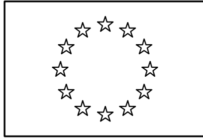

EUROPEAN COMMISSION

Brussels, 1.12.2010
SEC(2010) 1455 final

COMMISSION STAFF WORKING DOCUMENT

Accompanying document to the

GREEN PAPER

on the future of VAT

Towards a simpler, more robust and efficient VAT system

{COM(2010) 695 final}

COMMISSION STAFF WORKING DOCUMENT

Accompanying document to the

GREEN PAPER

on the future of VAT

Towards a simpler, more robust and efficient VAT system

INTRODUCTION

This Staff Working Document, which supplements the Green Paper on the future of VAT, consists of a series of individual topic papers which can be read separately, allowing stakeholders to go directly to those topics they have a particular interest in without having to read the whole document. The order of the topics follows the structure of the Green Paper.

The aim is to supply additional background information on a number of issues raised in the Green Paper, in order to provide food for thought. The aim is not to provide comprehensive guidance on all issues relevant to the topic or an exhaustive list of options; solutions other than those mentioned here are equally welcome.

Furthermore, the solutions given here should not be seen as Commission policy. They are merely illustrative of potential solutions that could be considered in a specific area of VAT.

CONTENTS

1. VAT treatment of cross-border transactions within the single market ... 4
2. Scope of VAT: The VAT treatment of the public sector ... 24
3. Exemptions from VAT and the specific problem of passenger transport ... 27
4. Deductions ... 38
5. International services ... 49
6. The legal process ... 52
7. Derogations and the ability to react quickly ... 59
8. VAT rates ... 64
9. The Commission action programme for reducing administrative burdens and streamlining VAT obligations ... 69
10. Small businesses ... 80
11. A one stop shop system ... 87
12. Adapting the VAT system to large and Pan-European businesses ... 92
13. Synergies with other legislation - Customs legislation ... 100
14. Reviewing the way VAT is collected ... 101
15. Protecting bona fide traders against potential involvement in VAT fraud ... 105
16. Efficient and modern administration of the VAT system ... 113

Topic 1.

1. VAT TREATMENT OF CROSS-BORDER TRANSACTIONS WITHIN THE SINGLE MARKET

1.1. History and references

When the First and Second VAT Directives were adopted in 1967[1], the Council made a legal and political commitment as part of the Treaty's objective to create the most efficient possible common market, within which there would be healthy competition, similar to a domestic market. It decided to establish a common system of value added tax which would not distort conditions of competition or hinder the free movement of goods or services within the common market. Accordingly, the taxation of imports and the non-taxation of exports in trade within what was then the European Economic Community were to be abolished. The Council reaffirmed its commitment when, in 1977, the Second VAT Directive was replaced by the Sixth VAT Directive[2].

The 'origin' system of VAT (first attempt)

That Council commitment underpinned the objective of designing a VAT system that was tailored to the internal market and operated within the EU, as it is now, in the same way as it would within a single country. The Commission made proposals for such a system in 1987[3] to complete the internal market by 1 January 1993 in keeping with the removal of formalities and fiscal controls at borders for intra-EU trade, but with goods circulating within the EU still being subject to VAT.

The proposals were based on the principle of 'taxation in the country of origin', i.e. at the place where the goods are when transport to another Member State begins or the sale is made. Their key features were a harmonised tax structure with two rates of VAT; harmonisation, within two defined bands, of the rates applied by Member States; and a clearing mechanism for redistributing VAT receipts to the Member State where consumption takes place on the basis of declarations made by taxable persons.

The transitional system

By 1989, despite the new approach proposed by the Commission, which included a transitional phase until the end of 1992, a minimum standard rate and a new clearing

---

[1] First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax.

[2] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment. Fifth recital.

[3] COM(87) 321, COM(87) 322 and COM(87) 324, 21.8.1987.

mechanism based on macroeconomic data[4], it had become clear that it would be impossible to adopt the Commission's proposals by 1 January 1993[5].

Beside the resistance to the close harmonisation of rates that they required and the potential national budgetary implications of the rates chosen by other Member States, certain Member States considered that the remaining rates differences would be excessive and could lead to distortions of competition and budgetary risks as regards sales to final consumers (in particular sales of cars and mail-orders) including institutional non-taxable persons and exempt taxable persons and also to the relocation of the sellers.

Some Member States also felt that the clearing-house mechanism would over-centralise administration of the system and that the redistribution system would not offer all the necessary guarantees as to fiscal controls and might therefore be a source of dispute and budgetary conflicts between Member States.

The Council therefore decided to adopt transitional arrangements proposed by the Commission[6] which would enable fiscal frontiers to be abolished whilst allowing tax to continue to be collected in the Member State of destination of the goods at the rate and under the conditions of that country. This involved a system of exemption for the supplier and taxation by the acquirer, taxable persons and non-taxable legal persons, with additional reporting obligations for both[7].

For sales to private individuals, the principle of taxation in the Member State of origin was accepted other than for distance sales exceeding a significant threshold and the sales of new means of transport. As a general rule, the place of taxation of services remained the place where the supplier was established or, for intangible services provided to a taxable person, where the latter was established.

At the same time, however, in Directive 91/680/EEC the Council reaffirmed the commitment made in 1967 and confirmed in 1977 of abolishing the imposition of tax on importation and the remission of tax on exportation in trade between Member States and acknowledged that such an objective required a definitive system for the taxation of that trade based on the principle of taxation in the Member State of origin of the goods or services, supplied with the tax revenue at the final consumption stage accruing to the Member State where that final consumption takes place. The Council set a new target date of 31 December 1996.

The origin system of VAT (second attempt)

Before making new proposals, the Commission carried out a thorough evaluation of the operation of the transitional arrangements[8] and polled the Member States on their

---

4 Completion of the internal market and approximation of indirect taxes, Communication from the Commission to the Council and the European Parliament, COM(89) 260, 14.6.1989.

5 Council Conclusion (Economic and Financial Affairs) of 9 October 1989.

6 COM(90) 182, as amended by COM(91) 157.

7 Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers.

8 Report by the Commission to the Council and the European Parliament on the operation of the transitional arrangements for charging VAT in intra-Community trade (COM(94) 515 final of 23 November 1994, unpublished).

views. It concluded that a different approach to that proposed in 1987 would be needed to achieve a VAT system tailored to the internal market. In 1996, the Commission put forward a gradual programme[9] which differed in two main respects from the 1987 proposals.

It proposed that taxation should be based on a trader's 'tax domicile', with his entire economic activity being taxed in one single Member State and redistribution based on official macroeconomic statistics to ensure that VAT receipts accrued to the Member State of consumption. It also envisaged a gradual changeover to the definitive system, the first stage being to modernise and more uniformly apply the existing system whilst introducing changes which would shape it into a definitive system.

However, it very soon became clear, as it had in 1987, that the degree of harmonisation required by this system, notably for the level and structure of rates, could not be achieved because of differing domestic arrangements in the Member States. Consequently, very little progress was made in the Council on the Commission's proposed 1996 programme even though it was accepted that the transitional arrangements had a number of shortcomings. They were complicated, susceptible to fraud and did not help achieve the objectives of an internal market.

The VAT Strategy (2000)

Therefore, in 2000, the Commission presented a communication setting out its strategic programme for improving the operation of the VAT system within the context of the single market[10]. The strategy set four main objectives — simplifying and modernising existing rules, applying them more uniformly and enhancing administrative cooperation — and a pragmatic programme of action for achieving them.

Its main objective was to give new momentum in the Council to concrete and essential improvements in the existing tax system in the short term, without, however, questioning the ultimate shift to the origin principle as a long-term EU goal. At the end of three years, the Commission reviewed progress, presenting new initiatives and highlighting a number of emerging guidelines for future action[11]. It also raised some questions about what kind of common VAT system was best suited to an internal market of, at that stage, 25 Member States.

Several of the Commission proposals made in that framework and related to intra-EU trade were adopted by the Council. These included abolishing the requirement that taxable persons established in the EU appoint a tax representative, if they are not established in the Member State where the tax is due; taxing electronically supplied services provided from non-EU countries to EU private individuals at their place of residence, linked to an online one stop shop for the non-established supplier's compliance obligations, and taxing supplies of electricity and natural gas to a taxable

---

9 A common system of VAT — a programme for the single market (COM(96) 328 final of 22 July 1996, unpublished).

10 COM(2000) 348.

11 COM(2003) 614.

dealer where he is established and the same supply to other customers where they actually use and consume the goods.

