

Value-Added Taxation of Travel in the EU:

Lack of Neutrality in the Application of Special Scheme for Travel Agents

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Summary:

Special VAT scheme for travel agents, as laid down in Articles 306–310 of the VAT Directive, is no longer suitable in the globalized travel industry. Travel agencies are competing with an increasing number of foreign operators, intermediaries, online agencies and new technologies. The current provisions and their application give rise to unequal treatment of taxable persons supplying similar or comparable services. This master's thesis aims at analysing the lack of neutrality within the current EU normative framework of provision and intermediation of travel services. The research focuses on three issue areas: inconsistent implementations of TOMS in different Member States, the VAT treatment of different economic operators, and the unequal position of travel agents established in the EU in comparison with those located in third countries. Finally, possible solutions are discussed, and recommendations given as to how the TOMS may be brought up-to-date in order to levy tax on travel in a more neutral manner.

Keywords:

Tax Law, Value-Added Tax, Fiscal Neutrality, Tour Operators' Margin Scheme

Additional information:

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TABLE OF ABBREVIATIONS

AG	Advocate General
B2B	Business-to-business
B2C	Business-to-consumer
CJEU	Court of Justice of the European Union
EU	European Union
MNE	Multinational enterprise
MOSS	Mini one-stop shop
OECD	Organisation for Economic Co-operation and Development
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TOMS	Tour Operators' Margin Scheme
VAT	Value-Added Tax
VAT Directive	Council Directive 2006/112/EC

1 INTRODUCTION

1.1 Introduction to the topic

European Union ('EU') Member States' Value-Added Tax ('VAT') laws have been harmonized in the service of the creation and establishment of the European internal market.¹ The internal market is defined in Article 26(2) of the Treaty on the Functioning of the European Union ('TFEU') as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties'. It is a single market where products and production factors may circulate freely within the territory of the EU without facing internal borders, thus facilitating international trade.² Indicators of a properly functioning single market include compliance with EU legislation and policy measures, increased cross-border activities within the EU as well as increased global trade, to mention a few.³ The elemental link between the common VAT system and the internal market is evident from Article 113 of the TFEU which confers the EU bodies the power to adopt legislation in order to harmonize Member States' VAT laws in so far as is required for the seamless functioning of the internal market.

In the field of VAT, decision-making at the EU level is strongly dependent on the political will in the Council. The Council must act unanimously, which implies that every Member State practically has a veto power over legislative proposals.⁴ As EU VAT legislation has to accommodate all 28 Member States' interests, the search for suitable solutions may be challenging to say the least. Member States' attitudes will not allow complete harmonization and some aspects of VAT law, such as VAT rates apart from common minimum rates, have been accordingly left primarily in the Member States' competence. Many reasons of national politics contribute to potential unwillingness from Member States' side to commit to new reforms. In the context of VAT, Member States might fear e.g. loss of VAT revenue, or complexity of the rules

¹ Prior to the completion of the internal market, EU law would speak about a 'common market'. This was a preliminary phase of merging Member States' national markets towards a genuine market without internal borders. The First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes already referred to the objective of establishing a common market that would allow the free movement of goods and services, and that this goal could be best reached by harmonization of laws.

² See also Commission website on the concept and recent measures and developments in relation to the single market.

³ *Chari and Kritzinger* 2006, p. 63.

⁴ *Tyc* 2008, p. 3.

and control thereof that would result in increased administrative burden for national tax authorities. Furthermore, the EU area hosts a range of different societies and economies where it is obvious that the divergence has an impact on political preferences of the Member States' governments.⁵

The EU Commission has a vision on the future of the EU VAT system where the next stage in the harmonization process is a single VAT area.⁶ However, debates over the necessity of EU legislation and failures to achieve consensus among Member States are symptomatic to decision-making in the EU and as such constitute a threat to the successful adoption of new rules as well as to any major reform of old ones. These political constraints are so significant that they must be kept in mind when considering any changes of the current normative framework.

For these reasons, the Commission's perseverance is in a central role. This holds true for VAT on travel where the Commission's previous proposals were rejected by the Council. The Commission has recently conducted a study, the outcome of which indicates that the VAT rules on travel agents need to be revised in order to bring them up-to-date with the current business environment. The Commission is expected to come up with a new proposal to re-open discussions on the reform with the Council, but the fate of this legislation is ultimately in the hands of the Member States.

1.2 Research question

This thesis discusses the current rules for the value-added taxation of the provision and intermediation of travel services. The current normative framework constitutes of the regular scheme of the VAT Directive and a special VAT scheme for travel agents (so-called Tour Operators' Margin Scheme, hereinafter referred to as 'TOMS'). The research is concerned with the juridical problem of the determination of the applicable VAT scheme and the VAT consequences which imply differential treatment in three respects in particular:

- i. Supplier's right to input VAT relief;
- ii. Business customer's right to input VAT relief; and

⁵ See *Weatherill* 2016, chapter 5 'Does EU law apply uniformly?' on the challenges of common policy-making.

⁶ As envisaged in COM (2016) 148 final.

iii. Application of reduced VAT rates and exemptions.

In this legal analysis, the principle of fiscal neutrality is used as a benchmark in reviewing the distortions that arise from the current rules. More specifically, compatibility with the neutrality principle will be assessed through the equality of taxable persons.⁷

Therefore, the main research question in this thesis is: *To what extent do the current rules decisive for the application vs. non-application of TOMS achieve fiscal neutrality?*

In answering this question, the focus will be on three relevant legal relationships:

- i. Operators based in different Member States;
- ii. Operators employing different channels of service provision; and
- iii. Operators based in the EU and outside the EU.

For each legal relationship, the distinction in levying VAT between the taxable persons under assessment will be shown through theoretical as well as practical observations. Consequently, reasons for the unequal VAT treatment are reviewed in order to determine whether these are sufficient to justify the distinctions.

Finally, suggestions will be made on how the taxation of travel facilities should be amended in order to be more compatible with the neutrality principle which is a central objective in the VAT Directive. Due to the large amount of possible approaches, a limitation is made as to the suggested solutions. It is realistically anticipated that the TOMS will be retained and, therefore, any possible reforms that indicate the total abolishing of the TOMS are excluded from the scope of this thesis. The approach will be limited to envisioning suitable solutions as to how the TOMS should be amended to better answer to the current challenges.

1.3 Research methods and materials

This research is to a large extent based on EU legislation, above all the VAT Directive. Case law of the Court of Justice of the European Union ('CJEU') is as well an

⁷ See *Terra and Kajus* 2015, p. 247–248 for an extensive explanation of different approaches to fiscal neutrality. According to Terra and Kajus, fiscal neutrality can be characterized by a legal relationship e.g. equality of taxpayers.

important source supporting the research. In addition to legislation and case law, other official documents are used in conducting this research, most importantly the analysis carried out by KPMG for the Commission study on the review of the VAT Special Scheme for travel agents and options for reform (the ‘Commission Study’). Moreover, a large part of the research materials used consists of academic literature.

1.4 Outline of the thesis

Chapter 2 introduces the benchmark, i.e. fiscal neutrality principle, and in particular its role and implementation in EU VAT law. Chapter 3 describes the relevant rules of the VAT Directive; first the regular scheme and subsequently the special scheme for travel agents. Chapters 4 through 6 look in detail at how the application of TOMS results in unequal treatment of taxpayers from the chosen perspectives, respectively. The differential VAT treatment is assessed based on the Member State of residence of a travel agent (chapter 4), the classification of a supplier of travel services (chapter 5) and intra- versus extra-EU operations and operators (chapter 6). Finally, chapter 7 summarizes the prior chapters and sets out the final conclusions.

2 FISCAL NEUTRALITY: AN OVERARCHING PRINCIPLE IN THE EU VAT SYSTEM

EU VAT law is governed by several important principles. Two of the most essential principles of EU VAT law are the principle of VAT as a general tax on consumption and the principle of fiscal neutrality. The focus of this thesis is on the principle of fiscal neutrality as the primary benchmark of the issues under assessment in later chapters of this thesis.

The principle of fiscal neutrality incorporates requirements such as uniformity, equality and elimination of distortion of competition. According to *Rita de la Feria*, these are considered sub-principles that the CJEU has developed as ‘corollaries’ of the neutrality principle.⁸ This chapter deals with fiscal neutrality both in its broad meaning and as sub-principles in the narrower context of VAT.

2.1 Principles in EU VAT law

2.1.1 Sources of EU VAT law

When examining general principles and their effect in the EU VAT system, it is first necessary to understand where they come from and what their role is vis-à-vis other instruments of EU VAT law. This section provides a brief introduction on the different sources of EU VAT law.

2.1.1.1 Primary EU law

Primary EU law refers to those sources of law on top of the hierarchy of the EU legal system. It is composed of the texts of the founding treaties, most importantly the Treaty on European Union (‘TEU’)⁹ and the Treaty on the Functioning of the European Union (‘TFEU’)¹⁰. These Treaties lay down the foundation for the EU, including its integral objectives and principles as well as the division of competences among its institutions.

The most important primary law provisions that have a direct bearing on the policy area of VAT appear in the TFEU. The essential basis for EU-level harmonization of national VAT systems can be pinpointed to the process of economic integration and establishment of an internal market. The internal market entails so-called fundamental

⁸ *De la Feria* 2016, p. 4.

⁹ Consolidated version of the Treaty on European Union, Official Journal C 326 of 26 October 2012.

¹⁰ Consolidated version of the Treaty on the Functioning of the European Union, Official Journal C 326 of 26 October 2012.

freedoms, i.e. the free movement of goods, services, persons and capital within the area of the EU. From a VAT perspective, the free movement of goods (Articles 28–37 of the TFEU) and the freedom to provide services (Articles 56–62) are particularly relevant.

Whereas the fundamental freedoms have major implications in the field of direct taxation, their practical role is, however, less compelling in indirect taxation. This is due to the fact that the TFEU also imposes further, more precise provisions on the harmonization of indirect taxes.¹¹

In Article 114 of the TFEU, the EU legislator is equipped with the regulatory power to adopt binding measures in order to bring Member States' indirect tax systems closer to each other. This provision makes a direct link between the regulatory competence and the aim of achieving a flawlessly functioning internal market. With particular regard to VAT, this competence has its specific basis in Article 113, a *lex specialis* provision complementing Article 114 of the TFEU. Article 113 calls for harmonization of national laws to a necessary extent to ensure the good functioning of the internal market and to prevent distortion of competition. Any legal acts adopted on the basis of Article 113 of the TFEU are instruments of secondary EU law.

2.1.1.2 Secondary EU law

Secondary EU law refers to legislation and other acts issued by EU bodies, expressly regulations, directives, decisions and opinions, as well as communications and recommendations. Since 1967, the harmonization of VAT has been principally realized through directives. Since EU directives are not as such binding on anybody but the Member States' legislators, each Member State has to transpose directives into acts of local law in order for them to become applicable (Article 288 of the TFEU).¹² Hence, another layer of VAT law is constituted by the national implementing acts and other locally applied VAT practices.

Council Directive 77/338/EEC¹³ (the 'Sixth VAT Directive'), a predecessor to the current VAT Directive, is a remarkable milestone in the history of European VAT law. The introduction of the Sixth VAT Directive marked the creation of the common VAT

¹¹ *Terra and Wattel* 2012, p. 36.

¹² *Raitio* 2016, p. 204.

¹³ Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the member states relating to turnover taxes.

system. Over the decades, this directive has been followed by numerous amendments and revisions to further harmonize and improve the common VAT system.

Today, the most important instrument of secondary EU VAT law currently in force is Council Directive 2006/112¹⁴ (the ‘VAT Directive’). In addition to this principal VAT Directive, there are a few other directives in place which lay down more detailed rules for certain specific circumstances,¹⁵ as well as Council Regulation 1777/2005¹⁶ (the ‘VAT Regulation’) that provides for guidance with the aim of consistent implementation and application of the VAT Directive.

2.1.1.3 Supplementary sources

Other sources of EU law, which are supplementary to the Treaties and the legislation issued based on Treaty provisions, are sometimes put in their own separate category. This source of EU law involves *inter alia* case law of the CJEU and general principles of EU law.

CJEU case law is considered as a supplementary source of EU law for the reason that the Court gives preliminary rulings regarding both the interpretation of the Treaties, i.e. primary EU law, and the interpretation and validity of acts of EU bodies, i.e. secondary EU law (Article 267(1) of the TFEU). In other words, as EU case law touches both layers of EU law, it cannot sensibly be put in either category but is instead regarded as a separate layer complementing the two. This may cause confusion as to the priority of different sources of EU law in case of a collision between norms or principles.

Notwithstanding the classification of case law as merely a supplementary source of law, the CJEU in fact has a crucial role in interpreting and, consequently, determining the scope and extent of provisions of EU law. The spectrum of interpretation methods employed by the CJEU includes the literal, historical, contextual and teleological interpretation methods.¹⁷ The rulings of the CJEU as well as the choice of interpretation method which the CJEU leans towards in its decision-making in each case, can have a

¹⁴ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

¹⁵ Directive 2008/9/EC and Directive 86/560/EEC (refund), Directive 2009/132/EC (VAT-free importation), Directive 2006/79/EC (private consignments) and Directive 2007/74/EC (travellers’ allowances).

¹⁶ Council Regulation (EC) No 1777/2005 of 17 October 2005 laying down implementing measures for Directive 77/388/EEC on the common system of value added tax.

¹⁷ See *Tervoort* 2015, p. 112.

remarkable impact on the development of EU law. That being said, the role of CJEU case law as a source of EU law should not be understated.

2.1.2 Sources of EU VAT principles

Generally, all principles can be derived from primary EU law, secondary EU law or supplementary sources of EU law. However, many principles are based on more than one layers of EU law and, furthermore, the source does not unequivocally determine the importance and position of a principle in the system of EU law. As will be discussed in section 2.2, fiscal neutrality is one of those principles that have their bases in several legal instruments.

Many of the leading concepts of EU law are unwritten principles, i.e. do not appear in the texts of the Treaties or EU legislation. Nevertheless, these principles have often been identified and have gained more substance through consistent case law by the CJEU.¹⁸

The CJEU has recently given a strong emphasis on general principles, especially since the EU legislator is often faced with new, significant challenges to adapt to the quickly globalizing and constantly changing economy and increase in new technologies.¹⁹ General principles can be utilized to temporarily fill in those gaps that the legislation in its current state does not specifically address.²⁰

2.2 Fiscal neutrality in the broad sense

The general meaning of the principle of fiscal neutrality, i.e. tax neutrality, is that taxation should not affect or distort economic decision-making.²¹ *Terra and Kajus* have asked the ineluctable question that arises in the assessment of neutrality: ‘neutral as regards what?’²² This implies that neutrality is a relative concept and it is necessary to pick a benchmark in relation to which neutrality is analysed. *Terra and Kajus* suggest a number of applicable benchmarks, among others international trade, competition, economic relations and legal relations. The equality of taxpayers is mentioned as one relevant legal relation in this context, supported by the OECD VAT/GST Guidelines

¹⁸ See *Terra and Wattel* 2012, p. 20–21.

¹⁹ *De la Feria* 2016, p. 16.

²⁰ *Raitio* 2016, p. 258.

²¹ *Endres and Spengel* 2015, p. 22.

²² *Terra and Kajus* 2015, p. 247–248.

which deal with similar treatment of different taxpayers.²³ In the context and terminology of VAT, where in principle consumers alone bear the tax burden, businesses should be referred to as taxable persons rather than taxpayers.

In the assessment of internal neutrality of EU provisions, a legal, competition, and economic perspective can be distinguished. Legally neutral VAT rules impose a tax burden of an equal amount for identical taxable persons or taxable events. If legal neutrality is achieved in this sense, the tax legislation does not affect competition either, and the VAT is thus also competition neutral. The economic aspect of neutrality is further concerned with the allocation of production. Irrespective of the different emphasis, in short, complete internal neutrality would require that the same amount of VAT is charged on all economic activities. In addition to the internal aspect, we can assess external neutrality, i.e. the EU VAT system against third countries.²⁴

2.3 Fiscal neutrality in the context of VAT

The key elements of the fiscal neutrality principle are expressed in Article 1(2) of the VAT Directive:

The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.

The first sentence of Article 1(2) entails two principal dimensions of neutrality of VAT. On one hand, horizontal neutrality requires that similar supplies of goods and services are treated equally for VAT purposes.²⁵ On the other hand, vertical neutrality postulates that the VAT treatment should not be affected by the length of the production and distribution chain.²⁶

²³ Ibid.

²⁴ Ibid.

²⁵ See Case C-309/06 *Marks & Spencer*, para 47.

