



# Final management letter

to the Federal Ministry of Finance

on the audit of

Enforcing VAT on e-commerce -

Goods sold online by non-EU based internet traders

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The present management letter comprises the final audit findings issued by the German SAI in accordance with article 96 para. 4 clause 1 Federal Budget Code. This management letter is available at [www.bundesrechnungshof.de](http://www.bundesrechnungshof.de).

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## 0 Executive summary

- 0.1 In earlier work, we examined taxation regarding e-services (online sales) provided by traders located outside the European Union (non-EU based businesses). We found that only few e-commerce traders were registered to pay tax and that practically no checks were carried out. This was the driver for us to expand our audit work to non-EU based traders that deliver consignments (offline sales) to final consumers in Germany. (item 1)
- 0.2 In general, non-EU businesses trade on e-marketplaces to offer their goods. The marketplace thus gathers relevant data on such traders' turnover. In order to reduce delivery times, traders temporarily store their goods in fulfilment houses located in the target country. The customs administration imposes value added tax (VAT) on the import of goods. Once a customer has purchased an item over the internet, the consignment is sent from the fulfilment house to the customer. In Germany, VAT is due on consignments ordered over the internet. (items 2 and 3)
- 0.3 We found that, as a rule, non-EU based online traders did not comply with their duty to pay VAT in Germany, irrespective of whether or not they paid import VAT. The tax authorities only captured data on businesses that had voluntarily registered with the tax authorities or on which operational data or intelligence was available. Tax authorities are neither aware of the actual number of non-EU based businesses selling goods in Germany nor of their offline sales that are subject to VAT. Therefore, the number of non-registered online retailers is likely to be largely understated. (items 4.1 and 4.2)
- 0.4 We also found that even registered non-EU based businesses did not comply with their duty to pay VAT in Germany. They often failed to file returns or pay VAT. Frequently, tax authorities did not succeed in enforcing their tax regime. This led to number of cases of VAT shortfalls since the tax due was higher than the import VAT paid.

(items 4.3 and 4.4)

- 0.5 We considered it imperative that the tax authorities ensure that VAT revenues be collected from offline sales. To this end, we recommended that the Federal Ministry of Finance ensure that e-marketplaces in the European Union are also subjected to taxation. Such e-marketplaces should be held liable to remit the VAT imposed on the businesses to the respective member state's tax authorities. In addition to that, we recommended that the businesses designate a fiscal representative in the target country. (items 5 and 6)
- 0.6 The Federal Ministry of Finance stated that a working group composed of representatives of the Federal Government and the Federal States was discussing our recommendations. The Ministry stated that the Conference of the Ministers of Finance of the Federal States had requested it to develop a provision governing the liability of e-marketplaces and to consider the pros and cons of an additional fiscal representative rule. The Ministry intended to submit a Bill in the first quarter of 2018. According to the Ministry, at its initiative, in December 2017, the European ministers of finance had adopted far-reaching measures to ensure that tax revenue from online trading be collected in full. (item 7)
- 0.7 We welcome the steps taken at European level according to which e-marketplaces will be covered by taxation of non-EU based online traders. In order to address tax erosion prior to the implementation of the EU measures in 2021, we hold that timely action needs to be taken at national level. The duty to designate a fiscal representative for non-EU businesses and imposing on e-marketplaces the liability to remit VAT are appropriate instruments for enforcing tax claims. (item 8)

## 1 Driver and scope of audit work

In earlier work, we examined taxation regarding foreign e-commerce traders. At first, we focused on traders located outside the European Union (non-EU based businesses) providing e-services (online sales) to private consumers in Germany.<sup>1</sup> Such services are subject to value added tax (VAT).

We found that only few non-EU based businesses were registered to pay tax and that practically no checks of online sales were carried out. Thus foreign e-commerce traders were easily tempted to provide services without charging VAT. As a fact, the traders were free to decide whether or not to pay VAT due.<sup>2</sup> We also found similar weaknesses in the case of e-services provided by EU based businesses. Therefore, we considered tax claims for online sales to be generally at risk.<sup>3</sup>

Our previous findings were the driver for us to expand our audit work to non-EU based e-commerce traders that deliver consignments (offline sales) to private consumers in Germany. We did field work at the Federal Ministry of Finance and at selected tax authorities responsible for non-EU based businesses.