In the mean time, a new regulation[12] boosted administrative cooperation on cross-border transactions. Regrettably, no agreement was reached on other proposals to reduce the administrative burdens on intra-EU supplies, such as a single threshold for distance sales and the introduction of a generalised one stop shop for non-established taxable persons,[13] extending to B2C transactions, in particular distance sales, and to B2B supplies not subject to 'reverse charge'.

The VAT Package

These moves away from the principle of taxation at origin towards taxation in the Member State of destination (*i.e.* of establishment of the customer or of consumption, with either the administrative obligations fulfilled at a distance or increased use of reverse charge and more cooperation between tax authorities) were confirmed with the adoption in 2008 of the 'VAT package'.

From 1 January 2010, supplies of services to taxable persons and non-taxable legal persons identified for VAT purposes are in principle taxed in the Member State where the customer is established, with the reverse charge applying if the supplier is not established in the same State.

From 2015, the current rules for taxation in the Member State of residence of private individuals receiving electronic services supplied by non-EU-established businesses, and the corresponding online one stop shop, will be extended to telecommunications and radio and television broadcasting services and to the same services provided by EU businesses. Strengthened means of assistance between the Member States of consumption and of establishment are also provided for with the possibility for the former to require from the latter to hold an administrative enquiry or to obtain in any event minimum information.

VAT fraud

In the mean time, VAT fraud had grown as a result of the systemic weaknesses in the transitional system which allows cross-border VAT-free purchases of goods and services. This greatly preoccupied Member States and the Commission. In 2006, the Commission presented a Communication on the need to develop a coordinated strategy to improve the fight against fiscal fraud[14].

The debate which followed focused on the reinforcement of the existing VAT system but also on the possibility for introducing a general reverse charge system or for the taxation of intra-EU supplies. In 2008, the Commission presented a Communication[15] analysing these latter, more far-reaching options.

---

[12] Directives 2006/65/EC, 2002/38/EC, 2003/92/EC and Regulation (EC) No 1798/2003.

[13] COM(2004) 728.

[14] COM(2006) 254.

[15] COM(2008) 109.

It looked in particular at the possibility to replace the exemption of intra-EU supplies of goods by a system of taxation at a single rate of 15 %. Here, the Member State of arrival would either collect the additional VAT from the customer to reach the applicable rate or refund the VAT paid in excess. This would be combined with a redistribution mechanism between Member States based on monthly recapitulative statements. The Council did not however invite the Commission to proceed further with these concepts.

In absence of political agreement on the more 'far reaching measures', efforts were concentrated on the so-called conventional measures to enhance the traditional methods in the fight against VAT fraud. The Commission therefore presented a short term action plan[16] containing a range of measures.

All the legislative proposals announced therein have in the meantime been presented and all of them except for one have been adopted by the Council, notably the Commission's proposal for reducing the timeframes for submitting and transmitting recapitulative statements of supplies of goods and tightening the conditions for exemption on importation followed by an intra-EU supply[17]. The adoption of the recast of new Council Regulation on administrative cooperation and combating fraud in the field of VAT[18], providing notably the legal base for the setting up of Eurofisc, has completed this short term action plan.

1.2. Evaluation of the current VAT system for intra-EU transactions

1.2.1. Overview of the current rules on cross-border supplies of goods and services

The place of supply of goods is situated, and the transaction taxed at the rate and conditions of the relevant Member State, where the goods are located when the supply takes place and, in the case of transport, where the goods are located when transport to the customer begins.

However, firstly, the cross-border supply of goods to a taxable person or a non-taxable legal person is exempt whilst the acquisition of the goods is subject to taxation in the Member State where the transport ends, the VAT being paid by the customer[19]. The same rule applies to the supply of new means of transport, including those carried out by private individuals as sellers or purchasers and the transfer by a taxable person of goods forming part of his business assets to another Member State.

Secondly, the place of supply of goods to non-taxable persons[20] above a certain threshold or subject to excise duty or on option and transported by the supplier (distance sales) is situated where the transport ends, the VAT being paid by the

16 COM(2008) 807

17 Council Directive 2008/117/EC of 16 December 2008 amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions and Council Directive 2009/69/EC of 25 June 2009 amending Directive 2006/112/EC on the common system of value added tax as regards tax evasion linked to imports.

18 Council Regulation (EU) N° 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of VAT (recast).

19 Special and simplified rules apply to so-called 'triangular supplies'.

20 Or to taxable persons or non-taxable legal persons whose intra-EU acquisitions of goods are not subject to VAT.

supplier in the Member State concerned. The supply of electricity and natural gas to a taxable dealer is situated where he is established and the same supply to other persons where the customer actually uses and consumes the goods[21]. If the supplier is not established in the Member State in which the VAT is due, the customer identified for VAT purposes there is liable for payment of the tax (reverse charge).

The place of supply of services to a taxable person or a non-taxable legal person identified for VAT purposes is situated as a general rule in the Member State where the customer is established, whereas the same supply to a non-taxable person is situated where the supplier is established. In the former case, if the supplier is not established in the Member State where the VAT is due, the customer is liable for payment of the tax (reverse charge).

Specific rules apply to supplies connected to immovable and movable property, transport, vehicle hire or restaurants and catering[22]. Electronic services supplied by non-EU-established businesses to private individuals are situated in the Member State of their residence. The VAT declaration and payment are made in one Member State through an online one stop shop.

These rules and practical arrangements will be extended as from 2015 to electronic, telecommunications and radio and television broadcasting services provided by EU businesses to private individuals. Certain intangible services, such as those of consultants or banking, financial and insurance transactions provided to non-taxable persons established in non-EU countries, are situated outside the EU.

1.2.2. Positive aspects

The transitional arrangements, whatever their shortcomings, allowed the abolition of fiscal borders and the ending of checks at the EU's internal borders. These were clearly incompatible with the principle of free movement of goods and persons and the smooth functioning of the single market. That is obviously a major achievement.

Nevertheless, without any redistribution mechanism, VAT revenue directly accrues to the Member State of consumption according to its own rates and exemption rules in almost all cases. That avoids one major distortion of competition which could occur between businesses operating in the same local market based on their place of establishment or the origin of the goods or services.

Such rules allow Member States to enjoy a high degree of flexibility when setting the rates of VAT and the scope of exempt transactions. They can decide the fiscal pressure on households that they deem appropriate and sustainable, and the corresponding revenue needed, without undermining the competitiveness of their businesses.

---

[21] Special rules also apply to supplies of goods on board ships, aircraft and trains and supplies of goods installed and assembled by the supplier.

[22] And to the supply of services by intermediaries, cultural, artistic, sporting, scientific, educational, entertainment and similar services, ancillary transport services, and restaurant and catering services for consumption on board ships, aircraft or trains.

With the reverse charge mechanism and the taxation of intra-EU acquisitions of goods, persons liable for the payment of VAT on cross-border transactions to the Member States are mainly established on their own territory and thus under their direct supervision and primary responsibility in case of fraud, avoidance or insolvency. They therefore have a strong incentive to encourage compliance and perform fiscal controls.

This system of exemption or reverse charge applicable to intra-EU supplies also releases non-established suppliers from having to be registered and pay VAT in each Member State of taxation and thus from various administrative obligations.

The abolition of fiscal borders and the circulation of VAT-free goods led the Member States to strengthen the system of cooperation between tax authorities, first with the adoption in 1992 of a new Regulation supplementing Directive 77/799/EEC, then with the single new Regulation in 2003[23] which combined and improved the previous texts, and recently with the recast adopted in 2010.

1.2.3. Shortcomings of the current VAT system

1.2.3.1. Differences in treatment between domestic and intra-EU transactions may hamper the proper functioning of the single market

Under the principles of the free movement of persons, goods, services and capital, coupled with harmonised rules and de-regulation in key sectors, widespread progress has been made, notably in services, to make it easier for enterprises to do business within the European Union. In a VAT system perfectly adapted to the single market, there should be no distinction between supplies or purchases made by a business with a customer or supplier established in its Member State or in another Member State. Every difference in treatment is therefore to be considered a potential obstacle to the single market and implies that traders and consumers are not benefitting from the full advantages of a real single market.

Despite the adjustments made over the years to the VAT system, in particular the abolition of fiscal borders, a business willing to take full advantage of the single market has still to apply diverse VAT rules which often are not easy to handle. This may involve additional VAT obligations merely because a customer or a supplier is not established in his Member State. Additional obligations may also arise when, in establishing a branch, it crosses one of the European Union's internal borders. The transitional arrangements applicable to supplies of goods, and subsequent changes to improve taxation in the Member State of consumption of intra-EU transactions in services or to tackle fraud resulting from weaknesses in the transitional arrangements, have led to a complicated and heterogeneous system which puts high administrative burdens on businesses.