²⁶ See e.g. Case C-174/11 *Zimmermann* where the CJEU acknowledges the existence of the two dimensions of neutrality.

It speaks for the prominence of the neutrality principle that its requirements are explicitly mentioned in the text of the VAT Directive. Nevertheless, for more specific contents of the principle, it is necessary to look into CJEU case law on the interpretation of neutrality in VAT cases. Case law on the status of the neutrality principle is not completely coherent. On one instance, the CJEU has indicated that neutrality in itself would not be a principle of primary EU law. Moreover, the Court has characterized neutrality as a principle of interpretation²⁷ as well as a concept of the common VAT system²⁸.

The International VAT/GST Guidelines²⁹, published by the Organisation for Economic Co-operation and Development ('OECD'), provide for a rather detailed content analysis on the meaning of neutrality in context with value-added taxes. Many similarities can be found between the EU and OECD concepts of VAT neutrality. Therefore the more precise description, included in the OECD Guidelines, is used in this chapter to support the content requirements of the same principle in the context of EU VAT.

2.3.1 Burden of VAT

On the subject of VAT burden, neutrality principle imposes two material requirements. Firstly, the VAT burden should be borne by the end consumers and not by businesses; irrespective of how many times a product changes owner within the production and distribution chain before ending up in the hands of the person who consumes it. Being a tax on consumption, VAT should not become an expense for businesses except for taxable supplies that companies consume for their own benefit.

Secondly, the VAT burden should be of the correct amount i.e. exactly proportional to the final sales price. This point was especially laboured on in the early phases of the harmonization process for the reason that national turnover taxes, which were in place in most Member States prior to the common VAT system, usually led to the cascading of tax. A turnover tax is said to cascade when taxable persons along the production and distribution chain incorporate non-deductible tax in their sales prices to the next person in the chain, who in turn charges tax on the full price including the hidden tax, and so

²⁷ Case C-44/11 *Deutsche Bank*, para 45.

²⁸ Case C-174/11 *Zimmermann*, para 22.

²⁹ OECD VAT/GST Guidelines.

on until the multiplied tax burden is finally passed on to the end consumer.³⁰ In other words, the cascading of tax means imposing tax on tax.

The key requirements regarding the neutrality of VAT burden were already included in the preamble to the First VAT Directive:

Whereas a system of value added tax achieves the highest degree of simplicity and of neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution and the provision of services; whereas it is therefore in the interest of the common market and of Member States to adopt a common system which shall also apply to the retail trade - - .³¹

In the same spirit, OECD VAT/GST Guideline 2.1 declares that the burden of VAT ‘should not lie on taxable businesses except where explicitly provided for in legislation’.³²

2.3.2 Input VAT relief

The mechanism of input VAT relief is exercised in order to ensure the correct subject and amount of VAT burden in line with the neutrality principle. The neutrality of VAT towards all forms of similar economic activities is guaranteed for all stages in the chain of business transactions by allowing businesses to set off the input VAT incurred in relation to their economic activities against their output VAT liability.

The VAT Directive grants an immediate and full relief of input VAT for taxable persons. Hence, the principle of input VAT relief is meant to implement the principle of neutrality in practice.³³ The CJEU has articulated on the connection between the right to input VAT relief and the neutrality principle e.g. in *Rompelman*:

The deduction system is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of value-added tax therefore ensures that all economic activities,

³⁰ *Doesum, Kesteren and Norden* 2016, p. 350.

³¹ First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes.

³² OECD VAT/GST Guidelines, p. 20.

³³ *Henkow* 2008, p. 233.

*whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way.*³⁴

The deduction of input VAT is regulated in Title X of the VAT Directive. Articles 167 through 168 provide taxable persons with an immediate and full right to input VAT relief. Full relief implies that even if a taxable person's input VAT exceeds its output VAT in a certain period, he is entitled to reclaim a refund for the excess from tax authorities.³⁵

2.3.3 Equal treatment

Equal treatment is a general principle of EU law, underlying all written provisions of primary and secondary EU law.³⁶ According to the concept of equal treatment, comparable situations must be treated similarly unless a different treatment can be objectively justified. Equal treatment can therefore be seen as the reverse side of the non-discrimination principle that has its legal basis in Article 18 of the TFEU.³⁷

The relationship and interaction between the fiscal neutrality principle and the principle of equal treatment have been debated in CJEU case law as well as in academic literature on several occasions.³⁸ In several judgements of the CJEU, the neutrality principle is described as a particular implementation of the principle of equal treatment at the level and in the context of VAT.³⁹ This is considered to be settled case law, e.g. in *Commission v Sweden*. However, in that ruling, the CJEU considers these principles to have different scopes:

Although infringement of the principle of fiscal neutrality may be envisaged only as between competing traders, infringement of the general principle of equal treatment may be established, in matters relating to tax, by other kinds of

³⁴ Case 268/83 *Rompelman*, para 19.

³⁵ *Doesum, Kesteren and Norden* 2016, p. 348–349.

³⁶ See Case C-265/78 *Ferwerda*, para 7.

³⁷ However, it is noteworthy that Article 18 of the TFEU only speaks about 'discrimination on grounds of nationality'. The scope of this provision is quite narrow since, in a similar manner to the fundamental freedoms, the application requires the involvement of a cross-border element or rather the involvement of nationals of at least two Member States.

³⁸ A predominant part of this discussion has been focused on the principle of neutrality in context with the interpretation of various exemptions allowed by the VAT Directive.

³⁹ Case C-174/08 *NCC Construction Danmark A/S*, para 41; Case C-174/11 *Zimmermann*, para 50 and Case C-309/06 *Marks & Spencer*, para 49.

*discrimination which affect traders who are not necessarily in competition with each other but who are nevertheless in a similar situation in other respects.*⁴⁰

The OECD Guidelines also state on the matter of equal treatment. In accordance with Guideline 2.2, businesses in similar situations carrying out similar transactions should be subject to similar level of taxation.

2.3.4 Absence of distortion of competition

European competition policy aims to ensure a level playing field for economic operators and activities within the internal market. A level playing field entails that no enterprise or no product is given a favourable market position in comparison with its competitors.⁴¹

The preventing of distortion of competition has been explicitly mentioned in Article 113 of the TFEU as a key objective of EU VAT harmonization, next to the general well-functioning of the internal market. These two objectives are interdependent. Fair, undistorted competition is necessary in order to maintain the benefits that arise from the free circulation of products and production factors within the European internal market. Moreover, both objectives ultimately have to do with the abolishment of market restrictions and obstacles.⁴² In addition to the provisions touching upon indirect tax and competition, Articles 101 through 109 of the TFEU lay down specific rules and measures on establishing fair conditions for competition.

The competition aspect of fiscal neutrality has been present in CJEU case law, e.g. in case *Hong Kong*.⁴³ Furthermore, in case *Commission v France*, the CJEU explicitly pronounces that the principle of fiscal neutrality includes the principle of elimination of distortion in competition.⁴⁴ In light of this case law, it appears that undistorted

⁴⁰ Case C-480/10 *Commission v Sweden*, para 17.

⁴¹ *Chari and Kritzinger* 2006, p. 83.

⁴² *Raitio* 2016, p. 700.

⁴³ See Case 89/81 *Hong Kong*, para 6 on the purpose of the EU VAT: ‘-- the need to achieve such harmonization of legislation concerning turnover taxes as will eliminate factors which may distort conditions of competition and therefore to secure neutrality in competition, in the sense that within each country similar goods should bear the same tax burden, whatever the length of the production and distribution chain.’

⁴⁴ Case C-481/98 *Commission v France*, para 22.

competition is a relevant part of the neutrality principle and is as such absorbed therein.⁴⁵

By the same token, fair competition is interconnected with the rest of the sub-principles that are part of fiscal neutrality. The preamble to the Sixth VAT Directive emphasizes the importance of ensuring that the common system of VAT ‘is non-discriminatory - - so that a common market permitting fair competition and resembling a real internal market may ultimately be achieved’. Hence, the link is made between fair competition and equal treatment. In like manner, the Commission Study of 2017 on TOMS defines distortion of competition as change in the behaviour of businesses due to unequal treatment.⁴⁶

While the focus of EU policies is distinctly on establishing fair competition within the EU, ensuring the competitiveness of the EU vis-à-vis third countries is an even more complicated task. This is in particular due to the European legislator’s lack of jurisdiction in non-EU countries. Nevertheless, making the European market globally competitive is also an important goal on the EU legislator’s agenda.⁴⁷

⁴⁵ See also de la *Feria* 2016, p. 4.

⁴⁶ Commission Study 2017.

⁴⁷ *Chari and Kritzinger* 2006, p. 62.

3 NORMATIVE FRAMEWORK: VAT TREATMENT OF PROVISION AND INTERMEDIATION OF TRAVEL SERVICES

3.1 Reasons for the existence of two VAT schemes

3.1.1 Introduction

Special VAT schemes entail different rules for circumstances where the regular VAT scheme would be difficult or impossible to apply. The rationale behind these special rules that deviate from the regular regime is the reduction of administrative and compliance burden for businesses by allowing them to apply simplified VAT procedures. According to an OECD report, most developed countries employ specific margin schemes in their VAT law, however only EU Member States and Turkey currently utilise such a scheme for travel agencies.⁴⁸

The Tour Operators' Margin Scheme ('TOMS') is one of the special schemes laid down in the EU VAT Directive.⁴⁹ The TOMS was first introduced in Article 26 of the Sixth VAT Directive which was adopted in 1977. The Commission proposal for a Sixth VAT Directive⁵⁰ did not involve a special scheme for travel agents, but the provisions on TOMS were included in the directive in a later stage of the legislative process. For that reason, there is hardly any documentation or reasoning in the preparatory works as to the objectives of TOMS.⁵¹ In spite of the lack of *travaux préparatoires*, the purposes of introducing a special scheme for travel agents have since been clarified in CJEU case law as well as in academic literature and are now considered to be well established.⁵²

3.1.2 Simplification

As the travel industry has been facing rapid changes due to the internationalization of the branch since the early days of the European integration, a central objective of the adoption of TOMS was to simplify the VAT system for an increasing number of travel agents engaged in cross-border business activities.

⁴⁸ OECD 2016, p. 76.

⁴⁹ In addition to travel agents, Title XII of the VAT Directive includes special schemes for small and medium-sized enterprises, farmers, second hand goods and artworks, and investment gold.

⁵⁰ COM (73) 950).

⁵¹ *Doesum, Kesteren and Norden* 2016, p. 552.

⁵² Commission Study 2017, p. 31.

The VAT procedure under TOMS imposes fewer local VAT registration obligations for travel agents as compared to the regular rules of the VAT Directive. Under the regular scheme, a travel agent purchasing and selling services outside its Member State of residence would have to register in each country where it makes business. Besides the formal registration requirement, the travel agent would have to incur costs in order to understand and comply with the local VAT laws of each Member State as well as deal with correspondence and provide proper documentation to be able to claim relief of input VAT in those States. Travel agents acting under TOMS can avoid such costs and administrative complexity, and therefore TOMS is particularly convenient for travel agents that purchase and sell services in many different countries, since it allows them to avoid administrative complexity due to several places of supply.⁵³

Support for the aim of simplification can be found in the CJEU's reasoning, e.g. in case *Van Ginkel*:⁵⁴

The services provided by these undertakings most frequently consist of multiple services, particularly as regards transport and accommodation, either within or outside the territory of the Member State in which the undertaking has established his business or has a fixed establishment.

*The application of the normal rules on place of taxation, taxable amount and deduction of input tax would, by reason of the multiplicity of services and the places in which they are provided, entail practical difficulties for those undertakings of such a nature as to obstruct their operations.*⁵⁵

3.1.3 Correct allocation of VAT revenue

Furthermore, taxation under TOMS provisions is better in line with the objective of taxing goods and services where they are consumed. In recent years, the so-called destination principle has had an increasingly important role in EU VAT law. According to this principle, every supply should be taxed where it is consumed. Moreover, VAT revenue relating to each supply of service should be allocated to the Member State in which the consumption of that service takes place.⁵⁶ Therefore, taxation in accordance with the destination principle eventually leads to a fair allocation of VAT revenue

⁵³ See *Doesum, Kesteren and Norden* 2016, p. 552; *Terra and Kajus* 2015a, p. 5037–5038.

⁵⁴ See also Case C-557/11 *Maria Kozak*, para 19 in which the Court has used a wording nearly identical to the one in *Van Ginkel* ruling.

⁵⁵ Case C-163/91 *Van Ginkel*, paras 13-14.

⁵⁶ Commission Study 2017, p. 31.

between Member States where cross-border supplies are concerned. As will be explained in more detail in section 3.3, the special scheme aims at taxing travel services in the Member State where they are performed, separately from the travel agent's service which is taxed where the agent is established.

3.2 Regular scheme

3.2.1 Taxable transactions

Under the EU VAT system, there are four main types of transactions that are subject to VAT: 1) domestic supply of goods, 2) intra-Community supply of goods, 3) supply of services and 4) importation of goods (Article 2(1) of the VAT Directive). Furthermore, Article 2 requires that the transaction must occur for consideration⁵⁷ and the supplier must be a taxable person.

Travel industry is primarily focused on supplies of services, which are regulated in Title IV, chapter 3 of the VAT Directive. All transactions that do not constitute supplies of goods are supplies of services (Article 24 of the VAT Directive). Hence, the VAT Directive covers a vast range of transactions, and the CJEU has confirmed the general principle that 'VAT is to be levied on all services supplied for consideration by a taxable person'.⁵⁸ Moreover, based on CJEU case law, a supply of a service is regarded to occur for consideration when there is a direct link between the service and the consideration received.⁵⁹ The requirement of the supplier's taxable status indicates that no VAT is levied on transactions between private individuals. In relation to travel services, the criteria of consideration and taxable person hardly give rise to any interpretative issues.

Travel agents often sell several products as part of the same project, package or invoice. There may be both goods and services included in the same package, as well as services subject to different VAT rates. Application of the regular VAT scheme will usually result in splitting such a package into several independent supplies that follow their own VAT treatments. For example, when a travel package consists of hotel accommodation and breakfast in Finland, the provider would charge 10 % VAT on the price of hotel and

⁵⁷ I.e. against a remuneration, most often a payment in money.

⁵⁸ Case C-287/00 *Commission v Germany*, para 43.

⁵⁹ Case 154/80 *Coöperatieve Aardappelenbewaarplaats*, para 12.

14 % VAT on the restaurant service, in accordance with the VAT rates determined in national law for these types of services.

On the other hand, if a supply clearly has one principal element while the other elements are purely ancillary, this may be regarded as one single supply that shares the VAT treatment applicable to the principal service.⁶⁰ For example, whereas foodstuff and restaurant services are normally taxed at 14 % Finnish VAT, a pack of blueberry juice on an aircraft on a domestic route will not be separately taxed at 14 % but instead, as merely an ancillary product, is absorbed in the VAT treatment of the air ticket which will be taxed as a single supply with 10 % VAT, the rate applicable to passenger transport.

3.2.2 Place of supply and VAT liability

The place of supply rules of the VAT Directive are concerned with the allocation of taxing rights between countries. These rules determine the jurisdiction in which a supply is made and, consequently, taxed. Under the regular scheme, the place of supply is determined differently for supplies of goods (Arts. 31–39 VAT Directive) and supplies of services (Arts. 43–59c VAT Directive). The place of supply rules for services generally aim at taxing cross-border supplies in the country where these are consumed, in line with the destination principle.⁶¹ The current place of supply rules for services have been in force since 2010.⁶²

In respect of services, we must further distinguish between supplies to other taxable persons⁶³ ('B2B supplies') and supplies to consumers and other non-taxable persons ('B2C supplies'). The applicable rule thus depends on the VAT status of the recipient of the service. According to the main rules of the VAT Directive, the place of supply of a B2B supply of services is in the Member State where the business customer is established (Article 44 VAT Directive), whereas a B2C supply is regarded to be made in the Member State where the supplier is established (Article 45 VAT Directive).

⁶⁰ *Doesum, Kesteren and Norden* 2016, p. 135–136.

⁶¹ *Ibid* p. 151–152.

⁶² The place of supply rules were brought in line with the destination principle with Council Directive 2008/8/EC. According to recital 3, VAT should in principle be levied where the actual consumption takes place.

⁶³ The concept of a taxable person for the purposes of the place of supply rules is clarified in Article 43 of the VAT Directive. The term covers also taxable persons who also carry out activities that are not considered to be taxable supplies of services in accordance with Article 2(1) and non-taxable legal persons who are identified for VAT purposes.

