

# Northwestern Journal of International Law & Business

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Volume 9  
Issue 3 *Winter*

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Winter 1989

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### Recommended Citation

Michel V.M. Van Beek, *Indirect Taxation and 1992*, 9 *Nw. J. Int'l L. & Bus.* 552 (1988-1989)

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# Indirect Taxation and 1992

*Michel V.M. Van Beek\**

## I. INTRODUCTION

Since June 1985, when the Commission of the European Communities ("Commission")<sup>1</sup> presented to the European Council its "White Paper" on completing the Internal Market by the elimination of physical, technical, and fiscal barriers inside the European Communities ("EC" or "Community"),<sup>2</sup> the harmonization of indirect taxation has become a main topic in the European press. In this article an attempt will be made to clarify the impact of indirect taxation, or more correctly, the obstacles created by indirect taxes to the realization of the Internal Market, by looking at the past, the present and the future. However, what indirect taxes create these obstacles should be clarified.

In the Member States of the Community ("Member States") a large number of indirect taxes exist. However, not all of them necessarily create obstacles for intra-EC trade because they do not all give rise to formalities when people or goods cross the borders. The Commission has concentrated on those indirect taxes that create such obstacles and, more particularly, on the most important of them, *i.e.*, the Value Added Tax ("VAT") and excise duties.

The VAT aims to apply to all goods and services a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production

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\* Commission of the European Communities — Customs Union and Indirect Taxation. In this article, the author expresses his personal view that in no way reflects the position of any of the institutions mentioned. Except for the statements regarding Mrs. Scrivener's speech on April 10, 1989, this Article was completed on January 31, 1989.

<sup>1</sup> The Commission of the European Communities is the executive body of the European Communities.

<sup>2</sup> *Completing the Internal Market: White Paper from the Commission to the European Council*, COM(85)310 final (June 14, 1985)[hereinafter *White Paper*].

and distribution process before the stage at which tax is definitively charged, *i.e.*, the retail trade stage. On each transaction VAT is calculated on the price of the goods or services at the rate applicable to such goods or services and is chargeable after deduction of the amount of VAT borne directly by the various cost components. An excise duty is a consumption tax levied only once, at the factory or on importations, and it only applies to specific categories of goods such as alcoholic beverages, manufactured tobacco and mineral oils, mineral water, coffee, tea, and sometimes sugar. Excise duties enter into the taxable amount for VAT.

## II. THE EUROPEAN HARMONIZATION IN THE FIELD OF INDIRECT TAXATION

### A. From National Turnover Taxes to a Coherent Common System of VAT

#### 1. *The First and Second Directive*

The Treaty Establishing the European Economic Community, ("Treaty" or "EEC Treaty"), clearly envisaged from the outset the creation of a Common Market,<sup>3</sup> free of restrictions on the movements of goods, persons, services and capital. This free movement of goods was to be realized by a prohibition of customs duties, of quantitative restrictions, and of charges and measures of equivalent effect on the trade between Member States. Moreover, distortions were to be avoided by means of competition rules, by the prohibition of discriminatory tax treatment of similar domestic and imported goods, and by the prohibition of repayments exceeding the internal taxation imposed on them. Finally, the Commission was to consider how the harmonization of indirect taxation in particular turnover taxes and excise duties could be realized in the interest of the Common Market.

In the early days of the Community, the attention was focused on the abolition of the intra-Community customs duties through the realization of a common customs tariff. The Commission, however, did not neglect its other tasks. In 1960, a working party of national fiscal experts was set up which presented its "Neumann" report in 1962. In this report, the working party concluded that a broad harmonization of turno-

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<sup>3</sup> Treaty Establishing the European Economic Community, March 25, 1957, 298 U.N.T.S. 3 [hereinafter "EEC Treaty"]. The Commission has the authority to draft proposals for Council Directives and Regulations on matters dealt with in the Treaty. One of these matters is the realization of a Common or Internal Market. *Id.* art. 2, at 15. A Common Market could be described as a market composed by different national markets having analogous characteristics to a national market and where sound competition can take place.

ver taxes would be required and that the cascade system, existing in most Member States should be replaced.

Since, in a cascade system, the turnover tax is included in the price, it accumulates from stage to stage in the production process. As a result, vertical integration of production cycles results in lower tax charges and in lower prices. In this way, vertical integration is artificially encouraged, and competition can be distorted. In addition, it can be most difficult to determine with precision the exact tax burden at most of the stages of production and distribution. Therefore, on import and export, the tax adjustments (payments or refunds) will be either too low or too high.

Nevertheless, it took until 1967 for the Council of the European Economic Community ("Council") to adopt the First and Second Directives<sup>4</sup> on the harmonization of legislation of the Member States concerning turnover taxes, introducing the general multistage, non-cumulative VAT. It was not until January 1, 1973, that the Member States at that time<sup>5</sup> implemented the general structure and procedures laid down in those two directives.