Equality between domestic and intra-EU transactions has almost been achieved for supplies made to private individuals where the supply of goods or services is taxed where the sale takes place or where the supplier is established. However, equality is

---

[23] Council Regulation (EEC) No 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation (VAT). Council Regulation (EC) No 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax and repealing Regulation (EEC) No 218/92.

valid only in so far as these supplies do not fall under one of the numerous specific rules (e.g. distance sales, new means of transport, certain services etc). Furthermore, suppliers need, in any event, to know the status of their customers beforehand. Sometimes, for services to taxable persons, even the purpose of a service is relevant.

Complexity of the rules

On the whole, the VAT system is now built on taxation at the presumed place of consumption instead of the place of establishment of the supplier or origin of the goods as initially foreseen. Therefore, for each transaction with a cross-border element (a non-established customer or supplier, the dispatch or location of goods or services elsewhere etc.), businesses are faced with complex rules for determining the place of supply and the person liable for VAT and identifying the reporting obligations and checks that follow from these decisions. This complexity leaves businesses unsure of their legal position.

The place of supply depends on many factors. These include the kind of transactions (services or goods) and their nature. For goods, their location at different points of the transaction, their dispatch, the person carrying out that dispatch, the status of the customer and the relevance for both parties of different thresholds or options may all be determining factors. For services, the status of the customer, their VAT identification number and their place of establishment (place of business, fixed establishment, domicile or residence) may play a role. In addition, businesses can face different national interpretations of 'place of supply' rules.

In principle, once the place of supply is determined, the supplier has then to calculate, declare and pay the tax. This may even be in a Member State where he is not established. However, in some cases, those obligations can be transferred to the customer either directly under the 'reverse charge' rules or, in two steps, by exempting the supply of goods and taxing intra-EU acquisition by the customer. Again, the transfer of liability and the exemption of the supply have to be assessed by the supplier and depend on many factors: in particular, for goods, the status of his customer and dispatch or transport; for services, their nature, the customer's tax status and VAT number and any intervention in the supply by a fixed establishment in the Member State where the tax is due.

Moreover, the Member State where the tax is due may have made use of the option referred to in Article 194 of the VAT Directive to apply the reverse charge to some supplies of goods or services carried out by non-established businesses, which are in principle not covered.

However complex, in many cases the rules allow businesses operating in the Member States where they are not established (or deemed so) to be released from any VAT obligations there. That might be thought to encourage such transactions compared to domestic ones in certain situations. Such an assumption is nevertheless questionable. Aside from the complexity of the rules and the specific obligations attached to them (see below), there are cash flow consequences for suppliers, who are paid immediately, and for purchasers with a right of deduction, who pay later. Moreover, the supplier cannot immediately subtract the VAT incurred in the Member State of taxation but has to submit a refund claim.

In any event, transferring liability for the VAT is not always possible, in particular where the customer is not a taxable person (or cannot be deemed a taxable person).

Special and additional obligations and risks

The general rules applicable to intra-EU transactions exempt or subject to reverse charge imply additional obligations for both the supplier and the customer. Those particular burdens on cross-border activities and sometimes the enforcement of those obligations by national tax authorities hinder businesses, especially SMEs, in developing trade within the European Union and can even deter a purchaser from buying goods or services from a seller in another Member State.

For each intra-EU supply, the supplier has to keep additional and specific records, e.g. of the validation of the customer's VAT identification number, evidence of his tax status and compliance, his address, and evidence of transport even where it has been arranged by the customer. Such details are needed not only to justify the VAT treatment of the transaction but also to avoid the supplier being subsequently held jointly and severally liable if the customer liable for the payment of VAT does not pay it. To hold the supplier jointly and severally liable, the tax administration must prove that he knew or should have known that the customer would not pay the VAT[24]. The question has even been put to the European Court of Justice whether that exemption can be denied for a supply has actually been made, if it can be determined that the vendor knew that he was participating in a transaction aimed at evading VAT[25] .

The inherent weakness of the transitional arrangements and the need for Member States to tackle the consequential risk of fraud has added new burdens to operators in a chain of transactions where an intra-EU supply is exempt or subject to reverse charge. The ECJ introduced a first link between the customer's right to deduct and the payment of VAT by the supplier, putting new responsibilities on customers[26]. If the tax administration can prove that the customer knew or should have known that he was participating in a transaction linked to VAT evasion, the tax administration can refuse the right to deduct to that taxable person.

With the 'knowledge test' and the consequential risk for a time (which could be several years) of being held indirectly liable for a fraud committed by somebody else, compliant businesses have to take 'every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud'[27]. The constant need to meet this requirement for each transaction could be very burdensome and carries no guarantee that it will satisfy the tax administrations or national courts.

The supplier must also complete a monthly (quarterly for small businesses and services) recapitulative statement of all intra-EU customers for exempt goods and

---

24 On the so-called 'knowledge test', see case C-384/03, Federation of Technological Industries and Others.

25 See the pending case C-285/09.

26 See case C-439/04, Axel Kittel.

27 See case C-439/04, Axel Kittel, para. 51.

services subject to the general intra-EU reverse charge. This must show their VAT identification numbers and the value of sales.

The customer has to calculate, declare and pay the VAT on the supply or the corresponding intra-EU acquisition of goods. He also needs to have obtained a VAT identification number, which may involve burdensome formalities.

Where, in the Member State where the tax is due, the supplier only makes supplies subject to reverse charge, he cannot subtract from the output VAT due the VAT he has incurred on this territory notably in order to carry out those transactions. He cannot simply put the corresponding amount on a VAT return. He has to submit a special claim and provide further information and evidence not usually required where the input VAT is directly subtracted.

According to a study made for DG Enterprise and Industry[28], the administrative costs of submitting intra-EU sales listings or refund claims in another Member State are high. For sales listing, these costs have been estimated at €706 million per year, increasing by €204 million with the introduction of a monthly listing. The administrative costs for 800 000 businesses submitting VAT refund claims in another Member State each year have been estimated at €705 million (€881 per business). This is, however, expected to be reduced by €447 million with the new refund Directive[29].

Distortions in the conditions of competition

In the First Council Directive, the Council indicated that establishing a common market within which there is no distortion of competition and where goods and services move freely as within a domestic market requires that Member States adopt in their legislation a model of turnover taxes such as will ensure that outcome and which is 'bound to result in neutrality'[30].

The system which has evolved aims at taxing supplies of services and goods in the Member State of consumption, extending to the more economically important cross-border purchases by private consumers (distance sales, cars etc.); one could thus suppose that the risk of distortion of competition is low. However, certain features of the VAT system put at risk just such an outcome within the single market.

- Threshold and options

The simplification measures for distance-selling arrangements could cause the same product purchased cross-border to be taxed under the rate of either the Member State of the seller or of the Member State of the customer. Whilst for e-services there will be no threshold or option, for e-commerce in goods, the rules applicable can depend

---

28 Communication from the Commission to the Council and the European Parliament, Action Programme for Reducing Administrative Burdens in the EU — Sectoral Reductions Plans and 2009 Actions (COM(2009) 544).

29 Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State.

30 Eighth recital in the preamble to the First Directive.

on the seller's turnover in the Member State of destination or a decision to make use of the option to tax his supplies there.

The VAT obligations (identification, returns, payment, additional checks) for intra-EU acquisitions above the minimum threshold of €10 000 made by fully exempted taxable persons (such as small businesses), and non-taxable legal persons (such as public bodies) could deter them from purchasing goods in other Member States, impeding full market access in particular for public procurement. This could be even worse for intra-EU acquisitions of services where no such threshold has been set for taxable persons.

- Right to deduct

When assessing whether businesses operate on a level playing field, one cannot ignore the costs that they incur. With the principle of neutrality, VAT should have no influence on business costs. However, in some Member States certain business expenses are excluded from the right to deduct, or pro rata or capital goods scheme calculations are applied differently. The system of taxation is now based on the application of the rules of the Member State of taxation whilst the deduction system depends on the Member State where the expense occurs. The supply will be taxed at the same rate whether the supplier is established in the Member State or not.

It can, however, happen that, because of the particular rules in the Member State where the trader is established, certain business expenses are excluded from the right to deduct. A trader in this position will be forced to reflect this non-deductible VAT in selling prices. He therefore suffers an appreciable competitive disadvantage when selling in other Member States which do not apply such a restriction or when selling in his own Member State in competition with suppliers established in Member States not applying that restriction.