There are many exceptions to these main rules, among which intermediation and passenger transport are relevant in the field of travel. The particular places of supply often deviate from the destination principle, which can be reasoned with administrative convenience and policy reasons.⁶⁴

According to Article 193 of the VAT Directive, the person liable to pay VAT to the tax authorities is any taxable person carrying out a taxable supply of goods and services. The place of supply assigned by the VAT Directive does not always coincide with where VAT in fact becomes payable. Namely, sometimes the recipient of a supply, instead of the supplier, is accountable for the declaration and payment of output VAT.⁶⁵ In particular, for cross-border supplies of services within the EU a mandatory reverse charge mechanism applies in B2B scenarios (Article 196 of the VAT Directive). Consequently, even if the place of supply were the country of establishment of the supplier in accordance with Article 44 of the VAT Directive, the reverse charge mechanism implies that the supplier charges 0 % VAT, and the service recipient must self-assess the appropriate amount of VAT on the purchase in its country of establishment.⁶⁶

3.2.3 Relief of input VAT

Relief of input VAT is regulated in Title X, Articles 167–192 of the VAT Directive. Generally, businesses are granted a right to deduct the VAT charged upon them for their purchases in relation to their taxable activities. As the relief of input VAT implements the principle of fiscal neutrality, the right to deduct input VAT applies in principle to all purchases by taxable persons.

For example, a company providing bus transportation can in principle claim from the tax authorities all input VAT upon the acquisition of new vehicles as well as other purchases starting from filling the tank with gas and ending with maintenance and

⁶⁴ Council Directive 2008/8/EC, recitals 3 and 6.

⁶⁵ *Doesum, Kesteren and Norden* 2016, p. 415.

⁶⁶ Council Directive 2008/8/EC, recital 7.

cleaning of the busses.⁶⁷ In this way, the neutrality principle is given its effect in practice as none of the input VAT becomes an expense for the company.

According to Article 179, the total amount of VAT due for a period is decreased by the total amount of VAT in respect of which the right of deduction has arisen and is exercised. Technically, the recovery of input VAT can take the mechanism of a deduction or a refund, depending on whether the VAT on output transactions carried out by a business during a reporting period is larger or smaller than the input VAT.⁶⁸

3.2.4 Intermediation

Article 28 of the VAT Directive lays down the main rule for taxable transactions carried out by agents who act as undisclosed agents i.e. in their own name but on behalf of third parties. According to this provision, the agent is deemed to receive and supply the service himself. In other words, there is a fiction with two supplies: one from the principal supplier to the agent and another one from the agent to the final customer. All circumstances shall be taken into consideration when determining whether the agent is acting in his own name or in the name of another party.⁶⁹ In the provision of travel services, agents acting in their own name will most likely fall within the scope of TOMS,⁷⁰ as will be discovered below in section 3.3.1.

Where an agent is acting as a disclosed agent, in the name and on behalf of another person, i.e. as an intermediary in the terminology of the VAT Directive, different rules are in place. There is no fiction of buying and re-selling, but the supply of the underlying products is only between the principal supplier and the end customer. The agent is purely acting in the role of an intermediary, and the intermediation service is considered as a distinct taxable event separate from the mediated, underlying supply. Therefore, the intermediary is not party to the underlying supply but merely helps the

⁶⁷ This, of course, is a simplified example and assumes that all legal requirements for input VAT are met, e.g. using the acquired products only for taxable activities and being in possession of a compliant invoice.

⁶⁸ *Doesum, Kesteren and Norden* 2016, p. 351.

⁶⁹ *Rendahl* 2013, p. 451–452.

⁷⁰ With the exception of a few Member States that allow travel agents to apply the regular scheme instead of TOMS. In such cases, this ‘commissionaire’ article (Art. 28) might become relevant in order to determine the VAT treatment.

contracting parties, without having his own interest in the contract terms of the underlying supplies.⁷¹

Article 79 point (c) applies to services supplied by intermediaries. This provision articulates that the taxable amount shall not include ‘amounts received by a taxable person from the customer as repayment of expenditure incurred in the name and on behalf of the customer’. In practice, even though the agent often pays the amount of the underlying supply in the name and on behalf of its customer and then charges the same amount to the customer, it is in fact not considered to be the travel agent’s revenue but only a pass-through item that does not touch the travel agent’s VAT reporting at all.

The place of supply of an intermediation service depends on whether the customer is a taxable person or a consumer. For B2C situations, the taxation of the intermediation service is as a main rule dependent on the VAT treatment of the underlying supply, as is evident e.g. from the place of supply rule in Article 46 of the VAT Directive.

In respect of intermediation to B2B customers, the VAT treatment is generally determined by three factors: where the customer is located; where the underlying service is performed; and what the underlying service is.

The intermediary will usually charge a fee or commission for its intermediation service. As a rule, the remuneration for intermediation of a travel service, such as hotel, air, car or rail, will have the following VAT handling:

- 1) Domestic business customer:
 - a. In relation to domestic air/hotel/car/rail, the travel agent charges domestic standard VAT on its fee;
 - b. In relation to EU hotel/car/rail, the travel agent charges domestic standard VAT on the fee;
 - c. In relation to non-EU hotel/car/rail, the travel agent charges 0 % VAT on the fee;⁷²

⁷¹ *Terra and Kajus* 2015a, p. 1765.

⁷² Article 153 of the VAT Directive prescribes certain situations where intermediation is exempt. For example, the intermediation of supplies that take place outside the EU will be taxable at 0 % VAT. Here it is noteworthy that the VAT system applies two kinds of exemptions: 1) exemptions with the right to a relief of input VAT and 2) exemptions without the right to a relief of input VAT.

- d. In relation to international air tickets, the travel agent charges 0 % VAT on its fee.⁷³
- 2) Business customer established in another EU Member State: The fee will always be subject to reverse charge mechanism, which indicates that the travel agent charges 0 % domestic VAT and the customer reports VAT locally in its Member State of establishment.
 - 3) Non-EU business customer: the fee is not subject to VAT in the EU, but the B2B customer will self-assess local VAT if applicable.

3.3 Special scheme for travel agents

3.3.1 Scope

According to Article 306(1) of the VAT Directive, TOMS applies to ‘transactions carried out by travel agents who deal with customers in their own name and use supplies of goods or services provided by other taxable persons, in the provision of travel facilities’.⁷⁴ Thereupon, three central conditions for the application of TOMS can be concluded from this provision:

1. The travel agent acts in its own name;
2. It sells supplies that it purchased from other businesses; and
3. The products are travel-related.⁷⁵

Furthermore, Article 306(2) explicitly excludes supplies by mere intermediaries, to whom Article 79(c) applies, from the scope of TOMS. Therefore, it is important to distinguish between travel agents acting in the name and on behalf of suppliers or customers and those doing business in their own name.⁷⁶

Article 153 does not disallow the intermediary’s relief of input VAT. Therefore, this exemption belongs to the first category, also known as a ‘zero-rated’ supply.

⁷³ Supplies of international air is in most cases exempted, however some exceptions apply.

⁷⁴ The wording in Article 26(1) of the Sixth VAT Directive was almost the same: ‘- - where the travel agents deal with customers in their own name and use the supplies and services of other taxable persons in the provision of travel facilities’.

⁷⁵ See VAT Committee Guidelines of 4–5th July 1984, p. 2.

⁷⁶ In practice, above all the contracts that the travel agent engaged into with the supplier and customer will indicate what kind of agency structure is used.

3.3.2 Taxable transaction and place of supply

Article 307 of the VAT Directive deals with the matters of taxable transaction and place of supply in relation to supplies under TOMS. According to the first sentence of Article 307, ‘transactions made, in accordance with the conditions laid down in Article 306, by the travel agent in respect of a journey shall be regarded as a single service supplied by the travel agent to the traveller’. In other words, whenever a travel agent under TOMS sells a package that might consist of diverse travel services, the supply is treated as a single taxable event for VAT purposes. Whether the package includes services or goods that are normally subject to different VAT rules or rates, or only one service, is in principle irrelevant.⁷⁷ This single supply under Article 307 is therefore often a fiction for VAT purposes.⁷⁸

The second sentence of Article 307 provides that the single supply is taxable in the Member State where the travel agent is established or from which it carries out the supply of services. The provision stipulates that the tour operating service is taxed in the country where the travel agent carries out its business. In respect of the underlying services, i.e. the actual travel services that the travel agent purchases from third party suppliers and sells onward to travellers, these are in effect taxed where the respective services are enjoyed or where the suppliers are located. Here the rules of TOMS deviate from the regular VAT scheme, as it is set out that only the value added by the travel agent in the transaction is taxed in its country of establishment, and not the value created during the entire supply chain.

3.3.3 Margin calculation and VAT liability

The taxable amount under TOMS is the travel agent’s margin in relation to the single service. Based on Article 308 of the VAT Directive, the TOMS margin is the difference between the sales price, exclusive of VAT, that the travel agent charges to the traveller and the actual cost, inclusive of VAT, of the services that the travel agent purchased from third parties for the direct benefit of the traveller. Under Article 308, VAT is in practice paid by the travel agent from the margin. The taxable base is therefore the margin decreased by the amount of VAT payable.

⁷⁷ Without regard to the different implementations of Member States which are dealt with in chapter 5 of this thesis.

⁷⁸ *Terra and Kajus* 2015a, p. 5058.

For example, Travel Agent A who is established in Finland creates a package holiday for a group of Finnish ice hockey fans. Travel Agent A purchases flight tickets from Helsinki to Prague, bus transport between the airport and hotel, accommodation in a hotel in Prague, and entrance tickets to an ice hockey match. The purchase prices including VAT are EUR 17.500 in total. Travel Agent A sells the package to its customer for EUR 20.000. The margin including VAT is EUR 2.500 (20.000 – 17.500). The VAT payable is EUR 480 (2.500 * 24/124).⁷⁹ After the payment of output VAT, the travel agent's net margin is in fact reduced to EUR 2.020 (2.500 - 480).

The applicable VAT rate is not determined by the VAT Directive. However, TOMS margin is as a main rule subject to standard VAT rate,⁸⁰ unless local VAT law provides for a special relief. For instance, some Member States⁸¹ allow an exemption for the part of the travel agent's margin that relates to international air tickets.

3.3.4 Relief of input VAT

Article 310 of the VAT Directive disallows travel agents to deduct any input VAT incurred in relation to their transactions under Article 307 that are for the direct benefit of the traveller. Hence, the travel agents are not entitled to recover the input VAT in respect of bought-in supplies that will later be sold under TOMS.⁸² This is a deviation of the principle of immediate and full deduction of input VAT, and thus contrary to the neutrality principle. Nevertheless, when the TOMS margin is calculated on the basis of the VAT inclusive costs of purchases, the effect is that the margin is reduced by the amount of input VAT. It can be argued that it is not necessary to grant further relief for input VAT.⁸³ However the effect does not always constitute a full relief.⁸⁴

In practice, travel agents selling packages under TOMS add the unrecoverable input VAT in their sales prices and thus pass the tax expense on to their customers. By

⁷⁹ As Travel Agent A is established in Finland, it charges Finnish VAT. Finland currently has a standard VAT rate of 24 %.

⁸⁰ Commission: VAT rates applied in the Member States of the European Union – Situation at 1st January 2018.

⁸¹ E.g. France.

⁸² However overheads, i.e. costs that are not directly related to TOMS packages, remain within input VAT relief in accordance with the regular VAT rules.

⁸³ *Woolf* 2007, p.11.

⁸⁴ Furthermore, in some Member States, e.g. Belgium, it is possible or even mandatory to use a fixed margin instead of calculating the margin based on actual costs. In these cases, the input VAT on the travel agent's purchases is practically not taken into account.

operating in this way, travel agents manage to avoid the undesirable situation where VAT becomes a cost for them. On the other hand, as a result they will then be forced to charge higher prices to their customers.

The recipient of a TOMS supply is generally not entitled to deduct the margin VAT. This is a relevant issue in respect of B2B sales where the business customer generally expects to be able to deduct this input VAT. However, some Member States allow business customers to recover the input VAT provided that a VAT compliant invoice is issued.⁸⁵ Different country practices in this respect will be discussed in more detail in chapter 4.

⁸⁵ Commission Study 2017, p. 36.

4 DISPARITIES: DIFFERENTIAL TREATMENT OF OPERATORS LOCATED IN DIFFERENT MEMBER STATES

The VAT Directive currently leaves room for flexibility for Member States to apply the special VAT scheme for travel agents in different ways. Disparities arising from this flexibility may result in unequal VAT treatment for entities established in different Member States, since some country practices are considered more beneficial from a business perspective than others. This chapter provides a general explanation as to why disparities occur in the first place and discusses examples of material disparities in the field of TOMS. Finally, I will conclude with possible solutions how to bring more unity into the application of the VAT rules concerning travel agents across the EU.

4.1 Causes of disparities

According to Article 288(3) of the TFEU, a directive is ‘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’. Consequently, the text of a directive is not *per se* applicable. Every Member State must transpose the contents of a directive into an instrument of national law. As long as the same result is achieved, it is in the competence of each Member State’s domestic legislator to decide how to implement the Directive.⁸⁶ The text of a directive is thus like a blueprint for domestic legislation.⁸⁷

Since Member States are not required to copy the text of EU directives word by word into national law, the directive as a legal instrument is rather general in nature. Directives typically entail guidelines for Member States instead of specific obligations. It is therefore justified to say that the framework of EU law leaves jurisdiction for Member States to deviate from the VAT Directive.⁸⁸ However, sometimes the provisions of a directive are more detailed, in which case national legislators have less room for flexibility.⁸⁹ In general, the more discretion Member States have, the less consistency can be expected of the national implementation measures.⁹⁰ It varies per directive how much discretion is granted to Member States, but the extent of flexibility

⁸⁶ See *Steunenberg* 2011, p. 362.

⁸⁷ *Doesum, Kesteren and Norden* 2016, p. 13.

⁸⁸ *Bomer* 2016, p. 657.

⁸⁹ *Raitio* 2016, p. 205.

⁹⁰ *Thomson* 2009, p. 8.

can also vary within one and the same directive. For instance, it has been mandatory for Member States to implement TOMS in their local VAT laws, while some other special schemes of the VAT Directive are completely optional.⁹¹

Disparities are obstacles to intra-community trade resulting from differences in the national laws of Member States.⁹² As VAT has been harmonized by means of directives, the national VAT laws of Member States need not be identical to each other. Inconsistencies in the implementation of EU Directives may arise due to differences in national transposition, application and enforcement of the Directive,⁹³ as well as different interpretations of CJEU case law.⁹⁴ In other words, both ‘law in the books’ and ‘law in action’ should be taken into account when reviewing existing disparities.⁹⁵ With particular regard to the TOMS provisions of the VAT Directive, there is divergence across the EU in both the letter of the law and its practical application. Besides the local applications of the special scheme itself, further disparities may result from different national VAT rules applicable to situations that fall outside the scope of TOMS.⁹⁶

Several causes explain the divergence in national compliance measures and practices in relation to EU Directives. First of all, the translation from EU working languages to multiple language versions might result in slight differences in certain terms or concepts. Moreover, as is also the case for the VAT Directive, EU law often involves its own concepts independent from national laws and international law, and the unlike use of terminology in different layers of law may cause ambiguity as to the contents of provisions that refer to such terminology. Lastly, for the provisions of a directive are applied and enforced at the level of Member States rather than at EU level, the enactment might be affected by different characteristics of national legal systems as well as economic and social factors.⁹⁷

⁹¹ *Doesum, Kesteren and Norden* 2016, p. 549. For instance, special schemes for small and medium sized enterprises and farmers are optional for Member States.

⁹² *Terra and Wattel* 2012, p. 64.

⁹³ *Mastenbroek* 2005, p. 1114.

⁹⁴ *Commission* 2017, p. 55.

⁹⁵ See *Conant* 2012 where, in the context of compliance and non-compliance, a distinction is made between ‘law in the books’ on one hand and ‘law in action’ on the other. By ‘law in the books’, Conant means the transposition of directives, whereas ‘law in action’ refers to how law applies in practice i.e. the application and enforcement of the directive on a national level.

⁹⁶ *Commission* 2009, p. 133.

⁹⁷ *Prechal and Roermund* 2008, p. 5–6.

