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VAT IN THE DIGITAL AGE: LEGAL AND ADMINISTRATIVE RESPONSES TO THE TAX GAP IN THE DIGITAL ECONOMY

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Abstract

The digitalization of the global economy has fundamentally disrupted traditional indirect tax frameworks, necessitating a paradigm shift from physical-presence-based taxation to destination-based consumption taxation. This thesis provides an exhaustive analysis of the legal and administrative evolution of Value Added Tax (VAT) systems, with a specific focus on the European Union (EU) and the Organisation for Economic Co-operation and Development (OECD). It critically assesses the transition from the 2021 VAT e-Commerce Package to the landmark adoption of the "VAT in the Digital Age" (ViDA) package in March 2025. Drawing upon the 2025 VAT Gap Report and 2024 revenue statistics, the research evaluates the efficacy of the One-Stop-Shop (OSS) mechanisms and the introduction of mandatory digital reporting requirements. Furthermore, it examines the jurisprudential implications of recent Court of Justice of the European Union (CJEU) decisions, notably Xyrality (2025) and Fenix International (2023), in defining the liability of digital platforms as "deemed suppliers." The paper argues that while administrative modernization—exemplified by the integration of AI, e-invoicing, and the DAC7/DAC8 transparency directives—has significantly enhanced revenue resilience and reduced fraud, it has simultaneously introduced profound compliance burdens

and friction with fundamental rights, particularly regarding data privacy and the proportionality of surveillance mechanisms.

Introduction

The advent of the digital economy has not merely influenced tax systems; it has fundamentally challenged the architectural premises upon which they were built. Traditional Value Added Tax (VAT) systems, conceptualized in the mid-20th century, were predicated on the physical movement of tangible goods and the clear identification of the location of the supplier and the consumer. In this analog era, the 'taxable person' was typically a brick-and-mortar entity, and the 'place of supply'— the crucial determinant of tax jurisdiction — was inextricably linked to physical infrastructure.

However, the rapid advance of digital technology has severed the link between physical presence and economic activity. We have entered an era of 'scale without mass', where multinational enterprises (MNEs) and micro-entrepreneurs alike can interact with a global customer base without establishing a physical footprint in the market jurisdiction. [1] This dematerialization of commerce affects every aspect of life and business, rendering the traditional proxies for value creation — such as warehouses, factories, and retail outlets — increasingly irrelevant for tax purposes.

Consequently, traditional VAT systems began to struggle significantly to keep pace with technological advancements. The rise of e-commerce, the explosion of digital services (streaming, cloud computing, software-as-a-service), and the emergence of the platform economy created structural fissures in the tax base. Two primary phenomena emerged: distinct competitive disadvantages for domestic businesses that could not escape VAT liability, and the proliferation of complex fraud schemes, most notably Missing Trader Intra-Community (MTIC)

fraud, which exploits the lack of real-time visibility into cross-border transactions.

The Policy Response

Recognizing the urgency of the situation, governments and international organizations such as the European Union (EU) and the Organization for Economic Cooperation and Development (OECD) have been at the forefront of efforts to adapt VAT systems to this new reality. The primary objective has been to shift the taxation right from the jurisdiction of origin (where the supplier is located) to the jurisdiction of destination (where the consumption occurs), thereby ensuring that VAT acts as a true tax on consumption rather than a tax on production.[2]

The OECD's Base Erosion and Profit Shifting (BEPS) Action Plan, while primarily focused on corporate income tax, laid the theoretical groundwork for this shift in indirect taxation. Action 1 of the BEPS project specifically addressed the tax challenges of the digital economy, recommending that non-resident suppliers be required to register and account for VAT in the jurisdiction of consumption. This was codified in the 2017 International VAT/GST Guidelines, which provided the template for global reform.