1.2.3.2. Derogations and options have led to a complicated system and added unnecessary administrative burdens on businesses

The VAT system was designed to sustain the single market. Simplifying obligations on businesses, notably those operating in several Member States, has been a focus in so far as this is possible. However, in the interest of preserving Member States' fiscal sovereignty and to allow them appropriate flexibility, businesses, whether established there or not, have to comply with diverse legislation on VAT due to the numerous options and derogations available. Differences in interpretation, transposition and enforcement of the VAT Directive add to the diversity.

Traders therefore require knowledge of the differences in application in different Member States, particularly when operating through a branch or a subsidiary. This makes the VAT-related costs of doing business in the single market higher than in the domestic market. Businesses do not find this encourages them to expand their activities in other Member States or establish branches there.

1.2.3.3. Non-taxation of intra-EU transactions is a source of fraud

Since the transitional arrangements began, the Commission and Member States have become aware of fraud opportunities in the current system. Put simply, if a person

gives a VAT number to his supplier established in another Member State, and, for supplies of goods, provides proof that they have left the Member State of the supplier, he acquires the goods or services without paying the VAT to his supplier. An operator who acquires goods or services in this way and then does not pay VAT on their subsequent resale circumvents the self-policing feature of the VAT system, in which the right of deduction provides an effective incentive to declare the corresponding output sale. Any resulting fraud is rendered more lucrative because no input tax has been incurred on the cross border purchase. The current system is thus amenable to fraud and has a systemic weakness.

In 2009, the Commission published a study[31] which set out to quantify and analyse the VAT gap for each Member State, based on a comparison of national VAT receipts with a theoretical net VAT liability for the national economy as a whole. The VAT gap includes factors other than fraud such as legal avoidance and unpaid VAT from insolvencies. This means that the entire VAT gap is not due to fraud. The study estimates the gap at € 106.7 billion in 2006 within the EU-25 (excluding Cyprus). This represents an average of 12 % of the net theoretical liability, although several Member States are above 20 %.

The systems put in place in 1993 to manage such risks (EC listings initially for goods, then for services) are not very efficient in tackling certain types of fraud such as where the intra-EU acquirer promptly disappears. Some Member State therefore implemented a domestic reverse charge for certain high-value goods (cell-phones, computer chips) and certain services (CO2 emission allowances). The latest attempts to combat fraud, arising from the Commission's 2006 Communication on fraud strategy (reducing timeframes for submitting EC listings and boosting administrative cooperation) have yet to prove their efficiency and the systemic weaknesses of the transitional system persist.

With several Member States implementing derogations and imposing new reporting obligations on businesses, the underlying weaknesses have certainly led to less harmonisation, a greater administrative burden on businesses and additional costs for tax administrations, particular in control and administrative assistance. It could be argued that the costs (VAT losses plus additional burdens for both Member States and businesses) are too high compared to the actual benefits of applying an exemption or the reverse charge to intra-EU transactions.

Moreover, Member States and the Commission are regularly alerted to possible fresh fraud patterns in other services and goods. Fraudsters repeatedly use the same loopholes and the same schemes. Once tax administrations have plugged the gap by amending the rules, the fraudsters switch to other sectors or Member States. The continual refinement of the VAT system by means of further reverse charge schemes being introduced by Member States is not sustainable with the current adoption rules, and fire-fighting requests will be endless. Moreover, the reverse charge may result in further losses in particular for goods likely to be sold to final consumers and thus it requires additional reporting obligations and controls.

[31] Reckon LLP (London), 'Study to quantify and analyse the VAT gap in the EU-25 Member States', 21 September 2009.

1.2.3.4. Changes in technology and the economic environment have not all been taken into account

Since 1993 and even more since 1977, the way in which business is conducted on a daily basis has changed. Increasing use of new technologies, where costs have tumbled and speed exploded, is illustrated by the increase of e-commerce and by administrative practices such as computerised accounting. However, the VAT system, and particularly the reporting obligations of taxable persons operating in several Member States and the way in which the VAT is collected, has remained largely unchanged. The significant and appealing exception of the special scheme for e-services is rather limited in practice and is accessible only to a handful of non-EU-established businesses until 2015. One significant development is the new refund procedure allowing an online claim to be submitted through the web portal of the Member State of establishment, although this is experiencing teething problems.

The nature of business and the way it is organised have changed too. Whilst manufacturing remains important to trade in the EU, by 2007 services represented just over 70 % of gross value added in the European Union. Some consideration therefore needs to be given to how the VAT system adjusts to a service-driven economy. The special scheme for e-services could, again, be seen as a precursor.

The VAT treatment of services has, however,[32] recently been completely overhauled. The new system uses concepts and criteria different from those for goods, thus worsening the heterogeneity of VAT treatment of intra-EU supplies. For instance, small or completely exempt businesses are liable for VAT if they purchase services from a non-established provider, whatever their value, whereas they are accountable for acquisitions of goods only if they opt or reach a particular threshold.

Many businesses now operate in more than one Member State as a result of the deepening of the single market. The EU has also experienced a wave of international mergers and acquisitions. Large European companies now view the whole European Union as their 'home market' and accordingly seek, like non-EU international companies, to establish effective Pan-European business structures. This has resulted in an increase in the proportion of cross-border transactions carried out within the same group of companies and centralisation of business functions such as finance and accounting.

However, these groups have to deal with up to 27 different sets of rules notably regarding invoicing or reporting obligations, without the option of using any simplified rules for their intra-group cross-border transactions. These large European businesses have to compete with major international companies. In order to improve their competitiveness at international level, the cost of doing business in their own 'domestic' market needs to improve.

1.3. Possible alternatives to the current system

The purpose here is to address options for removing the differences in treatment between domestic and intra-EU transactions and to design a simpler and business-

[32] Directive 2008/8/EC.

friendly VAT system while allocating revenue to the Member State of consumption, reducing administrative burdens for businesses and limiting collection costs and the scope for fraud.

Several possible solutions are available both for goods and services. Academics have also proposed various alternatives: Viable Integrated VAT (VIVAT), Compensating VAT (C-VAT), Dual EU and local VAT (Dual VAT), a prepaid VAT system (PVAT), etc.

Some solutions have already been thoroughly discussed with the Council, mainly those based on the principle of origin. Others, less analysed, take account of the progressive shift toward a system based on taxation in the Member State of destination. The question remains, however, who should be liable for payment of the VAT where the supplier is not established in the Member State where the tax is due and, if the supplier is liable, how this Member State should collect that revenue.

Of course, all these options must not impede the free movement of goods in the sense that they do not give rise to controls or formalities at frontiers.

Some of those options are addressed here. They are as far as possible simply described. All have both advantages and disadvantages which will deserve an exhaustive and thorough examination. The purpose of this part is not to conclude such an assessment but to try already to point out their major advantages and disadvantages.

The options can be divided in two major groups according to the choice made on the place of taxation of the intra-EU supplies. This can be either the Member State of destination or the Member State of origin. Both concepts can however again be defined in different ways.

Within each group, different alternatives are available depending on the way VAT would be charged on the intra-EU transactions.

1.3.1. Place of taxation in the Member State of destination

In such a system, the rules applicable to B2C cross-border transactions would be maintained, although simplified obligations such as a wider one stop shop could be provided for. The amendment would essentially concern the place of taxation of B2B supplies of goods.

1.3.1.1. Place of taxation where the customer is established, both for goods and services

This would mean harmonising the rules applicable to goods and to services provided to businesses. In B2B transactions, the supplier often does not know the specific destination of the goods that he has sold because transport is organised by the customer and also because of commercial reasons. However, he always knows the identity, the location and the VAT identification number of the customer to whom he has transferred ownership of the goods.

As is the case for supplies of services, it could be stipulated, as a general rule, that the place of supply of goods to taxable persons is where the customer has established his business or has his fixed establishment to which the goods have been provided.

A follow-on supply with no additional dispatch would be either a domestic supply, if the goods have arrived in the Member State where the customer is established, or another intra-EU supply, if the goods were previously transported to another Member State or subject to a distance sale in the case of supply to a non-taxable person.

If the customer is established outside the EU, the place of supply would be where the goods are located when the supply takes places or transport or dispatch begins. However, the transaction would be exempt from VAT as exportation if the goods were dispatched to or transported outside the EU.

In the same way, if the customer is established in the EU but the goods are located outside the EU when the supply takes place or dispatch or transport begins, the place of supply would be outside the EU or where the goods enter the EU. The usual rules on importing goods would apply. If the goods were located in the EU and were then transported out of the EU, the transaction, although taking place in the Member State of establishment of the customer, would of course be exempt from VAT as exportation.

The place of supply would be no longer linked to the actual flow of the goods within the EU and would remain situated in the EU as long as the goods circulate within the EU's borders.