It is also worth mentioning that the incorrect or incomplete national implementations may be either deliberately planned or unintentional. *Weatherill* talks about ‘creative compliance’ which is a relevant risk relating to directives, as Member States might attempt to take advantage of the flexibility granted in directives and draft their transposition measures in a way that ensures the minimization of costs for them.⁹⁸ Furthermore, competition among Member States for attracting foreign businesses and investments can also affect their willingness to fully comply with EU legislation in its strictest meaning.⁹⁹

4.2 Existing disparities in the application of TOMS

4.2.1 Incomplete implementation

From the time of the introduction of TOMS in the Sixth VAT Directive in 1977, it has been mandatory for all EU Member States to include this special scheme in their national VAT acts. At present, all 28 Member States have indeed transposed this scheme into their national laws. However, there has been divergence as to the types of supplies falling within the scope of TOMS, which the CJEU has attempted to address in several rulings in the last few years. With a few Member States still defining the scope of TOMS in a substantially different manner from the Court’s interpretation, the effective implementation in these cases is questionable at the very least.

4.2.1.1 CJEU ruling against 8 Member States

The VAT Directive speaks about services for the benefit of a ‘traveller’ but does not further define which types of travellers are included in the scope of TOMS.¹⁰⁰ All Member States apply TOMS to B2C transactions where the customer is a non-taxable person. In addition to B2C supplies, a large part of travel agents’ business is focussed at B2B supplies where the customer is another taxable person. B2B supplies can be further

⁹⁸ *Weatherill* 2016, p. 284.

⁹⁹ Tax competition is increasingly recognized as an important phenomenon in EU tax law. To some extent, tax competition between Member States can benefit the EU, the Member States and individual businesses and citizens alike. However, at the same time there is a concern for taking the competition too far would mean a dangerous ‘race to the bottom’ if the Members start competing with who has the most attractive tax regimes and excessively granting tax benefits and lowering their taxes. This kind of tax competition is not merely related to direct taxation but can be also imagined in the context of VAT where the Member States have competence to deviate from the Directive, most notably in the specific context of VAT rates and exemptions.

¹⁰⁰ Furthermore, the term ‘traveller’ is often not defined in national law either. See e.g. *Finnish Tax Administration* 2013, section 3.1.5 ‘Ostot välittömästi matkustajan hyväksi’.

divided into two principal categories, namely business travel and wholesale. Business travel refers to transactions where a company purchases travel services for its own use, e.g. a train ticket and a hotel night for an employee who is attending a meeting in another city. In the wholesale setup, another travel agent buys travel services and sells them onward to the end traveller.

Due to the indefiniteness of the TOMS provision in the Directive, Member States have adopted various differing approaches on the determination of the B2B supplies covered by the scheme. Strictly speaking, some Member States have been applying TOMS with a narrower scope than others.

As an outcome of an infringement procedure against eight Member States initiated by the Commission,¹⁰¹ the CJEU clarified in 2013 that TOMS applies regardless of the type of the travel agent's customer. In line with prior case law,¹⁰² the Court ruled that the term 'traveller' covers both B2C and B2B customers. It confirmed the Commission's argument that businesses are factually the end users of travel services where they buy travel services for their own purposes, such as for their employees.¹⁰³ Within B2B supplies, the Court took the view that both business travel and wholesale are in the scope of TOMS:

Where an operator organises a package travel service and sells it to a travel agent who then resells it to a final consumer, it is that first operator who takes on the task of combining several services purchased from various third parties who are subject to VAT. In the light of the objective of the special scheme for travel agents, that operator must be able to benefit from simplified VAT rules and those rules must not be reserved to travel agents who limit themselves, in such a case, to reselling to the final consumer the package they have purchased from that operator.¹⁰⁴

¹⁰¹ See Cases C-189/11 *Commission v Spain*, C-193/11 *Commission v Poland*, C-236/11 *Commission v Italy*, C-269/11 *Commission v Czech Republic*, C-293/11 *Commission v Greece*, C-296/11 *Commission v France*, C-309/11 *Commission v Finland* and C-450/11 *Commission v Portugal*.

¹⁰² To support its conclusion, the Court referred to Case C-149/01 *First Choice Holidays* in particular.

¹⁰³ Case C-189/11 *Commission v Spain*, para 32.

¹⁰⁴ *Ibid*, para 62.

To sum up, the interpretation of the Court confirms that TOMS applies to business travel as well as private travel, and furthermore to wholesale as well.¹⁰⁵ Therefore, CJEU case law prefers a so-called customer-based definition to a traveller-based approach.¹⁰⁶

4.2.1.2 Current situation

Even after the CJEU ruling against eight Member States, inconsistencies remain in the scope of application of TOMS in respect of B2B supplies. The Commission Study of 2017 on the application of TOMS uncovers that eleven Member States consider wholesale to be outside the scope of TOMS and subject these to the regular VAT rules instead.¹⁰⁷ Furthermore, Germany, Austria and Slovakia apply TOMS to B2C transactions only.¹⁰⁸ For instance, the German VAT Act and the most recent version of interpretative guidance of the German ministry of finance explicitly indicate that TOMS is not applicable to purchases of travel services for business purposes of the recipient.¹⁰⁹ In its recent ruling of February 2018 regarding an infringement case *Commission v Germany*, the CJEU confirmed that Germany has failed to comply with the VAT Directive, and that it should include B2B supplies in the scope of TOMS.¹¹⁰

Moreover, the local VAT laws of Sweden and Spain respectively provide travel agents a possibility to opt-out of TOMS under certain conditions. In principle, when Swedish and Spanish travel agents sell travel services to other taxable persons for business travel

¹⁰⁵ See also Opinion of AG Sharpston in Case C-189/11 *Commission v Spain*, where AG Sharpston points out that, when taken literally, the term ‘traveller’ does not seem to refer to other travel agents, however the scope of supplies covered by TOMS should be interpreted by taking account of the context and objectives of TOMS. According to AG Sharpston, ‘a contextual reading which has regard to the purpose and general scheme of the provisions may lead to a broader interpretation’.

¹⁰⁶ It is irrelevant for the application of TOMS whether the travel services are sold to the end traveller, the company where the traveller is employed, or another travel agency that will sell the services onwards to the end traveller.

¹⁰⁷ See Commission Study 2017, p. 61.

¹⁰⁸ Commission Study 2017, p. 70–71.

¹⁰⁹ See Umsatzsteuergesetz § 25 Besteuerung von Reiseleistungen: ‘1. Die nachfolgenden Vorschriften gelten für Reiseleistungen eines Unternehmens, die nicht für das Unternehmen des Leistungsempfängers bestimmt sind - -’. Furthermore, guidance of the German ministry of finance, Umsatzsteuer-Anwendungserlass vom 1. Oktober 2010, BStB1 I S. 846 – aktuelle Version (Stand 8. Dezember 2017) mentions: ‘(2) Da § 25 UStG keine Anwendung findet, soweit Reiseleistungen eines Unternehmens für das Unternehmen des Leistungsempfängers bestimmt sind, unterliegen insbesondere Kettengeschäfte und Incentive-Reisen in den jeweiligen Vorstufen nicht der Besteuerung nach § 25 UStG’.

¹¹⁰ Case C-380/16 *Commission v Germany*.

purposes, they can choose to apply TOMS or the regular VAT rules.¹¹¹ For example, in accordance with Swedish VAT law, ‘traveller’ has the meaning of either a consumer or a business that purchases travel services to its employees.¹¹² However, the Swedish VAT Act allows travel agents to apply the regular VAT scheme instead of TOMS in case of B2B supplies where the recipient is entitled to a relief of input VAT.¹¹³

To this day, Germany and the other Member States, that exclude B2C supplies from the scope of TOMS or allow an opt-out, have not managed to adjust their national VAT law to the CJEU’s interpretation of the broader scope of TOMS. The Commission Study of 2017 points out that travel agents established in those Member States enjoy a competitive advantage as compared to travel agents based in Member States where it is mandatory to apply TOMS.¹¹⁴ Considering the differences in the VAT treatment in accordance with TOMS versus the regular regime of the VAT Directive, as presented in chapter 3, it is certainly easy to imagine that a travel agent would in many cases opt for the regular rules instead of TOMS. For example, in a purely domestic situation where applying TOMS does not bring the added value of simplification benefits in relation to local VAT registrations, the travel agent would most likely apply the regular scheme where it is entitled to recover its input VAT. Furthermore, since the opt-out provided in Swedish and Spanish law is related to business travel, the B2B customer often wishes to deduct the VAT on its travel purchase as well, which as a rule is only allowed under the regular scheme.¹¹⁵

It remains to be seen whether the recent ruling in *Commission v Germany* will make any difference, in other words, whether Germany, Slovakia, Austria, Spain and Sweden will be more willing to comply now that the scope of TOMS as regards all types of customers is supported with a consistent line of CJEU case law.

¹¹¹ Where the travel agent acts in its own name, the commissionaire structure as meant in Article 28 of the VAT Directive will most likely apply.

¹¹² See *Swedish Tax Administration* 2013, p. 1104: ‘Bestämmelserna om vinstmarginalbeskattning förutsätter att ett tillhandahållande sker gentemot en resenär. Med resenär bör enligt Skatteverket avses den som själv eller genom någon annan förvärvar en resetjänst. Ett företag kan betecknas som resenär när företaget förvärvar resor till sina anställda.’

¹¹³ See *Mervärdesskattelag 6 § under chapter 9 b Särskilt om viss resebyråverksamhet*: ‘Om resenären är en beskattningsbar person vars verksamhet medför rätt till avdrag för eller återbetalning av ingående skatt, får resebyrån i stället tillämpa de allmänna bestämmelserna i denna lag på en sådan omsättning som omfattas av detta kapitel.’

¹¹⁴ Commission Study 2017, p. 70.

¹¹⁵ Disparities exist also in respect of the business customer’s right to deduct the VAT on TOMS margin. Please refer to section 4.2.2.

4.2.2 Disparities in interpretation

As the TOMS provisions in the VAT Directive leave flexibility as to how the scheme is applied and interpreted by Member States, substantial variation exists within the framework of the current rules. In the Commission Study of 2017, disparities were discovered in many aspects, including but not limited to how travel services are defined, when TOMS is applicable, how the taxable margin is calculated and whether B2B customers receiving TOMS supplies are entitled to reclaim the VAT or not. Due to the extensive amount of disparities, it would not be practical to examine all of them in more detail in this thesis. Instead, for presentational purposes, the focus will be on disparities in the national interpretations as regards the deductibility of input VAT.

As discovered in chapter 3, the relief of input VAT is blocked in two instances whenever TOMS applies. Firstly, a travel agent cannot deduct the input VAT that it incurs on purchases of travel services which it will sell onward under TOMS. Secondly, the recipient of a TOMS supply cannot deduct the VAT on the margin which the travel agent has paid out and consequently included in the sales price on the TOMS invoice. For the latter, there are inconsistent country practices in place. According to the Commission Study, five Member States allow business customers to deduct the VAT on a TOMS invoice.¹¹⁶ For instance, in accordance with Finnish VAT law, the amount of VAT on a travel agent's margin must be shown on a TOMS invoice, and the B2B customer can deduct this VAT in the same way as under the regular VAT scheme.¹¹⁷

According to the Commission Study, the competition impact of this disparity is considered to be limited due to the fact that only a minority of all Member States provide for a right to input VAT deduction.¹¹⁸ Nevertheless, from the perspective of fiscal neutrality, this disparity is of a fundamental nature.

4.3 Different VAT treatment: practical examples

As there are material differences in the implementation and interpretation of the TOMS by Member States, the rules for travel agents that are established in different Member States may lead to different VAT consequences. As a result, their business transactions

¹¹⁶ These five Member States are Belgium, Finland, France, Hungary and Sweden. See Commission Study 2017, p. 71.

¹¹⁷ See Finnish Tax Administration 2013, section 5.3.

¹¹⁸ Commission Study 2017, p. 71.

are treated differently. European travel agents will therefore face different VAT handling depending on which Member State they have their establishment in. According to the Commission, double taxation, distortions of competition and incorrect allocation of VAT revenue, among other undesirable consequences, result from the inconsistent application of TOMS by Member States.¹¹⁹

4.3.1 Travel agent established in the Netherlands

Travel Agent N, established in the Netherlands, purchases in its own name bus tickets in Sweden for SEK 2.000 + 6 % VAT (gross amount SEK 2.120) and hotel in Stockholm for SEK 4.000 + 12 % VAT (gross amount SEK 4.480) in Stockholm.¹²⁰

Dutch travel agents are forced by local VAT law to apply TOMS when selling third-party travel services in their own name. Travel Agent N sells the bus and hotel services to a Swedish business customer for SEK 9.000¹²¹ and applies TOMS to this sale. The VAT of SEK 600 on the purchases will be lost as Travel Agent N has no right to input VAT relief. The taxable margin of Travel Agent N is calculated in the following way:

$$\begin{aligned} \text{Sales price} - \text{cost of sales including VAT} &= \text{TOMS margin} \\ 9.000 - (2.000 + 6 \% * 2.000) + (4.000 + 12 \% * 4.000) &= \text{SEK 2.400} \end{aligned}$$

The output VAT due on the TOMS margin is further calculated by multiplying the margin without the part of VAT by the applicable VAT rate. As the TOMS margin is always subject to the general VAT rate,¹²² that being 21 % in the Netherlands, the calculation is as follows:

$$\begin{aligned} \text{TOMS margin} - \text{VAT due} &= \text{Taxable amount} \\ 2.400 - 2.400 * 21/121 &= \text{SEK 1.983} \\ \text{Taxable amount} * 21 \% &= \text{VAT due} \\ 1.983 * 21 \% &= \text{SEK 417} \end{aligned}$$

¹¹⁹ Commission Study 2017, p. 26.

¹²⁰ In Sweden, domestic passenger transportation is taxed with 6 % and hotel services with 12 % VAT.

¹²¹ For the sake of presentational convenience and comparison, all amounts in section 4.3 are expressed in the same currency.

¹²² As a main rule, the only situation in which the margin on services supplied under TOMS is exempted is where the service takes place outside the EU, e.g. flight tickets from Helsinki to Moscow.

In the end, after paying out a VAT amount of SEK 417 to the tax authorities, Travel Agent N will end up with a net margin of SEK 1.983 (2.400 – 417).

4.3.2 Travel agent established in Sweden

Travel Agent S, established in Sweden, purchases in its own name bus tickets and hotel accommodation in Stockholm. The purchase price of the bus tickets is SEK 2.000 + 6 % VAT (gross amount SEK 2.120) and the purchase price of the hotel is SEK 4.000 + 12 % VAT (gross amount SEK 4.480). The total amount of input VAT incurred by Travel Agent S is SEK 600 (6 % * 2.000 + 12 % * 4.000).

In case Travel Agent S sells these services on to a Swedish B2B customer, Travel Agent S may choose to apply TOMS or the regular VAT regime. Especially in domestic cases, where no foreign VAT registration requirements are involved, the regular scheme will be more beneficial for Travel Agent S. Under the regular VAT rules, Travel Agent S will be allowed to deduct the SEK 600 input VAT that it incurred on its purchases. Moreover, it will charge VAT on the bus tickets and hotel at reduced rates of 6 % and 12 % respectively. If the sales price is SEK 3.000 + 6 % VAT (gross amount 3.180) for the bus and SEK 6.000 + 12 % VAT (gross amount 6.720) for the hotel, the total amount will be 9.000 net and 9.900 including VAT. As the VAT is reclaimable for both the travel agent and its business customer, the VAT of SEK 900 will not become a cost for either party. Travel Agent S will make a net margin of SEK 3.000 (9.000 – (2.000 + 4.000)).

Under TOMS, on the other hand, Travel Agent S would not be allowed to deduct the SEK 600 input VAT in relation to its purchases, and furthermore it would have to pay out 25 % Swedish VAT on its margin. Similar to the previous example in 4.3.1, the margin will be:

$$\begin{aligned} \text{Sales price} - \text{cost of sales including VAT} &= \text{TOMS margin} \\ 9.000 - ((2.000 + 6 \% * 2.000) + (4.000 + 12 \% * 4.000)) &= \text{SEK } 2.400 \end{aligned}$$

The output VAT due on the TOMS margin is further calculated by multiplying the margin without the part of VAT by the applicable VAT rate. As the TOMS margin is always subject to the general VAT rate, that being 25 % in Sweden, the calculation is as follows:

$$\begin{aligned} \text{TOMS margin} - \text{VAT due} &= \text{Taxable amount} \\ 2.400 - (2.400 * 25/125) &= \text{SEK } 1.920 \\ \text{Taxable amount} * 25 \% &= \text{VAT due} \\ 1.920 * 25 \% &= \text{SEK } 480 \end{aligned}$$

After paying out a VAT amount of SEK 480 to the tax authorities, Travel Agent S will end up with a margin of SEK 1.920 (2.400 – 480). However, as in accordance with Swedish law the business customer is entitled to input VAT relief under TOMS, the VAT of SEK 480 will not become a cost for either party. Therefore, in the end Travel Agent N's net margin will be 2.400.

