while those in the industrialized countries would increase.

103. See, the new Title V of Part III of the EEC Treaty: "Economic and Social Cohesion", particularly Art. 130a (2), 130b EEC Treaty as amended by the Single European Act.

104. See, Table of Estimated Revenue Flows, EC-Commission, COM (87)323 final at 2.

105. See, Chr. Prout, FIDE 1990, p. 283, 289.

106. The reduced tax rates usually are applicable to basic needs, in particular agricultural products, the normal ones to other products; for a list of products to which such reduced rates will apply in the future, see Directive 92/77 of 19 October 1992 on Approximation of VAT Rates, 1992 O.J. (L 316) 1.

In addition, Member States with high VAT rates would benefit because they would receive VAT at their rate, against which the right of deduction based on lower tax rates of goods originating in other countries would be applied. The low tax rate countries would have to credit the high level VAT deductions based on goods imported from countries with high tax rates, which would reduce the low tax rate countries' revenue.¹⁰⁷

These consequences seem incompatible with the basic goals of the Common Market, which set out to diminish the differences between the different regions.

However, the system would be easy to operate since no exemptions would be necessary for intra-community "exports", and imports would not have to be a taxable event.

The principal problems associated with the system relate to the revenue flows. If one could find a method of adjustment which would, with a sufficient degree of certainty, correct the "distorted" revenue flow between Member States, then - it was thought - the origin principle, coupled with a system of compensatory payments, would cause the least amount of restrictions to the free movement of goods.

The "adjustments" required are payments by the benefiting Member States to those whose revenue decreases. Thus, a system had to be devised to calculate and to effect the necessary compensatory payments. The Commission first proposed the "clearing-house system".¹⁰⁸ Taxable persons under VAT would have had to report the VAT balance of their intra-Community sales and purchases separately to their respective tax authorities. Member States would have reported their total balance to the Commission's clearing house which would have adjusted the differences between Member States. Some Member States, in particular France and the Netherlands, objected¹⁰⁹ on the ground that the system was too vulnerable to mistakes and proposed to require traders to supply lists of all intra-Community transactions. The Commission found this too burdensome for the economic operators involved.¹¹⁰

107. See, H. Nieskens, *Das Umsatzsteuer-Binnenmarktgesetz*, 47 *BETRIEBSBERATER*, Beilage 17, p. 3 (1982); Chr. Prout, *FIDE* 1990, p. 283, 299.

108. Completing the Internal Market - The Introduction of a VAT Clearing Mechanism for Intra-Community Sales, COM (87)323 final/2.

109. See, Chr. Prout, *FIDE* 1990, p. 283, 299.

110. See, COM (87)323 final/2, para. 1.2, 1.4, 1.5.

A third possible solution, which was later advocated by the Commission, would have used a macro-economic approach.¹¹¹ Trade statistics were to be used to monitor the flow of goods and calculate the corresponding revenue flows. The problem with this method relates to the accuracy of the statistics and the treatment of services, which are not covered by trade statistics. Revenue flows associated with services would not have been monitored and the adjustments would not have been accurate.¹¹²

The Council of Ministers concluded that the complexity of the issues, related to reliable yet simple adjustment procedures, were too complex to be dealt with under extreme time pressure. Several Ministers, in particular from countries which would have received money through the compensation system, were not willing to accept any system which did not permit them to have full confidence that the system would work from the start, and that they would receive their "fair" share of the revenue without delay.

These perhaps more technical uncertainties with respect to the proper adjustment procedure have so far held up the adoption of the definitive VAT system.

The discussion on this point still seems to be in flux. Any detailed analysis of the "clearing house proposal", the "listing system" or the "macro-economic approach" must be postponed until some common ground is reached in the negotiations. The Commission seems to favor a revised macro-economic approach based on improved trade statistics,¹¹³ and some observers of the negotiations have concluded that, if such improved statistics (and the increased reporting requirements for the economic operators) can be implemented, this model is most likely to be the mechanism upon which the Member States will agree.¹¹⁴

It is, however, also possible that the adoption of the definitive system will be delayed and that the transitional system will share the fate of many provisional arrangements: it may have a long life.

Let us now turn to the question of whether it will be a happy life (and whether the people subject to the transitional system will continue to live a happy life).

111. See, COM (87)323 final at 2, para. 2.2.4.

112. See, Chr. Prout, FIDE 1990, p. 283, 300.

113. COM (90)177 final of June 15, 1990.

114. See, Chr. Prout, FIDE 1990, p. 283, 300.

3. The Transitional VAT System Effective January 1, 1993

The new transitional system¹¹⁵ for the collection of the VAT is based on the destination principle.¹¹⁶ The "consumption" of goods (and services) is taxed in a country of consumption or destination. For that reason, the system must monitor the goods on their way from production to consumption to ensure that the tax is charged at the destination and that the appropriate relief can be granted in the country of origin. In principle it works in a similar manner as the previous system, and thus Example II of the Annex still illustrates the principal features of the system for commercial transactions.

a. What does not change

The pre-1993 VAT system was also based on the destination principle. With the implementation of the internal market, only intra-Community borders will disappear. The external frontiers of the Community will continue to exist.

Because within Member States there were no borders to begin with, the situation with respect to purely national transactions will not change. Similarly, exports to third countries will be tax exempt, and imports from those countries will be taxable events just as they were under the old system. Thus, the examples given on how the VAT system works do not change insofar as no intra-Community transactions are involved.¹¹⁷

Secondly, services are provided irrespective of controls at the frontier. Under the old system, the destination principle was not

115. Adopted through Council Directive 91/680 of 31 December 1991 Supplementing the Common System of Value Added Tax, 1991 O.J. (L 376) 1, as amended by Council Regulation 92/111, of 30 December 1992, 1992 O.J. (L 384) 47; see also, Albert J. Rädler, *Die Grundzüge der Umsatzbesteuerung im Binnenmarkt*, 1 INTERNATIONALEN STEUERRECHT [IStR] 2 (1992).

116. See EC Commission, Revised proposal COM (90)182 final of 17 July 1990, 1990 O.J. (C 176) 8; EC Commission, Guide to VAT in 1993 - The New VAT System in the Frontier-Free Community, Brussels-Luxembourg, p. 1 (1992); Chr. Prout, FIDE 1990, p. 283, 290; H.D. Rondorf, *Das Umsatzsteuer-Binnenmarktgesetz*, 3 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [EuZW] 727, 728 (1992).

117. Minor changes of the rules applicable to dealings with third countries were necessary. The internal transit rules (goods imported from a third country into Member State A and released into free circulation there but intended to be shipped immediately to a Member State B) will no longer apply with respect to VAT because in such cases the new rules on the monitoring of goods within the EEC will apply; see also EC Commission, Guide to VAT, p. 5.

maintained in this respect on the basis of border controls or similar devices. With respect to most services, the rules on the definition of where the service is deemed to have been performed were sufficient for that purpose. Therefore, the removal of internal frontiers does not affect the functioning of the VAT system insofar as it relates to services.¹¹⁸ It is for that reason that the VAT on services will also be based on exactly the same principles as have previously existed.

The only minor change in this context relates to transport services. VAT on transport had been technically tied to the transport of goods, because no VAT was charged in the country of origin and the import VAT on the goods would be charged on the basis of the purchasing costs including the transport cost. The new VAT rules disassociate the VAT on transport services from that of the goods transported.¹¹⁹

The important changes, therefore, refer to transactions involving the shipment of goods from one Member State to another. Given the fact that both the old and the transitional VAT system are based on the destination principle, the same amount of VAT should in the end be paid to the same tax authority. Nevertheless, the technical way of bringing about this similarity is the important distinguishing feature between the old and the new system. While it may sound as if it is a simple thing to do, the technical difficulties are very significant.¹²⁰

b. The collection of VAT on intra-Community transactions

The new transitional system replaces the old taxable event "import" with a new one, the intra-Community "acquisition".¹²¹ The old exemption of export is replaced by a similar exemption for intra-Community transactions with persons who have obtained a VAT registration number.¹²² This VAT registration, which is based on similar registrations which existed in some Member States, is among the most important additional features of the transitional

118. See EC Commission, Guide to VAT, p. 3.

119. See EC Commission, Guide to VAT, annexed note 4.

120. For a description and severe criticism of the new system, see Hans Nieskens, *Das Umsatzsteuer-Binnenmarktgesetz*, 47 *BETRIEBSBERATER*, Beilage 17. (1992).

121. Art. 28(d) Sixth Directive, *supra* at note 32, as amended by A Council Directive 91/680, art. 1, 1991 O.J. (L 376) 1.

122. Art. 28(c), 22 para. 1(c) Sixth Directive, *supra* at note 32, as amended by Council Directive 91/680, art. 1, 1991 O.J. (L 376) 1.

VAT system. VAT registration requires the purchaser in an intra-Community transaction to declare and pay VAT in the country of destination upon completion of an "acquisition". If the seller sells to a non-commercial purchaser (a purchaser who has no VAT number), then the Seller is obliged to declare and pay VAT for the underlying transaction.

For the purposes of the transitional system, four basic types of transactions with respect to goods can be differentiated:¹²³

- sales from taxable persons to taxable persons
- sales from taxable persons to economic operators who are not taxable persons
- sales from taxable persons to private individuals
- sales among private individuals

The rules applying to these transactions will be explained separately below.

aa. *Transactions between taxable persons*

A normal sales transaction between taxable persons would involve a seller in Member State A and a purchaser in Member State B. A would sell and invoice B without charging VAT provided that

- a) B has supplied him with his VAT registration number and
- b) the goods are physically transported to another Member State.