## 2 Legal situation

### 2.1 Import VAT

As a matter of principle, the import of goods from a non-EU country to Germany is subject to import VAT. It does not matter for taxation if imported goods are delivered directly to a customer or temporarily stored in fulfilment houses located in the target country. Any non-EU traders importing goods for resale on their own account have to pay tax due. Depending on the arrangement in place, the purchaser may also become liable to pay import tax. The customs office charges the import tax upon arrival of the goods in Germany. Only once import tax due has been paid when declaring the goods at the border, the customs offices declare these free for movement in Germany.

<sup>1</sup> This includes e.g. music and video services, e-books, live cams and software.

<sup>2</sup> 2013 annual report – further audit findings – reporting item 11 – enforce VAT due on internet traders based abroad.

<sup>3</sup> 2015 annual report – reporting item 82 – The internet as tax haven.

## 2.2 Turnover tax

In Germany, consignments attract VAT, in the same way as goods bought impersonally if the goods are delivered to a domestic location. This is regularly the case if

- delivery or shipping is done through a domestic fulfilment house;
- the goods are imported to Germany from a fulfilment house in another EU member state and if the business from outside the EU trades above the threshold of EUR100,000 or chooses not to apply that threshold; or
- the goods are shipped from a non-EU country directly to a final purchaser in Germany and the non-EU traders or the business providing fulfilment services for them are liable to (pay) import tax.

Once shipments on which tax is due enter Germany, any non-EU traders are subject to the same tax liabilities as domestic traders. They must register with the tax authorities responsible and account to these for the VAT charged to customers. Such traders may reclaim any eligible import VAT paid on the goods delivered through their tax returns.

## 2.3 Fiscal representation

Any non-EU based traders may appoint a fiscal representative in Germany to act on their behalf relating to the German tax offices. Such a fiscal representative saves the trader the administrative effort of VAT registration in Germany, and the associated declaration and recording obligations. In accordance with the German Turnover Tax Act, a fiscal representative is provided only for cases where a resident business exclusively generates tax-free sales and is not entitled to recover any input tax (limited fiscal representation service).

In almost all other EU member states, foreign businesses may also designate a fiscal representative if they export goods that are subject to tax (full fiscal representation service). In some EU member states, full fiscal representation is even compulsory.

### 3 Offline sales over e-marketplaces

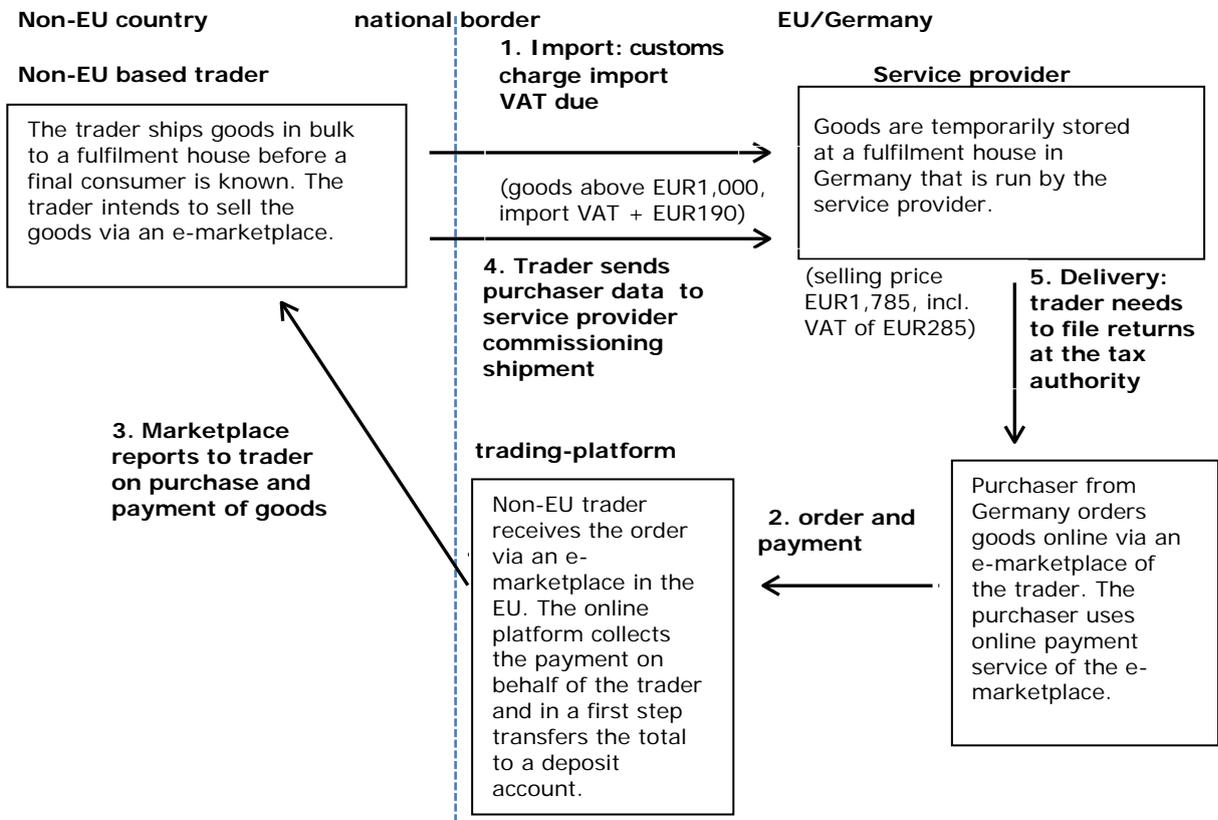
In case of offline sales, purchasers have ordered and paid goods online but these goods are shipped by surface mail delivery services. Offline sales are either generated via internet shops of non-EU based traders or via e-marketplaces.