The European Union has operationalized these guidelines through a series of legislative waves. The first major wave, the 'VAT e-Commerce Package', came into full effect in July 2021, introducing the One-Stop-Shop (OSS) and Import One-Stop-Shop (IOSS) to simplify compliance for B2C cross-border trade. This was followed by the even more ambitious 'VAT in the Digital Age' (ViDA) package, which was proposed in 2022 and formally adopted by the Council of the European Union in March 2025.[3] ViDA represents a comprehensive overhaul of the VAT Directive, introducing mandatory electronic invoicing, real-time

digital reporting, and extending the 'deemed supplier' regime to the platform economy.

The VAT Gap Context

The backdrop to these reforms is the persistent 'VAT Gap' — the difference between the expected VAT revenue (VAT Total Tax Liability) and the amount actually collected. The 2025 VAT Gap Report, released in December 2025, revealed that the EU-wide VAT compliance gap stood at €128 billion in 2023, representing 9.5 per cent of the total liability [4]. While some Member States like Austria and Finland boast gaps as low as 1-3 per cent, others like Romania (30 per cent) and Malta (24.2 per cent) face massive revenue leakage.

This thesis aims to critically assess the legal and administrative developments in this area, with a reference to both their advantages and their risks. It will examine how the 2021 and 2025 reforms attempt to close the VAT gap through automation and the deputation of platforms, while simultaneously analyzing the new burdens these measures place on businesses and the potential infringement on data privacy rights.

The Theoretical Framework: VAT in a Borderless Economy

Historically, cross-border trade within the European Union was governed by complex rules that attempted to balance the taxing rights of the exporter and the importer. The 'transitional regime' established in 1993 exempted intra-Community supplies from VAT in the Member State of origin, operating on the assumption that VAT would be accounted for by the customer in the Member State of destination via the reverse charge mechanism.

While this facilitated the free movement of goods, it created a systemic vulnerability: the break in the fractional collection of VAT. In a domestic

transaction, the supplier charges VAT, and the customer (if a business) deducts it. In a cross-border transaction, the goods move VAT-free. This gap is the breeding ground for MTIC fraud (carousel fraud), where a fraudster imports goods VAT-free, sells them domestically with VAT, and then disappears without remitting the collected tax to the authorities. The digital economy exacerbated this by increasing the volume and speed of transactions, making post-audit detection nearly impossible.[5]

The OECD responded to the digitalization challenge by firmly establishing the **Destination Principle** as the international norm for services and intangibles. The 2017 International VAT/GST Guidelines dictate that for consumption tax purposes, internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.[6]

This theoretical shift serves two primary purposes:

1. Neutrality: By taxing at the destination, VAT becomes neutral regarding the location of the supplier. A digital service provider in Silicon Valley, a software developer in Estonia, and a local IT firm in France should all face the same VAT burden when selling to a French consumer. This prevents tax competition where businesses relocate to low-tax jurisdictions to gain a pricing advantage.

2. Certainty: It provides a clear rule for determining the place of supply in a world where the 'place of performance' is increasingly ambiguous (e.g., cloud computing servers distributed globally).

The OECD also introduced the concept of the 'Deemed Supplier' in its model rules for the sharing and gig economy. Recognizing the difficulty of collecting tax from millions of micro-sellers and gig workers, the OECD recommended that digital platforms (the intermediaries) be treated as the suppliers for VAT/GST purposes.[7] This recommendation has heavily influenced EU legislation,

shifting the compliance burden from the atomized underlying supplier to the centralized digital interface.

Legal Developments: The First Wave (The 2021 E-Commerce Package)

To operationalize the destination principle within the EU, the Council adopted the 'VAT e-Commerce Package', which entered into force on 1 July 2021. This package represented a radical simplification of compliance obligations and a decisive move against unfair competition from non-EU suppliers.

Prior to 2021, distance sellers of goods were required to register for VAT in every Member State where they exceeded a certain sales threshold. This created massive administrative burdens and compliance costs, estimated at €8,000 per Member State annually.[8]

The 2021 reform introduced the **One-Stop-Shop (OSS)**, extending the previous Mini One-Stop-Shop (MOSS). The OSS allows businesses to declare and pay VAT on all cross-border B2C supplies of services and intra-Community distance sales of goods through a single online portal in their Member State of identification. This mechanism creates a centralized clearinghouse system, where the home tax authority distributes the revenue to the destination states.