If these conditions are not met, A must charge VAT. If the goods do not leave Member State A, then it is not really an intra-Community transaction so that the normal (old) rules apply. If B does not have a VAT number, then A must presume that B is not really a taxable person and must therefore apply the rules relating to transactions with private parties.

A, therefore, has the obligation to verify and to maintain sufficient documentation on two things: the VAT number of his customer and the intra-Community transport. With respect to the first verification obligation, A can turn to his home country's tax administration which will have an on-line computer data base listing all taxable persons and their VAT numbers. With respect to the second verification obligation, A needs to keep the normal commercial transport document which provides evidence of an intra-Community transport.

123. See also, H.D. Rondorf, *Das Umsatzsteuer-Binnenmarktgesetz*, 3 EuZW 727, 728 (1992); A.J. Rädler, *Die Grundzüge der Umsatzbesteuerung*, 1 IStR 2, 3 (1992).

For verification purposes, the seller must state on his normal periodic VAT returns the total amount of all intra-Community sales to customers for which he did not charge VAT. In an additional special VAT declaration, he must declare for each purchaser (identified by his VAT number) the amount of such VAT-exempted sales during the last quarter.

The purchaser has to "charge" VAT upon arrival to himself. However, he has the advantage of being able to charge VAT on the one side and, in the same tax return, claim the deduction (the set-off) so that effectively the purchaser is not actually burdened with any financial charge at the time of the acquisition. This is an advantage compared to the previous situation where the purchaser had to pay import VAT and would only be able to claim a refund for the import VAT in his next periodic VAT return, thus having to bear certain finance costs.¹²⁴ The rules with respect to the value for tax purposes will be essentially the same as those applied to national sales. Thus, the net invoice value will determine the value for tax purposes and not the C.I.F. value (including freight) which had been important in the context of calculating the import VAT. This also marks a further alignment of the internal VAT rules with those relating to intra-Community sales.

While a sale between taxable persons is the most important and common transaction which involves moving goods from one Member State to another, there are two other major kinds of transactions which are not sales. In the new rules these situations are described as "contract work" and as "transfers".

Contract work takes place if the taxable person in Member State A sends raw or semi-finished materials to a contractor in Member State B.¹²⁵ After the assembly or contract work has been performed, the goods are returned to Member State A and A receives an invoice from B with respect to the work performed (but not the value of goods originally provided by A). This work had previously been dealt with as "outward/inward processing" under special VAT and customs arrangements. Under the new system, the raw or semi-finished materials are not subject to VAT when

124. EC Commission, Guide to VAT, annexed note 1. Some Member States (e.g. France and Italy), however, seem to have implemented rules which perpetuate the requirement to reclaim the "acquisition-VAT" in a subsequent VAT-return. Other Member States have already asked the Commission to take formal action; see *Handelsblatt*, 19 February 1993, p.1.

125. See Art. 28(a)(5)(a) Sixth Directive, *supra* at note 32, as amended by Council Directive 91/680, 1991 O.J. (L 376) 1.

they are sent to Member State B. When the goods are returned, VAT only accrues with respect to the amount charged on the contract work according to the processing agreement. The VAT will have to be declared in Member State A by the beneficiary of the contract work. It is, however, necessary to maintain some form of control over the goods which move within the Community on the basis of such contract work arrangements. For this purpose, the new VAT rules require both A in Member State A and B in Member State B (who both must be registered traders having VAT numbers) to keep a special register of products which move under the special scheme. This additional register did not have to be kept under the old system (where similar information was compiled by the customs authorities). Here, an additional burden is placed on the economic operators. In addition to keeping the registers, the two parties must also mention the contract work on a summary statement to the VAT authorities.

Finally, certain transfers of goods may occur if one business dispatches or transports its goods to another Member State for the purposes of its own business. If such transfers involve capital goods (investment items) and goods sent for storage to another Member State, VAT will accrue on such transfers and the situation will be considered to be a supply against consideration.¹²⁶ This is necessary because, in the case of stored goods, Member States need to keep track of where the goods are in order to ensure the correct taxation in the country of destination. With respect to capital goods, consumption takes place where the capital goods are actually used, and it is therefore reasonable to burden the acquisition of capital goods at the place where they are eventually used. On the other hand, mere temporary storage or temporary use with the intent to return the goods to the country of origin or to transfer them to yet another EEC Member State does not give rise to a taxable transaction. This is to avoid unnecessary and additional burdens on traders and finance authorities.

In such cases the traders are again obliged to keep appropriate registers¹²⁷ which show where and for how long certain goods have been transferred.

A third category of special transactions refers to sales as part

126. See Art. 28(a)(5)(b) Sixth Directive, *supra* at note 32, as amended by Council Directive 91/680, 1991 O.J. (L 376) 1.

127. See Art. 28(h), 22(2)(b) Sixth Directive, *supra* at note 32, as amended by Council Directive 91/680, 1991 O.J. (L 376) 1.

of a chain of sales. As is common practice for many commodities, goods may be sold from a seller in Germany to a buyer in France, who in turn sells it on to Spain from where, in turn, the goods are sold to Portugal. It may happen that the goods will then actually be shipped from Germany directly to Portugal without necessarily passing through the two other countries involved. In principle, the transaction should only be taxed in the country of destination. The VAT legislation of some Member States already took this into consideration and contains appropriate specific rules,¹²⁸ even before the Community was able to adopt some clarifications.¹²⁹

The basic principles which govern these rules may seem simple. However, in practice there are a number of cases (in particular, combined transfer, outward processing and sale in a chain cases) where it is very difficult to determine who actually has to pay which tax authority which amount on the basis of which legal provision. It is this feature which has already caused a substantial amount of criticism.¹³⁰

The Council has for that reason recently adopted amendments to the (revised) Sixth Directive and introduced simplification measures intended to reduce the technical problems which may arise in this (and certain other) contexts.¹³¹

bb. *Sales to non-taxable persons*

Under the normal application of the existing VAT rules, certain businesses were fully outside the VAT system (fully exempt businesses like insurance companies and banks¹³²). Similarly, public authorities and other legal persons under public law would be non-taxable because they do not conduct a business in a technical sense.

However, where such companies or authorities make substan-

128. See, e.g., § 1a Abs.1 Nr.1 Satz 2 Umsatzsteuergesetz [German VAT act]. As regards the German approach to the newly enacted simplification measures see Drucksache des Bundesrates 743/92, 27 October 1992.

129. Council Directive 92/111 of 30 December 1992, art. 1, para. 11, 12, 1992 O.J. (L 384) 47. These rules may, however, not be sufficient and have already been criticized; see *Handelsblatt*, 19 February 1993, p.6.

130. See Hans Nieskens, *Das Umsatzsteuer-Binnenmarkt-Gesetz*, 47 BETRIEBSBERATER, Beilage 17, p. 31 (1992).

131. Council Directive 92/111 02 30 December 1992, 1992 O.J. (L 384) 47; See also the EC Commission's proposal, COM(92)488 final of 4 November 1992.

132. See *supra* at Section III(2)(e).

tial purchases in other Member States it was thought that it would facilitate the operation of the system and reduce distortions of competition associated with these entities' purchasing volume if they were treated for purposes of intra-community acquisitions in the same way as taxable persons. Thus, these operators may apply for a VAT number (they will still not become liable for VAT on their sales) and, having received the VAT number, sales by taxable persons to such operators would be treated as if they had been made between taxable persons.¹³³

As for those exempt companies or public authorities who do not wish to be registered for VAT purposes (because they have only a very small intra-community turnover), sellers in other Member States will have to apply in principle the same rules they apply for sales to individuals in other Member States.

cc. Sales by taxable persons to individuals

For sales by taxable persons to private individuals or such other operators who do not have a VAT number, two different cases must be distinguished with respect to intra-community sales. If the taxable person sells and arranges for transport to the individual, the sale will be covered by a special regime related to sales at a distance.

In both cases the responsibilities relating to charging VAT lie entirely with the seller. If the seller is engaged in distance selling,¹³⁴ his responsibilities depend on his total distance selling turnover. If he sells for more than ECU 100,000 per year into any given Member State, he must charge VAT in and at the rate of the Member State of destination (he knows the destination because he arranges for transport). If he sells below that threshold, then VAT is charged in and at the rate of the Member State where the seller is established.

If no sale at a distance is involved (because the purchaser either comes to the seller or arranges for transport himself), the sale is made in the country of the seller and all VAT (regardless of any special turnover requirements) is charged in and at the rate of the

133. See EC Commission, Guide to VAT, p. 4; H. Nieskens, *Das Umsatzsteuer-Binnenmarktgesetz*, 47 BETRIEBSBERATER, Beilage 17, p. 7, 8 (1992).

134. See H. Nieskens, *Das Umsatzsteuer-Binnenmarktgesetz*, 47 BETRIEBSBERATER, Beilage 17, p. 15, 16 (1992).

Member State of the seller.¹³⁵

It is an important feature of the new system that a private individual buying goods anywhere in Europe shall be free to transport them to his country of residence without any administrative restrictions or requirements to pay VAT or other duties or fees.

dd. *Sales between private individuals*

Intra-community sales between private individuals are not subject to VAT. VAT is only charged if the sale is made by a taxable person. A private individual is by definition not a taxable person.