## 2. *The Common System of VAT and the Community's Own Resources: The Sixth Directive*

If the first harmonization, as described above, was a result of the wish to determine exactly the tax burden at most of the production and distribution stages, the second harmonization was, among other things, based on the need to finance the Community's budget. On April 21, 1970<sup>6</sup> the Council decided that from 1975 onwards the Community's budget would be financed entirely from the Community's own resources, which included customs duties, agricultural levies, and a part of the VAT, as collected by the Member States. The VAT portion was to be obtained by applying a rate not exceeding 1% to a basis of assessment which needed to be uniformly determined for all Member States. As the First and Second Directive did not provide for such a uniform basis of assessment, on June 29, 1973<sup>7</sup> the Commission submitted a proposal for a sixth VAT directive. The proposal, substantially modified during the negotiations at Council level, was adopted by that institution on May 17,

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<sup>4</sup> 10 J.O. COMM. EUR. 1301, 1367 (1967).

<sup>5</sup> Belgium, Germany, France, Italy, Luxembourg and the Netherlands. Currently, the EC consists of twelve Member States, which also includes Denmark, Greece, Spain, Ireland, Portugal and the United Kingdom.

<sup>6</sup> 13 J.O. COMM. EUR. (No. L 94) 19 (1970).

<sup>7</sup> 16 J.O. COMM. EUR. (No. C 80) 1 (1973).

1977,<sup>8</sup> and the Member States of that date aligned their national legislations on the Directive during the period up to January 1, 1980.<sup>9</sup>

The Sixth Directive represents the high water mark of EC legislation in the field of indirect taxation. Providing for a legal framework with harmonized rules, the Sixth Directive constitutes substantial progress. On the other hand, it was also the result of intensive negotiations and failed to standardize the Member States' VAT legislations. As a result, it contains optional provisions in relation to the recognition of "groups of undertakings", the use of the customs value as taxable amount on import, flat-rate schemes for small undertakings and farmers, and the possibility to retain or introduce simplification procedures that derogate from the Sixth Directive.<sup>10</sup> Further, additional transitional provisions were inserted relating to the maintenance of reduced rates and exemptions with refund of input tax (zero-rating), the freedom to continue to tax transactions which will have to be exempt under the final arrangements, the freedom to continue to exempt transactions which will have to be taxed under final arrangements, the freedom to maintain or grant the right to opt for taxation in certain cases (notably the banking sector), and the freedom to derogate the principle of immediate deduction.<sup>11</sup> Finally, the Sixth Directive does not provide for harmonized rates. Although the Sixth Directive has not created a coherent common VAT system as envisaged by the Commission's proposal, it provided a harmonized common basis of assessment for the calculation of the VAT portion in the Community's own resources. Thus, the Commission concluded in its first report on the application of the common system of VAT, that the system was relatively successful.<sup>12</sup>

## B. Harmonization in the Field of Excise Duties

Parallel to its activities in the field of turnover taxes, the Commission has also concentrated on the problems created by the existence of different national excise duties. More specifically, the Commission has focused on the excise duties on tobacco, alcoholic drinks and hydrocar-

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<sup>8</sup> 20 J.O. COMM. EUR. (No. L 145) 1 (1977)[hereinafter Sixth Directive].

<sup>9</sup> For more details, see the *First Report from the Commission to the Council on the Application of the Common System of Value Added Tax*, COM(83)426 final (Sept. 14, 1983)[hereinafter *First Report*].

<sup>10</sup> See *id.*; *Second Report from the Commission to the Council on the Application of the Common System of Value Added Tax*, COM(88)799 final (Dec. 20, 1988).

<sup>11</sup> See *Report from the Commission to the Council on the Transitional Provisions Applicable Under the Common System of VAT, Submitted in Accordance with Article 28 of the Sixth Council Directive of 17 May 1977*, COM(82)885 final (Jan. 17, 1983).

<sup>12</sup> See *First Report*, *supra* note 9.

bon oils. This coverage is similar to that adopted by many Member States.

In 1972, the Council adopted a basic directive.<sup>13</sup> It established a mixed structure (specific element plus ad-valorem element) for cigarettes and provided for a harmonization of the relationships between the specific elements (of the different Member States) and the total excise duty in successive stages. As a result of a modification of this basic directive, which was adopted in 1977,<sup>14</sup> the specific elements must now be calculated in relation to the total fiscal burden (excise duties plus VAT).

In the case of alcoholic drinks and hydrocarbon oils, the Commission has had far less success, despite the presentation of proposals for a number of directives. Only a small degree of progress has been made as a result of rulings by the European Court of Justice.<sup>15</sup> The Court has compelled Member States to abandon tax arrangements which benefit domestic producers to the detriment of producers in other Member States.<sup>16</sup>

### III. THE CHANGE

In January 1985, the Commission proposed to the European Parliament to establish and realize, in the eight years to come, a detailed program for the abolition of the barriers inside the Community. At the European Council of Milan on June 28 and 29, 1985, the Commission then presented its "White Paper on Completing the Internal Market,"<sup>17</sup> which groups all the proposals considered necessary for the realization of this aim. One of the three parts exclusively concerned the elimination of fiscal barriers; the other obstacles were identified as physical and technical barriers.

The main problem of the current VAT system is that the rates applied in the twelve Member States are not harmonized.<sup>18</sup> The Member States have been able to maintain these widely different rates because the actual VAT legislation of the EC provides for the possibility of "zero-rating" at export (*i.e.*, on export of goods the national VAT of the Member States of export will be refunded) and taxing at import. These tax

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<sup>13</sup> 15 J.O. COMM. EUR. (No. L 303) 1 (1972).

<sup>14</sup> 20 J.O. COMM. EUR. (No. L 338) 22 (1977).

