ECTAA
THE EUROPEAN TRAVEL AGENTS' AND TOUR OPERATORS' ASSOCIATIONS

GUILD OF EUROPEAN BUSINESS TRAVEL AGENTS

Associations Internationales sans but lucratif

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ANNEX - SHORTCOMINGS IN THE CURRENT TOMS SCHEME

1. Background of TOMS

The special VAT scheme for travel agents, often referred to as the Tour Operators' Margin Scheme, in short 'TOMS', was introduced for the first time in the main EU VAT Directive in 1977. This special scheme should be applied to transactions carried out by travel agents who deal with customers in their own name and who use supplies of goods/services provided by other persons. In such cases, the margin that is calculated as the difference between the total amount (exclusive of VAT) to be paid by the traveller and the actual cost to the travel agent is subject to VAT.

The objectives of TOMS are twofold; firstly, the special scheme should ensure a correct sharing of the total tax (VAT) revenues between the place where the travel agent is established and that where the underlying supply of services (e.g. accommodation, transport, guides, etc.) is made; and secondly, that the special regime is a simplification measure designed to avoid travel agents having to register for VAT in every EU state where the underlying supplies take place.

In 2002 the European Commission proposed a legislative proposal to revise the special scheme. The objective was to simplify and update Community legislation relating to VAT and promote more uniform and hence fairer application of the rules. Despite intensive discussions in the Council in 2002-2003 and 2010, Member States failed to reach an agreement on a revised scheme.

In the meantime the European Commission started infringement proceedings against a number of Member States for the incorrect application of the special scheme. In September 2013 the European Court of Justice handed down its decision in the 8 joined cases C-189/11, C-193/11, C-236/11, C-269/11, C-293/11, C-296/11, C-309/11, C-450/11 and interpreted the special scheme in the following way:

- TOMS must apply to sales made in accordance with Article 306 to all types of customers, thus including both B2C and B2B transactions;
- A global margin calculation is not allowed under the VAT Directive and thus the margin and output VAT must be determined on a transaction by transaction basis.

2. Industry appraisal

The special scheme for travel agents has been working well for the trade in some respects and avoiding the need for multiple VAT registrations is much appreciated by the trade.

However, the scheme has a number of shortcomings, among other:

- **Scope**: the special scheme applies to all transactions performed in accordance with article 306, including supplies to taxable customers, who are denied input VAT recovery;
- **Margin calculation**: the margin has to be calculated on a transaction basis rather globally for a period;
- **Distortions inherent in the current scheme**: Travel agents suffer distortions of competition from other travel services providers, who are able to benefit from reduced VAT rating / exemptions, as well as from non-EU providers who are outside the scope of EU VAT and thus have a lower VAT cost;
- **Outdated provisions**: the market for travel services has undergone fundamental changes since the introduction of the special VAT arrangements in 1977 that are not reflected in the VAT rules.
- **Unclear provisions**: the text of articles 306-310 is ambiguous, giving rise to real uncertainty in many circumstances and very diverse application of the special scheme across Member States.
- **Infringement of principles of Community Law**: the scheme creates certain competitive distortions that are not compatible with the principles of the Internal Market and the principles underpinning the EU VAT system.

These points will be elaborated in more detail under the next headings.

3. VAT principles

Before going into the details of the shortcomings of the current margin scheme, it is important to recall the main principles underpinning the EU VAT system.

Paragraph 4 in the preamble to Directive 2006/112/EC states that the attainment of the Internal Market presupposes that turnover tax legislation does not distort competition. Furthermore, paragraph 7 requires that the VAT system should result in neutrality of competition so that similar goods and services bear the same tax burden.

These overriding principles of non-discrimination on the basis of nationality, fiscal neutrality and non-distortion of competition have been confirmed by the European Court of Justice in settled case law.

The principle of non-discrimination requires that similar situations must be treated equally. Fiscal neutrality requires equal treatment for similar economic activities in order to avoid distortions caused by the drawing of unimportant or unjustified distinctions. The principle of non-distortion of competition has much the same effect.