Although the details with respect to sales of second-hand goods are still under consideration by the Council¹³⁶ it is clear, regardless of the rules which may be agreed upon with respect to sales by taxable persons of second-hand goods, that the sale of second-hand goods between private individuals will not be subject to any VAT.

ee. *The special regime for new means of transport*

In addition to the special rules on sales at a distance, the Member States devised a special rule with respect to new means of transport.¹³⁷ It was thought that in particular cars would be the most important valuable item which private individuals would buy by themselves in other Member States if a VAT differential would make that attractive. No serious transportation problem would be involved because people would simply drive their new cars home. Thus, these products could cause significant distortions of competition if VAT differentials continue to exist. The regime applies, however, not only to new cars but also to boats, including pleasure boats; aircraft; motorcycles; etc.

According to this special regime, the intra-community sale of new means of transportation is VAT exempt in the country of ori-

135. EC Commission, Guide to VAT, p. 4; A.J. Rädler, *Die Grundzüge der Umsatzbesteuerung im Binnenmarkt*, 1 IStR 2 at 4 (1992).

136. This proposed Seventh Directive is still pending in the Council, see G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtDE 79, 118 (1991).

137. EC Commission, Guide to VAT, p. 4; H. Nieskens, *Das Umsatzsteuer-Binnenmarktgesetz*, 47 BETRIEBSBERATER, Beilage 17, p. 9 (1992); H.D. Rondorf, *Das Umsatzsteuer-Binnenmarktgesetz*, 3 EuZW 727, 730 (1992).

gin even if made to a private individual. The good would then be taxed in the Member State of destination. That the taxes are actually paid is insured by tying the VAT payment requirement to the registration process for the vehicle concerned. This appears to be a very practical solution, in particular with respect to cars, as there already is a system of tight control with respect to the requirement of driving only registered cars on public roads.

c. Fraud prevention and exchange of information

Since the transitional system will not benefit from the "self policing" nature of the internal VAT,¹³⁸ additional control mechanisms were devised by the Member States.¹³⁹

As mentioned above, the economic operators must verify that their customer has a VAT number, and must report the total value of their intra-community supplies to each customer (identified by the VAT number) on a quarterly basis to the tax authorities. On the basis of a computerized system, Member States will regularly exchange the information thus received. Tax authorities on both ends of the transaction know or can determine the turnover declared by the traders involved. The system also has a second function. All Member States' tax authorities will have access to all VAT numbers and the corresponding company name of the economic operators established in other Member States. Thus, a trader who wishes to determine whether his customer really is registered for VAT purposes and has a "valid" VAT number can contact his own tax authority to verify information supplied by the customer.

As data protection laws in Member States restrict tax authorities from communicating information covered by the "tax secret" to other tax authorities in the Community, the EC needed to adopt special rules to authorize the data transfer. Therefore, the Council adopted the respective Regulation.¹⁴⁰

138. See *supra* Section III(3).

139. See M. Langer, *Umsatzsteuer und Binnenmarkt*, 44 DER BETRIEB 462, 465 (1991); A.J. Rädler, *die Grundzüge der Umsatzbesteuerung im Binnenmarkt*, 1 IStR 2, 5 (1992).

140. Council Regulation 218/92 of 27 January 1992 on Administrative Cooperation in the Field of Indirect Taxation, 1992 O.J. (L 24) 1.

4. Approximation of the Tax Rates

After very extensive deliberation the Ministers of Finance managed to agree on certain lower limits for the VAT rates.

Under the pre-1993 system, determination of the VAT rates was left entirely to the Member States. In fact, the rates as well as the goods and services to which they applied differed significantly.¹⁴¹ Were these rates to be left unchanged, a strong trade-diverting effect would have been created, especially between neighboring countries where large VAT-induced price differences would have led to an artificial trade diversion and possible tax fraud.¹⁴²

The trade diversion would only apply to sales to the ultimate consumer or tax-exempt entities (government agencies, banks, hospitals).¹⁴³ For the taxable person, the VAT is only a transient position, whether it is high or low is of little interest because any VAT payment he makes can be credited against his VAT-receipts. The rate of the VAT, however, is important to the final consumer, and his buying behavior will be influenced by high VAT differentials.¹⁴⁴ Most Consumers would find it an attractive idea to travel from say, France to Luxembourg or Spain, if they could find the goods for 6.6% less due to the VAT differential. In case of luxury items (say a luxury car) the differential can be far greater (e.g. 33.33% in France, 14% in Germany equals a 19.33% price difference).¹⁴⁵

The willingness of the final consumer to take advantage of this price difference is limited by several factors. The cost of transportation is a major one,¹⁴⁶ but there are other factors such as the nuisance caused by having to spend time and effort in an unknown shopping environment, differences in warranty rules, etc. The Commission concluded that only significant VAT differentials

141. See *supra* at Section III(2)(f).

142. EC Commission, Completion of the Internal Market: Approximation of Indirect Tax Rates and Harmonization of Indirect Tax Structures, COM (87)320 final at 2, p.11; see also S. Menner, A. Haufler, *Wettbewerbsverzerrungen und Harmonisierung der Umsatzsteuer im Europäischen Binnenmarkt*, 37 RECHT DER INTERNATIONALEN WIRTSCHAFT 128 (1991).

143. See *supra* at Section III(2)(e).

144. See EC-Commission, COM(87)320 final at 2, p.11; Chr. Prout, FIDE 1990, p. 283, 294; M. Bos, H. Nelson, *Indirect Taxation and Completion of the Internal Market of the EC*, 27 JOURNAL OF COMMON MARKET STUDIES [JCMSt] 27, 38 (1988).

145. See table of pre-1993 VAT rates, *supra* at Section III(2)(f).

146. See EC-Commission, COM(87)320 final at 2, p.11; M. Bos, H. Nelson, *Indirect Taxation and Completion of the Internal Market of the EC*, 27 JCMSt 27, 38 (1988).

would lead to considerable trade diversion and tax fraud.¹⁴⁷ Therefore, it was not strictly necessary to reach a point where all Member States charge the exact same tax rate for a particular product. The differentials had only to be limited, especially between neighboring states. A one rate harmonization would not have been politically realistic, because the revenue problems created would have been too large for several Member States.¹⁴⁸

The proposal for an approximation directive dealt with three technical problems: the number of rates, their level, and the allocation of goods and services to the rates.¹⁴⁹ The proposal called for the introduction of two different rates in all Member States: a reduced and a standard rate.¹⁵⁰ Presently, almost all Member States use more than one rate, and the Commission took that as an indication that some differentiation was desired. However, it did not propose a three rate system, which was considered to create too many complications and ambiguities. To clearly define which rate ought to be applied to which service or good would be difficult. While the pre-1993 reduced tax rates had a certain common denomination with respect to the products they applied to, the increased tax rates did not. The reduced tax rates comprised about 30% of the taxable basis,¹⁵¹ while the increased rates in their diversity only applied to about 10%.¹⁵²

On the basis of this proposal (as modified),¹⁵³ but only after significant discussions, the Council of Ministers agreed¹⁵⁴ to allow standard and reduced rates only. However, they agreed that each Member State should be allowed to have two different reduced

147. EC Commission, COM(87)320 final at 2, p.11.

148. EC Commission, COM(87)320 final at 2, p.11; S. Menner, A. Haufier, *Wettbewerbsverzerrungen und Harmonisierung der Umsatzsteuer*, 37 RECHT DER INTERNATIONALEN WIRTSCHAFT 128 (1991), claiming that a rate unification is legally necessary; this isolated opinion is not shared by the author.

149. EC Commission, Proposal for a Council Directive supplementing the Common System of VAT and amending Directive 77/388 on Approximation of VAT rates, COM(87)321 final at 2, p.1, revised proposal, 1990 O.J. (C 176) 8.

150. EC Commission, COM(87)320 final at 2, p.11; proposed art. 12(3)Sixth Directive as amended by EC Commission, Proposal for a Council Directive Supplementing the Common System of VAT and Amending Directive 77/388: Approximation of VAT rates, COM(87)321 final at 2, p.1.

151. EC Commission, COM(87)320 final at 2, p.11.

152. EC Commission, COM(87)320 final at 2, p.10.

153. See revised EC Commission proposal of 17 July 1990, 1990 O.J. (C 176) 8.

154. Council Directive 92/77 of 19 October 1992 Supplementing the Common System of Value Added Tax and Amending Directive 77/388 on Approximation of VAT Rates, 1992 O.J. (L 316) 1.

rates as had previously been the case in some Member States.

A more important deviation from the original proposals by the Commission is that only the lower limits of the VAT rates are fixed. Based on British thoughts, the idea behind fixing only lower limits was the idea that too diverse upper limits would be eliminated by "competition" among Member States. Consumers would, if rate differentials were too great, show an increased tendency to go and buy in a lower rate Member State.¹⁵⁵ That would effectively mean that countries imposing a high VAT rate would lose tax revenue because the turnover would be generated in other Member States.

Thus, the Council of Ministers agreed that the minimum rate of the standard rate as of January 1, 1993 shall be 15%. The normal minimum rate for the reduced rate(s) is set at 5%.

Several Member States have certain zero-rate schemes. The directive allows Member States which presently use zero rates or "super reduced rates" to maintain them to a limited extent and only with respect to goods covered by the reduced rate.