<sup>15</sup> The Court of Justice of the European Communities must ensure that in the interpretation and application of the Treaty the law is observed. Normally, this is done through "reasoned opinion[s]" or "preliminary . . . ruling[s]". See EEC Treaty, 298 U.N.T.S. at arts. 164, 169 and 177.

<sup>16</sup> See Barents, *Recent Case Law on the Prohibition of Fiscal Discrimination Under Article 95, 23 COMMON MKT. L. REV.* 641 (1986).

<sup>17</sup> See *White Paper*, *supra* note 2.

<sup>18</sup> See Appendix I.

adjustments also apply to excise duties and normally<sup>19</sup> take place at the borders between the different Member States. For thirty years after the establishment of the EC, they have remained one of the main reasons for maintaining intra-Community border controls. These tax adjustments hinder the free movement of goods.

What was revolutionary in the "White Paper" was that it did not propose to simplify all the formalities related to the "import-export scheme" at the intra-EC borders, but that it purely and simply aimed, through the adoption of 250 Regulations and Directives by the Council, to eliminate all existing intra-EC barriers before January 1, 1993. At the Milan European Council, the heads of government confirmed the principles set out in the White Paper and invited the Council of Ministers for Economic and Financial Affairs to examine the ideas of the Commission in relation to the harmonization of indirect taxation.

Another illustration of the seriousness of the Member States Governments towards the realization of the Internal Market is to be found in the Single European Act,<sup>20</sup> which came into force in 1987. This Act, which modifies the Treaty, links the harmonization of indirect taxation directly to the establishment and the functioning of the Internal Market. A time limit of December 31, 1992<sup>21</sup> was laid down in Article 8a.

In August 1987, in order to give the national authorities of the Member States the possibility to assess the full impact of its intentions and plans, the Commission presented to the Council a "fiscal package,"<sup>22</sup> *i.e.*, a "Global Communication" setting out the full details of its indirect taxation proposals, accompanied by seven proposals for Directives and a

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<sup>19</sup> On the basis of Article 23 of the Sixth Directive, Member States may provide that the VAT payable on importation of goods by taxable persons need not be paid at the time of importation. *See* Sixth Directive, *supra* note 7, at art. 23. At present, a postponed accounting system is applied by Belgium, Luxembourg and the Netherlands.

<sup>20</sup> Single European Act, 30 O.J. EUR. COMM. (No. L 169) 1 (1987).

<sup>21</sup> *Id.* art. 17, at 7-8 (replacing EEC Treaty art. 99). Nevertheless, the Member States have felt the need to add to the Single European Act a declaration, stating that "[s]etting the date of 31 December 1992 does not create an automatic legal effect," even though "by means of the provisions in Article 8A [they wish] to express [their] firm political will to take before 1 January 1993 the decisions necessary to complete the internal market . . ." 1 TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES 1067 (1987).

<sup>22</sup> *Global Communication* COM(87)320 final (Aug. 5, 1987); *Approximation of VAT-rates*, 30 O.J. EUR. COMM. (No. C 250) 2 (1987); *Removal of Fiscal Frontiers*, 30 O.J. EUR. COMM. (No. C 252) 2 (1987); *Working Paper on a Community VAT Clearing Mechanism*, COM(87)323 final (Aug. 5, 1987); *Convergence of Rates of VAT and Excise Duties*, 30 O.J. EUR. COMM. (No. C 250) 3 (1987); *Approximation of Rates of Excise Duties on Cigarettes*, 30 O.J. EUR. COMM. (No. C 251) 3 (1987); *Approximation of Rates of Excise Duties on Manufactured Tobaccos Other Than Cigarettes*, 30 O.J. EUR. COMM. (No. C 251) 4 (1987); *Approximation of Rates of Excise Duty on Mineral Oils*, 30 O.J. EUR. COMM. (No. C 262) 8 (1987); *Approximation of Rates of Excise Duty on Alcoholic Beverages and on the Alcohol Contained in Other Products*, 30 O.J. EUR. COMM. (No. C 250) 4 (1987).

working paper on the VAT "clearing mechanism." The most important aspects of the documents are set out below.

#### IV. THE "FISCAL PACKAGE" OF AUGUST 1987

As described above, the "fiscal package" contains a number of proposals for Directives, a document on the proposed "VAT clearing mechanism", and a "Global Communication", outlining the Commission's motives for its proposals.

##### A. The "Global Communication" from the Commission

In this working document, the Commission points out that it has not sought to design an ideal fiscal system for the EC, but only to abolish the existing fiscal frontiers for the VAT; *i.e.*, the existing system of zero-rating exempts goods from VAT at export and imposes VAT at import. Therefore, the Commission has limited itself to the strictly necessary. For example, no proposals have been made for taxes on the registration of vehicles or on the purchase of houses, as these indirect taxes are not supposed to give rise to controls or formalities at the borders.

Nevertheless, even though the Commission has restricted its goal, it realized that class specific problems for Member States might arise. On the condition that their possible adverse effects on the functioning of the Internal Market be severely limited as much as possible, the Commission is prepared to examine with these Member states the possibilities of temporary derogations in order to adjust to the new fiscal system. It emphasized that until December 31, 1992, the Member States are free to determine their own path and the pace of work towards the realization of the Internal Market. Also, the Commission kept in mind the need to minimize budgetary disturbance for the Member States. While elaborating its proposals, the Commission took into account the existing wide spread of rates and rate structures<sup>23</sup> of the indirect taxes in the different Member States. Despite this prudence, the Commission has made some very preliminary and indicative estimates that: 1) Spain and Portugal will receive substantial increases in budgetary receipts from VAT and excise duties; 2) Germany, the United Kingdom and Greece will have moderate increases; 3) Belgium, Italy and the Netherlands will stay at the same level of total revenues out of indirect taxation; but 4) the other Member States will suffer slight (France) or considerable (Ireland and Denmark) budgetary losses.