Such a system would build on existing concepts of establishment and identification and could thus be introduced without other major structural changes to the VAT system. Based on the identification number of the customer, it would be easier to manage, both for the tax administration and businesses. The concept of 'intra-Community acquisition of goods' or transfer of goods would no longer be needed.

This system would not require any approximation of tax rates, and so would give Member States a large leeway to set VAT rates as they see fit. The business locations of suppliers would not be influenced and exempt or institutional purchasers would pay the same amount of VAT whether or not their supplier was established in their Member State.

1.3.1.2. Place of taxation where the goods arrive

The flow of the goods would still be taken into account and the place of supply for intra-EU B2B supplies of goods would be the place where the transport or dispatch of the goods ends. Unlike the current system with the combination of two transactions, the supply of goods and intra-EU acquisition by the customer, such a rule could only be applied where the supplier knows the destination of the goods. This creates no particular difficulty where transport is organised by the supplier: the supplier would apply the rules currently applicable to distance sales, but without a threshold.

Where transport is organised by the customer, the supplier would have to rely on the information provided to him. One has to distinguish between two situations:

(1) the customer provides the relevant information, with an incentive to do so correctly, as this determines the place of taxation and the place where the

customer can claim the right of deduction; to ensure legal certainty for the supplier the information has to be recorded and confirmed by the customer;

(2) where the customer wants to keep the destination of the goods hidden from the supplier, e.g. for commercial reasons, it would be presumed that the transport has ended at the place of establishment of the purchaser (see above). If that place differs from the place of arrival of the goods, the customer would be required to declare a transfer of goods in the Member State of arrival.

Such a system would build on the existing concepts of current intra-EU distance sales (to private individuals) combined with the 'place of supply of services' rules, and could thus be introduced without other major structural changes to the VAT system. The Member States would remain free to set the level of taxation they deem appropriate.

However, the combination of both rules, depending on the person organising the transport and/or the willingness of the customer to indicate the place of destination, could complicate their application. Such a system would require another transaction for VAT purposes if the place of arrival was unknown to the supplier and differs from the place of establishment of the customer.

1.3.1.3. The taxation of intra-EU transactions in such systems

The taxation of intra-EU transaction would considerably reduce the potential impact of fraud linked to intra-EU supplies on Member States' treasuries by removing the profit for fraudsters and their accomplices in obtaining refunds of VAT on supplies on which VAT has been charged but not remitted to the Treasury or in charging a customer VAT on goods or services acquired free of VAT and then going missing without accounting for this VAT. It maintains the integrity of the VAT system, together with the fractionated payment mechanism and the existing flow of revenue.

Generally, B2B intra-EU supplies of services are already taxed under the reverse charge procedure with the customer, not the supplier, being responsible for the payment of the VAT. It could also be envisaged to extend that system, to all supplies of goods cross border. This creates consistency between all intra-EU B2B supplies.

With such a system, consistency between domestic and intra-EU transactions could be achieved by applying a reverse charge mechanism on domestic B2B transactions.

A wider one stop shop

Taxation of intra-EU transactions would mean, however, that the supplier would have to have a relationship with the Member State of arrival of the goods or of establishment of the customer for services or/and goods, in order to fulfil administrative obligations there. This would involve registration in that Member State. A simpler solution would be a one stop shop scheme where the Member State of establishment of the supplier acted as a proxy in relations with the Member State of taxation.

The taxable person making the intra-EU supply would fulfil identification and declaration obligations in the Member State of taxation through a one stop shop in his own Member State. The taxable person making the supply would charge VAT at

the appropriate rate of the Member State of taxation and make payments directly to that Member State through the one stop shop.

A supplier would have therefore to know the VAT rates and their coverage in the Member State of arrival, in particular the products and services covered by any reduced rate. This could be handled by appropriate computer software and a binding list of rates for all products and services would be made available by Member States (see topic 8). This could be facilitated by setting up a Pan-European database with all CN (customs nomenclature) codes and the corresponding VAT rates. It might also be advisable to provide rules by which Member States would link the use of reduced rates to specific CN codes.

Use of the one stop shop concept would minimise the burden on traders, who would only need to allocate the appropriate rate of tax to their supply. It would enable revenue on intra-EU sales to accrue directly to the Member State of consumption without using a clearing mechanism.

The EC-sales listing requirement could be abolished. The taxable purchaser would deduct input VAT in the normal way. However, for control purposes, because the person liable for VAT would be in another Member State, the taxable purchaser might have to include the intra-EU supplies in his VAT declarations with the VAT identification of the supplier, in order to allow the Member State of taxation to cross-check the input credit with the payment made through the one stop shop.

The right to deduct could perhaps be limited to purchases in the acquirer's declaration, which would include that information. This would make the link between the right to deduct and actual payment of the VAT by the supplier much stronger. The so-called 'knowledge test' could also be strengthened by reversing the burden of proof while giving the customer the option to pay the VAT charged by his supplier directly to the Treasury ('reverse payment' see topic 15) if there was any doubt about the supplier's compliance and he did not want to check up on it. In any event, Member States would use the options offered by mutual assistance (including recovery), particularly the new ones, for control and collection in the Member State of establishment of the supplier.

Enhanced administrative cooperation, e.g. the obligation to inform the Member State of consumption of control visits, that Member State's right to attend multilateral controls, financial incentives for control visits (e.g. retaining a percentage of any undeclared tax revenue) or compensation for the Member State of establishment, might also be considered.

Gradual changes towards a wider OSS and possible exclusions

In case a 'one-step' move to such a system would be considered too drastic, a gradual introduction could also be examined. It could be envisaged to extend the current reverse charge system applicable to intra-EU services, initially, to all intra-EU supplies between taxable persons (particularly supplies of goods) and to progressively include transactions in the one stop shop (on which VAT would have been charged by the supplier). One could start with specific goods and services that are susceptible to fraud (obviously not covered by domestic reverse charge derogations) or easy to follow (new means of transport traded between taxable

persons, for instance). In the mean time, B2C transactions such as distance sales could be rapidly included in the scope of the one stop shop already used for electronic, telecommunications and radio and television broadcasting services.

Another idea would be to make transactions between members of a group of businesses (parent/subsidiary) which account for a high proportion of intra-EU supplies subject to reverse charge or consider them non-taxable transactions (like transactions between branches), possibly subject to a system of authorisation. This would mean in practice that the territorial scope of the VAT group would be extended to branches and companies established in other Member States but within the EU. The ongoing work on the Common Consolidated Corporate Tax Base (CCCTB),[33] in particular the scope of consolidation, might be of particular relevance and should be taken into account (see topic 12).

The last step in such a development would be to merge the one stop shop firstly with the web portal for refund claims and secondly with national VAT declarations. That would allow businesses directly to subtract the VAT incurred in each Member State of taxation from the VAT due in that Member State, in the same way as in their Member State of establishment. For reasons of fiscal sovereignty, offsetting the net amounts due or to be refunded for each Member State could not be considered. Then a single, standard and EU-wide declaration through the one stop shop would cover all transactions and would be submitted with the corresponding payment in the Member State of the place of business, or main establishment if the taxable person did not have a place of business in the EU (see topic 11). Such a scheme could also be envisaged for businesses not established in the EU.

The application of the reverse charge to all B2B cross borders supplies

The current reverse charge system, applicable generally to B2B supplies of services would apply to all intra-EU supplies of goods between taxable persons. As at present, businesses selling goods in Member States where they are not established (or deemed so) would be released from any VAT obligations necessary under a OSS and they could preserve the advantages of the current system. Moreover, goods and services sold cross border could be treated equally.

However, current specific obligations and shortcomings (see above) would remain in particular for the supplier such as the recapitulative statements, the need to keep additional and specific records and the impossibility to subtract from the output VAT due the VAT incurred in the Member State where the tax is due. It would not resolve the endemic weakness in the current system (MTIC fraud) and the independence of two transactions, a supply followed by an intra-Community acquisition, would be lost requiring as for services a consistent application by all Member States of the place of supply rules.

The extension of the reverse charge to domestic B2B supplies

Consistency between domestic and intra-EU transactions could be achieved by also applying a reverse charge mechanism on domestic B2B transactions.

---

[33] See communications COM(2001) 582, COM(2003) 726 and COM(2007) 223.

This would deal with the endemic vulnerability to fraud of the current VAT system in B2B transactions following a cross border purchase exempt or subject to the reverse charge.