The goods to which the reduced rate must be applied are set out as a new Annex H to the Sixth Directive and include 17 items, most of which refer to basic needs of the population (foodstuffs, water supplies, pharmaceutical products, medical equipment for the disabled, transport of passengers, supply of books, newspapers and periodicals, admission to theater shows, etc.).¹⁵⁶

V. THE ORIGINAL SITUATION AND THE PLANS FOR HARMONIZATION WITH RESPECT TO EXCISE DUTIES

1. Excise Duties Before Harmonization

Before the end of 1992, a wide variety of excise duties existed in the various Member States. The variety covered not only the types of excise duties levied but the rate and tax structures applied as well.

The following table shows the revenue generated in the various Member States with respect to their various excise duties.¹⁵⁷

155. The Belgian experience shows that such competition exists, see M. Dassesse, *Rapport national belge*, FIDE 1990, p. 31, 34.

156. Annex H is published with Directive 92/77 of 31 October 1992, 1992 O.J. (L 316) 4.

157. S. Cnossen, *Harmonization of indirect taxes in the EEC*, BRITISH TAX REVIEW, 232, 234.

SEE TABLE 1. EEC: Revenue Importance of Sales Taxes and Excises, 1980

The bulk of the revenue is generated by three types of excise duties: tobacco, mineral oil and alcohol. The relative insignificance of the rest of the excise duties is set out in the following table, indicating the (lack of) importance of such "nuisance taxes".¹⁵⁸

SEE TABLE 2. EEC: Receipts from Nuisance Taxes, 1980.

In order to reduce the large variety of taxes and their distorting effects on competition, the Commission initiated proposals for the harmonization of such excise duties as early as 1972. However, little progress was made for many years, with some exceptions in the case of excise duties on manufactured tobacco.¹⁵⁹

The reason for the slow progress was attributed by the Commission to "a symbiotic relationship between national industries and national excises".¹⁶⁰ However, Community Law was not without impact on the national excise duty laws. Some of the more protectionist forms of excise duties were struck down by the Court of Justice,¹⁶¹ usually because they were discriminatory in the sense of Article 95 of the Treaty. The evolving body of case law provided some guidance for the Commission and the Member States with respect to the basic principles which the proposals and the final compromise had to comply with.

2. The Development of Plans for Harmonization

In its first proposals, the Commission had attempted to tackle the excise duty harmonization in the same way as the VAT harmonization - harmonizing the tax structure first and worrying about the tax rates later. Its proposals for the structural harmonization date as far back as 1972.¹⁶² The proposals were not accepted at

158. *Id.* at 232, 251.

159. See Chr. Prout, FIDE 1990, p. 283, 304; S. Cnossen, *Harmonization of indirect taxes in the EEC*, BRITISH TAX REVIEW, 232, 245 (1983).

160. Quoted by S. Cnossen, *Harmonization of indirect taxes in the EEC*, [1983] British Tax Review, 232 (245).

161. Case 170/78, *Commission v. United Kingdom*, 1980 E.C.R. 417; Case 168/78, *Commission v. France*, 1980 E.C.R. 347.

162. The framework of the Commission's proposals is laid down in the Bulletin of the European Communities, Suppl. 3/72; see also Report to the Council on the Scope of Convergence of Tax Systems in the Community, 20 March 1980, COM(80)139 final; for subsequent proposals see K.R. Simmonds (Ed.), *Encyclopedia of European Law* (looseleaf), Vol B., para B-10-230, London (1974). In the context of the white paper the Commission published specific proposals, see COM(87)325 final at 2 through COM(87)328 final at 2.

that time. This was due to a certain general reluctance, after the first enlargement of the Community, to deepen the integration process because of the many technical difficulties which were noticed to their full extent only when the proposals were discussed and analyzed in detail and also due to the very diverse interests of the Member States (some produce wine, others beer, others cigarettes, etc.).¹⁶³

When the Commission published the "White book", it believed that, with the disappearance of border tax adjustments, a difference in excise duty rates would greatly distort competition.¹⁶⁴ It therefore pursued a strategy of having both the structural proposals and the rate unification adopted at the same time.¹⁶⁵ The Commission intended to abolish all but three types of excise taxes.¹⁶⁶ Only the excise on the use of alcohol, cigarettes and mineral oils would be maintained. These excises would not only be harmonized, but effectively unified.¹⁶⁷ To reduce the impact of possible revenue disruption, the Commission proposed unified rates on the basis of the average rate of the duties in the various Member States. While use of a weighted average ensures complete revenue neutrality on the level of the Community as a whole, an arithmetic average gives equal weight to each Member State, that, in itself, being an important principle of the Community's structure.¹⁶⁸ The Commission, therefore, proposed a combination of the two averaging methods.

The Commission felt that the VAT proposals left enough room for maneuver in order for the Member States to allow a "unification" of the excise taxes. Several arguments support that view.

163. Chr. Prout, FIDE 1990, p. 283, 305; see also W. Ritter, *Steuerharmonisierung als Voraussetzung eines EG-Binnen-marktes*, 44 BETRIEBSBERATER 77, 81 (1989).

164. Since excise duties amount to cost factors for the business community (unlike the VAT) even relatively small rate differentials will induce diversion of trade; see M. Bos, H. Nelson, *Indirect Taxation and the Completion of the Internal Market of the EC*, 27 JCMSt 27, 38 (1988).

165. EC Commission, COM(87)320 final at 2, p. 15,16.

166. See EC Commission, COM(87)320 final at 2, p. 15; see also proposed Council "Framework Directive" submitted on March 7th, 1972, Bulletin of the European Communities, Suppl.3/1972; Alex Easson, *Tax Harmonization in the EEC: The Commissions program*, BRITISH TAX REVIEW 329, 331 (1981).

167. See G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtDE 79, 120 (1991); M. Bos, H. Nelson, *Indirect Taxation and the Completion of the internal market of the EC*, 27 JCMSt 27, 41 (1988).

168. See EC Commission, COM(87)320 final at 2, p. 16; see also M. Bos, H. Nelson, *Indirect Taxation and Completion of the Internal Market*, 27 JCMSt 27, 42 (1988).

VAT is charged on top of any applicable excise duty.¹⁶⁹ Any differences with respect to such duties will automatically have repercussions on the VAT. It seems sensible to avoid this inherent instability and instead to permit the Member States some leeway with respect to the VAT rates in order to satisfy their budgetary needs.

Secondly, and more importantly, excise tax differentials have a much stronger impact on commerce and trade than VAT differentials.¹⁷⁰ The VAT paid by an enterprise to its supplier is only a transient figure and not a real cost factor, because of the right to a set-off.¹⁷¹ Excise duties, however, constitute a real cost factor. The rate of the excise is a determining factor for the cost (and the price) of a taxed product. Producers of goods which are subject to the excise duty or producers which need raw material for which an excise duty is imposed have a competitive advantage if they produce at a place where a low excise duty applies.

Under the pre-1993 system, border tax adjustments tied to import/export procedures (as in the case of VAT) ensure tax neutrality.¹⁷² Once border controls and adjustments disappear, problems arise. The important difference between VAT and excise taxes is, therefore, that trade diversion is likely to occur with excise taxes on all production levels, while VAT differentials create trade diversion only insofar as they constitute a cost factor - and that occurs only at the level of the final consumer.¹⁷³

Since excise duties are much more likely to interfere with the goals of the Common Market and the neutrality of competition, it seemed appropriate to try to eliminate those differentials altogether.

A complete unification, coupled with a system where excise duties are imposed once the goods are released from bond, would have allowed the removal of fiscal frontiers without creating the need for compensation between Member States, as in the case of VAT. The destination principle with respect to commercial trans-

169. G. Montagnier, *Fiscalité*, 24 RtDE 518, 528 (1988).

170. See M. Bos, H. Nelson, *Indirect Taxation and the Completion of the Internal Market of the EC*, 27 JCMSt 27, 41 (1988).

171. See *supra* Section III(f)-III(g).

172. S. Cnossen, *Harmonization of indirect Taxes in the EEC*, BRITISH TAX REVIEW 232, 235 (1983).

173. Certain entities are in a similar situation as the final consumer: such as, the VAT exempt sector (banks, insurance, health care) and government entities, see *supra* Section III(2)(e).

actions would have been effectively ensured by economic logic: since the duty is identical it makes sense to wait as long as possible to release it from bond. The real taxable event (release from bond) would then generally take place in the country of final consumption.¹⁷⁴

However, the Commission seemed to have underestimated both the weight of the "symbiotic relationships" and the importance which national treasuries attach to their fiscal sovereignty. The proposals met with significant resistance in various Member States. As in the case of the VAT, Member States indicated that they would not accept upper limits even with respect to excise taxes.

The Commission was forced to restructure its proposals.¹⁷⁵ Harmonization of the tax structure coupled with a minimum rate was proposed instead of a perfect unification of excise taxes.

This change in the structure of the approach had one major impact. With a unified excise tax, relatively simple rules on the control of the movement of goods subject to an excise before it is levied would have been sufficient. However, if tax rate differentials exist, it is necessary to ascertain compliance with the destination principle and to ensure that the distortion of competition and the budgetary effects are kept to a minimum. For this reason it was necessary to devise a system which monitors the movement of such goods and ensures that the excise duties in the context of commercial transactions are paid in the country of consumption (that is, the country of destination).