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<sup>23</sup> See Appendix II.



## B. Approximation of VAT-Rates

Although the Sixth Directive has not standardized national VAT-rules, it has nevertheless created an irrefutable and identifiable common VAT-base within the EC. In order to eliminate the still existing formalities related to the imposition of tax on importation and the remission of tax on exportation in EC trade, the Commission proposes to tackle the absence of harmonized VAT-rates.

The approximation of VAT-rates poses three major technical problems: the number of rates to apply, the allocation of the products to the rates, and the level of the rates. The Commission proposes a two-rate system with one standard rate and one reduced rate. This choice is supposed to have the least disruptive consequences as all Member States, except Denmark and the United Kingdom, apply a multi-rate structure. Moreover, a two-rate structure should be less cumbersome for all parties involved than a system of more than two rates. It should be noted that the higher rates, actually existing in the Member States, apply to relatively small and not particularly homogeneous categories of goods (normally "luxury" goods).

In relation to the goods to be brought within a reduced rate, the Commission concluded that, in general, it should only apply to items and services of basic necessity. Therefore, it only proposed that the reduced rate should be applied to foodstuffs, excluding alcoholic beverages, energy products for heating and lighting, water supplies, pharmaceutical products, books, newspapers, periodicals and passenger transport. This follows as much as possible the existing practice in the Member States. In addition, the Commission has repeated<sup>24</sup> its opposition to zero-rating in these cases (which Ireland and the United Kingdom use for some items). First, it does not consider fiscal price subsidy the most effective instrument of social policy (*e.g.*, compared with direct welfare benefit). Secondly, zero-rating in one area leads inevitably to a higher overall rate of VAT in other sectors, if the same revenue is to be obtained. Thirdly, zero-rating may adversely affect competition because of price advantages given in one Member State, particularly when applied to supplies which feed through into industrial and commercial costs. Finally, ever since the VAT was first adopted, zero-rating has always been considered, except in cases of export, to be a temporary measure to disappear with the completion of the Internal Market (Article 28(2) of the Sixth Directive).

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<sup>24</sup> See *e.g.*, COM(73)950 final (June 20, 1973)(French version)(containing the "Proposal for a Sixth Council Directive"). The Commission clearly states that it considers "zero-rating" as part of the final consumption to be a fundamental fault in the principle of the VAT as a general tax on consumption.

Provided that the integrity of the Internal Market is respected, the Commission, as already recognized in the White Paper itself, would be prepared to allow derogations to Member States in real problems.

In setting the level of the rates, the Commission was inspired by the American experience<sup>25</sup> where differences in tax levels of 5% to 6% between neighboring states exist without undue adverse effects. The Commission considered that, in order to permit the abolition of fiscal barriers to be realized without serious economic consequences, the level of the standard rate should be fixed between 14% and 20% and that the reduced rate should be fixed between 4% and 9%. Within these bands, the Member States are free to choose the rate that they prefer.

### C. Removal of Fiscal Frontiers

Once the Internal Market is created, intra-EC sales and purchases of goods and services will be treated in the same way as those transactions within one Member State. In relation to goods, VAT zero-rating ("exempting") at export and taxation at import between Member States will have to be eliminated. Also, certain territorial application rules relating to supplies of services will have to be amended. However, the Commission also wants to retain the principle that the tax charged should be allocated to the Member State of final consumption. Thus, a VAT clearing mechanism will have to be set up to transfer the VAT initially collected in the seller's Member State to the purchaser's Member State.

The proposal "Removal of fiscal frontiers" aims to create the legal framework for the realization of these objectives. It proposes to amend the articles of the Sixth Directive in such a way that the terms "import" and "export" will only apply to trade with third countries. Further, taxable persons in one Member State who deal with taxable persons established in other Member States will be required to declare the amount of VAT related to their mutual transactions. It also provides for: 1) rules on currency conversion for the deductible amounts which are linked to transactions with taxable persons in other Member States; 2) a final date of December 31, 1992; 3) the ending of all derogations or transitional provisions based upon Article 28 of the Sixth Directive by December 31, 1992; and 4) the withdrawal of those Directives or parts of Directives, which will become superfluous once fiscal frontiers have been abolished.

In regard to the "VAT clearing mechanism", the explanatory memorandum to the proposal states, that the system should be embodied in a Regulation, as "a Directive is not considered an appropriate means of

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<sup>25</sup> See *White Paper*, *supra* note 2, at 46.

managing a financial mechanism which is concerned with relations between Member States.”<sup>26</sup>

On the one hand, the proposal “Removal of fiscal frontiers” puts an end to the temporary measures admitted by the Sixth directive. On the other hand, it does not put an end to all imperfections. Other proposals have this as their aim (see Part VI Developments).