Discrimination can arise through the application of different rules to comparable situations. In the case of La Société Generale des Grandes Sources D'eaux Minerals Françaises (C-761/96), the Court said that the Directive:

> *"Must not lead to the treatment of taxable persons differing according to the Member State in the territory of which they are established".*

The Court has regularly confirmed the need to consider VAT in the light of the requirement to ensure fiscal neutrality. For example, in Wellcome Trust (C-155/94), the Court stated that:

> "[the principle of fiscal neutrality] *requires that all economic activities should be treated in the same way".*

Furthermore, in the Ambulanter Pflegedienst Kügler GmbH case (C-141/00), the Court thought that:

> *"the principle of fiscal neutrality precludes, inter alia, economic operators carrying on the same activities from being treated differently as far as the levying of VAT is concerned."*

In another case, J&M Gregg (C-216/97), the Court said (in relation to the exemptions) that the:

> *"principle* [of fiscal neutrality] *would be frustrated if the possibility of relying on the benefit of the exemption … was dependent on the legal form in which the taxable person carried on his activity".*

In the Ines Zimmermann case (C-174/11), the Court concluded that:

> *"compliance with the principle of fiscal neutrality requires in principle that all organisations other than those governed by public law be placed on an equal footing for the purposes of their recognition for the supply of services".*

ECTAA and GEBTA believe that certain aspects of TOMS as it is currently interpreted and/or applied contradict these requirements, as further explained hereafter.

4. Scope

4.1. Inclusion of B2B supplies

One of the two most problematic issues for travel agents is the recent interpretation given by the ECoJ on the determination of the scope of TOMS, i.e. TOMS must apply to supplies made in accordance with article 306 to all customers, irrespective of whether that customer is a taxable or non-taxable person.

The extension of the scope of TOMS to all supplies of travel agents will have a disastrous effect on B2B transactions, notably wholesale supplies, i.e. travel agents making supplies to other travel agents for on-supply, and supplies of certain types of corporate travel such as the organisation of meetings, incentives, conferences and events (referred to as MICE business – see also point 4.2.).

The application of TOMS to B2B supplies creates distortions of competition between these wholesale and corporate travel agents compared to the suppliers of the underlying services (e.g. hotel, transport undertaking etc.), who are subject to the normal VAT arrangements. This is because applying the special scheme to B2B transactions denies taxable customers the right to recover input VAT on both the underlying travel services (to the extent that VAT can be partially or fully recovered on such services) and the travel agent's margin. Consequently business customers will be financially better off buying their travel services directly from the service providers and financially worse off buying them via a travel agent, which cannot be right.

The essence of VAT is the deduction of VAT by non-consumers and any cause that inhibits a right to recover VAT that is otherwise deductible in the intermediary consumption stage for a taxable customer is contrary to the basic principle of neutrality of the Community VAT system. In our view, a system which denies a business the right to deduct input tax in this way cannot be called a Value Added Tax.

This problem of VAT neutrality has already been identified by the Commission in its legislative proposal revising the special VAT scheme for travel agents in 2002. As a solution to the problem of VAT neutrality, the Commission proposed the introduction of the possibility for travel agents to opt out of the special scheme and apply the normal VAT rules.

ECTAA and GEBTA support the introduction of such flexibility; indeed, we believe it is essential if the benefits of the scheme are to be preserved but the competitive distortions and other problems avoided.

4.2. MICE supplies

The MICE sector is an important segment of the corporate business travel supplies and covers events of many descriptions: conferences, business meetings, incentives, product launches, conventions, training courses and team bonding exercises, amongst others. What they all have in common however is a business purpose.

Art 168 of 2006/112/EC establishes that a taxable person is entitled to deduct input tax in so far as the goods and services on which the VAT is incurred are used for the purposes of that taxable person's taxed transactions. We believe it is clear, in many circumstances, that a taxable person purchasing the services required for a business event of a type listed above would be entitled to deduct the VAT incurred on those services (unless they were purchased in the course of making exempt supplies). However, if that taxable person appoints a specialist organiser then input tax deduction will be denied if the organiser is required to adopt TOMS for the event. The organiser is unable to recover the VAT on costs of the event and must accordingly pass on a VAT inclusive cost to the client in such a way that the client cannot recover any VAT. A taxable person is thereby denied his entitlement to deduct VAT incurred on costs used for the purpose of his taxed transactions. We believe this contravenes one of the fundamental principles of the EU VAT system and it is essential that a solution is found.