VI. THE RULES ON EXCISE DUTIES APPLICABLE AS OF JANUARY 1, 1993

The Finance Ministers of the Member States came under increasing political pressure after the heads of state¹⁷⁶ reaffirmed their political commitment to remove the border controls as of January 1, 1993.

At the end of 1990, they agreed in principle that goods subject to excise duties would move within the EC under a system of inter-

174. See EC Commission, COM(87)320 final/2, p. 7; G. Montagnier, *Fiscalité*, 24 RtDE 518, 531 (1988).

175. See EC Commission, modified proposals, COM(89)525 final through COM(89)527 final; G. Montagnier, *Harmonisation Fiscale Communautaire*, 27 RtDE, 79, 121 (1991).

176. *E.g.*, the European Council, EC-Bulletin December 1990 para. 1.11.

connected warehouses.¹⁷⁷ In the course of the year 1991, they agreed in principle to accept a harmonized excise structure and minimum rates, but were still far from a compromise as to concrete details.

The first important definitive step was the adoption in February 1992 of a directive to monitor the movement of goods subject to excise duties within the EC.¹⁷⁸ These rules had to be adopted, pending resolution of the issues related to the details of the structure and rate of the excise duties, to allow the enterprises and tax administration involved sufficient time to prepare for the implementation of such measures by the end of 1992.

Then, in July 1992, the Ministers agreed on minimum VAT and excise duty rates pending resolution of more technical issues and certain derogations for Member States. Finally, during their meeting of October 19, 1992, most of the remaining issues were resolved and the excise duty directives were adopted.¹⁷⁹

1. The General System Regarding Goods Subject to Excise Duties

The removal of frontiers and border checks made it necessary to find other means of monitoring the movement of goods which are subject to excise duties, especially for those goods whose duty is not yet paid. If the aim is to ensure payment in the country of consumption, one must also keep track of such goods for which the duty has been paid.

Even before the introduction of the new system, goods subject to excise duties were normally stored in bonded warehouses and duties were paid only when the goods were actually needed (processed, sold) upon removal from bond. The new Directive is based on this existing feature.¹⁸⁰ It calls for the establishment of a network of bonded warehouses. The network allows the free movement of goods between bonded warehouses in one Member State to those of another without the duty becoming due. The release from bond triggers the excise duty to become due in the Member

177. G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtDE 79, 122 (1991).

178. Council Directive 92/12 of 25 February 1992 on the General Arrangements for Products Subject to Excise Duty and on the Holding, Movement and Monitoring of Such Products, 1992 O.J. (L 76) 1, Subsequently Amended to Introduce Certain Procedural Simplifications, Council Directive 92/108, 1992 O.J. (L 390) 124.

179. See generally, H. Jatzke, *Das neue Verbrauchssteuerrecht im EG-Binnenmarkt*, 48 BETRIEBSBERATER 41 (1993).

180. Council Directive 92/12, arts. 6, 15, 1992 O.J. (L 076) 1.

State of consumption (that is, the destination).

In order to facilitate trade in such goods even further, the Directive allows transactions between bonded warehouses and certain categories of commercial buyers of bonded goods,¹⁸¹ where the suspension of the excise duty is extended to such transaction (duty becomes due upon arrival at the commercial buyer, who is described as either a registered trader or a non-registered trader, the latter has to put up a guarantee in the amount of the duty due upon arrival of the goods).

To ensure the destination principle, goods for which the duty has been paid in one Member State but which are "exported" for commercial purposes to another Member State will be subject to the excise duty upon arrival in the new Member State. The buyer can reclaim the excise duty in the Member State of origin, provided that certain administrative procedures were followed with respect to the transaction.¹⁸²

However, the transactions of private parties for non-commercial purposes do not require the excise duty in the country of destination and a refund cannot be claimed in the country of origin. Thus, for those transactions the origin principle applies. Private use is deemed to exist for transactions below certain threshold quantities, but if an individual can prove that larger than threshold quantities are not intended for commercial use, they will be treated as non-commercial. Hence, the internal frontiers will disappear only for the private individuals, while commercial traders will only avoid border controls but will remain subject to the duty of the country of consumption.

Certain technical details as regards paperwork and procedures to be followed were criticized as impractical. Thus, on December 14, 1992, the Council adopted some last minute changes and transitional rules (as it did as regards the VAT rules) in order to accommodate some of the criticism.¹⁸³

2. Harmonization with Respect to Tobacco¹⁸⁴

In December 1972 the Council adopted Council Directive

181. Council Directive 92/12, art. 6, 1992 O.J. (L 076) 1.

182. Council Directive 92/12, art. 22, 1992 O.J. (L 076) 1.

183. Council Directive 92/108 of 31 December 1992, 1992 O.J. (L 390) 24.

184. See COM(87)325 final at 2; COM(87)326 final at 2, G. Montagnier, *Fiscalité*, 24 RtDE 518, 537 (1988); G. Montagnier, *Harmonisation fiscale communautaire*, 27 RtDE 79,

72/464/EEC,¹⁸⁵ which has been amended subsequently.¹⁸⁶ A second directive was adopted in December 1978.¹⁸⁷

The objective of the measures is to harmonize the tax structure. The Member States undertook not to burden manufactured tobacco with any indirect tax other than VAT and the excise duty described in the Directives.¹⁸⁸ Manufactured tobacco is said to include cigars, cigarettes, cigarrillos and other forms of smoking tobacco. Snuff and chewing tobacco, included in the original definition, have been excluded from the scope of application¹⁸⁹ as part of the recent compromise. The second Directive defines these terms, allowing some differing national traditions to be maintained.¹⁹⁰

The excise duty on cigarettes must contain two elements - a specific (fixed) per unit part and a proportional (ad valorem) part, to be calculated on the maximum retail price.¹⁹¹ In addition, VAT must be charged. The fixed part must be kept within certain limits.¹⁹² The Member States may also impose a minimum tax, provided that it does not exceed 90% of the total tax charged to the most popular price category for cigarettes or fine cut tobacco.¹⁹³

The Directive also leaves the manufacturers and importers free to set the maximum retail selling price for each of their products,¹⁹⁴ although the states are free to maintain or introduce price control mechanisms.¹⁹⁵

823 (1991); H. Jatzke, *Das neue Verbrauchssteuerrecht im EG-Binnenmarkt*, 48 *BETRIEB-SBERATER* 41, 42 (1993).

185. Council Directive 72/464 of 19 December 1972 on Taxes Other Than Turnover Taxes Which Affect the Consumption of Manufactured Tobacco, 1972 O.J. (L 303) 1.

186. An important modification was introduced by Council Directive 77/805 of 19 December 1977, 1977 O.J. (L 338) 22; the Directive 72/464 was last amended by Art 1 of Council Directive 92/78 of 19 October 1992, 1992 O.J. (L 316) 5.

187. Second Council Directive (79/32/EEC) of 18 December 1978 on taxes other than turnover taxes which affect the consumption of manufactured tobacco, O.J. L 10/8 of 16.1.1979, last amended by Art. 2 of Council Directive 92/78/EEC of 19.10.1992, O.J. L 316/5 of 31.10.1992.

188. Shoup, in: Smit Herzog, *The Law of the EEC, Commentary*, Release 11-8/84, Art. 99.06 p. 3-466.10; S. Cnossen, *Harmonization of indirect taxes in the EEC*, *BRITISH TAX REVIEW*, 232, 246, 248 (1983).

189. Council Directive 72/464 as amended by Directive 92/78.

190. Council Directive 79/32 of 18 December 1978 on Taxes Other than Turnover Taxes Which Affect the Consumption of Manufactured Tobacco, 1979 O.J. (L 10) 8.

191. See Council Directive 92/79, art. 1(2) of 19 October 1992, 1992 O.J. (L 316) 8.

192. See Council Directive 72/464, art. 10(b) as amended.

193. Council Directive 72/464, arts. 10(b), 10(c)(5) as amended.

194. Council Directive 72/464, art. 5(1).

195. Council Directive 72/464, art. 5(2); see also, *Case 13/77 G.B. Inno v. A.T.A.B.*, 1977 *E.C.R.* 2115 (2150, para. 64).

The Commission proceeded on the basis of existing legislation. The 'three elements taxation', consisting of the fixed excise duty, the ad valorem portion and VAT part, will continue to apply to cigarettes. Also with respect to cigarettes, the compromise calls for an overall minimum duty level of 57% of the retail selling price of the price category most in demand.¹⁹⁶ The Member States can allocate this to the fixed and ad valorem part of the duty as they see fit, provided that the overall minimum duty rate is maintained. With respect to the other types of tobacco, Member States have a choice.¹⁹⁷ They can introduce either:

- an ad valorem duty,
- a specific duty by 'quantity',
- or a combination of both.

The minimum duty is as follows:

- for cigars and cigarettes: 5% of the retail selling price OR ECU 7 per 1000 items or per kilogram,
- for fine cut smoking tobacco intended for the rolling of cigarettes: 30% of the retail selling prices OR ECU 20 per kilogram,
- for other smoking tobaccos: 20% of the retail selling price OR ECU 15 per kilogram.