4.4 Conclusion

4.4.1 Justifications

In principle, dissimilarities in national VAT laws tend to cause distortions in the flows of goods and services and ultimately in the functioning of the European internal market.¹²³ For that very reason previous national transaction taxes were replaced with a common European VAT system in the first place. Nevertheless, the harmonization process remains incomplete and a work in progress, which naturally implies that disparities still occur.

To this end, the CJEU has expressed e.g. in its ruling in case *Amsterdam Beheer* that since the harmonization of national VAT laws is performed gradually, ‘this harmonization, as brought about by successive directives - - is still only partial’.¹²⁴ In *Amsterdam Beheer*, the main question was about the taxation of sale of second-hand goods where the Council had not yet provided for rules for a basis on which consistent national VAT schemes could be drafted. The Court took the stand that until further legislation was adopted at EU level, Member States were allowed to keep their existing systems in place, but those Member States that did not apply a special scheme for second-hand goods were not obligated to introduce such a system as long as the Directive did not provide a sufficient basis for a detailed set of rules.¹²⁵

¹²³ *Tyc* 2008, p. 88.

¹²⁴ Case C-165/88 *Amsterdam Beheer*, para 21.

¹²⁵ *Ibid*, paras 23–25.

In the same spirit, the Court reasoned in case *Idéal Tourisme* that the principle of equal treatment does not prevail over a provision of the VAT Directive that in its current state gives rise to disparities.¹²⁶ This conclusion leaned on the argument that gradual harmonization may cause discrimination that is transitional of nature and will only be eliminated once further harmonization measures are taken at EU level.

In the context of supplies of travel services, the VAT Directive does provide for a definitive special scheme. Yet, it can be debated whether the general TOMS provisions of the Directive are sufficiently detailed. As discovered earlier in this chapter, the Directive allows for a number of inconsistent implementations.

4.4.2 Elimination of disparities

*Neutral tax system, generated through the tax harmonization within the European Union, would give the advantage of eliminating distortions in economic decisions.*¹²⁷

Harmonization is the obvious solution in order to mitigate the persisting disparities in national practices.¹²⁸ However, harmonization does not necessarily result in perfect and complete unity. In fact, it can be argued that harmonization is an exaggerated term for the approximation of laws via directives, as the actual effect of directives often comes short of consistency once all 28 national implementations are adopted and applied in practice.¹²⁹

The legal limitations to harmonization are already apparent from the TFEU where harmonization is required to the extent that is necessary for the functioning of the internal market, but not beyond that extent. However, as it is now acknowledged that the inconsistencies in the application of TOMS cause distortions and unequal treatment of operators depending on their location, it would be justified to adopt further EU-level measures to clarify the correct application of TOMS.

Further approximation of Member States' laws can be achieved via two routes that are in interaction with each other. The first, preferred route is positive integration i.e.

¹²⁶ Case C-36/99 *Idéal Tourisme*.

¹²⁷ *Peci and Morina* 2017, p. 94.

¹²⁸ In the words of *van Gerven* 1993, '[H]armonization refers to legislation that is intended to do away with disparities'.

¹²⁹ *Weatherill* 2016, p. 278.

harmonization via legislation. The second, complementary way is negative integration which mainly refers to CJEU case law and certain measures of soft law.¹³⁰ In either case, the fiscal neutrality principle among other general VAT principles has an important guiding role in the decision-making.

This section discusses potential EU policy measures in order to bring country practices closer to each other and thus promote the uniform application of TOMS. For presentational purposes, measures of positive and negative integration are dealt with in their own sections. The choice of available harmonization measures is largely influenced by political aspects. For example, after failed attempts to introduce more detailed TOMS provisions in the VAT Directive (positive integration), the Commission has had to rely on the CJEU (negative integration) in the form of infringement proceedings in order to address disparities with regard to TOMS.¹³¹

4.4.2.1 Measures of positive integration

Positive integration i.e. ‘integration through legislation, coordination and cooperation’ first and foremost refers to legislation issued at EU level.¹³² With regard to the integration of national VAT systems, positive integration includes the VAT Directives and Regulations, as well as coordination measures such as guidelines of the VAT Committee. Furthermore, EU bodies and coordination measures for administrative cooperation fall in this category.

The most effective way to bring consistency into national practices would be to expand the wording of the TOMS provisions of the VAT Directive where needed in order to clarify the most ambiguous aspects. For instance, the definition of ‘traveller’ as well as clear rules on the deductibility of TOMS VAT could be included in the text of the

¹³⁰ See *Terra and Wattel* 2012, p. 24–26 on the roles of positive and negative integration in relation to direct and indirect taxation. Since indirect taxation has been harmonized to a large extent, negative integration via CJEU case law in particular has a role of correcting national implementations and confirming technical meanings and interpretations. On the other hand, in the field of direct taxation, where there is not a lot of positive law in place at EU level, CJEU case law may have more major implications e.g. on the application of TFEU fundamental freedoms. For this reason, whereas it is mentioned that negative integration is of a complementary nature, this only applies when put in the context of indirect taxation and more specifically VAT.

¹³¹ In academic literature it is usually regarded that, as a rule, disparities cannot be addressed by negative integration. However, the disparities discussed in this thesis arise in the field of a largely harmonized area of law where the differences occur rather in interpretations and implementation acts than in separate national acts that fall under Member States’ competence. For this reason, negative integration is regarded as an effective way to abolish differences.

¹³² *Terra and Wattel* 2012, p. 4.

Directive in order to eliminate the differing country practices that inevitably lead to distortions and unequal treatment of businesses.

The text of the VAT Directive is certainly long and extensive as it is. Therefore, there is also another instrument available that would be suitable for codifying the necessary guidance on the interpretation of TOMS in the form of binding law. Namely, in accordance with Article 397 of the VAT Directive separate implementation measures, in practice regulations, shall be adopted. The VAT Regulations are commonly used for the purpose of giving more detailed guidance on the interpretation of the Directive.¹³³ This instrument could be utilized in the context of TOMS as well. However, it must be noted that this would require unanimity in the Council.

Moving on from hard law to instruments of soft law, there is one influential instrument in the field of VAT that has already been employed in relation to TOMS among other issue areas. This instrument is an advisory committee on value-added tax, i.e. the VAT Committee, which issues guidelines on the application of EU VAT law. The mandate of the Committee is based on Article 398 of the VAT Directive. This instrument has its advantages as compared to a legislative process at EU level. The procedure where the Committee examines interpretation questions and subsequently issues guidelines is certainly faster and simpler. Moreover, the Committee can focus on more specific and narrow issues as well, since it is addressing questions arising from real-life practical cases. However, the major disadvantage of harmonization through the VAT Committee lies in the fact that this body has merely advisory powers, hence its guidelines have no binding force. Soft law, while being likely to increase uniformity, does not completely eliminate disparities since there is no effective way to ensure compliance.¹³⁴

To that end, the Commission has proposed in 1997 that the VAT Committee would be turned into a regulatory body with the competence to issue guidance binding on Member States. The VAT Committee's guidelines would then be published as official, legally binding decisions of the Commission.¹³⁵ However, this proposal was in the end not accepted and to this day the VAT Committee has remained merely an advisory body.

¹³³ *Rendahl* 2013, p. 458.

¹³⁴ *Ibid*, p. 459.

¹³⁵ COM (97) 325 final.

4.4.2.2 Measures of negative integration

Negative integration refers to ‘integration through prohibitions’, often by the CJEU requiring the abolishment of national measures that are incompatible with EU law.¹³⁶ The Commission has the power to initiate investigations on the compatibility of national practices with EU legislation. It is necessary to recall that, while the infringement must be formally established by the Commission and in case of disagreement by the CJEU, the Member States nonetheless have a general obligation to cooperate. Article 4(3) of the TFEU requires that Member States facilitate the Commission’s work in ensuring compliance and correct application on Member State level.¹³⁷ Besides the Commission, Member States have the power to challenge other States’ implementation measures and start infringement procedures in front of the CJEU.

Although CJEU case law is supposed to complement written EU law and give more detailed guidance on aspects that are not covered in detail by the Directive, the Court however has more political influence where the Directive provisions are imprecise.¹³⁸ The CJEU is known for creating law especially in situations where EU legislative bodies do not address certain issues by means of positive integration. In such circumstances, the need for negative integration increases. In the words of AG Sharpston in *Commission v Spain*:

It is hard to avoid the impression that the Court is being called upon to decide a matter of VAT policy (and of legislative drafting) which has proved beyond the capabilities or the willingness of the Member States and the legislature.¹³⁹

In summary, the Commission has the power to propose legislation. However, in the event that the Commission proposals are rejected by the Council, it must resort to means of negative integration by invoking an infringement procedure.

¹³⁶ *Terra and Wattel* 2012, p. 4.

¹³⁷ See Case C-189/11 *Commission v Spain*, para 81.

¹³⁸ See *Weatherill* 2016, p. 279–280.

¹³⁹ See opinion of AG Sharpston in Case C-189/11 *Commission v Spain*, para 35.

5 SCOPE OF TOMS: TYPES OF ECONOMIC OPERATORS

5.1 Introduction

Nowadays, there are a variety of different business models available in the travel sector, including intermediation, selling as a principal, and various combinations of the two. Further factors contributing to the complexity of the sector include the extent of different stakeholders, policy measures, travel products as well as customers, not to mention the increase in e-commerce and online applications.¹⁴⁰ Since the commercial environment has changed drastically over the past few decades and the spectrum of transaction chains has become more diverse, this implies that there is also significantly more complexity with regard to the taxation of the variety of transactions in the travel sector. On account of these developments, the determination of the applicable VAT scheme is not as straightforward as it was at the time when TOMS was introduced in the VAT Directive. The Commission has now recognized that the way in which the Directive draws the line between situations where TOMS applies and those within the regular scheme might be outdated.¹⁴¹

Travel agents typically engage into business transactions in the role of an agent. In other words, they are acting between suppliers and customers; bundling, packaging and promoting travel services and providing these to customers. The suppliers include e.g. hotels, airlines, rail companies and other businesses that perform the underlying travel services. The customers are often the travellers i.e. the persons who ultimately consume the travel services, be it business or leisure. However, it is not uncommon that the travel agent's customer is another business that sells the services onwards to the end traveller.

In the context of tourism and travel industry, and in the particular sub-sector of tour operators and travel agents, the Commission makes a classification into five categories depending on the type of the customers and the services supplied. The five categories are: Tour Operators, Travel Management Companies, Travel Agents, Destination Management Companies and Meeting, Incentives, Conference and Events organizers.¹⁴²

¹⁴⁰ Commission Study 2009, p. 36.

¹⁴¹ Commission Study 2017, p. 16.

¹⁴² The five categories are described in the following way in the Commission Study of 2009:
 '1. Tour Operators – ranging from the large international tour operators to the small independent niche operators (mainly B2C)
 2. Travel Management Companies (TMC) – which mainly focus on business travel as intermediaries and which serve primarily corporate customers (B2B)

This distinction was first introduced in the 2009 Study and the same classification also appears in further publications by the Commission,¹⁴³ including the recent 2017 Study on TOMS.

In the framework of the VAT Directive, which was explained in chapter 3, we cannot merely rely on the commercial classification of travel agents. Instead, for VAT purposes a distinction is often made between business models that potentially have different VAT consequences. Such categories would include intermediation, TOMS, in-house supplies and commissionaire model.¹⁴⁴ This chapter explores how to draw the line between the different categories of operators from a VAT perspective.

5.2. Determination of applicable VAT scheme

In short, there are four categories of transactions that fall outside the scope of TOMS:¹⁴⁵

- 1) Supplies by travel agents acting as intermediaries;
- 2) Supplies by travel agents or service suppliers dealing in their own name and using their own services;
- 3) Supplies of services performed outside the EU; and
- 4) Supplies by travel agents established outside the EU.

The first two categories are dealt with in this chapter, while the latter two will be covered in chapter 6.

3. Travel agents – covering mainly the leisure market as intermediaries. Travel agents can operate as ‘brick & mortar’ enterprises or as ‘online’ agents or both (mainly B2C)
 4. Destination Management Companies (DMC) – which are mainly operating in the inbound segment (mainly B2B)
 5. MICE organizers, i.e. Meeting, Incentives, Conference and Events organizers – mainly in the corporate segment (B2B)’.

¹⁴³ See, *inter alia*, Commission: ‘Study on the impact of EU policies and the measures undertaken in their framework on tourism (12/10/2012).

¹⁴⁴ Supplies by commissionaire agents usually fall in the scope of TOMS. However, in some cases, e.g. if the supplies do not constitute travel facilities in the meaning of Article 306(1), the main commissionaire rules of the VAT Directive may be applicable instead of TOMS. In addition, the range of business models available for a travel agent varies depending on the Member State of residence. For instance, as explained in chapter 4, some Member States offer an opt-out from TOMS and in these cases the option is usually to apply the VAT rules for commissionaires.

¹⁴⁵ This listing of supplies excluded from TOMS is based on the VAT Directive in light of relevant CJEU case law i.e. how the VAT Directive should be applied. That fact notwithstanding, some Member States currently apply TOMS to a different scope of supplies. See also discussion of incomplete implementations in chapter 4 of this thesis.

5.2.1. Scope of TOMS as regards different agent structures

The second sentence of Article 306(1) of the VAT Directive prescribes that transactions by travel agents that act ‘solely as intermediaries’ are excluded from the scope of TOMS. Consequently, such supplies follow the VAT treatment in line with the regular rules on the intermediation of services as laid down in the VAT Directive.

There is no comprehensive definition of an intermediary in the VAT Directive, but the Member States appear to be quite consistent in drawing the line between intermediation and tour operating. Intermediation is customarily defined as acting in the name and on behalf of another person, i.e. as a disclosed agent.¹⁴⁶ The VAT Directive does not mention any further criteria to be taken into account in determining whether or not an agent is acting in its own name. Such clarifying criteria may exist in national VAT law, nevertheless local law cannot extend the scope of intermediation from what is meant in the Directive.¹⁴⁷

For example, the Finnish Tax Administration has provided detailed guidance on the interpretation of TOMS, including a number of useful benchmarks for distinguishing between intermediation and tour operating. According to the Finnish Tax Administration, mere intermediation typically encompasses e.g. that the supplier determines the sales price of the underlying service and is contractually liable for the contents of the service. Moreover, when the customer is aware of who the principal supplier is, it suggests that the agent is acting as an intermediary.¹⁴⁸ While these criteria can only be used for the assessment in relation to travel agents established in Finland, other Member States may of course have adopted similar guidance on the matter.

In case of intermediation, the travel agent does not buy and sell travel services but, instead, it is regarded that the supply occurs directly between the supplier and the customer. The prices of the underlying products are therefore not part of the travel agent’s revenue. In this business model, the travel agent’s turnover consists of the remuneration for its intermediary services that it receives from the supplier or the traveller or both, such as fees, commissions or provisions. Since intermediation is a

¹⁴⁶ This is a main rule in the Member States. According to the Commission Study of 2017, Lithuania is the only Member State that applies TOMS to intermediaries as well as principal travel agents.

¹⁴⁷ See *Rendahl* 2013, p. 452.

¹⁴⁸ See Finnish Tax Administration 2013, section 3.3 *Palvelun välittäminen*. It must be kept in mind that these characteristics are only suggestive, and not necessarily decisive for the classification of a transaction.

separate service from the underlying supply, it constitutes a separate taxable transaction and as such is in principle subject to VAT.¹⁴⁹

5.2.2 Scope of TOMS as regards in-house supplies

The roles of different actors in the value chain of travel service supplies have changed over the last few decades. Previously, it was easier to make a distinction between suppliers, who provide travel services themselves, and travel agents, who bundle third party services into packages and sell them to travellers. Recently, however, it has become ever more common that a supplier such as an airline or a hotel sells its own products directly to the traveller without the involvement of any travel agent. The other way around, travel agencies may also use their own resources to supply their own travel services as principal suppliers. This development has been driven to a large extent by increased competition in the travel market. More competitive markets and price-consciousness among travellers have, consequently, also created more pressure on travel agents to lower their profit margins.¹⁵⁰

To simplify, two types of competitors can be identified to whom TOMS does not apply due to the fact that they supply services from their own resources instead of services purchased from third parties. The first type includes businesses that are principally travel service suppliers instead of travel agents. The second type refers to travel agents that make in-house supplies. The Commission has made use of a similar categorisation in the specific context of VAT rates:

- *Where the travel agent is competing against a person falling outside of the scheme; and*
- *Where a travel agent is competing against another travel agent who is supplying the services from its own resources (i.e. an in-house supply) which the case law - - demonstrates is not subject to VAT within the Special Scheme but is subject to 'normal' VAT rules.¹⁵¹*

With regard to the latter category, it is noticeable that travel agents may as well engage in real, genuine in-house supplies using their own staff, facilities, vehicles etc. On the other hand, there is an opportunity for travel agents to artificially create structures that legally qualify as in-house supplies, through buying services from another business for

¹⁴⁹ *Äärilä et al.* 2017, p. 695.