#### D. The Vat Clearing Mechanism

The working document on the VAT clearing mechanism outlines the ideas of the Commission on the subject, without, however, providing for a detailed proposal for a legal instrument. The ideas of the Commission can be divided into two parts: the clearing system itself and controls at the EC level. As to the VAT clearing system, the Commission envisages a central account in ECUs<sup>27</sup> into which net exporting Member States would be required to pay and through which net-importing Member States would receive payments. The account would be managed by the Commission. Member States would be responsible for the monthly determination of their own net positions, based upon information obtained from traders’ declarations and converted into ECU terms. The proposed system should only impose minimal additional administrative requirements on traders. Thus, it only requires two extra elements of information which can be easily incorporated into the existing periodic VAT declaration. Moreover, it should be entirely self-funding and even create surpluses. This is because not only the output VAT on the intra-EC transactions of registered taxable persons will be transferred into the account, but also the output VAT on intra-EC transactions will exempt taxable persons. However, the input VAT (*i.e.*, claims against the account) will only be based upon the deductions of the first group of persons.

On the other hand, a “clearing control system” should be introduced and designed to validate the claims put forward by Member States. The Commission should be given the management powers to operate the VAT clearing system, to make the clearing control system work, to pro-

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<sup>26</sup> In relation to VAT, EC legislation has been embodied in directives. A “directive” is a binding codicative instrument upon each Member State to which it is addressed; however, it leaves the choice of forms and methods to the national authorities. On the contrary, a “regulation” normally has a general application; moreover, it is binding in its entirety and directly applicable to all Member States.

<sup>27</sup> A European Currency Unit (“ECU”) is a basket of Member State currencies. Precise rules exist for determining the composition of the baskets. Initially used as a unit of account for budgetary purposes, the ECU is now also used for commercial transactions. At present, 1 ECU is worth approximately \$1.10.

vide for arbitration in case of dispute between Member States, to have the power to investigate complaints, and to reinforce and coordinate the work against VAT fraud, particularly frauds of a transfrontier nature.

To restate, no formal proposal was made in August 1987. Whatever form this proposal may have, it will have to provide for a sound and reliable system that attributes to the appropriate Member States the VAT collected in intra-EC sales after abolition of the fiscal frontiers. It should not impose more than the minimal additional burden on traders and on national administrations involved. At the same time, however, it should be subject to credible control and verification. Finally, all clearing mechanisms should be, in the long term, self-financing.

#### E. Harmonization of Excise Duties

As noted above, the harmonization of excise duties at the EC-level has, until now, been far less successful than that of the VAT-rules. Thus, not only the rates, but also the structures of the excise duties, still differ widely from Member State to Member State.

Yet, the harmonization of the excise duties will be necessary, as the excise duties enter into the taxable amount for the calculation of VAT.<sup>28</sup> Because of the fact that tax differences between Member States should not exceed 5% to 6% in order not to disturb competition within an Internal Market, any flexibility in the rates of the excise duties should be out of the question, as it would result in tax-induced price differences in excess of 5% or 6%. Consequently, the Commission proposes to reserve the possibility of flexibility to VAT-rates because of their overall coverage and, thus, their overriding importance for the Member States' budgets.

For tobacco products, spirits and gasoline, the rates of the excise duties, as proposed, have been calculated on the basis of the Community arithmetic average. For wine and beer, it is proposed to tax them equally per liter of product on an overall revenue-neutral basis. For diesel, heating gas oil and heavy fuel oil, an average weighted by consumption has been chosen, as it minimizes the effects on industrial costs.

The Commission considers that in the period up to 1992 the amounts of the specific duties will have to be adapted annually in accordance with the general consumer price index in the EC. Also, it is noted that a "clearing system" of the type proposed for VAT will not be needed for excise duties as these will be collected at the moment that the excisable goods leave the customs warehouses, *i.e.*, in the Member State of final consumption.

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<sup>28</sup> See Sixth Directive, *supra* note 7, at art.11a, ¶ 2.

## F. Convergence of Rates of VAT and Excise Duties

The proposal for a Directive on the convergence of rates of VAT and excise duties replaces the amended "stand-still" proposal of February 1987.<sup>29</sup> The new proposal aims to ensure that Member States do not diverge from the overall objective between 1987 and December 31, 1992. In other words, it prohibits any divergence in the number and level of VAT-rates and rates of excise duties applied by the Member States and encourages changes in national legislation towards the harmonized system that has to be realized by December 31, 1992.

## V. REACTIONS "IN A NUTSHELL"

It is not surprising that a reform as drastic as the one proposed by the Commission in its "fiscal package" has led to numerous reactions. An example is the "tax free sales" sector.<sup>30</sup> This reaction can be explained by the fact that after December 31, 1992, the whole Community will be considered as one. Thus, flights or boat trips between places in different Member States must be treated as "internal trips." In logic, there can be no place in the completed Internal Market without frontier controls for tax-free shopping in travel between Member States.<sup>31</sup> However, the reactions of the institutions directly involved with the legislative process inside the EC, *i.e.*, the Council, the European Parliament ("EP") and the Economic and Social Committee ("ESC") will be the focus of this section.