The Commission had based its original proposals on the arithmetic average between the tax rates as they are presently levied by the Member States. In choosing the arithmetic average, which caused the tax rate to be higher than with a weighted average, the Commission took into account that its health policy calls for a reduction of tobacco consumption.¹⁹⁸ Using the tax provisions of the Treaty to implement the health policy may reach a "grey zone" of Community Law,¹⁹⁹ but similar ideas are pursued by Member States. The final compromise on the duty rates has reduced the originally proposed rates. The Directives do not mention health policy considerations in their recitals. It is unclear whether this is a reaction to criticism as to the legality of using the tax provisions of

196. Council Directive 92/79, art. 2, on the Approximation of Taxes on Cigarettes, 1992 O.J. (L 316) 8.

197. See Council Directive 92/80, art. 3, on the Approximation of Taxes on Manufactured Tobacco Other Than Cigarettes, 1992 O.J. (L 316) 10.

198. See EC Commission, Report to the Parliament on the Harmonization of Excise Taxes, COM(82)61 final; EC Commission, Europe against Cancer, COM(86)717 final.

199. Pierre H. Teitgen, Colette Megret, *La fumée de la cigarette dans la "zone grise" des compétences de la C.E.E.*, 17 RtDE 68 (1981).

the EC Treaty to pursue health policy concerns.²⁰⁰

3. Harmonization with Respect to Mineral Oils

In August 1973 the Commission proposed a Directive to harmonize the structure of the excise duties on mineral oils.²⁰¹ The Directive defined the taxable products with reference to the Common Customs Tariff.²⁰²

The new proposals²⁰³ of the Commission and the compromise reached by the Council²⁰⁴ follow this approach.²⁰⁵ A broad definition of mineral oils (including certain gaseous hydrocarbons) includes various special categories, namely petrol (gasoline in leaded and unleaded form), gas oil (diesel), heavy fuel oil, liquid petroleum gas (LPG) and kerosene. Directive 92/82 establishes rates which ought to be charged by the Member States with respect to the defined products. The rates for some products vary, however, depending on the use of the mineral oil. The highest rate applies if the product is used as a propellant for motor vehicles; a medium rate if the product is used in stationary motors, plants or machinery for construction, civil engineering, and public works; with the most favorable rate applying to mineral oils used for heating purposes.

The following rates were fixed:²⁰⁶

200. See John W. O'Hagan, Kevin M. Carcy, *The Proposal for Upward Alignment of Tobacco Taxes in the European Community: A Critique*, BRITISH TAX REVIEW 329 (1988).

201. EC Commission, Proposal for a Council Directive on the Harmonization of Excise Duties on Mineral Oils, COM(73)1234, 1973 O.J. (C 92) 36.

202. Proposal for a Council Directive on the Harmonization of Excise Duties on Mineral Oils, COM(73)1234, 1973 O.J. (C 92) 36.

203. EC Commission, Proposal for a Council Directive Concerning the Approximation of the Rates of Excise Duties on Mineral Oils, COM(87)327 final at 2.

204. Council Directive 92/81 of 19 October 1992 on the Harmonization of the Structures of Excise Duties on Mineral Oils, 1992 O.J. (L 316) 12, *as amended as regards certain technical details by*, Council Directive 92/108, 1992 O.J. (L 390) 24; Council Directive 92/82 of 19 October 1992 on the Approximation of the Rates of Excise Duties on Mineral Oils, 1992 O.J. (L 316); Council Decision 92/510 of 19 October 1992 authorizing Member States to maintain certain reduced tax rates, 1992 O.J. (L 316); *see also*, H. Jatzke, *Das neue Verbrauchssteuerrecht im EG-Binnenmarkt*, 48 BETRIEBSBERATER 41 (1993).

205. Council Directive 92/81, art. 2; Council Directive 92/82, art. 2.

206. Council Directive 92/82, arts. 3,8.

TYPE OF OIL	PROPULSION	STATIONARY MOTORS, ETC.	HEATING
Unleaded Petrol	287 ECU/1000l	287 ECU/1000l	287 ECU/1000l
Leaded Petrol	337 ECU/1000l	337 ECU/1000l	337 ECU/1000l
Gas Oil	245 ECU/1000l	18 ECU/1000l	18 ECU/1000l
Heavy Fuel Oil	13 ECU/1000kg	13 ECU/1000kg	13 ECU/1000kg
LPG Methane	100 ECU/1000kg	36 ECU/1000kg	0 ECU/1000kg
Kerosene	245 ECU/1000kg	18 ECU/1000kg	0 ECU/1000kg

The advantage granted to unleaded fuel reflects the present situation of the Member States, but is also an expression of the environmental policy pursued by the Commission.

The use of mineral oils for purposes other than in motors or for heating is to be exempt from the duty, as well as for use in air and sea navigation (private planes and pleasure crafts are not exempted).²⁰⁷

Due to the large variety of existing exemptions, reductions, special rules, etc., the compromise allows the Member States to continue to apply a large number of exemptions either permanently or for a limited time period.²⁰⁸

4. Harmonization of the Excise Duty on Alcohol

Prior to the publication of the "White book", all Member States taxed the consumption of alcohol through excise duties.²⁰⁹ As alcohol serves many different functions, many different types of alcohol exist. Excise taxes have traditionally been imposed only on

207. Council Directive 92/81, art. 8.

208. Council Directive 92/82, arts. 3,4,5,9; Council Directive 92/81, art. 8; Council Decision 92/510.

209. S. Cnossen, *Harmonization of Indirect Taxes in the EEC*, BRITISH TAX REVIEW 249 (1983); Commercial Clearing House, Common Market Reporter (Looseleaf), art. 99 para. 3201.09 (Chicago 1962-1989).

ethyl alcohol fit for human consumption. Denatured alcohol, which is unfit for human consumption, has been traditionally outside the scope of the tax.

The scope and structure of the tax varied widely. However,²¹⁰ many important differences remained, such as differences between distilled and fermented alcoholic beverages, beer, wine and sparkling wines, intermediate products and such products which contain drinkable (undenatured) ethylic alcohol, like cosmetics, perfumes and toiletries.

The compromise²¹¹ on the structural harmonization of the excise duties on alcohol is based on existing rules in some Member States and on "pre-White book" proposals.²¹² They define several types of alcoholic beverages to which different tax rates²¹³ apply. These different types are defined through a reference to the Common Customs Tariff (the so called "combined nomenclature").

The rate approximation was an unusually difficult task. In its proposal,²¹⁴ the Commission not only had to take into account the general objectives, such as revenue neutrality and cost structure maintenance, but it also had to consider several principles²¹⁵ which had been subject to litigation in the Court of Justice.

The Court had established that Member States could not protect their local beer production by charging higher duties on (imported) wine than on the (locally produced) beer.²¹⁶ Similar rules applied to the taxation of spirits.²¹⁷

210. S. Cnossen, *Harmonization of Indirect Taxes in the EEC*, BRITISH TAX REVIEW 249 (1983); Commercial Clearing House, Common Market Reporter (Looseleaf), art. 99 para. 3201.09 (Chicago 1962-1989).

211. Council Directive 92/83 of 19 October 1992 on the Harmonization of Excise Duties on Alcohol and Alcoholic Beverages, 1992 O.J. (L 316) 21; see also, H. Jatzke, *Das neue Verbrauchssteuergesetz im EG-Binnenmarkt*, 48 BETRIEBSBERATER 41 (1993).

212. See EC Commission, Proposal for a Council Directive Concerning the Harmonization of Excise Duties on Alcoholic Drinks, COM(82)153 final; see also Commercial Clearing House, Common Market Reporter (Looseleaf), art. 99 para. 3201.09 (Chicago 1962-1989).

213. Council Directive 92/84 of 19 October 1992 on the Approximation of the Rates of Excise Duty on Alcohol and Alcoholic Beverages, 1992 O.J. (L 16) 29.

214. EC Commission, Proposal for a Council Directive on the Approximation of the Rates of Excise Duty on Alcoholic Beverages and on the Alcohol contained in other Products, COM(87)328 final at 2.

215. See J. Sedemund, *Wettbewerbsneutralität als Verfassungsgebot bei der Steuerharmonisierung für alkoholische Getränke*, 2 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTS-RECHT 658 (1991).

216. Case 170/78, *Commission v. United Kingdom*, 1980 E.C.R. 417, see also [same case] 1983 E.C.R. 2265 (Re: excise duties on wine).

217. Case 168/78, *Commission v. France*, 1980 E.C.R. 347.

A reduced rate can be applied to products from small distilleries.

The Directive on the harmonization of the tax structure contains a number of exemptions²²⁶ from the excise duty. Denatured alcohol (made unfit for human consumption) is not subject to the duty, and a refund can be obtained for a duty paid for alcoholic drinks which, due to their age or condition, become unfit for human consumption after the duty has been paid. The Member States may exempt other uses of alcohol (use in medicinal products, scientific research, etc.).

5. Summary

The three groups of products which have traditionally generated substantial revenues for Member States will continue to benefit them. While excise duties on other products are not formally banned, the use of such duties will decrease because collection of such duties may not be associated with frontier controls and the products would not be circulating within the bonded warehouse system.²²⁷ Hence, several Member States have abolished other forms of excise duties (e.g. Germany eliminated its sugar, salt and lamp taxes). On the whole, the tax structure with respect to indirect taxes will be much less diverse and easier to understand as of January 1, 1993.

VII. EVALUATION

The plan to create a single European Market is as old as the Communities themselves. However, the expectations people had of a free and open Europe when the Communities were founded²²⁸ was not quick to materialize. Indeed, the expectation has still not turned into reality - despite many advances.