On the other hand, that would mean discarding the principle of 'fractioned payment', which is a major benefit of VAT: in such a system, the Treasury would collect all the VAT at the last stage. In particular all the tax due on the total final consumption would be paid by retailers which would be allowed to buy VAT free all their products. That risk could therefore require additional checks and reporting obligations for all domestic B2B transactions.

The Commission assessed such a system in 2008 and highlighted the potential shift in fraud to the retail sector[34].

The Commission concluded that the reverse charge concept should not be ruled out but that it could never be introduced on an optional basis without affecting the workings of the single market. The Commission was willing to consider a pilot project to test the introduction of a compulsory generalised reverse charge system.

1.3.2. Place of taxation in the Member State of 'origin'

1.3.2.1. Place of taxation in the Member State of origin of the goods and services

First proposed in 1987 to abolish fiscal borders in 1993, raised again in 2008 as a far-reaching measure to tackle intra-EU fraud, and ruled out twice by the Council, such a system provided that the place of supply of goods was deemed to be where the goods were located at the time when the supply took place or the dispatch or transport of the goods to the customer began, whereas the place of services remained situated where the supplier was established, with certain limited exceptions.

No exemption was applicable to supplies of goods transported in another Member State. All supplies were taxed according to the rules and in particular the rate of the Member State of origin with a reallocation of the revenues to the Member State of consumption (see below). In 2008, however, the Commission examined the possibility of a two-step approach with the taxation of intra-EU supplies of goods between taxable persons in the Member State of origin at a single rate of 15 %, the Member State of arrival either collecting from the customer the additional VAT in order to reach the rate applicable there or refunding the VAT paid in excess.

1.3.2.2. Place of establishment of the supplier of goods and services — single place of taxation

This system was proposed in the Commission's 1996 work programme. In such a system, all of a given supplier's transactions would be taxed in one place for the entire EU, with no distinction any longer according to the Member State in which they were carried out or to the flow of goods.

In 1996, it was proposed that that single place would be the 'tax domicile' of the taxable persons but that concept was open to discussion. It could be the firms'

[34] COM(2008) 109, 22.2.2008 and SEC(2008) 249, 22.2.2008.

registered office, or the place where it was actually managed, or other criteria could be used. One could also consider the place of establishment (place of business or/and fixed establishment) an appropriate place.

1.3.2.3. The requirements and the possible outcomes of the two systems

Both systems would require a high degree of harmonisation of the level and structure of rates and of exemption rules in order to avoid damaging the conditions of competition and causing businesses to relocate and because the revenue of each Member State of consumption would directly depend on rates and exemption rules set in the Member States of establishment of the suppliers or origin of the goods.

It would also require close cooperation and a high degree of mutual confidence between Member States because the effectiveness with which each Member State administers and controls the tax would directly affect the budget of other Member States. However, the taxation of intra-EU transactions would considerably reduce the potential impact of 'MTIC' and carousel frauds on Member States.

Such systems would also either end or significantly reduce the difference in treatment between domestic and intra-EU transactions and the additional obligations or complexity of the latter. They would greatly simplify and reduce administrative burdens for businesses, whether as buyers and sellers. The obligation to submit a recapitulative statement might, however, be kept to serve as a basis for the reallocation system (see below). The single place of taxation would, in addition, allow businesses to meet their obligations to declare and pay VAT and exercise the right to deduct in one place.

The direct allocation of VAT revenues to the Member State where consumption takes place and where the VAT is deducted when the customer is a taxable person would no longer be possible. Such systems would therefore need a clearing mechanism for the redistribution of VAT receipts to that Member State.

Clearing could be done on the basis of declarations made by taxable persons either in their VAT returns (as proposed in 1987) or in monthly sales listings similar to the current recapitulative statements (as envisaged in 2008). As proposed in 1989[35] and in 1996, one might also consider macro-economic reallocation of Member States' VAT revenue on the basis of either trade statistics or the consumption side of National Accounts.

[35] Completion of the internal market and approximation of indirect taxes — Communication from the Commission to the Council and to the European Parliament, COM(89) 260.

Topic 2.

2. SCOPE OF VAT: THE VAT TREATMENT OF THE PUBLIC SECTOR

2.1. Introduction

This topic only deals with the VAT treatment of public bodies, which is a long-standing issue within the EU.

The Commission is aware that determining the scope of VAT raises a number of other concerns, in particular how to treat the activities of holding companies and of charities. The fact that these issues are not dealt with here should not prevent stakeholders from contributing on them in the public debate (see questions 3 and 4 in the Green Paper).

2.2. The legal framework

For the purposes of the VAT Directive, a taxable person is any person who carries out economic activities, whatever the person's status — private or public.

However, Article 13 of the VAT Directive contains special rules for public legal entities where they engage in transactions as a public authority. Where this occurs, the public body will not be considered to be a taxable person for VAT purposes and the activities or transactions performed as a public authority are outside the scope of VAT law.

Nevertheless, where these out-of-scope activities could lead to 'significant distortions of competition' they are treated as taxable activities.

Additionally, there are two lists: a list of activities for which public bodies will be regarded as taxable persons (Annex I of the VAT Directive) and a list of public-interest exemptions (Articles 132 to 134).

Member States are also authorised to consider certain exempt activities engaged in by bodies governed by public law as activities in which those bodies engage as public authorities, thereby treating them as being outside the scope of VAT.

There is a large body of case law in this area, which is an indication of the complexity of the current rules.

2.3. Shortcomings

2.3.1. Neutrality

Problems of distortion of competition may occur because the same activity may be taxed if carried out by a private body but not taxed if carried out by a public body. As the status of the supplier determines whether the activity is taxable or non-taxable, this could give rise to distortions in a liberalised environment.

The exempt and non-taxable status of public bodies creates an incentive to self-supply inputs since in that way non-deductible VAT can be avoided. This results in a

bias towards in-house supplies of goods and services and the use of own employee labour. This bias can create inefficiencies in public sector production and delivery of services. Spending decisions are often based on VAT rather than on real economic factors.

As exempt or non-taxable status makes it impossible for operators to deduct the input VAT charged on their acquisitions of goods and services used for subsequent exempt or non-taxable transactions, it also creates a 'hidden VAT' which will be passed forward and will result in a higher cost if the public authority supplies goods and services to a taxable person who has a right to deduct input VAT.

Because VAT on investment by public bodies cannot be recovered, it is often argued that the present VAT regime works against the need to develop investment in public goods.

2.3.2. Lack of harmonisation

The Directive leaves wide discretion to Member States to define notions such as 'public body'. As a result, there is no EU approach to the activities that public bodies engage in as 'public authorities'.

2.3.3. Complexity

The current VAT regime for public bodies recognises three categories of activities. They can be taxed, they can be within the scope of VAT but exempt or they can be outside the scope of VAT. The problem is not restricted to determining the VAT status of the supply; it also makes determining the right of deduction of public bodies more complicated.

Exemptions in the public interest are also not very precisely defined. The extent to which an activity can be considered as 'closely linked' is, for example, difficult to determine. As a result, it is often difficult to determine the legal nature and the conditions under which an entity's activities might benefit from exemption.

Additional complexities are created by the different options available to the Member States: the option in Article 13(2) of the VAT Directive to regard exempt activities as out of scope, and the options in Article 133 to make the granting of certain exemptions listed in Article 132(1) to bodies other than those governed by public law dependent on additional conditions.

2.4. The way forward

A first initiative was launched by the Commission in 2003 with its proposal to remove the VAT exemption applicable to postal services. This proposal is still on the table at the Council.

Beyond that proposal, the Commission has recently initiated an in-depth study of the current provisions on public bodies and exemptions in the public interest.

This study will look at the problems created by the present EU and national rules on the application of VAT to the public sector.

The study will go beyond a description of the problems and will also look how economically important the differential VAT treatment is. Based on an assessment of the economic importance of the differences, the study will look at what options exist to reduce VAT distortions and present the pros and cons with a view to achieving a level playing field for VAT.

Wide-ranging options like extending the regular VAT system to all the activities of public institutions will not be disregarded in the study. A ‘full taxation’ model of this type, along the lines of what is currently in force in countries such as New Zealand or Australia, has major advantages in terms of tax neutrality. However, it also raises a number of issues, such as how to arrive at a definition of many public services. If such a model were chosen, the question would also arise as to which VAT rate (reduced or even super reduced rate) should be applied to these supplies in order to mitigate the impact of VAT on the final consumer.

More limited reforms could also be envisaged such as an option to tax for public bodies, along the lines of what has been proposed by the Commission for financial services. Modernisation of the current exemptions and clarification of the rules laid down in Article 13 could also be envisaged.

A third avenue could also be to rely on Member States’ present capacity to implement national refund schemes outside the VAT system. This solution, which is also used elsewhere in the world (Canada for example) gives a lot of flexibility to Member States.