### A. VAT

#### 1. Council

In the Council, the discussion of the "fiscal package" rests with the Council of the Ministers of Economic Affairs and Finance ("Ecofin"). Ecofin discussed the proposals for the first time in November 1987. At that time, only West Germany and the Netherlands declared themselves, in principle, in favor of the proposed harmonization of rates. On the other hand, it also became clear that for the United Kingdom, where the government had promised to keep food and children's clothes "zero-rated", or Denmark with its very high VAT-rate (22%), the proposals would be difficult to accept.<sup>32</sup> These points of view were confirmed at the

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<sup>29</sup> 30 J.O. EUR. COMM. (No. C 30) 3 (1987).

<sup>30</sup> See, *e.g.*, Wood, *Abolition of Duty-free Shopping Poses Challenges for Retailers*, *Fin. Times*, July 25, 1988, at 4, col. 1; DUTCH ASSOCIATION OF SHIP OWNERS, *OPEN GRENZEN KOSTEN DE EUROPESE REIZIGER GELD* (Open Frontiers Cost the European Traveler Money)(Sept. 1988).

<sup>31</sup> Reply by the Commission to Written Question No. 1600/87 by Mr. Pearce (forthcoming).

<sup>32</sup> *THE ECONOMIST*, Nov. 21, 1987.

Ecofin meeting at Travemunde in May 1988.<sup>33</sup> In addition, Luxembourg declared that, because of the different implications, they probably would have to reject the harmonization proposals. However, the most serious criticism against the Commission's proposals was put forward by the British Chancellor of the Exchequer a week before an informal Ecofin meeting in Crete.

On September 8, 1988, the Chancellor launched the plan to allow each Member State the right to set its own VAT-rates, subject to competitive pressures (thus enabling the United Kingdom to continue "zero-rating").<sup>34</sup> In the opinion of the British Administration, this "market-based approach", resulting in "a progressive reduction of frontier controls" and implying greater freedom for cross-border shopping, would "force" the Member States with the higher rates to lower them in order to prevent unacceptable budgetary losses. In addition, the plan included the introduction of postponed VAT-accounting. The Commission could not accept the plan because it would not result in the complete elimination of frontier controls, an aim which the Member States had committed themselves to in the Single European Act. At the same time, it would put the burden of harmonization exclusively on the higher taxing Member States.

Nevertheless, the informal Ecofin meeting of September 1988 in Crete clarified the position of the Member States. Only two Member States, Luxembourg and Denmark,<sup>35</sup> joined the United Kingdom in reserving their position on the basic principles of the "fiscal package", *i.e.*, that for the realization of the Internal Market a harmonization of indirect taxation is indispensable. On the other hand, the Commission was supported by the other Member States.<sup>36</sup> Moreover, most Member States accepted the Commission's orientation towards only two rates inside limited bands, however, without committing themselves to how goods and services should be divided between these two rates. Finally, in December 1988, the Ministers of Finance met again. The Commissioner responsible for indirect taxation suggested to the Member States that the practical work on the "fiscal package" should begin, first of all in relation to the question concerning the goods and services covered by the reduced rate and, secondly, with the Commission's "blueprint" for the VAT clearing mechanism.<sup>37</sup>

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<sup>33</sup> The Independent, May 16, 1988; NRC (Dutch Newspaper), May 16, 1988.

<sup>34</sup> Fin. Times, Sept. 9, 1988.

<sup>35</sup> In October 1988, the Danish Prime Minister in his opening speech to the Danish Parliament declared the Danish Government to be in favor of the tax harmonization.

<sup>36</sup> The Independent, Sep. 19, 1988.

<sup>37</sup> See EUROPE, Jan. 28, 1989.

## 2. *Economic and Social Committee and European Parliament*

After being consulted by the Council, the ESC published its opinion in September 1988.<sup>38</sup> At present, the EP is preparing to take its position which it is expected to set forth at its April 1989 plenary sessions. It will do this on the basis of reports drafted by rapporteurs, who are appointed members of the EP. The draft reports are first voted on by specialized working committees, notably by the Committee on Economic and Monetary Affairs and Industrial Policy. The Resolution of the EP may propose amendments to the Commission's proposals. On the basis of the ESC opinion and the draft-reports<sup>39</sup> of the above-mentioned committee of the EP which have appeared, it can be expected that both institutions will support the principles of the "fiscal package." However, modifications of some elements have already been or will be proposed. In this context, it is not possible to discuss all of the proposals; only a few points will be highlighted.

While approving the reduction of the number of VAT-rates to two, the ESC thought that the proposed bands of rates were too wide and that they would distort competition. The ESC prefers bands with a width of 3%. Also, it proposed an addition to the list of goods and services to which the reduced rate is to apply, namely work in the housing sector. Further, the EP draft report suggests setting the two VAT-bands 0% to 6% and 14% to 22%. This acknowledges "zero-rating" as a means of social policy and allows for the specific Danish situation of only one very high VAT-rate. It also sees the need to add certain categories to the "reduced rate list", e.g., publishing, musical instruments and labor-intensive services.

Further, the Commission has proposed to exempt banking operations after 1992 in its proposal "Removal of fiscal frontiers." Thus, banks would not be allowed to deduct their input VAT. Both the ESC opinion and the EP draft report recommend the opposite, *i.e.*, the right for the banks to opt for taxation. Presently, the right of option for taxation of the banking sector is reserved to the Member States.

### B. Excise Duties

#### 1. *Council*

From the start, the Member States have shown reluctance in rela-

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<sup>38</sup> 31 O.J. EUR. COMM. (No. C 327) 14 (Dec. 9, 1988).