During the eighties it was felt that the "Common Market" was not likely to turn into a truly integrated market unless there was additional legal and political momentum. "Eurosclerosis" was feared. The most important counter-move was a parliamentary effort: the draft treaty establishing the European Union.²²⁹ The

226. See Council Directive 92/83, art. 27.

227. See Council Directive 92/12, art. 3.

228. Students burning customs barriers were the celebrated public messengers of those feelings.

229. Draft Treaty establishing the European Union, adopted by parliament on 14 Feb-

Treaty, after having focused the discussion in both political and academic circles, led to the subsequent White Paper of the Commission²³⁰ and its general endorsement by the European Council. This resulted in the drafting and subsequent adoption of the Single European Act,²³¹ which called for the implementation of the Internal Market before the famous deadline of December 31, 1992.²³²

The drafters of the Single European Act could not know that, by the time the White Paper projects were about to reach the finish line, they would face important competition from political attention and substantial skepticism from the people because yet another "Euro-project" was under discussion. The Maastricht Treaty, which deals with quite different issues, was negotiated and subsequently debated in national parliaments in 1991 and 1992. The negative first Danish referendum increased the skepticism and many old "euro-sins" (e.g. the cost of agricultural subsidies, the lack of democratic structures) were associated with Maastricht or the Single European Act, even if these Treaties had been intended to remedy the problems in part or had nothing to do with the problems.

The discussions and problems relating to the Maastricht Treaty may, however, have actually aided in the process of having the 1993 White Paper projects adopted, because many governments needed "European results" both internally (to be able to claim that European issues were high on the agenda and that the government had again been successful in defending the countries' interests in Europe) and because they realized that a standstill would increase skepticism and would amount to a step back.

The Commission has increasingly forcefully advocated its opinion that no border controls can be maintained for any reason after January 1, 1993. It fears that the continued use of border controls for any reason would cause Member States to use them for other old purposes as well. It has therefore threatened to sue those Member States which do not abolish the controls.²³³

ruary 1984; See F. Capotorti, M. Hilf, F. Jacobs, J.P. Jaqué, *The European Union Treaty*, Oxford 1986.

230. EC Commission, *Completing the Internal Market*, White paper from the Commission to the European Council, COM(85)310 final of 14 June 1985.

231. Single European Act of 28 February 1986, *Bulletin of the European Communities*, Suppl. 2/1986.

232. ART. 8 A EEC TREATY, *as amended* by the Single European Act.

233. See EC Commission, *Communication on the Lifting of Internal Border Controls*,

The remaining intra-community borders fulfill only limited functions.²³⁴ A limited number of immigration controls are carried out and compliance with certain sanitary and safety regulations is checked, but it is an important remaining function of the border controls to monitor the importation or exportation of goods, so that the tax adjustments associated with import and export can be carried out.

Recently some skepticism has arisen concerning whether immigration controls can (or should) be abolished. The Schengen Agreement which was intended to move such controls to the external borders has not been ratified yet, and the (illegal) influx of many Eastern European immigrants had not been expected at the time the Single European Act was adopted. Similarly, issues of crime control and fighting drug trafficking are used to defend the need for some border controls. It is difficult to determine (and certainly falls outside the scope of this article) what effect these discussions will have.

For an evaluation of the results of tax harmonization it suffices to note that the removal of the need to use border controls for tax adjustments is an indispensable requirement for abolishing internal frontiers. The success of the idea of a Single European Market, therefore, depends to a very large extent on whether a workable solution is adopted with respect to "tax-borders".

Evaluating the Commission's original proposal from a technical standpoint reveals that the Commission kept its promise to present functional solutions, which insist on the abolition of the tax frontiers in their entirety.²³⁵ However, the original proposals will only be adopted (probably in a modified form) as part of the final system, envisaged by the Council for January 1, 1997.

The transitional VAT rules continue to apply the destination principle, which assumes the existence of countries and borders. However, the system complies with the important overall aim - it

of 6 May 1992, Europe Documents, No. 1773 of 12 May 1992; see also EC Commission, Seventh Report concerning the implementation of the White Paper, COM(92)383 final of 2 September 1992.

234. Regarding the other issues which need to be clarified before the Internal Market is fully operational, see EC Commission, Seventh Report, COM(92)383 final.

235. Pierre Guieu, Claire Bonnet, *Completion of the Internal Market and Indirect Taxation*, 25 JCMSt 209, 221 (1987); Servaas van Thiel, *Harmonization of Turnover Taxes in the European Communities: Towards the Internal Market without Frontiers*, EUROPEAN TAXATION 77,84 (1988).

will work without frontier *controls*, thus eliminating a large amount of red tape and administrative procedures.²³⁶

It does burden the economic operators with a set of very complex rules for situations where they engage in trading activities which are a little more complex than a simple sale between two parties. The risk of making mistakes is on them, rather than on the Member States' administrations, which may make matters worse if they adopt conflicting interpretations on how the system should operate. Does it make sense, then, to introduce new and complex rules for only four years, and would it not have been easier and wiser to wait four more years and introduce the definitive VAT rules immediately?

In summary, the answer is that it does make sense. It is questionable whether Member States would muster the political will to come to an agreement later. Psychologically, Europe needed to prove to itself that there is progress now. Member States will gain experience in an environment without frontiers. They will be able, on the basis of the new VAT returns, to monitor VAT flows and to assess, to a larger extent, the likely revenue flows at the time of the shift to the origin principle. The national administrations will gain experience in the exchange of large amounts of data. This may eventually become a basis for a clearing mechanism which would contain some of the characteristics of the proposed French "listing system". Thus, Member States may look at the transitional system as a test to determine how the proposed definitive system would work best. The majority of the traders will find it easier to operate under the transitional system than under the old system.

The political evaluation of the final compromise is an even more difficult task. The Commission arrived only at a rough estimate of the impact its proposals would have on the revenues of the various Member States.²³⁷ In particular, those countries which may suffer revenue losses seem to worry.²³⁸ The Member States have not published their complete estimates but have usually determined that they would lose more than the Commission had estimated.²³⁹ France is afraid that it will not be able to raise direct

236. The Commission has estimated that approximately 60 million customs declarations per year will no longer be necessary.

237. See Chr. Prout, *FIDE* 1990, p. 283, 296.

238. P. Guieu, C. Bonnet, *Completion of the Internal Market and Indirect Taxation*, 25 *JCMSt* 209, 219 (1987).

239. The French Prime Minister Rocard called the effect of the proposed VAT rates a

taxes to an extent such that the losses will be compensated.²⁴⁰ This problem will be even greater for countries like Denmark, which not only has a high quota of indirect taxes,²⁴¹ but which already maintains an equally high quota with respect to direct taxes. The countries with comparatively low VAT rates fear the inflationary and the regressive effects of the upward alignment of indirect taxes.²⁴²

Having reached an agreement on the lower levels of VAT and excise taxes, these effects and problems will doubtlessly be analyzed during the course of the coming years on the basis of the actual revenue development. The evolving data will also influence the willingness for further political compromise. The fact that a compromise was finally reached may be an indication that the political will to create a more unified Europe is still alive.

The drive to complete the Internal Market by the end of 1992 has spurred fears of the coming "Fortress Europe", which would exclude third countries' business interests.

This study shows, however, that advantages will accrue for the third country businessmen as well. Red tape will be cut. Once a product has been imported to one of the Member States, it will be easier to send it to another destination within the Common Market.

The Single European Market can be a device to effectively limit the danger of national protectionism. One example may demonstrate that: In 1982 France ordered that all VCRs produced in third countries had to be inspected by the hopelessly understaffed customs office of Poitiers. The inspection had to take place, regardless of whether or not the VCRs had been legally imported into another Member State and enjoyed therefore the privileges of the free movement of goods.²⁴³ By carrying out the inspections at a time when most of the Christmas business imports were to take place, France effectively limited the number of (in particular Japanese) VCRs imported. The Christmas business was lost even

"pauperisation de l'Etat", see G. Montagnier, *Fiscalité*, 24 RtDE 519, 548 (1988); with respect to Belgian estimates see M. Dassesse, *Rapport National Belge*, FIDE 1990, p.31,34.

240. G. Montagnier, *Fiscalité*, 27 RtDE 519, 548 (1988).

241. See EC Commission, *Completing the Internal Market*, White Paper, COM(85)310 final, p. 47 para. 189.

242. See P. Guieu, C. Bonnet, *Completion of the Internal Market and Indirect Taxation*, 25 JCMSt 209, 219 (1987).

243. See EC Commission, *Bulletin of the European Communities*, No. 11/1982, para. 2.1.10; EUROPEAN PARLIAMENT, *Bulletin*, para. 2.4.9; Resolution, 1982 O.J. 334/85 of 20 December 1982, see also EUROPEAN PARLIAMENT, *Documents* 1-872/82 and 1-896/82.

though the Commission brought an infringement procedure²⁴⁴ against France.

Under the provisions which have now been adopted, no French customs control will exist with respect to goods already imported into other Member States. The Single European Market will be an effective buffer against protectionist measures in the interest of a particular Member State.

Looking at 1992 from this angle, the fears that have surfaced in the U.S. and elsewhere with respect to the effects of the Single European Market seem unfounded. Not only European businesses, but also their foreign competition will gain advantages.