Besides, perhaps the most significant change was the abolition of the Low Value Consignment Relief (LVCR). Previously, goods imported into the EU valued at less than €22 were exempt from VAT. This exemption was widely abused; high-value goods were fraudulently undervalued to escape tax, and EU retailers faced a competitive disadvantage against non-EU sellers who could ship effectively VAT-free.[9] Furthermore, the 2021 package removed this exemption, making all commercial goods imported into the EU subject to VAT regardless of value and the **Import One-Stop-Shop (IOSS)** was introduced to prevent this from overwhelming customs authorities.

The success of the OSS and IOSS regimes can be quantitatively assessed using data from the European Commission's 2025 reports. The data confirms a steady increase in adoption and revenue collection, validating the administrative simplification hypothesis. In 2024 alone, over **€33 billion** in VAT was collected through these schemes. Specifically, the Import OSS (IOSS) saw a dramatic **62 per cent increase** in declared VAT in 2024 compared to the previous year, reaching €6.3 billion.[10] This suggests that non-EU sellers and marketplaces have largely integrated into the compliance regime, effectively closing the loophole that existed under the old LVCR rules.

Administrative Developments: VAT in the Digital Age (ViDA) - The 2025 Reform

While the 2021 reforms addressed the B2C sector, the B2B sector and the broader platform economy remained ripe for modernization. On 11 March 2025, the Council of the European Union formally adopted the **VAT in the Digital Age (ViDA)** package, which represents the most significant change to the EU VAT Directive since 1993. [11]

Pillar 1: Digital Reporting Requirements (DRR) and Mandatory E-Invoicing

The cornerstone of ViDA is the transition from 'post-audit' to 'real-time' data visibility. Currently, tax authorities rely on periodic VAT returns which are submitted weeks or months after transactions occur. This latency allows MTIC fraudsters to disappear before audits can detect discrepancies.

Under ViDA, electronic invoicing will become the default and mandatory system for all intra-Community B2B supplies starting **1 July 2030**.[12] Businesses must transmit data on each intra-Community supply to their national tax administration on a transaction-by-transaction basis (near real-time), which is then fed into a central EU database (**Central VIES II**), enabling automated cross-matching of

supplies and acquisitions. The Commission estimates this measure alone will reduce the VAT gap by **€11 billion annually**.[13]

Pillar 2: The Platform Economy and the 'Deemed Supplier' Expansion

The second pillar addresses the inequality between the traditional economy and the platform economy, particularly in the **Short-Term Rental (STR)** and **Passenger Transport** sectors. Currently, many providers on platforms like Airbnb or Uber operate below the VAT registration threshold, rendering their services VAT-free, whereas hotels and taxis must charge VAT. ViDA extends the 'deemed supplier' rule to these service sectors. Under this rule, the platform is legally treated as having received the service from the underlying provider and supplied it to the customer.

The 'Estonia Compromise': This pillar faced fierce opposition, particularly from Estonia, which argued it would disproportionately burden platforms. The deadlock was broken in late 2024 with a compromise:

- Voluntary Phase (July 2028): Member States may choose to apply the deemed supplier rule to these sectors starting 1 July 2028
- Mandatory Phase (January 2030): The rule becomes mandatory across the EU on 1 January 2030. [14]

Pillar 3: Single VAT Registration (SVR)

The third pillar aims to reduce the 'compliance footprint' of businesses. ViDA expands the OSS to cover the **transfer of own goods** cross-border. From **1 July 2028**, businesses will be able to report these transfers via the OSS return, eliminating the need for foreign VAT registrations for inventory movements (e.g., Amazon FBA models).[15]