The above problem has caused many organisers to adopt operating structures which they would not otherwise have done. Typically, organisers may agree with their clients to act as disclosed agent of their client in order to avoid the VAT disallowance inherent in the use of TOMS. It is regrettable that the VAT system forces taxable persons into such positions merely to safeguard a right which should not be in doubt. This is not tax avoidance but simply a way to remain competitive.

It is also clear that VAT can lead clients to seek to organise their own events as a means of avoiding the VAT cost which the appointment of a specialist organiser can bring. Such a move denies the client the opportunity of benefiting from the skills of such a specialist and may also mean that the protection of the Package Travel Directive is not available to the client.

This also creates real uncertainty for the organiser. Firstly, it is often far from clear whether TOMS applies to the organiser's own activities, and, if it does, to what extent. The analysis required to identify the values to be applied to the margin calculation and to the normal accounting regime are often complex. Secondly, there is normally a high level of uncertainty about the rules in other Member States. MICE is naturally an international operation with events being held throughout the world. Unfortunately, Member States' application of the VAT rules in this area is highly divergent and this makes planning for events extremely difficult.

We believe there are two ECoJ decisions which highlight the inappropriate approach adopted in many Member States to MICE and also the divergent approach. Firstly, under the current rules, MICE supplies should not be taxed under TOMS where the travel services form only a small part of the event and other services such as programme development, sourcing speakers and trainers, printing and web support, funding and sponsorship, audio-visual support, management of registrations, etc predominate. In such circumstances, the travel elements should be treated as incidental to the services falling outside TOMS and it is inappropriate to apply TOMS to any part of the services provided.

This is supported by the Madgett and Baldwin case (ECoJ C-308/96 and C-94/97), in which the ECoJ found that where traders buy in travel services, which only take up a small

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proportion of the package price, those bought-in services do not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied by the trader. The Court concluded that the bought-in travel services were a means of enjoying the principal service, and were therefore ancillary and did not fall under Article 26. This reasoning can also be applied to MICE services where the travel related services form only a small part of the whole price and only constitute a means of enjoying the principal service, which is the meeting, conference, incentive or other event.

Secondly, in the Maria-Kozak case (ECoJ C-557/11) the judge recalled that the essential aim of TOMS is simplification for travel agents who would otherwise have to register and account for VAT in all the EU countries where the underlying travel services are deemed to be supplied. As an exception to the normal regime applicable under the VAT Directive, the special scheme for travel agents must be applied only to the extent necessary to achieve its objective. Clearly where a supply such as event management would fall within the general place of supply rules, there is no reason to extend the simplification provided through the TOMS to the supply, merely on the grounds that it is a supply containing travel services. In these circumstances, the simplification of TOMS is not required; the general rule is a perfectly adequate and straightforward approach to the collection of VAT. Indeed, in these circumstances, TOMS is often an undue complication.

Thus, we consider that there are compelling reasons to exclude corporate MICE supplies from TOMS but this is not the approach adopted in many Member States.

5. Margin calculation

The second most problematic issue with TOMS is the ECoJ's conclusion that the global margin calculation is not allowed, on the basis that Article 1(2) of Directive 2006/112 specifies that VAT is to be chargeable on 'each transaction' and that article 73 defines the taxable amount in terms of an individual supply.

The calculation of the margin on a transactional basis is simply unworkable and, furthermore, undermines some of the basic principles of VAT.