244. EC Commission, Bulletin of the European Communities, No. 11/1982, para. 2.1.10.

Table 1. EEC: Revenue Importance of Sales Taxes and Excises, 1980
(In % of Total Tax Revenues)

Kind of Tax	Member States (a)										
	IRL	DK	F	UK	D	I	B	NL	LUX		
Value-Added Tax	14.8	22.1	21.1(b)	14.1	16.8	15.8	16.4(b)	15.9	10.7(b)		
Excises	26.5	13.9	6.7	12.7	8.5	9.3	8.3	6.9	1.2(c)		
Tobacco Prod.	4.6	2.7	0.7	3.3	2.0	1.8	1.8	1.2	(...)		
Alcoholic Bev.	8.9	2.4	0.8	3.1	1.0	0.2	1.1	1.0	0.4		
Spirits	(3.7)	(0.8)	(0.7)(d)	(1.9)	(0.7)	(0.2)	(0.6)(d)	(0.7)	(0.4)		
Wine	(0.5)	(0.4)	(0.1)	(...)(e)	(0.1)	(...)	(0.2)	(0.1)	(...)		
Beer	(4.7)	(1.2)	(...)	(1.2)	(0.2)	(0.1)	(0.3)	(0.2)	(...)		
Motoring	12.4	6.7	4.6	6.3	5.0	6.5	5.1	4.6	0.8		
Fuel (f)	(8.2)	(3.2)	(4.0)	4.1	(3.8)	(6.1)	(4.2)	(2.3)	(...)		
Purchase	(3.6)	(1.8)	(VAT)	(0.6)	(...)	(VAT)	(VAT)	(0.9)	(...)		
Use	(0.6)	(1.7)	(0.6)	(1.6)	(1.2)	(0.4)	(1.0)	(1.5)	(0.7)		
Other Prod. (g)	0.6	2.2	0.7	(...)	0.4	0.7	0.2	0.1	(...)		
Total	41.3	36.1	27.8	26.8	25.3	25.1	24.7	22.7	11.9		
As % of GDP	(15.2)	(16.5)	(11.8)	(9.7)	(9.4)	(8.1)	(11.1)	(10.5)	(5.4)		

Source: S. Cossen, Harmonization of indirect taxes in the EEC, [1983] British Tax Review 232 (234), based upon data of the Organisation for Economic Co-operation and Development, Revenue Statistics of OECD Member Countries 1965-1980 (Paris 1981). Dashes (---) denote that excises are not imposed; dots (...) mean that receipt cannot be disaggregated or are less than half the final digit shown. VAT means that motor vehicles are subject to increased value-added tax rates, figures may not add because of rounding.

(a) In the order in which they are listed, the capital letters stand for Ireland, Denmark, France, United Kingdom, German Federal Republic, Italy, Belgium, Netherlands and Luxembourg. Countries are listed in descending order of their reliance on sales tax and excise revenues.

(b) Value-added tax receipts include small amounts of other general sales tax.

(c) Excise receipts are understated because most cannot be disaggregated from customs receipts.

(d) Including receipts from alcohol consumption tax.

(e) Including receipts from excises on spirits.

(f) Including receipts from excises on household and industrial fuels.

(g) See Table 2 for breakdown.

Table 2. EEC: Receipts from Nuisance Taxes, 1980
(In % of Total Tax Revenues)

Taxable Products	Member States (a)									
	IRL	DK	F	UK	D	I	B	NL	LUX	
Sugar	(-)	0.43(a)	0.08	(-)	0.06(b)	0.04(c)	0.02	0.05(b)	(.)	
Excises	26.5	13.9	6.7	12.7	8.5	9.3	8.3	6.9	1.2(c)	
Soft drinks	0.28	0.11	(.)(a)	(-)	0.02	(-)	0.16	0.08	(-)	
Coffee	(-)	0.15	(-)	(-)	0.27	(-)	(-)	(-)	(-)	
Tea	(-)	0.01	(-)	(-)	0.01	(-)	(-)	(-)	(-)	
Radios, TVs	0.19	0.09	(-)	(-)(e)	(-)	(-)	(VAT)	(-)	(-)	
Audio-visual aids	0.03	0.15(d)	(VAT)	(-)	(-)	(VAT)	(VAT)	(-)	(-)	
Perfumery, cosmetics	(-)	0.13	(VAT)	(-)	(-)	(VAT)	(VAT)	(-)	(-)	
Jewelry	(-)	(-)	(VAT)	(-)	(-)	(VAT)	(VAT)	(-)	(-)	
Furs	(-)	(-)	(VAT)	(-)	(-)	(VAT)	(VAT)	(-)	(-)	
Salt	(-)	(-)	(-)	(-)	0.01	(-)	(-)	(-)	(-)	
Matches	0.03	0.01	(.)	(-)	(.)	0.04	(-)	(-)	(-)	
Playing Cards	(-)	(.)	(.)	(-)	(.)	(-)	(-)	(-)	(-)	
Light bulbs	(-)	0.04	(-)	(-)	0.02	(-)	(-)	(-)	(-)	
Other products (e)	0.05	1.04	0.58	0.02	(.)	0.63	(-)	(-)	(.)	
Total	0.57	2.16	0.66	0.02	0.39	0.72	0.18	0.13	(-)	

Source: S. Cnossen, Harmonization of indirect taxes in the EEC, [1983] British Tax Review 232 (234), based upon data of the Organisation for Economic Co-operation and Development, Revenue Statistics of OECD Member Countries 1965-1980 (Paris 1982). A dash (-) means that an excise is not levied; dots (.) indicate that receipts cannot be disaggregated or are less than half the final digit shown, VAT means that products are subject to an increased value-added tax rate. Figures may not add because of rounding.

(a) Including excises on confectionery and ice-cream

(b) Including EEC sugar contribution

(c) Sugar and chocolate confectionary are also subject to a higher VAT rate of 20 percent

(d) Including receipts from excise on household appliances

(e) Most excises do not involve border tax adjustments because they are in the nature of administrative or agricultural fees.

EXAMPLE 1
Basic transactions in the production of a Merchandise:

Stage of Production <u>Cost of Production</u>	Manufacturer	Wholesaler	Retailer	Consumer
Purchase Price	1,000,-	2,000,-	3,000,-	4,000,-
VAT (paid to previous pro- duction stage)	140,- (Import VAT)	280,-	420,-	560,- Total: 4,560,-
Office Supply charges VAT paid	100,- 14,-	100,- 14,-	100,- 14,-	
Accounting charges VAT paid	100,- 14,-	100,- 14,-	100,- 14,-	
VAT received by national treasury	From Manufacturer 280,- - 14,- - 14,- -140,- <u>112,-</u>	From Wholesaler 420,- - 14,- - 14,- -280,- <u>112,-</u>	From Retailer 560,- - 14,- - 14,- -420,- <u>112,-</u>	Total for Treasury <u>Import VAT</u> 140,- + 42,- + 42,- + 112,- + 112,- <u>560,-</u>
	From office supply (total) 3 * 14,- = 42,-	From Accounting firm (total) 3 * 14,- = 42,-		Total: 560,-

EXAMPLE II

State of Production Cost of Production	Country A		Country B	
	Manufacturer	Wholesaler	Retailer	Consumer
Purchase Price	1,000,-	2,000,-	3,000,-	4,000,-
VAT (paid to previous production stage)	140,-	280,-	600,-	800,-
Office Supply charges VAT paid	100,- 14,-	100,- 14,-	100,- 20,-	
Accounting charges VAT paid	100,- 14,-	100,- 14,-	100,- 20,-	
VAT received by national treasury				
	Upon Import	From Wholesaler/Exporter (VAT exempt export sale)	Import VAT	<u>Total Country B</u>
	140,-	0,-	600,-	600,-
	From Manufacturer	-280,-	Office supply and Accounting	+ 40,-
	-140,-	-14,-		+160,-
	-14,-	-14,-		=600,-
	-14,-	= -308,-	Retailer	
	= 112,-	<u>Total Country A</u>		
		140,-		
	From Office Supply and Accounting	+112,- + 56,-		
	4 * 14,-	= 308,-		
	= 56,-	= 0,-		

EXAMPLE III

	Country A (VAT rate = 14%)		Country B (VAT rate = 20%)	
	Manufacturer	Wholesaler	Retailer	Consumer
State of Production				
Cost of Production				
Purchase Price	1,000,-	2,000,-	3,000,-	4,000,-
VAT paid to previous production stage	140,-	280,-	420,-	800,-
Office Supply charges VAT paid	100,- 14,-	100,- 14,-	100,- 20,-	
Accounting charges VAT paid	100,- 14,-	100,- 14,-	100,- 20,-	
VAT received by national treasury	Upon Import from Non-Member State 140,- From Manufacturer 280,- -140,- -14,- -14,- = 112,- From Office Supply and Accounting 4 * 14,- = 56,-	From Wholesaler/Exporter 420,- -280,- -14,- -14,- = 112,- Total Country A 140,- + 112,- + 28,- + 28,- + 112,- = 420,-	Import VAT 0,- Office Supply and Accounting 40,- Retailer 800,- -420,- -40,- = 160,-	Total Country B 0,- + 40,- + 340,- = 380,-
Clearing System, (EC-Commission)		Surplus with respect to Intra-Community Trade: 420,- To be paid into the Clearing mechanism. Total Country A: 0,-	Deficit with respect to Intra-Community Trade: 420,- To be received from Clearing mechanism.	Own Revenue: 380,- Compensation through Clearing mechanism: 420,- Total Country B: 800,-