The study is being carried out by Copenhagen Economics and is due to be finalised by early 2011. Once it is finalised, the Commission will launch a public consultation and call on all stakeholders to contribute.

Topic 3.

3. EXEMPTIONS FROM VAT AND THE SPECIFIC PROBLEM OF PASSENGER TRANSPORT

This topic covers two issues. The first is exemptions from VAT in general.

The second is the specific problem of VAT on passenger transport. VAT exemption is, however, only part of the issues to be examined; the place of taxation is another factor to be looked at when dealing with VAT on passenger transport.

EXEMPTIONS FROM VAT

3.1. History and references

If VAT were indeed the neutral tax on consumption that it is supposed to be, exemptions would not exist. They run counter to the logic of VAT but their existence is nevertheless of great practical importance

The rationale for the application of exemptions has traditionally been twofold. One is that they sustain distributional and social objectives and compensate for the perceived regressive nature of VAT. Linked to that may have been some desire expressed in these '*Exemptions for certain activities in the public interest'* to promote the consumption of certain goods or services which were considered as having beneficial qualities and where VAT exemption was seen as having a beneficial effect on prices for the final consumer. To a great extent, these exemptions reflect the established practices in Member States before the Sixth Directive came into existence. Probably there was also a perception that many of these exemptions related to 'public goods' which could not be exchanged in a market or consumed individually and consequently should be left outside the scope of VAT. It is noteworthy, even if it does not make any contribution to the overall coherence of the list, that these exemptions extend to 'certain' but not all activities in the public interest.

The other rationale is the 'difficult to tax' argument which sustains the exemptions for gambling, financial and insurance services and many transactions involving immovable property.

In addition, Article 371 of the VAT Directive allows some Member States to continue to exempt certain transactions (listed in Annex X, Part B). Articles 375 to 390b extend this facility to other Member States. The reason here is that complete agreement on a common list of exemptions could not be reached at the time the Sixth Directive was adopted and it was therefore limited to measures already in force. Seemingly this arrangement was envisaged as transitional but now seems to have acquired an indefinite life.

Taken together, these exempt goods and services constitute a considerable part of the potential tax base. Even disregarding the numerous technical difficulties which exemption gives rise to, the degradation of the tax base alone raises serious questions, not only in the light of the supposedly neutral nature of the tax, but also in

the context of the current economic downturn. The OECD has drawn attention to methodologies for comparing the efficiency of VAT systems[36]

The ECJ has on many occasions pointed to the need for strict interpretation of exemptions since they are exceptions to the general rule that all supplies of goods or services are subject to VAT. Strict is, however, not a synonym of narrow and the Court has increasingly taken the position that the requirement to interpret them strictly must not have the effect of construing the terms used to specify VAT exceptions in such a manner as to deprive the exemptions of their intended effect. This brings a certain tension to understanding the scope of the exemptions set out in the Directive. In so far as it produces uncertainty, would it not be preferable to resolve this by reforming the legislation on clear policy grounds rather than leaving it in the hands of the Court?

Maurice Lauré is usually seen as the father of VAT. Writing long before the current crises, he suggested that in considering the negative impact of exemptions in the VAT system, the European VAT system should be interpreted in the light of the coherent economic principles on which a VAT system should be based[37]. The first step in this process would be to develop a clear idea of the financial consequences of the VAT exemptions, something which has never really been undertaken since the first steps were taken to set up the common VAT system. A critical re-examination along these lines seems long overdue.

3.2. Evaluation of the current legislation

3.2.1. Exemptions and tax revenue

Even if exemptions remove a considerable part of the tax base, Member States are to some extent compensated by the associated restriction on deduction. It is not easy to observe and measure this but the figures are probably significant even if they fall short of what would be expected under taxation[38]. The effect on revenue probably also depends on where in the chain of supply the break in taxation occurs.

In any critical review of exemptions generally, this revenue would probably act as a force for inertia. It is nevertheless a factor in any debate but without reliable data on this and the corresponding figures for revenue foregone because of the exemption, it will not be easy to arrive at an objective assessment.

The non-recoverable VAT accrues to the Member State of the place where services or goods are supplied. For most exempt activities this will probably be the Member State of the exempt activity itself.

Where, however, the exempt service is supplied to a recipient in another Member State, the place of supply will generally be where the recipient is established. This

---

[36] *Consumption Tax Trends* OECD Paris, annual publication.

[37] *Les Impôts Gaspilleurs*, Lauré, Babeau et Louit, Presses Universitaires de France — PUF (17 octobre 2001). More colourfully, he also described exemptions as ‘the cancer of the VAT system’.

[38] Member States do not generally release this information but Jon Cannon, head of the UK Revenue and Customs partial exemption said last year at a seminar in Oxford University that exemptions contribute about 15 % of VAT yield.

will be the case whether this recipient is a taxable person or not. As a result, the link between the place where the inputs are taxed and the place where the resulting output is supplied (and consumed) is broken.

For many of the exempt services, this will not be a source of concern as they are unlikely to be supplied across borders or traded between Member States. Some financial and insurance services are, however, widely traded internationally and this pattern can be expected to grow with the deepening of Pan-European markets for these services. The outcome here is that those Member States who are net exporters of financial and insurance services are disproportionate beneficiaries of non-recoverable tax revenue whilst other Member States who are net recipients of these services contend with what is in effect a drain on their receipts. Deepening the Pan-European market will accentuate this unevenness in the accrual of tax receipts.

The question arises whether the wide *de facto* freedom given to Member States to manage and set recovery levels (in effect, the level of taxation) and at the same time to retain this tax even when all the consumers of the exempt services are established in other Member States is not a potential source of mischief.

3.3. Shortcomings of the current system

3.3.1. Distortions of economic decisions

VAT exemptions encourage internalisation (the performance of services by the taxable person's own personnel), even if external suppliers could offer higher quality at lower VAT-exclusive prices. Thus, exemptions and out of scope activities discourage outsourcing of activities which could more efficiently be performed by specialised providers. This bias creates inefficiencies in the production and delivery of goods and services. Entities carrying out exempt activities therefore often base spending decisions on the VAT effect rather than on real business or other economic factors.

Exempt status makes it impossible for the operators concerned to deduct the input VAT charged on their acquisitions of goods and services used for subsequent exempt supplies. It thereby creates a 'hidden VAT' which will be passed on and will result in a higher cost when these exempt supplies are made to a taxable person with a right to deduct input VAT.

Because VAT on investment by entities that perform exempt activities cannot be recovered, it is often argued that the present VAT regime is a disincentive to investment.

The result is that organisational forms are at least to some extent driven by other than purely economic considerations and to that extent the outcome is sometimes undesirable and distorted. For the most part, the activities exempted in the 1970s were not capital intensive and were limited in their distribution to the national territories of Member States — this is far from being the case today.

3.3.2. *Time to re-assess the exemptions and out–of-scope status of supplies made by public bodies and others*

It would not be unreasonable therefore to cast a critical eye on the existing exemptions and ask whether they are still justified.

As long ago as 2003 the Commission put forward a proposal to remove the current exemption for the public postal services. However, the Council has still not been able to reach a consensus.

As far as 'difficult to tax' services are concerned, their continued exemption should depend on the answer to two interconnected questions. Firstly, what were the original technical, legal and economic justifications for them? This need to be investigated. Secondly, depending on the answer to that question, can an alternative and more efficient VAT treatment for these services be found?

For immovable property, the existing legislation has produced a complex mix of taxation, exemption and optional taxation. It could be argued that as there are internal market considerations at stake here, a pragmatic approach would leave things unchanged. This ignores the reality that exempting supplies to taxable persons is inefficient and jeopardises the functioning of the VAT system. Whereas certain aspects of this exemption can be justified on economic and social grounds, it is not so easy to find similar justification for the inclusion of transactions involving hotel premises or premises for industrial or commercial purposes. One approach to rationalising the existing exemption might be to limit its scope to three restricted categories:

(a) the letting of houses to private individuals;

(b) supplies of buildings that are not new and where the supplier has not recovered input VAT on the building's acquisition; and

(c) supplies of land other than building land.

This indeed was what the Commission originally envisaged in its preparatory work on the Sixth VAT Directive. Perhaps it is now time to reconsider this more streamlined approach in the interests of the efficiency of the VAT system?