Firstly, there are numerous practical difficulties in calculating individual margins for each sale. For example:

- the receipt of a year-end volume rebate would require adjustment of purchase values leading to a revised margin for the sales affected and hence an adjustment to output VAT. Re-working margins would be an administrative nightmare.
- what would happen where a service, say a hotel, has been block-booked? How could the total cost be allocated to individual sales?
- late invoices are common. How would a tour operator put a value on costs if the supplier has not invoiced?
- if a refund is given to a customer to reflect poor service, would this reduce the value and hence require a second TOMS calculation?
- where margin scheme and in-house supplies are made, the value of the margin is dependent in part on the in-house costs. Some of the in-house costs are often calculated on an annual basis (e.g. depreciation, insurance, property taxes) and how would such costs be allocated to individual sales when the full year's use of the assets on which such costs are incurred is not known?
- similarly, how would something like a coach leasing cost be treated? This may be part of the in-house cost and is likely to be an agreed amount due over a period. How can the proper value be identified at the time of sale if the total use of the coach over the period for which the leasing charge is payable is not known at the time of sale?

- and what about foreign currency transactions? What happens if a tour operator budgets for a cost at one foreign exchange rate but then incurs a different rate when the supplier is paid? The budgeted cost may be brought into the calculation if this had to be done at the time of the transaction, but would the margin then need to be adjusted later on to reflect the actual cost?

Secondly, calculating individual margins for each sale raises additional technical questions. For example, what happens if an operator makes a loss on a particular transaction? Could the operator off-set that negative margin against a positive margin? And if they could, then why require them to calculate an individual margin in the first place?

Thirdly, if a global margin calculation were not possible, it would also raise a number of questions on the applicability of other VAT rules, such as the following:

- VAT invoice to taxable persons: in the opinion of the Advocate General in the case brought against Spain (C-189/11), the Advocate General made the observation, that since there is no derogation in articles 306-2010 to the contrary, the normal invoicing and deduction rules apply and thus there should in fact be a requirement for travel agents to issue a tax invoice to taxable customers, so that the latter are able to deduct the VAT amount from their output tax. Issuing a VAT invoice to taxable customers would mean that the travel agent would have to disclose his margin. In no other industry do businesses have to reveal their margin.
- VAT chargeability: Similarly, in the absence of any derogation to the contrary, the VAT chargeability rules should also apply, which means that VAT is due when the service is supplied or if payments have been received. However, in the case of margin supplies, the taxable amount –the margin- can only be determined once the real costs have been determined, which is often only possible after the journey has been completed (see above). So the rules cannot be applied.

  In practice this could mean that a travel agent would have to estimate a margin and account for VAT on a first and possible second deposit payment by the customer; then he has to estimate the margin when he receives the balance from the customer; he then has to calculate and account for VAT when the holiday is complete and possibly go back again and adjust his VAT declarations if any additional late invoices changes the real margin. This is simply not workable.

ECTAA and GEBTA strongly feel that a transaction by transaction calculation of the margin VAT defeats the very essence of the margin taxation scheme which is to simplify the VAT obligations of travel agents. It should be seen as a simplified accounting system, which does not affect Member States' VAT revenue. It is not only a simplification for the travel agents who have to complete the calculations but also for the national fiscal administrations that have to check them.

Furthermore, we would even suggest that a transaction by transaction calculation further undermines some of the basic principles of the tax and further discriminates against travel agents / tour operators. Businesses subject to normal VAT rules are not required to calculate the nett amount of VAT due on each transaction. Instead they off-set all input tax incurred in a period against all output tax due and are not restricted to only claiming input tax incurred on profitable transactions.

ECTAA and GEBTA thus strongly insist that travel agents be given the possibility of calculating their margin globally for a period, similar to the provisions of a global margin provided for under Articles 311-343 on special arrangements for Second-Hand Goods, Works of Art, Collectors' Items and Antiques.

6. Distortions inherent in the current scheme

6.1. VAT rate

It is important to appreciate that the reduced rate of VAT and/or zero-rating applied by many Member States to many tourist related services cannot be applied to the margin earned by businesses that are subject to the scheme. The margin made by travel agents / tour operators on services enjoyed within the EU is always subject to standard rate VAT even if the services provided for the direct benefit of the traveller, and on which the margin is made, are eligible for the lower rate. This is an important distortion of competition and inevitably makes it difficult for those businesses that are subject to the scheme to compete with those that aren't.