¹⁵⁰ Commission Study 2009, p. 86.

¹⁵¹ Commission Study 2017, p. 59.

a longer period of time, adding additional services and then selling these to customers. The purpose of such structures is to avoid the margin taxation under TOMS and end up under the regular rules where the VAT treatment is often more advantageous, as e.g. many travel services are taxed against lower VAT rates and input VAT is recoverable.

5.2.2.1 Combinations of bought-in and in-house supplies

In practice, it is not always possible to simply draw the line between a travel provider and a travel agent since we encounter an increasing amount of combinations of bought-in and self-supplied services by both types. For instance, hotels often offer their customers transportation, excursions, tickets to cultural events and other additional services purchased from third parties. In the same manner, travel agents may as well package bought-in products with their own services carried out by their own employees. In consequence, it becomes more difficult to determine which VAT regime applies. The TOMS provisions, that were drafted in a different time, provide for an ‘either – or’ solution that cannot always be applied as such any longer.

The CJEU has dealt with the topic of in-house supplies and the mix of in-house and bought-in services in a few cases. In its ruling in *Madgett and Baldwin*, the Court assessed whether and how TOMS should be applied to sales of travel packages consisting of both in-house and third-party services. The case was about a UK-based hotel that, in addition to selling hotel accommodation, bundled and offered travel packages to its customers. The UK High Court of Justice, which turned to the CJEU for a preliminary ruling, considered that applying TOMS only ‘to traders who are travel agents or tour operators within the normal meaning of those terms would mean that identical services would come under different provisions depending on the formal classification of the trader’.¹⁵² According to the Advocate General, this would further result in a distortion of competition between traders and put both the purpose of TOMS and the consistent application of the VAT Directive at risk.¹⁵³

Consequently, the CJEU arrived at an interpretation that the type of transactions performed, rather than the formal classification of the trader, is decisive. Therefore, travel service suppliers such as hoteliers should not be strictly outside the scope of application of TOMS. Instead, the TOMS rules might apply if suppliers also sell

¹⁵² Joined Cases C-308/96 and C-94/97 *Madgett and Baldwin*, para 21.

¹⁵³ *Ibid*, para 22.

packages which include travel services purchased from third parties. The decisive factor as regards whether a package is within TOMS or not should be the proportion of in-house and bought-in services in a package and their nature as principal and ancillary services. If the bought-in services were merely ancillary, i.e. a means to better enjoy the principal in-house service, TOMS would not apply. In order to determine whether a third-party service is ancillary, the CJEU would look at whether the service goes beyond the traditional tasks of the supplier and how big an impact the service has on the sales price of the package.¹⁵⁴

The CJEU repeated in its decision in *Maria Kozak* that TOMS cannot be applied to in-house services. Therefore, the principle that ancillary services share the same VAT treatment with principal services, does not apply when the situation is reversed i.e. it is about in-house services provided by a travel agent. In this case, Maria Kozak was a travel agent selling a travel package consisting of bought-in services and, in addition, transportation with its own coaches. According to the Court, such a package should be subject to TOMS for the part of third-party services and to the regular scheme for the part of in-house services¹⁵⁵, irrespective of whether the self-supplied services are or are not an essential part of the package.¹⁵⁶

5.2.2.2 Single services

Another relevant question, which has also been raised before the CJEU, is whether the sale of only one kind of travel services, instead of a package comprising different services, should fall in the scope of TOMS or not. In *Star Coaches*, the CJEU ruled on the VAT treatment of a sale consisting only of passenger transport by bus. Referring to existing case law and to *Van Ginkel* in particular, the Court expressed that the fact that a travel agent only provides a single type of services is alone not sufficient to exclude the service from the scope of TOMS.¹⁵⁷ In *Star Coaches*, the Court however ruled that transport services supplied by a travel provider in isolation, i.e. without any additional services such as reservation or information services, are not identical to those services supplied by travel agents and are therefore not within the scope of TOMS.¹⁵⁸

¹⁵⁴ Ibid, paras 23–27.

¹⁵⁵ Case C-557/11 *Maria Kozak*, para 27.

¹⁵⁶ Ibid, para 25.

¹⁵⁷ Case C-220/11 *Star Coaches*, paras 20 and 22.

¹⁵⁸ Ibid, paras 23–25.

The possible inconsistency between CJEU judgments in *Van Ginkel* and *Star Coaches* is also considered in the Commission Study of 2017. According to the Study, the ruling in *Van Ginkel* established that TOMS applies to single services, whereas on the basis of *Star Coaches* the application of TOMS is dependent on additional services.¹⁵⁹ Even though the Court makes an attempt to reason how the applicable VAT rules are determined in the same manner for both travel agents and transport operators, the ruling can be criticized as it seems like it makes a distinction based on the commercial classification, namely that the service provider in that case was not a travel agent. Furthermore, nowadays practically every business has its own website and several channels of social media where there is a lot of information available. This prompts one to ask the question whether it is even imaginable that an operator only supplies travel services without providing any advice or information next to the travel product.

5.3 Different VAT treatment: practical examples

In this section, the differences between the VAT treatment under TOMS and the intermediation rules as well as the VAT handling of a supply by the service provider itself will be demonstrated. In the following fictitious example three different operators sell airline tickets Rovaniemi-Helsinki and Helsinki-Stockholm, and each operator charges a margin of the same amount. The example will show in practice for each transaction how the margin is affected by VAT and how the customer expense is treated for VAT purposes.

5.3.1 VAT handling under TOMS

Travel Agent A, established in Finland, purchases in its own name flight tickets Rovaniemi-Helsinki and Helsinki-Stockholm. Domestic passenger transportation is subject to a reduced rate 10 % based on Section 85 a of the Finnish VAT Act. For the domestic ticket Rovaniemi-Helsinki, the purchase price is EUR 1.000 + 10 % VAT, the gross amount being EUR 1.100. In accordance with Section 71 of the Finnish VAT Act, supplies of passenger transport to or from another country are exempted from VAT. Hence, 0 % VAT is levied on the air ticket Helsinki-Stockholm which Travel Agent A purchases for EUR 1.200.

¹⁵⁹ Commission Study 2017, p. 32.

Subsequently, Travel Agent A sells both flight tickets in its own name to a customer for EUR 3.000. As Travel Agent A is acting in its own name and makes the purchases directly from the airline, which is a third party and a taxable person, and furthermore air transport constitutes a travel service, all the criteria for the application of TOMS as required in Article 306 of the VAT Directive are met. Therefore, TOMS determines the VAT handling of the sale by Travel Agent A.¹⁶⁰

Travel Agent A has incurred EUR 100 input VAT in relation to the purchase of domestic air tickets and EUR 0 on the purchase of international tickets. Since TOMS applies, it follows from 114 a § of the Finnish VAT Act (implementing Article 310 of the VAT Directive) that Travel Agent A is not entitled to a deduction of input VAT. Instead, its margin will be reduced by the amount of input VAT. In this example, the margin is calculated in the following way:

$$\begin{aligned} \text{Sales price} - \text{cost of sales including VAT} &= \text{TOMS margin} \\ 3.000 - (1.000 + (10 \% * 1.000) + 1.200) &= \text{EUR 700} \end{aligned}$$

The output VAT due on the TOMS margin is further calculated by multiplying the margin without the part of VAT by the applicable VAT rate. As the TOMS margin is always subject to the general VAT rate,¹⁶¹ that being 24 % in Finland, the calculation is as follows:

$$\begin{aligned} \text{TOMS margin} - \text{VAT due} &= \text{Taxable amount} \\ 700 - (700 * 24/124) &= \text{EUR 565} \\ \text{Taxable amount} * 24 \% &= \text{VAT due} \\ 565 * 24 \% &= \text{EUR 135} \end{aligned}$$

Therefore, Travel Agent A must withhold from its margin and pay to the tax authorities a VAT amount of EUR 135. In practice, Travel Agent A's net margin on the sale will be reduced from EUR 700 to EUR 565. If Travel Agent A wishes to reach a profit after VAT of the amount of EUR 700, it has to increase its sales price by the amount of VAT payable. The journey will become more expensive for the customer who might then

¹⁶⁰ According to Finnish VAT law, TOMS can also be applied to single services. In other words, there is no requirement that the travel package should consist of several types of services, but TOMS is also applicable to sale air tickets as long as the supply of travel services is carried out in the course of the company's regular business. See *Finnish Tax Administration* 2013, section 3.1.2.

¹⁶¹ As a main rule, the only situation in which the margin on services supplied under TOMS is exempted is where the service takes place outside the EU, e.g. flight tickets from Helsinki to Moscow.

prefer to purchase the air tickets either from an intermediary or directly from the airline. This constitutes a competitive disadvantage for travel agents as a result of applying TOMS.

When the VAT effect on the customer is examined, in a Finnish scenario, a B2B service recipient would exceptionally be entitled to an input VAT relief of EUR 135. However, in most Member States the input VAT relief would not be allowed, as discovered earlier in chapter 4. Therefore, as a main rule these cases will result in blocked input VAT.

5.3.2 VAT handling of intermediation

Travel Agent B, established in Finland, purchases flight tickets Rovaniemi-Helsinki and Helsinki-Stockholm in the name and on behalf of its customer. The purchase price of the underlying domestic ticket Rovaniemi-Helsinki is EUR 1.000 + 10 % VAT, the gross amount being EUR 1.100, and the ticket Helsinki-Stockholm cost EUR 1.200 + 0 % VAT.

Travel Agent B invoices the price of the underlying travel services, EUR 2.300, in the name and on behalf of the airline to the customer. As Travel Agent B is acting as a mere intermediary between the airline and the customer, TOMS does not apply (Article 306(1) second sentence of the VAT Directive). Instead, the VAT handling follows the provisions of the regular VAT scheme. The input VAT of EUR 100 is a pass-through expense for Travel Agent B. As such, Travel Agent B must handle this via balance sheet and cannot deduct the input VAT. Under the pass-through process, however, the VAT amount is charged on to the customer and does not become an expense for the travel agent.

Travel Agent B charges a booking fee to its customer for the intermediation service. The fee is EUR 300 for each domestic flight ticket and EUR 400 for international tickets, in total EUR 700. Since intermediation is a separate taxable service, Travel Agent B must apply VAT on the fee. The fee is taxable against general Finnish VAT rate 24 % for the part that relates to domestic air tickets. The intermediation fee does not share the VAT treatment of the underlying domestic tickets subject to 10 % VAT due to the fact that Section 85 a of the Finnish VAT Act only applies to the supply of passenger transport services but not to intermediation thereof. Instead, Section 71 of the Finnish VAT Act, which provides for an exemption for passenger transport with a

destination outside Finland, applies to both the underlying service and the intermediation of that service. Therefore, the part of Travel Agent B's intermediation fee that concerns international air, EUR 400, is zero-rated.

For the intermediation service, Travel Agent B will charge the following amount including VAT:

$$300 + (24 \% * 300) + 400 = \text{EUR } 772$$

After paying the output VAT of EUR 772 to the tax authorities, Travel Agent B's net margin on the sale is EUR 700.

Provided that all the requirements for the right to input VAT relief are fulfilled, a B2B customer is entitled to deduct the input VAT of EUR 72 on its VAT return.

5.3.3 VAT handling of in-house supplies

Airline C, established in Finland, sells air tickets Rovaniemi-Helsinki and Helsinki-Stockholm directly to its customer without the involvement of any travel agent. Since Airline C provides the services with its own resources, TOMS does not apply and the VAT treatment is governed by the regular VAT regime. The cost of sales for Airline C is EUR 2.300. Airline C charges EUR 1.200 + 10 % VAT on the domestic air tickets (Section 85 a of the Finnish VAT Act) and EUR 1.800 + 0 % VAT on the international air tickets (Section 71 of the Finnish VAT Act).

After paying the output VAT of EUR 120 (10 % * 1.200) to the tax authorities, Airline C's net margin on the sale is EUR 700. In addition, Airline C is entitled to a relief of input VAT that it potentially incurred for purchases in relation to the operation of air transport.¹⁶²

Provided that all the requirements for the right to input VAT relief are fulfilled, a B2B customer is entitled to deduct the input VAT of EUR 120 on its VAT return.

¹⁶² Also for the part that relates to provision of zero-rated services, since these are exempt with the right to input VAT relief.

5.4 Conclusion

The VAT treatment of supplies by travel agents under TOMS, in comparison with supplies by intermediaries, in-house supplies of travel agents or supplies by operators to which TOMS does not apply, is different in two principal ways. Firstly, travel agents selling services under TOMS cannot apply certain exemptions or reduced rates that are allowed under the regular scheme of the VAT Directive. Secondly, the rules regarding input VAT relief are disadvantageous under TOMS for both the supplier and the customer¹⁶³ alike.

We have now established that the EU VAT Directive treats supplies of travel services differently. I will follow with a review of possible justifications for the differential treatment and an assessment of the comparability of supplies where TOMS applies and supplies that fall outside the scope of TOMS. Finally, I will conclude with potential ways to improve the current framework of the VAT Directive in order to impose an equal VAT burden on all economic operators involved in the provision and intermediation of travel services.

5.4.1 Justifications for unequal treatment

5.4.1.1 Transitional harmonization

The elementary reason for a potential unequal treatment lies in the fact that the harmonization process of EU VAT law is not complete. Year after year, certain clauses remain in force although being originally meant as transitional provisions in the VAT Directive.¹⁶⁴ Article 371 allows Member States to continue applying exemptions that were included in their local VAT law on 1 January 1978 or at the time of their accession to the EU. Among other transactions, this may-clause allows the exemption of passenger transport. Passenger transportation has been regarded as one of the most important transitional exemptions¹⁶⁵ and, indeed, most Member States continue to provide such an exemption.¹⁶⁶

¹⁶³ With the exception of Finland and four other Member States that allow a B2B customer to deduct the TOMS VAT.

¹⁶⁴ See Case C-74/91 *Commission v Germany*, para 3.

¹⁶⁵ *Amand* 2010, p. 415.

¹⁶⁶ According to VAT Directive Annex X part B point 10, among the list of transactions which Member States may continue to exempt is 'the transport of passengers and, in so far as the transport of the passengers is exempt, the transport of goods accompanying them, such as luggage and motor vehicles, or the supply of services relating to the transport of passengers'.

As a consequence, the sale and intermediation of international passenger transport services, e.g. air tickets, is in most cases subject to 0 % VAT, whereas the travel agent's margin in relation to the zero-rated supply under TOMS is subject to standard VAT rate. Exemptions or reduced VAT rates are not taken into consideration when TOMS applies, but the margin on the single TOMS supply is subject to high VAT.¹⁶⁷ In this respect, a travel agent acting as an intermediary instead of making supplies in its own name, faces a more beneficial VAT treatment.

Interestingly, the CJEU has ruled on the relationship between the principle of equal treatment and national passenger transport exemptions. In case *Idéal Tourisme*, the Court was faced with a question on the equal treatment between suppliers of international passenger transport by air and by bus. The applicant in this case argued that the differential VAT treatment, where air transport was exempt and coach transport taxable according to Belgian VAT law, constitutes a breach of the principle of equal treatment.¹⁶⁸

The CJEU admitted that this differential treatment was contrary to the principle of equal treatment but ruled that the scope of the exemption for air transport could not be extended to apply to other forms of transport. As exemptions are exceptions in the framework of the VAT Directive, they ought to be interpreted strictly. Under transitional harmonisation, the different VAT treatment of air transport and bus transport could only be eliminated by beginning to tax air transport as well. However, transitional harmonization of VAT was considered an objective justification based on which Belgium was allowed to continue exempting one type of supply and taxing another one.¹⁶⁹ While this ruling reveals something important of the relationship between the requirement of equal treatment and the justification of transitional harmonization, the case did not in fact deal with identical products. International transport by air and by bus can hardly be regarded as interchangeable from a customer's perspective, and the less so the longer the distance travelled.

¹⁶⁷ Some local exceptions may apply depending on which Member State the margin is taxed in.