Any non-EU based traders intending to sell goods to German consumers usually rely on distance selling via e-marketplaces. Each e-marketplace serves as a mediator between the foreign trader and the domestic shoppers. In this function, e-marketplaces hold data on the trader and the amount of turnover generated by them. Some e-marketplaces offer pay systems of their own. If payment is processed via such a system, the e-marketplaces receive the purchasing price and transmit the amount to the trader once the deadline for returning the goods has elapsed.

Although the goods are speedily sold over the internet, the foreign traders face the problem that shipping the goods from outside the EU directly to the purchaser in Germany would take several weeks. The purchaser usually expects a speedy delivery. For this reason, non-EU based traders often rely on an external fulfilment service provider located in Germany: They import the goods to Germany before the final consumer is known and ship them for temporary storage at a fulfilment house that is operated by the service provider. When the goods are ordered from the trader over the internet, the trader ships the goods ordered to the service provider for further processing. The service provider is commissioned by the trader to ship the goods to the final consumer. Apart from storage at fulfilment houses, the fulfilment service also includes commissioning, packing services, franking and shipment as well as a product returns processing service. Some e-marketplaces have their own (internal) fulfilment service.

**Case study:**

**Ordering goods via an e-marketplace and reliance on an external fulfilment service provider**



## 4 Audit findings

### 4.1 Wrong data submitted at the point of import

The tax authorities have intelligence on non-EU based internet traders undervaluing their goods when importing them to the EU. Since import VAT is payable based on the value of the goods imported, by under-declaring the value of the goods, traders managed to reduce the amount of import tax due.

### 4.2 Number and activities of internet traders not known

We found that, frequently, non-EU based online traders did not comply with their duty to pay VAT in Germany, irrespective of whether or not they paid import VAT. The tax authorities only captured data on businesses that had voluntarily registered with the tax authorities or on which operational data was available. Tax authorities failed to carry out in-depth investigations to identify unknown trader data. Tax authorities were neither aware of the actual number of non-EU based businesses selling goods in Germany nor of their offline sales that are subject to VAT. However, they assumed the number of non-registered online retailers from outside the EU to be largely understated.

### 4.3 Tax claims largely not enforceable

We also found that even registered non-EU based businesses did not comply with their duty to pay VAT in Germany. They often failed to file returns or pay VAT. Eventually such businesses evaded paying tax by ignoring related letters received from tax authorities. Tax liability estimates and attempts to enforce the tax regime normally led to no result. This resulted in tax definitely foregone: Such traders were able to deduct the import tax paid from their VAT due on turnovers by way of the advance payment procedure and thus reduce the overall VAT tax load. Since generally the amount of tax due was higher than the amount of import VAT paid, the difference amount remained uncollected.

### 4.4 Unjustified tax reclaims

The risk of more tax losses resulted from internet traders registered with the tax authorities claiming a deduction of import tax paid in filing their tax returns but at the same time failing to mention their turnovers fully or in part. Such flawed data result in unjustified claims for reimbursement of tax against the tax authorities. The fiscal administration succeeded in preventing

reimbursements to non-EU based traders by making reference to the feedback history, the high number of customer ratings they had received and the relevant turnovers on e-marketplaces. As a result, internet traders stopped responding to the tax authority enquiries.

## 5 Conclusions

We noted with concern that tax authorities were unable to enforce the charging or payment of VAT on traders not located in Germany for their taxable offline sales. Either businesses managed to evade paying VAT or the tax claim could not be enforced since the traders did not have sufficient disposable assets to pay tax due. Although the tax gap is limited to the difference between VAT due and import tax paid, we are convinced this non-payment results in major tax losses. As a result of the unfair tax advantage, non-EU based traders can also offer their goods at significantly lower prices than domestic businesses which undermines the competitiveness of national traders.