<sup>39</sup> 1987-1988 PARL. EUR. DOC. (SEC No. 315) (1988); 1987-1988 PARL. EUR. DOC. (SEC No. 308) (1988); 1987-1988 PARL. EUR. DOC. (SEC No. 320) (1988); 1987-1988 PARL. EUR. DOC. (SEC No. 314) (1988).

tion to the Commission's proposals to harmonization of excise duties, not only because of important budgetary implications, but also because of considerations related to other than fiscal interests, *e.g.*, health and the environment. Therefore, the Commission has announced its intention to consider the question of introducing some flexibility in the proposals related to excise duties.<sup>40</sup>

## 2. *ESC and EP*<sup>41</sup>

On the proposal of approximation of excise duties on cigarettes and manufactured tobacco, the ESC has reported that it can not take a definitive position without a complete study of the effects of the proposal on the tobacco industry, employment, agriculture, and national budget. Nevertheless, the ESC considers that Member States should have some flexibility in determining the rate of the excise duties. In relation to the "mineral oil proposal," the ESC accepts the idea of harmonization, although it would prefer this to be done to the lowest possible level and not to the highest level, as this increases the prices of those goods or services for which mineral oil is the basic product. As to the "alcohol proposal," the ESC recommends some flexibility in the rates between Member States. This position takes into account the differing traditions and socio-economic circumstances of the Member States.

## VI. DEVELOPMENTS

After the ESC opinion and the EP Committee reports, one might consider that the first phase of the discussions in relation to the "fiscal package" is ending. What can be expected to happen now?

In the first place, the Commission has announced that it is willing to consider refining its proposals of August 1987 to allow for some flexibility in the field of excise duties.<sup>42</sup> In addition, the Commission will have to make a number of follow-up proposals to the ones of the "fiscal package." These proposals will need to include a proposal concerning the

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<sup>40</sup> EUROPA VAN MORGEN, Jan. 25, 1989, at 3.

<sup>41</sup> At the moment of finalizing this article, the draft reports of the Committees of the European Parliament were not yet available.

<sup>42</sup> *Supra* note 40. In her speech to the European Parliament on April 10, 1989, Mrs. Scrivener, the Commissioner for fiscal affairs since January 1989, expressed her intention to adjust the proposals of the Commission's 1987 "fiscal package" because unanimity for these proposals appears difficult to obtain. The modifications that she expressed include: 1) avoiding a VAT Clearing Mechanism which is too bureaucratic and centralized; 2) eventually replacing the proposed VAT rate bands by a minimum standard rate and a maximum reduced rate; and 3) introducing an element of flexibility into the proposals related to the harmonization of the excise duties. These modifications should make possible an easier realization of the work which has already been started.



system of linking bonded warehouses for commercial traffic in goods subject to excise duties and one concerning the minor excise duties.

Also, the Commission will continue its efforts to make the Council accept, as quickly as possible, the other proposals for Directives needed to obtain the necessary degree of harmonization, indispensable for the proper functioning of the Internal Market. In this context, one might think of the following proposals, some of which have been on the table of the Council for quite a long time: 1) the abolition of the transitional provisions of the Sixth Directive;<sup>43</sup> 2) the harmonization of expenditures on which tax is not deductible;<sup>44</sup> and 3) the harmonization of the rules applicable to stores of vessels, aircraft and international trains.

## VII. CONCLUSIONS

This Article can not pretend to be a complete treatment of the very complex field of indirect taxation. The aim has been to indicate the importance of further harmonization in the field of indirect taxation as a means to realizing the Internal Market as defined in Article 8a of the Treaty. Although some substantial harmonization has already been realized for VAT, this can hardly be said for the excise duties. Therefore, it is urgent to make the necessary decisions in order to achieve harmonization of excise tax by the 1992 deadline.

Although on January 31, 1989, none of the proposals of the "fiscal package" had been formally adopted by the Council, still one must conclude that most Member States have recognized the need to adopt the direction proposed by the Commission. Without awaiting the adoption of the proposals by the Council, some have even started modifying their national legislation in order to get nearer to the proposed rates. France has reduced its existing higher VAT-rate, and the Netherlands has reduced its normal rate. Belgium and Germany have increased the rates of some of their excise duties. However, it will not be an easy task to realize the aims set out by December 31, 1992. On the basis of Article 9, of the Treaty, all decisions of the Council in the field of indirect taxation must be taken unanimously, while in most other areas concerned by the completion of the Internal Market the necessary measures can be adopted by qualified majority.

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<sup>43</sup> 27 O.J. EUR. COMM. (No. C 347) 3 (Dec. 29, 1984)(amended by 30 O.J. EUR. COMM. (No. C 183) 9 (July 11, 1987)).

<sup>44</sup> 26 O.J. EUR. COMM. (No. C 37) 8 (Feb. 10, 1983)(amended by 27 O.J. EUR. COMM. (No. C 56) 7 (Feb. 2, 1984)).