¹⁶⁸ Case C- 36/99 *Idéal Tourisme*, para 31.

¹⁶⁹ *Ibid*, para 33–34.

As to the unequal treatment due to transitional exemptions, the Commission has long desired to abolish the exemptions currently allowed by the Directive. One of the Commission's priorities with regard to the current VAT rate structure is to revoke those zero-rates and reduced rates that cause distortions and are incompatible with the internal market.¹⁷⁰ The elimination of some exceptions would make the tax base broader and increase efficiency as well as neutrality.¹⁷¹ However the Member States are, understandably, very keen on retaining the exemptions and other VAT reliefs that they currently apply.

Whereas transitional harmonization to some extent explains the VAT rate aspect of the differential treatment of different economic operators, it does not clearly justify the other issue areas such as blocked input VAT.

5.4.1.2 Unequal suppliers

The argument that the unequal treatment between travel suppliers within the scope of TOMS and those outside the scope of TOMS distorts competition was invoked in *Commission v Germany*, which was also the very first TOMS case before the CJEU. The Court acknowledged these circumstances but, however, considered that supplies by travel agents are not sufficiently comparable with supplies by airlines:

That [Tour Operators' Margin] scheme does not cover transport services supplied without the involvement of any intermediary, which are covered by the general provisions applicable to transport undertakings. The tax position of those two types of transaction is thus not comparable. Even if the maintenance of a transitional scheme under which certain transport services are exempted may be liable to accentuate the differences in the circumstances of travel organizers, according to whether or not they are themselves transport undertakings, and between travellers, according to whether or not they use services of an agent, that fact likewise cannot justify incorrect application of the special scheme provided for in the directive.¹⁷²

The judgment *Commission v Germany* thus seems to differentiate between different operators in travel industry based on their formal classification. Nonetheless, when comparing travel agents acting in their own name to travel providers or in-house supplies, the circumstances are actually similar, particularly from the point of view of

¹⁷⁰ See Commission review of existing legislation on VAT reduced rates.

¹⁷¹ COM (2010) 695 final, p. 10–11.

¹⁷² Case C-74/91 *Commission v Germany*, para 26.

the customer. In TOMS supplies, the travel agent is the only counterpart to the customer for the supplied services, regardless of whether they are actually bought-in from a third party or created with own resources.

Moreover, the formal or commercial classification of economic operators, i.e. their labelling as travel agents, transport companies, hoteliers etc., is a problematic factor to point out which VAT regime is applicable. There is no register or official status that would enable straightforward classification of operators as travel agents in the sense of Article 306 of the VAT Directive. Neither has the VAT treatment been made dependent on the concept of travel agents under commercial or consumer law.¹⁷³ As such, the classification can only be based on customary law, case law or local practices without any grounding principle or definition at EU level. Logically, using the formal classification as a basis for determining the applicable VAT rules will then serve to increasing uncertainty and inconsistency.

The Court has not dealt with the comparability between travel agents acting within TOMS and travel agents acting as intermediaries. In practice, a travel agent can often choose to act as a disclosed or undisclosed agent. The main difference, from a VAT perspective, is whether the agent acts in its own name or in the name of its customers and suppliers.¹⁷⁴ From the point of view of a customer the two setups are rather similar.

5.4.1.3 Unequal supplies

In *Case Henfling and Others*, the CJEU examined the comparability of supplies by a principal with supplies by an agent acting in its own name but on behalf of the principal. Whereas this case involved exempt bet-taking supplies, the ruling cannot be directly applied to the interpretation of travel agents. However, certain elements can be extracted from the Court's reasoning and assessed in the context of TOMS. For example, the Court states that commission agent structures are regarded as a 'legal fiction of two identical supplies of services provided consecutively.'¹⁷⁵ If, though in a different context, the supplies by a principal and by an agent acting in name and on

¹⁷³ Most notably European Package Travel Directive that provides for precise definitions of providers which are to be regarded as tour operators.

¹⁷⁴ Sometimes it is a fine line, for example the fact whether a service provider issues its invoice in the name of the travel agent or in the name of the customer can be decisive for a transaction to fall in the scope of TOMS, irrespective of what has been agreed between the parties.

¹⁷⁵ Case C-464/10 *Henfling and Others*, para 35.

behalf of the principal are considered identical from a VAT law perspective, it is a strong indication that such supplies should in general be treated equally.

In order to look beyond the formal classification criterion, which the Court has resorted to in *Commission v Germany* but later denied in *Madgett and Baldwin*, it might be more fruitful to compare the similarity of supplies instead of supplier. In other words, the distinction between travel agents and travel providers should be disregarded and the attention should be focussed on the services they supply. As *Rendahl* has said, ‘there should be an equal treatment between equal supplies, but not necessarily between unequal supplies’.¹⁷⁶

CJEU case law on VAT rates in particular provides some relevant guidance for detecting whether or not two supplies are to be treated equally. For instance, in case *Commission v Netherlands*, the Court named the criterion whether or not two products are in competition with each other as a decisive factor in the assessment.¹⁷⁷ Competing in the same market was the prevalent requirement for two supplies to be considered equal for VAT purposes, until the Court took a milder approach in case *Rank Group*,¹⁷⁸ making the point of view of the customer decisive:

*The principle of fiscal neutrality must be interpreted as meaning that a difference in treatment for the purposes of value added tax of two supplies of services which are identical or similar from the point of view of consumer is sufficient to establish an infringement of that principle. Such an infringement thus does not require in addition that the actual existence of competition between the services in question or distortion of competition of such difference in treatment be established.*¹⁷⁹

When applied to the context of travel services, it can be argued that supplies of travel services by a travel agent, intermediary, or by a travel provider directly to the customer, often fulfil the same need of the customer. For example, when a customer needs hotel accommodation, it is often practically comparable from the customer’s perspective whether he books a room directly via the hotel’s own website or through a travel agent.

¹⁷⁶ *Rendahl* 2013, p. 453.

¹⁷⁷ Case C-41/09 *Commission v Netherlands*, para 66.

¹⁷⁸ *De la Feria* 2011.

¹⁷⁹ Joined Cases C-259/10 and C-260/10 *Rank Group*, para 1.

In such simple cases, the supplies of hotel accommodation service thus appear to be interchangeable.

The comparison becomes more complicated when the travel agent bundles different services together in one package. Surely, if a customer wants to book transport, accommodation and activities all at once, he will see the added value and thus the difference in using a travel agent's services. In other words, the more a travel agent's business resembles that of a 'traditional travel agent' as was originally meant to be included in TOMS, the more easily a justification of the different VAT treatment can be explained. Applying high VAT on the travel agent's margin can be justified by reasoning that the margin is a remuneration for services in relation to tour operating, such as organizing, managing and co-ordinating a travel package.¹⁸⁰

However, the difference between a travel agent acting in his own name and a travel agent acting as an intermediary might still go unnoticed by the consumer. All in all, the Commission recognizes that '[t]he differing treatment of intermediaries and principals is an inherent feature of the Special Scheme and provides incentives for businesses to adopt an agency rather than a principal model'.¹⁸¹ Irrespective of the difficulties to measure and, consequently, prove the magnitude of distortion, its existence is thus admitted by the Commission. As the different VAT treatment affects the choice of business model a travel agent applies, it constitutes a violation of the principle of fiscal neutrality and thus also of the principle of equal treatment.

5.4.2 Possible solutions

In order to achieve neutrality of VAT in the field of travel, equal treatment should be a central objective in drafting possible amendments to TOMS and in respect of the scope provision in particular. Equal treatment requires that equal supplies are taxed in a similar way.¹⁸² In order to achieve neutrality of VAT, the rules for all economic operators do not have to be exactly the same, but the outcome of the rules applied, i.e. the VAT burden, should be equal.

¹⁸⁰ Commission Study 2017, p. 58.

¹⁸¹ Commission Study 2017, p. 58.

¹⁸² See *Rendahl* 2013, p. 461, for the implications of equal treatment in the context of exemptions: 'Equal treatment should then not only be considered when deciding if a transaction is taxable or not, or which state that has the right to tax that transaction; but also how that transaction should be taxed including if the transaction is exempt or not, or if a reduced VAT rate applies.'

In drafting new rules for travel agents, the purpose of TOMS is essential. The primary question that must be asked is how the objectives of TOMS translate to the reality of new business models, and how the rules could be adapted to the new reality.¹⁸³

Considering the majority of the changes in travel business during the last 40 years that the TOMS has been in force, a simple change of the scope provision might not be sufficient to achieve the desired effect of increasing neutrality. In the new reality where operators engage in transaction under various different and mixed business models, it is no longer effective to categorize operators based on whether they are labelled as intermediaries, primary suppliers or travel agents. The focus should be rather on the products sold in each case, especially from the customer perspective as endorsed by the CJEU in Rank Group.

5.4.2.1 Limiting the scope of TOMS

It has been suggested by the Commission as well as by European travel agents that the scope of TOMS would be limited in respect of B2B supplies where the competitive position is most notably affected by the absence of input VAT relief.¹⁸⁴ Application of regular VAT scheme would bring B2B travel supplies on a level with travel agents and primary suppliers that do not act under TOMS. Nevertheless, the simplification benefits of applying TOMS would be lost as the travel agent might face multiple registration requirements with regard to its sales to business customers.

Therefore, it would be best to allow some flexibility as to the circumstances and particularly the importance of the registration aspect in an individual case. If the application of TOMS would not be necessary with regard to the objectives of the special scheme, then it should be possible to opt for the application of the regular scheme instead. For instance, in a domestic scenario, or otherwise where the travel agent is already registered in the country where the travel services take place, it hardly makes any sense to apply TOMS. In the same spirit, the CJEU has stated that ‘it should be recalled that the scheme - - constitutes an exception to the normal rules - - and must be applied only to the extent necessary to achieve its objective’.¹⁸⁵ However, if an opt-out

¹⁸³ *Linklater* 2014, p. 310.

¹⁸⁴ See e.g. COM (2002) 64 final, recital 6 and ECTAA CR14-151/422.

¹⁸⁵ Joined Cases C-308/96 and C-94/97 *Madgett and Baldwin*, para 34.

clause for certain B2B supplies were introduced to the TOMS provisions of the VAT Directive, it would have to clearly define the situations where the opt-out is possible in order to prevent the arising of further disparities in national practices.

5.4.2.2 Extending the scope of TOMS

The other way around, it could be imagined that the scope of economic operators covered by TOMS would be extended. However, as already mentioned in several instances, the TOMS is an exception to the regular rules of the VAT Directive and as such should not be applied where inadequate, in particular where the benefits of applying TOMS would not exceed the competitive disadvantages. Intermediaries and primary suppliers hardly ever have to register in other Member States when the place of supply is determined in accordance with the regular scheme.

5.4.2.3 Other options

Instead of bringing travel agents within the same treatment as intermediaries and primary suppliers by limiting the scope of TOMS or, vice versa, by extending the scope of TOMS, another approach would be to retain this distinction but address the most significant causes of unequal treatment. The unequal treatment could be mitigated e.g. by allowing travel agents under TOMS to apply a reduced VAT rate to their margin instead of the high rate, or by giving B2B customers a right to deduct the VAT on a TOMS invoice.

Where the applicable VAT rates are concerned, it has to be noted that the Member States have long held and will keep holding onto the transitional exemption for international passenger transport as allowed by the VAT Directive. The Commission has been envisioning the abolishment of these transitional rules already in 1992:

*Dangers of distortion of competition - - may indeed exist at the present time. However, these dangers are bound to disappear since they are attributable to derogations authorising the retention, for a transitional period, of the exemption for passenger transportation services, and in particular services involving international flights.*¹⁸⁶

Yet, after more than 25 years the same ‘transitional’ rules are still in place.

¹⁸⁶ Answer by the Commission to a question by a Member of the European Parliament; reference made in *Terra and Kajus 2015a*, p. 5113.

6 SCOPE OF TOMS: EU AND NON-EU OPERATORS

6.1 Different treatment based on location of services performed

The rise of digital economy is a global phenomenon. Besides the EU, the OECD has recognized the increase in e-commerce as one of the key challenges in the field of indirect taxation. Current technology enables businesses to supply goods and services to customers anywhere in the world without having a physical presence in the countries where the customers are located. According to the OECD, such remote supplies often lead to the collection of very little VAT – if at all. There is a competitive distortion for the disadvantage of domestic suppliers in comparison with foreign businesses,¹⁸⁷ and in larger scale for the disadvantage of EU businesses in comparison with non-EU businesses.

6.1.1 Determination of applicable VAT rules

The scope of application of TOMS is limited as regards the place where the travel services are performed. In general, only sales of services that take place within the EU shall be included in the travel agent's taxable margin. If the travel agent supplies services that take place outside the EU, the travel agent's margin in relation to those transactions will not be subject to EU VAT. Airline tickets with a departure or destination outside the EU are also regarded as non-EU services. If a package comprises a journey that takes place partly within the EU and partly outside the EU, the margin will be split between EU and non-EU, i.e. taxable and exempt parts.¹⁸⁸

The exemption for services performed in third countries stems from Article 309 of the VAT Directive. This provision prescribes a fiction where travel agents' sales which relate to services carried out in non-EU countries shall be treated as though they were supplies by intermediaries under Article 153. Article 153 deals with intermediaries acting in the name and on behalf of principals, providing an exemption for supplies of services by intermediaries where the underlying transactions are carried out outside the EU. While referring to Article 153 in this way, Article 309 practically places travel agents acting in their own name at a level with intermediaries. As a consequence, these

¹⁸⁷ OECD 2015, p. 120–121.

¹⁸⁸ While the VAT Directive does not provide for guidance on how the margin should be apportioned into EU and non-EU, the prevailing practice among Member States is to split the margin on the basis of cost prices. However, a few Member States base the apportionment on other factors, such as the proportions of kilometres travelled in relation to air or bus tickets.

supplies will be treated as exempt with the right of deduction.¹⁸⁹ This is only the case for services performed in third countries as is expressly highlighted in both provisions.

6.1.2 Practical example

Travel Agent D, established in Finland, supplies a package of airline tickets and hotel accommodation. As Travel Agent D is acting in its own name towards its suppliers and customer, and the travel services are purchased from third parties, the requirements for the application of TOMS are satisfied.

Travel Agent D purchases the following components which he will include in a TOMS package:

1) Airline tickets Helsinki-London	1.000 EUR	(EU)
2) Hotel accommodation in London	1.200 EUR	(EU)
3) Airline tickets London-New York	2.000 EUR	(NON-EU)
4) Hotel accommodation in New York	1.500 EUR	(NON-EU)
5) Airline tickets New York-Helsinki	<u>3.000 EUR</u>	(NON-EU)
	Total: 8.700 EUR	

Travel Agent D sells the package for one price of EUR 12.000, thus ending up in a margin of EUR 3.300 (12.000 – 8.700). As the package comprises services carried out both within and outside the EU, the next step in the calculation of VAT due is to exclude the part of the margin that relates to non-EU services. For that purpose, the proportions of EU and non-EU related TOMS margin are first determined as percentages of the cost prices incurred by Travel Agent D.

EU TOMS cost: $1.000 + 1.200 = 2.200$ EUR

Non-EU TOMS cost: $2.000 + 1.500 + 3.000 = 6.500$ EUR

EU proportion: $2.200 / 8.700 = 25 \%$

Non-EU proportion: $6.500 / 8.700 = 75 \%$

In consequence, EUR 2.475 ($75 \% * 3.300$) is deducted from the margin before calculating the payable VAT amount. No VAT is withheld from the non-EU part of the margin since it is exempt based on Articles 309 and 153 of the VAT Directive. The taxable TOMS margin is thus reduced to EUR 825, from which VAT is withheld

¹⁸⁹ *Terra and Kajus* 2015a, p. 1703–1704 and 5129.

against Finnish general rate 24 %. The VAT payable by Travel Agent D becomes EUR 160 ($825 * 24/124$).

6.2 Different treatment based on location of supplier

6.2.1 Determination of applicable VAT rules

It follows from the place of supply rule under TOMS that a travel agent's supply is subject to VAT in the Member State where it is established (Article 307 of the VAT Directive). Even though there is no case law regarding the interpretation of this provision, the prevailing, settled interpretation is that supplies by a travel agent who has no establishment in the EU are outside the scope of EU VAT.¹⁹⁰ Therefore, TOMS VAT is only applicable to supplies by travel agents that are located within the EU.