This distortion exists most commonly in relation to services such as accommodation, passenger transport and cultural services (e.g. entrances to museums, theatres and similar). In each case, the margin made by a travel agent is subject to standard rate VAT whereas the supply by a competitor outside the scheme (and indeed a competitor located outside the EU) is often not subject to VAT at all and, when VAT is due, it is usually at a rate much lower than the standard rate.

There is no fiscal neutrality in this area. It is important that a way is found to end this distortion.

6.2. EU versus non-EU supplies

Another important distortion exists between taxable persons in the EU and those outside the EU. The current arrangements clearly favour those outside the EU. It is generally agreed that suppliers of travel services established outside the EU are not subject to EU VAT. Typically, such suppliers are not subject to their own country's VAT when selling travel services enjoyed outside that country. Accordingly, such non-EU suppliers can supply EU travel without the payment of VAT. In contrast, EU suppliers of the same services, both when supplied on a B2C or a B2B basis (see below), must pay VAT on their gross margin. This amounts to a levy collected on the turnover of EU taxable persons which is not payable by competitors elsewhere.

Demand for travel services is very price sensitive and the market is very competitive. Technological advances have made it easy for a business to compete in the EU tourism market no matter where it is established. It now makes little economic sense for a business selling travel and tourism services to be located in the EU. It dis-incentives businesses to establish themselves in Europe. We must end the anti-competitive arrangements which so disadvantage EU taxable persons.

There are a lot of European wholesale operators that bundle hotel and other property related services for European destinations specifically targeted at the group market of third countries, such as the US, Japan, China, etc. These European programs are often sold via travel agents in third countries and whereas the margins of EU-based operators will now attract irrecoverable VAT, non-EU based operators are outside the scope of EU VAT and are thus less expensive. In our opinion, EU operators will come under intense price pressure and will either close or relocate their business outside of the EU to escape EU VAT. Indeed, we are already seeing this effect since the Court's decision last year, with businesses closing or moving in anticipation of the impact of that decision. This is not only to the detriment of the operators, who are forced by tax considerations to change the way they operate their business, but also Member States who lose VAT and other tax revenue. There are also serious implications for employment.

Tourism from third countries is hugely important to the whole of the EU. We need a VAT system which does not tax the export of tourism services and which also encourages those who service the demand for inbound tourism to base their operations in the EU. The current

system, as interpreted last year by the Court, does neither. Indeed, it is an obstacle to both. It is imperative that these problems are tackled.

7. Global context

The distortions of competition identified in this paper should be seen in the wider context of increasing competition between travel agents and travel service providers. Whereas in the past service providers were relying on third party distributors, such as travel agents, to sell their services to the customer, service providers are now increasingly pushing sales through their own distribution channels, such as their own websites or call centres.

According to the Commission Communication “Bringing the EU Package Travel Rules into the Digital Age” only 23% of EU travellers now purchase traditional, prearranged packages. More and more travellers either buy different parts of their trips separately from travel service providers (54% of Europeans who took a holiday in 2011), or buy customised holidays which are put together by one or more commercially linked traders to suit their needs and preferences. “Linked” travel arrangements are arrangements consisting of two or more elements, bought from different traders and concluded through separate contracts, but linked through personal data such as contact information, credit card details, or other data. Such ‘combined travel arrangements’ now account for 23% of the holiday market (roughly 118 million trips every year) and this is set to increase. The linked or individually sold services often escape the scope of TOMS and are thus cheaper owing to:

i) the lower VAT rate applicable on certain tourism services (reduced VAT rates on restaurant services and holiday accommodation, zero-rating for international air transport, etc.); and

ii) the right to input VAT recovery for taxable persons.

As a result, it is often very difficult for those businesses that are subject to TOMS to compete fairly and fiscal neutrality is often breached. Indeed, whilst technology has no doubt been the main driver of these changes, it is also probable that VAT has played a big part too.

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