APPENDIX I

	VAT-Rates: January 1989		
	<u>lower</u>	<u>standard</u>	<u>higher</u>
Belgium	6 and 17	19	25 <sup>(1)</sup>
Denmark	—	22	—
Germany	7	14	—
Greece	6	16	36
France	5.5	18.6	28
Ireland <sup>(2)</sup>	10	25	—
Italy	4 and 9	18	38
Luxembourg	3 and 6	12	6
Netherlands	6	18.5	6
Portugal	8	17	30
Spain	6	12	33
United Kingdom <sup>(2)</sup>	—	15	—

<sup>(1)</sup> An additional luxury tax of 8% is charged on certain products  
<sup>(2)</sup> Ireland and the United Kingdom apply zero-rates to a wide range of goods and services

APPENDIX II

LIST OF VAT RATES GENERALLY APPLIED IN  
THE MEMBER STATES TO CERTAIN  
GOODS AND SERVICES

GOODS AND SERVICES	B	DK	G	SP	F	GR	IRL	I	LUX	NL	P	UK
Food	6	22	7	6	5,5	6	0/25	2/9	3/6	6	0/8	C
Drink:												
— Spirits	25	22	14	12	18,60	16/36	25	18	12	18,5	8/17/30	15
— Wine	25	22	14	12	18,60	6/16	25	9	6	18,5	0/8	15
— Beer	19	22	14	12	18,60	16	25	9	12	18,5	8	15
— Mineral water	19	22	14	6	18,60	6	0	9	12	18,6	8	15
— Lemonade	19	22	14	6	18,60	6	25	19	12	18,5	17	15
— Fruit juice	25	22	14	6	18,60	6/36	25	19	6	18,5	17	15
Clothes Adults	19	22	14	12	18,60	16	10	9	12	18,5	17	15
Children	19	22	14	12	18,60	16	0	9	12	18,5	17	0
Shoes Adults	17	22	14	12	18,60	16	10	19	12	18,5	17	15
Children	17	22	14	12	18,60	18	0	9	12	18,5	17	0
Pharmaceutical products	6	22	14	6	5,5	6	0/25	9	3/6	6	0	0
Tobacco (Popular cigarettes; VAI calculated on maximum retail selling price) (2 excise duties and VAI)	5,66	18,03	12,28	10,70	22,475	36	20	15,25	6	16,67	13,79	13,04
Books	6	22	7	6	5,5	3	0	4	6	6	0	0
Newspapers	0	0	7	6	2,1	3	10	4	6	6	0	0
Periodicals	0	0	7	6	2,1	3	25	4	6	6	0	0
AIFI - Video	33	22	14	12	28	36	25	9/19	12	18,5	17	15

Appendix II Continued

GOODS AND SERVICES	B	DK	G	SP	F	GR	IRL	I	LUX	NL	P	UK
Household electrical appliances	25	22	14	12	18,60	16	25	19	12	18.5	17	15
Cultural services and entertainment	6	22	7	0/6	18,60 5,5	EXEMPT /6	EXEMPT 10/25	9	6	18.5	0/8	15
Furs	33	22	14	33	28	36	25	38	12	18.5	30	15
Jewelry	33	22	14	33	28	16	25	19/38	12	18.5	30	15
Water	6	22	7	6	5,5	6	EXEMPT	9	EXEMPT	6	0	0
Gas	17	22	14	12	18,60	6	10	9	6	18.5	8	0
Electricity	17	22	14	12	18,60	6	0	9	6	18.5	8	0
Oil products												
— Petrol	25	22	14	12	18,60	36	25	19	12	18.5	8	15
— Diesel	25	22	14	12	18,60	6	25	19	12	18.5	8	15
— LPG	25	22	14	12	18,60	6	10	19	6	18.5	8	15
— Fuel domestic	19	22	14	12	18,60	6	10	19	6	18.5	8	0
— Lubricants	19	22	14	12	18,60	6	25	19	12	18.5	17	15
Motor cars												
25/33 (33 if 3000 cc)		22	14	33/12	28	6	25	18/30 (38 if 2000 cc petrol 2500 cc diesel)	12	18.5	17	15
Transport of persons	6	EXEMPT	7/14	6/12	55	6	EXEMPT	19	6	6	8	0/15
Hotels	6	22	14	6/12	5.5 18,6	6/16	10	9/19	6	6	8	15
Restaurant	17	22	14	6/12	18,60	6/16	10	9/19	6	6	8	15

Appendix II Continued

GOODS AND SERVICES	B	DK	G	SP	F	GR	IRL	I	LUX	NL	P	UK
Building sector: — Building land — New buildings — Construction	OUT OF SCOPE	EXEMPT	EXEMPT	12	13	EXEMPT	OUT OF SCOPE	19	EXEMPT	EXEMPT	EXEMPT	EXEMPT*
	17	EXEMPT	EXEMPT	6/12	18,60	EXEMPT	10	4	EXEMPT	18,5	EXEMPT	0
	6/17	22	14	6	18,60	16	10	2/19	12	18,5	8/17	15
Works of art	6	22	7	12	18,60	16	25	19	12	6	17/	0/15
				(margin)	(margin or on 30% of total sale price)						EXEMPT (margin)	(margin) (0% if import)
Antiques	6	22	14	12	accord. category (margin or on total sale price)	16	25	19	12	6	17	0/15
				(margin)	category (margin or on total sale price)						(margin)	
Second-hand goods	accord. category (margin)	22	accord. category (margin)	12	accord. category (margin or on total sale price)	16	25	accord. category	12	18,5	17	0/15
				(margin)							(margin)	

(\*) From 1.6% to 1.5% for private use.  
Source: *The Evolution of VAT Rates Applicable in the Member States of the Community*, Commission Doc. XXI/53 188 (Jan. 1, 1989).