Critical Assessment: Advantages and Risks

Revenue Resilience and Fraud Prevention

The legal and administrative developments introduced by the EU and OECD have several advantages and one of the key benefits of those is that it helps prevent VAT fraud, which is a significant concern in the digital economy. The implementation of incentives, such as online marketplaces and e-commerce platforms has made it easier for businesses to engage in fraudulent activities such as carousel fraud and missing trader fraud. Also, new anti-fraud rules introduced by the EU and OECD help address these issues by improving cross-border cooperation and information sharing between tax authorities. The EU's legal and administrative developments, such as the VAT e-Commerce Package and OSS mechanism, simplify cross-border VAT compliance for businesses operating within the EU territory. By providing a centralized platform for VAT reporting and payment, it is stated that the OSS reduces administrative burdens and compliance costs for businesses engaged in cross-border trade. [16] This form of VAT compliance encourages market integration, makes cross-border transactions easier, and promotes countries' economic growth in the digital economy. For example, in March 2021, the Council approved new regulations ('DAC7'), starting from 2023, tax authorities of member states will exchange information automatically concerning on the income earned by sellers using digital platforms, which aids in combating tax evasion and avoidance related to digital platform activities, promoting tax fairness, and creating an equal environment for both platforms and sellers. [17] Furthermore another advantage of these developments is the stabilization and recovery of VAT revenue. The structural shift towards the 'Intermediary Collection Model' (ICM)—whereby platforms act as 'unpaid tax collectors'—has proven highly effective in narrowing this gap. [18] The Commission's 2025 report on the e-commerce package reveals that **€33.1**

billion in VAT was collected via OSS and IOSS in 2024 alone, a 26 per cent increase year-on-year. Most notably, the Import OSS (IOSS) saw a **62 per cent surge** in revenue to €6.3 billion, validating the hypothesis that removing the Low Value Consignment Relief (LVCR) would capture significant revenue previously lost to undervaluation fraud. [19]

The Regressive Compliance Burden on SME and

While the macro-economic arguments are strong, the micro-economic impact on Small and Medium-sized Enterprises (SMEs) warrants critical scrutiny. The Commission argues that ViDA will generate **€51 billion** in compliance savings over a decade by removing reporting redundancies (e.g.,Intrastat).[20] However, scholars argue that these savings are aggregate and mask the **regressive nature** of the initial implementation costs.[21]

For an SME, the transition to structured e-invoicing (standard **EN 16931**) requires significant upfront investment in ERP systems and API integrations. Unlike large Multinational Enterprises (MNEs), which benefit from economies of scale and dedicated tax technology teams, SMEs often lack the digital maturity to adapt quickly. The cost of connecting to networks like **Peppol**, often required for secure transmission, can be disproportionately high for smaller turnover businesses.[22]

Furthermore, the "simplification" of the OSS does not remove the complexity of determining the correct tax rate. A small business selling across the EU must still navigate roughly **900 different VAT rates** (standard, reduced, super-reduced, and parking rates) across 27 Member States. Without an affordable, centralized, and guaranteed database of rates—which the EU currently lacks—the risk of unintentional non-compliance remains high.[23]

Conclusion

The evolution of the digital economy has necessitated a radical reconstruction of the VAT landscape. The journey from the 2021 E-Commerce Package to the 2025 adoption of ViDA represents a shift from a system based on **trust and post-audit** to one based on **data and real-time verification**.

The statistics from 2024 and 2025 — record revenues in OSS, a narrowing but persistent VAT gap, and the solidification of platform liability through CJEU jurisprudence — demonstrate that the 'Destination Principle' is successfully being operationalized. The EU has effectively deputized digital platforms as the new tax collectors, leveraging their technology to capture revenue that previously evaporated in the digital ether.

However, this efficiency comes at a cost. The administrative burden has shifted from the state to the private sector, and the 'panopticon' of real-time reporting raises serious fundamental rights concerns. As the EU moves toward the full implementation of ViDA in 2030, policymakers must ensure that the pursuit of tax efficiency does not erode the privacy rights and entrepreneurial freedom that the digital economy was meant to foster.

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