In fact, two alternative technical interpretations arise, although both have the same effect in practice. First, it is possible to regard that supplies of non-EU operators are in the scope of TOMS, however not subject to VAT as they have no establishment in the EU. According to the other possible interpretation, which the VAT Committee has adopted, non-EU suppliers that have no establishment in the EU are not in the scope of TOMS in the first place.¹⁹¹ Under the latter interpretation, the non-EU operator would be covered by the regular VAT regime of the VAT Directive instead of TOMS. Consequently, it could enjoy advantages offered by the regular rules, such as input VAT deductions, provided that it registered in the Member State where it purchases services.¹⁹²

6.2.2 Practical example

Travel Agent E, based in Finland, supplies a package of airline tickets Helsinki-Stockholm and hotel accommodation in Stockholm. As Travel Agent E is acting in its own name towards its suppliers and customer, and the travel services are purchased from third parties, the supply is in the scope of TOMS. As the package only includes services that are performed in the EU, Travel Agent E's entire margin will be subject to

¹⁹⁰ Commission Study 2017, p. 81.

¹⁹¹ See VAT Committee Guidelines resulting from the 101st meeting of 20 October 2014, Document G.

¹⁹² Commission Study 2017, p. 83.

24 % Finnish VAT. Moreover, Travel Agent E will not have a right to reclaim the VAT it incurs in relation to the purchases of air tickets and hotel.

Travel Agent N is a travel agent established in Norway. It supplies a similar package of airline tickets Helsinki-Stockholm and hotel in Stockholm. As Norway is not a Member State of the EU, the place of supply is outside the EU and the supply is not subject to EU VAT. Depending on local Norwegian VAT rules, the package might be subject to Norwegian VAT. In general, there lies a potential for non-taxation in these cases since not all countries levy a tax similar to VAT.

6.2.3 Unequal treatment

The principle of fiscal neutrality is considered a key principle of VAT on global as well as EU level. The OECD VAT/GST Guidelines highlight the importance of neutrality in international trade. According to Guideline 2.4, foreign businesses should not be disadvantaged nor advantaged as regards the level of taxation in comparison with domestic businesses in the country where VAT is due.¹⁹³ In other words, any positive or negative discrimination in respect of VAT burden on foreign businesses should be avoided.¹⁹⁴ Since in the context of EU VAT ‘foreign businesses’ would refer to entities established in non-EU countries, the international neutrality principles require that transactions by EU and third country businesses face similar VAT treatment in the EU.

As demonstrated in the example in section 6.2.2, supplies of the same travel services that take place in the EU face different VAT treatment based on whether the travel agent selling those services is established in- or outside the borders of the EU. Since the VAT treatment of EU and non-EU travel agents is differential in favour of non-EU businesses, the place of supply rule under TOMS may constitute an infringement of the principle of fiscal neutrality.

A travel agent’s margin is taxed in the country where it has established its business. If a travel agent is located outside the EU and does not have a physical presence in the EU, its margin is not subject to European VAT. Considering that non-EU travel agents may supply travel packages without having to pay VAT from their margin, they enjoy significant savings in comparison to EU travel agents acting under TOMS. Since EU

¹⁹³ OECD 2017, p. 22.

¹⁹⁴ *Kogels* 2012, p. 231.

Member States apply standard VAT rates between 18 and 27 %, ¹⁹⁵ this is the amount of tax that European travel agents pay from their margin and in practice pass on to their customers. In consequence, that is the amount of the advantage for operators supplying the same services from outside the EU and not applying VAT. It goes without saying that VAT affects the competitive positions of EU and non-EU travel agents. ¹⁹⁶

The different level of VAT burden might indeed affect the way in which travel agents organize their business. In general, VAT law may have an impact on several business decisions such as where to establish, where to purchase and supply services and whether to outsource certain activities. ¹⁹⁷ The EU TOMS regime in particular might affect travel agents' choices as to the place of establishment and the place where to make purchases of travel services. EU-based travel agents with sufficient resources may be attracted to set up branches in non-EU countries and supply travel packages from those branches, in order to avoid paying EU VAT. Distinctly, the system allows for tax planning opportunities for multinational enterprises ('MNE'). This can be seen as a further distortion of competition between MNE's and small travel companies that do not have the same possibilities to create foreign branches.

According to *Hans Kogels*, 'businesses may try to achieve neutrality that does not exist'. However, the fact that businesses decide to operate from another jurisdiction for more beneficial tax treatment is against the very principle of neutrality, and therefore it should not be said that businesses seek for neutrality. They are rather looking for tax advantages, and as long as businesses choose the jurisdiction where they operate based on the level of value-added taxation, there is no neutrality. Moreover, such structures tend to distort the destination principle. For instance, when a package of travel services that take place in the EU is supplied to an EU customer, the destination principle would require those services to be taxed in the EU. If this supply is made by a non-EU travel agent and thus the place of supply is in a third country, the consumption nevertheless takes place in the EU and VAT, if applicable, is paid at the origin instead of the destination.

¹⁹⁵ European Commission: VAT rates applied in the Member States of the European Union – Situation at 1st January 2018.

¹⁹⁶ See COM (2016) 757 final.

¹⁹⁷ *Kogels* 2012, p. 231.

6.3 Conclusion

Lack of neutrality and the need to address the emerging issues have increased due to recent phenomena and rapid changes in the market, notably in respect of digitalization and globalization of trade. The EU legislator is faced with a challenge to adapt to these elemental developments. As currently almost any transaction can be carried out on the internet, service providers supplying services in the EU might as well choose to establish their business outside the union and carry on their business online. In other words, supplying services in the EU rarely requires a physical presence in the EU in these days.¹⁹⁸

6.3.1 Justifications

Despite of the challenges described in this chapter, the European legislator only has jurisdiction in the EU. Lack of jurisdiction implies that the EU cannot force third countries to adopt similar VAT rules to EU VAT in order to achieve neutrality globally. In other words, it cannot interfere in the tax sovereignty of non-EU countries. Only EU Member States have assigned their jurisdiction in the field of indirect taxation to the EU upon accession to the Union.

Neither can the EU force suppliers located in third countries to comply with EU VAT rules, since EU legislation is in practice difficult to enforce on non-EU persons. The inability to impose obligations on third country operators justifies the exclusion of non-EU activities and non-EU operators from the scope of EU VAT.

6.3.2 Possible solutions

6.3.2.1 *Changing the place of supply of TOMS sales*

The European Commission has previously attempted to address the distortion between travel agents located in the EU and those established in third countries. In 2002, the Commission issued a proposal¹⁹⁹ to amend the Sixth VAT Directive in several respects, among which the place of supply rule within TOMS. The initiative sought to bring travel agents established outside the EU within the scope of EU VAT in situations where they sell packages to EU customers.

¹⁹⁸ *Doesum, Kesteren and Norden* 2016, p. 9.

¹⁹⁹ COM (2002) 64 final.

The proposed amendment aimed at shifting the place of supply of travel agency services from the country of establishment of the agent into the country where the customer is located. According to the proposed provision:

When the travel agent is not established in the Community or has a fixed establishment outside the Community from where the service is supplied and he supplies a travel service the effective use and enjoyment of which takes place within the Community, the single service shall be taxable at the place where the customer has established his business or has a fixed establishment to which the service is supplied or in the absence of such a place, the place where he has his permanent address or usually resides.²⁰⁰

Such a rule would mean discontinuing to exempt third-country travel agents' margin in relation to travel services performed in the EU and sold to EU customers. It is also apparent from the proposed provision that it would apply to B2B as well as B2C supplies. It would eliminate the distortion for situations where the travel services take place in the EU and the customer is in the EU.

However, the exemption for supplies to customers established outside the Union would remain in force, which would still lead to differential treatment between EU and non-EU travel agents. Perhaps destination principle has been the principal objective in drafting the proposal, if one takes the view that the consumption of travel agency services takes place in the country of the customer. To this day, there is no consensus as to where the supply of a travel agent in fact takes place. The Commission Study carried out by KPMG in 2017 regards that the consumption actually takes place in the country where the services are performed.²⁰¹

After negotiations between the EU decision-making institutions, the Commission later complemented its proposal²⁰² with the introduction of a simplified mechanism for non-EU travel agents. This measure would aim at ensuring compliance and, ultimately, neutrality.

²⁰⁰ COM (2002) 64 final, Article 26(2) 3rd sentence.

²⁰¹ See Commission Study 2017, p.26.

²⁰² COM (2003) 78 final.

In the end, the proposal was not accepted by the Council, and it was not until 2014 that the proposal was officially withdrawn.²⁰³ Based on the review of all the reform options carried out by KPMG in the Commission Study, it seems likely that the negotiations over the amendment of the place of supply rule of TOMS will be re-opened.²⁰⁴

6.3.2.2 Compliance among non-EU suppliers

In case sales of services performed in the EU to EU customers by non-EU travel agents were brought within the scope of VAT in accordance with TOMS by shifting the place of supply to the Member State of residence of the customer, it would imply multiple foreign VAT registration obligations for the travel agents. However, the EU has no enforcement and control jurisdiction as to non-EU businesses and their VAT declarations.²⁰⁵

The Commission Study admits that amending the scope of TOMS alone would not be sufficient to bring non-EU travel agents within similar VAT treatment as those based in the EU unless the compliance with EU VAT would be made less burdensome for them. For this purpose, the Study suggests that the new place of supply rule would be paired with a simplification scheme for non-EU travel agents. Such a simplification measure already exists in the field of electronic services, and the same or similar scheme might be suitable for travel services as well.²⁰⁶

6.3.2.3 One-stop shop to cover travel services

The simplification scheme which since 2015 has been known as Mini One-Stop Shop ('MOSS') was first introduced in 2003 for non-EU suppliers in the provision of broadcasting and certain electronically supplied services to EU customers. The MOSS is currently only applicable in B2C scenarios and is applicable for declaration of output VAT in respect of telecommunications, broadcasting and electronic services.²⁰⁷ Despite of the low amount of registrations in the first years of the existence of this scheme, the scope of the services covered by MOSS will be expanded as the Commission envisages the use of a similar scheme for other kinds of services as well. In a proposal of 2016, the

²⁰³ Withdrawal of obsolete Commission proposals (2014/C 153/03).

²⁰⁴ See Commission Study 2017, section 6.

²⁰⁵ See e.g. *Lamensch* 2017.

²⁰⁶ *Terra and Kajus* 2015a, p. 1709.

²⁰⁷ See Council Directive 2002/38/EC of 7 May 2002 amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, which was in force in the years 2003–2006.

Commission suggested new types of services to be covered by MOSS.²⁰⁸ However the Commission still only regards this simplification scheme suitable for B2C transactions.²⁰⁹

Travel services are currently excluded from the VAT law definition of e-services, i.e. electronically supplied services.²¹⁰ Along the increase of online channels and technology-based tools employed in the provision and intermediation of travel services, it might be time to re-think the definition. To this end, it has been suggested that intermediation taking place online would be within the scope of electronically supplied services.²¹¹ For instance, it would be quite logical to parallelize online-booking of travel services with other services supplied over the internet and not in a physical location.²¹² Consequently, such transactions would be taxed in the Member State where the customer is established and the supplier would be allowed to account for VAT according to the simplified scheme, in line with the treatment of e-services.²¹³

²⁰⁸ COM (2016) 757 final.

²⁰⁹ Commission Study 2017, p. 91.

²¹⁰ See COM (2016) 757 final.

²¹¹ *Merkx* 2018, p. 4–5.

²¹² See Commission Implementing Regulation (EU) No 815/2012 Art. 7(3) (t) and (u).

²¹³ See also *Van Gerven* 1993, p. 67 on the distinction between intermediation and e-services.

7 CONCLUSIONS AND FUTURE PROSPECTS

7.1 Shortcomings of the current scheme

The Tour Operators' Margin Scheme, introduced in 1977, was once seen as a functional provision that enabled travel agents to apply simplified VAT on their business transactions and avoid administrative hassle due to registering and accounting for VAT in foreign countries. Nevertheless, as drastic global trends and phenomena, such as new technologies, rise of multinational entities and growth in corporate travel, have re-shaped the entire travel industry over the decades, the VAT Directive has not been adapted to the new circumstances and the reality that travel businesses are faced with today. Furthermore, the application and interpretation of TOMS has become increasingly complex while the scheme itself has largely remained the same.

Travel agents deal with an increasing variety of competitors: foreign travel agents, online travel companies, automated service tools, intermediaries and suppliers such as airlines or hotels making supplies to customers directly. Among the variety of business models that are nowadays available, it is often ambiguous which VAT rules will apply. The comparison, in order to determine if the facts or circumstances of different operators are sufficiently parallel for VAT law to require similar treatment, can be extremely difficult. The TOMS in itself is confusing as to where the line between application and non-application of the scheme should be drawn. The Commission Study of 2017 points out the following example: 'As the travel agent within the Special Scheme is considered to be an intermediary when selling services performed outside the EU, it does not seem unreasonable that he is also an intermediary when selling 'EU services'.'²¹⁴ This refers to the contradiction where on one hand, Article 306(2) excludes intermediaries from the scope of TOMS, whereas on the other, Article 309(1) places transactions by travel agents on a level with intermediary activities where the travel services take place outside the EU.

Travel agents falling in the scope of TOMS often suffer from disadvantageous taxation since the TOMS prevents input VAT relief by both the travel agent and its customer and, furthermore, all supplies under TOMS are taxable against the standard i.e. high VAT rate. Considering the changes in the market, travel agents have been shifting to other business models in order to avoid having to apply TOMS. In light of the resulting

²¹⁴ Commission Study 2017, p. 92.

distortions, equal VAT treatment is called into question by the principle of fiscal neutrality.

7.2 Principle of neutrality in the reform of TOMS

The EU legislator must quickly react to the developments in the travel sector as described in prior parts of this thesis. Furthermore, the interpretation and application of TOMS must become more compatible not only with the objectives underlying the special scheme but also with the general principles inherent in the EU common system of VAT. Equal treatment of taxable persons, giving effect to the principle of fiscal neutrality, is of particular importance. In light of neutrality, the main goal is to accord similar VAT treatment for similar supplies of travel services, irrespective of the formal classification and the place of establishment of the suppliers. In other words, the fiscal neutrality principle must be respected when designing the new rules that aim to ensure a level playing field within the framework of EU VAT law.

However, as the EU VAT system is very complex and governed by several other principles besides neutrality,²¹⁵ and especially with regard to TOMS which is above all driven by the objectives of simplification and correct allocation of VAT revenue, the scheme will have to be brought in line with all these principles. Taken all these aspects into consideration, there does not seem to be a satisfactory, easy way to fix the normative framework of VAT on travel all at once. However, the neutrality principle can no longer be set aside.

It has been recently recognized at EU level that the TOMS rules need to be updated to better adapt to the current economy. In case *European Commission v Spain*, the Commission expressed the need for EU measures:

*[T]he special scheme was introduced to deal with the prevailing situation in 1977, at a time when travel services were mainly sold directly to travellers by travel agents. The sector concerned now has a greater number of operators, but it is not for the Member States but for the European Union legislature to remedy the inadequacies of the special scheme.*²¹⁶

²¹⁵ In COM (2016) 757 final, the Commission has listed the following key principles that need to be taken into account when drafting new VAT measures: smooth functioning of the internal market, competitiveness of EU businesses, effective taxation and destination principle.

²¹⁶ Case C-189/11 *Commission v Spain*, para 31.

Even if it the biggest pressure lies at the EU level, it should be noted that in the end it is the Member States that by practicing their veto power actually stall these revisions for years or, as in the case of TOMS, decades.

7.3 Summary of suggested measures

Considering that limitations to the right of recovery of input VAT are contrary to the principle of neutrality, a preferred option would be to permit input VAT relief to travel agents and their B2B customers. Another optional way to reduce the unequal treatment between travel operators acting under TOMS and those supplying services under the regular rules would be to make the application of TOMS optional in respect of B2B services. Furthermore, it is suggested that in order to eliminate the disadvantage of having to pay high output VAT on travel services, travel agents under TOMS should be allowed to charge VAT at a reduced rate, similar to the regular scheme where travel services are often subject to reduced rates or even exempted.

As to the uniformity of national practices, the history has shown that case law and the guidelines of VAT Committee is not sufficiently effective. Therefore, it is necessary that the most relevant inconsistencies and disparities are addressed via positive integration in the form of EU legislation. Faithful implementation among Member States is called for, as the functioning of the common VAT system, based on a directive, crucially depends on cooperation of the States in reaching the common objectives.

Further, it is suggested that when operators that are not established in the EU supply EU travel services to EU customers, these transactions would be subject to EU VAT in accordance with TOMS. Whereas this would generally imply that these non-EU operators must register locally for VAT in all Member States where they supply services, a preferred option would be to provide a simplification scheme similar to the MOSS that is currently applicable in the provision of e-services.