We did not consider it appropriate practice that e-marketplaces granting access to national marketplaces to non-EU based traders could not be held liable for such traders' non-charging or non-payment of VAT. In our view, e-marketplaces should take their share in the responsibility to ensure that non-EU based traders pay accurate tax in Germany and remit tax due on their turnover from offline sales.

We were also concerned that non-EU based traders were not able to designate a fiscal representative when exporting to Germany goods that are liable to turnover tax. We considered it to be appropriate that a full fiscal representation should be made mandatory for such cases as is good practice in nearly all other EU member states. Such a fiscal representation would at least provide for tax authorities a domestic contact located in Germany. This would facilitate issuing tax assessment notices and accelerate settling any open questions on the facts and figures stated in the taxation procedure.

## 6 Recommendations

We considered it imperative that VAT revenues on offline sales over online platforms be collected in full from non-EU based businesses. To this end, we recommended that the Federal Ministry of Finance ensure that e-marketplaces located in the European Union be covered by the taxation procedure. Such e-marketplaces should be held liable for remitting the VAT charged by non-EU businesses to the respective member state's tax authorities.

We are fully aware that taxation of online sales constituted a European problem and that the collection of tax revenue due can only be ensured by means of uniform regulations adopted at EU level. We recommended initiating negotiations with the EU Commission and the other EU member states.

Also the German SAI recommended introducing in Germany a full fiscal representation rule for traders located outside the EU. Such a regulation will achieve its purpose only if it is compulsory for all businesses concerned. Such a regulation should also provide that in case fiscal representatives and traders provide wrong information in tax returns they may jointly and severally be held liable for tax evasion.

## 7 Comments provided by the Federal Ministry of Finance

The Federal Ministry of Finance stated that a working group composed of representatives of the Federal Government and the Federal States was discussing our recommendations.

The Ministry stated that the Conference of the Ministers of Finance of the Federal States had requested it to develop a provision governing the liability of e-marketplaces and to consider the pros and cons of a full fiscal representative rule. According to the Ministry's planning, e-marketplaces were to be held liable for non-EU based traders failing to register with the tax authorities and not complying with their duty to remit VAT due. Online platforms were also to be held liable by the tax authority if the trading account of registered but non-compliant traders was not removed from the e-marketplace within a specific deadline. The Ministry of Finance stated that it intended to draft an aggregate bill based on a collaborative arrangement with the federal states in the first quarter of 2018.

In an effort to tackle non-compliance with VAT law, the Ministry stated that it had initiated action at EU level making the point for uniform regulations to ensure tax due was paid for online trading. The Ministry also stated that in December 2017, the EU ministers of finance had adopted a variety of steps to be taken.<sup>4</sup> These included a provision to the effect that from 2021 e-marketplaces would become subject to the joint and several VAT liability rule for all deliveries of non-EU based traders to private-sector consumers.

<sup>4</sup> See Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, OJ L 348/7, 29 December 2017.

## 8 Final conclusions and recommendations

The German SAI acknowledges the steps adopted at EU level to ensure that from 2021, e-marketplaces will also have to share in the burden of remitting to the tax authorities the VAT due on goods sold to purchasers in the EU by non-EU based online-traders. Tax liability for e-marketplaces constitutes a major step to ensuring tax revenues for online sales. This liability rule will provide to tax authorities appropriate means of inspection and enforcement to effectively impose their tax regime against non-EU based businesses.

However, the new EU regulations will only take effect at the beginning of 2021 and need to be transposed into national law beforehand. Germany should take national steps as speedily as possible already before 2021 in order to limit the scale of VAT foregone for German tax authorities and major distortions of competition at the expense of domestic traders. The liability rules for e-marketplaces announced by the Federal Ministry of Finance seem to be an appropriate tool to enforce tax claims. However, the success of the liability rules will depend on whether non-compliant traders can be swiftly identified. The wording of the new provision should therefore be easy to understand by the authorities responsible for implementing it.

The liability rule for trading platforms should be supplemented by a compulsory full scale VAT fiscal representation for non-EU businesses. Such a rule may be implemented swiftly by the German and other EU national governments. In this way, the tax authorities would have available another instrument to ensure tax claims can be enforced against non-EU based traders. This is especially the case if the trader is located in a non-EU country with which no agreement on mutual administrative assistance has been concluded.

Signed by the audit director and senior audit director in charge