Looking beyond the outcome of the current debate in the Council on the exemption for financial services and insurance, the question of full taxation cannot be avoided. The well-known technical issues here are beyond the scope of this note and, although complexity has to be acknowledged, it is increasingly accepted that they can be overcome. The non-recoverable VAT has become a significant source of revenue, particularly for those Member States with established financial service centres who have become significant exporters of these services, but this revenue does not always accrue where the services are consumed. Apart from correcting this misallocation of tax, it is clear that many of the current technical and legal VAT difficulties around exemption would simply disappear. The potential for tax competition and other drawbacks associated with input tax recovery would be resolved. New developments such as Sharia banking, which do not sit easily within the current exemption, would not be a VAT problem if all financial transactions were taxed. The technical

difficulties here cannot be minimised but in any discussions on VAT strategy for the next 10 years, it is impossible not to raise the point of ending these particular exemptions.

As far as gambling is concerned, the Directive provides that it is exempt, subject to the conditions and limitations laid down by each Member State. A margin of discretion is thus conferred in regard to the exemption and it can in some cases extend only to a limited number of forms of gambling (typically lotteries and betting), even if they account for only a minor part of all gambling carried on in the territory of a Member States.

The evidence, based on the actual practice in several Member States, would seem to point to a conclusion that the 'difficult to tax' argument holds no water and the retention of a general exemption must now be called into question. A critical examination should look at any residual reasons for keeping it. This should obviously address the issues raised by the increasing market for online services, which is often supplied by service providers established in locations other than the Member State where the customer is established.

3.4. The way forward

The primary aim of the Sixth Directive was to establish a uniform basis for collection of the EU's own resources. This implied uniform rules on exemptions and deduction. The optimal solution from a VAT perspective would be to end most of the exemptions but, if this is not immediately achievable, a starting point would be to look at a more harmonised approach.

The study that is currently being carried out by Copenhagen Economics (see topic 2) also covers exemptions in the public interest. It will provide a useful input for the review of these exemptions.

The review should also include the derogations covered by Annex X which were never really to be seen as permanent fixtures in the Directive. Consideration should therefore be given to whether they are still justified.

VAT ON PASSENGER TRANSPORT

3.5. The current legal framework

Transport services, like any other service supplied by a taxable person within the EU, are subject to VAT. Transport may be domestic (departing from and arriving in the same country) or international (departing from and arriving in different countries). International transport covers transport going from one Member State to another as well as transport going to (outward) or coming from (inward) outside the EU.

Where VAT is applied, the supply of passenger transport is taxed pursuant to where the transport effectively takes place, proportionate to the distances covered (Article 48 of the VAT Directive) and may be subject to a reduced rate of a minimum of 5 % by the Member States as provided for in point (5) of Annex III.

The VAT Directive nevertheless leaves scope for passenger transport to continue to be exempted through derogations accorded to Member States. It reflects the

exemptions already in place in Member States before 1 January 1978 or accepted upon the accession of new Member States. Those exemptions are to be found in Articles 371 to 390 and, from 1 January 2011, Articles 390a and 390b.

In addition, exemptions related to international transport, allowing certain passenger transport providers to purchase some goods and services free of VAT, have been in force since the introduction of VAT for international sea and air transport.

This means that the VAT treatment of passenger transport combines different exemptions, depending on the kind of means of transport used to provide the transport and the place where the transport is deemed to take place:

– Exemption of passenger transport provided by transport providers to their customers, subject to certain conditions (output exemption);

– Exemption of some supplies to transport providers, subject to certain conditions (input exemption).

3.6. Historical overview

Under the definitive arrangements, according to Article 393(2) of the VAT Directive, passenger transport is supposed to be taxed in the Member State of departure for that part of the journey taking place within the EU. In 1992, the Commission therefore proposed to tax passenger transport at the place of departure[39], but the Council could not reach an agreement on the proposed amendment. One of the main issues standing in the way of an agreement was the patchwork of exemptions in force in the different Member States.

A study[40] was carried out for the Commission in 1997 and confirmed the differences in treatment between Member States and also between the different means of transport. Given the absence of political will among Member States to change that situation, the Commission took no new initiative in this field.

In July 2000, the Commission stated its intention to put forward a number of new proposals and to review existing proposals in the VAT area[41]. The rules on the place of supply of services were identified as one of the potential future priorities.

In its consultation paper[42] the Commission again suggested taxing the supply of passenger transport services taking place in the EU, irrespective of the means of transport used, at the place of departure. For domestic transport, this rule would not change the situation while, for international transport, it would ensure that to a large extent passenger transport services could be taxed where they are actually consumed, without the complication of having to split up the price according to the distances covered in each Member State.

---

39 COM(92) 416-rev2 as amended by COM(94) 378.

40 KPMG. 1997. A study of the VAT Regime and Competition in the Field of Passenger Transport, http://ec.europa.eu/taxation_customs/resources/documents/pass_tran_kpmg_final.pdf.

41 COM(2000) 348 Final, 7 July 2000 'A strategy to improve the operation of the VAT system within the context of the internal market'.

42 Commission Consultation Paper: VAT — The Place of Supply of Services to Non-Taxable Persons http://ec.europa.eu/taxation_customs/resources/documents/vat_place_of_supply_en.pdf.

Summarising the results of this public consultation[43], the Commission noted, however, that although '*some businesses supported this idea, there was also serious opposition mainly from airline companies fearing that the new rules could encourage Member State to abolish the current exemption'*, and that most businesses found that '*the real issue is that of the different rates and exemptions applied by Member States and the inequity in VAT treatment between air, sea and road/train transport'*.

Against this background, it was decided not to propose to change the rules concerning the place of taxation of passenger transport[44] The Council agreed with this approach when adopting the new rules concerning the place of supply of services.

Recently, the issue of the VAT taxation of passenger transport has again come into the picture, given the broad reflection launched in the context of the fight against climate change.

3.7. Evaluation of the current legislation or policy

The VAT treatment of passenger transport differs from one Member State to another[45].

Domestic passenger transport is taxed in almost all Member States, whatever means of transport are used. Denmark, Ireland and Malta, however, exempt domestic passenger transport, except some transport by road. International passenger transport, on the other hand, is in most cases exempted by Member States. Whilst international sea and air transport services are exempt of VAT in the whole of the EU-27, VAT is paid, subject to varying conditions, on international passenger transport within the EU on inland waterways, rail and road transport in nine Member States.

Where international passenger transport is taxed, it is often difficult for Member States to effectively ensure the actual taxation when transport starting and ending outside their territory is supplied by a transport provider not established in that Member State.

Specific exemptions for international transport are provided for in Articles 148 to 150 of the VAT Directive. These exemptions, which are applicable throughout the EU, apply to the input of certain businesses which provide international passenger transport by air or by sea, allowing them to purchase, free of VAT, vessels and aircraft as well as goods for fuelling and provisioning these means of transport and services to meet their direct need or that of their cargo. The application of these exemptions varies across the EU, given that Member States may limit their scope and adopt the detailed rules for their implementation.

These input exemptions are intrinsically reserved for international air and sea transport at the exclusion of other means of transport, like trains or busses. They

---

43 http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/rep_vat_ place_of_supply_en.pdf.

44 See the explanatory memorandum for the proposal COM(2005) 334 final (point 2.2.).

45 A description of the current situation can be found at: http://ec.europa.eu/taxation_customs/ resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf.

provide a cash-flow advantage for certain parts of the transport sector, with businesses benefiting from exemption not having to pre-finance the VAT before being able to exercise their right of deduction. Given the importance of the amount involved, this advantage is far from negligible.

It means that the current situation with a number of exemptions applied quite broadly in the sector of passenger transport raises the question of the neutrality of the applicable VAT treatment and its sustainability in the long term.

3.7.1. Positive aspects

3.7.1.1. Promoting certain sectors of passenger transport

The VAT exemption applied to international air and sea transport gives providers of this kind of transport within the EU a competitive advantage over other transport providers who have to charge VAT. Firstly, the exemption of passenger transport leads to lower operating costs for providers of international air and sea transport within the EU. Secondly, it facilitates such transport operations and reduces the administrative burden of alternative procedures for the VAT refund in situations where VAT is charged. Thirdly, numerous exemptions for the supply of goods and services for such operators lead to significant cash-flow advantages, which permit the operators to invest, for instance, in new means of transport.

3.7.1.2. Competitive prices for passenger transport for final consumers

The VAT exemption applied to certain sectors of passenger transport allows certain operators to lower their costs, which can lead to lower prices for passenger transport and a more competitive pricing policy.

3.7.2. Shortcomings

3.7.2.1. Economic distortions

The difference in treatment between different means of transport may influence the traveller's decision on the journey to be taken. The exemption for international air and sea transport gives providers of this kind of transport a competitive advantage over other transport providers who have to charge VAT. With the development of international bus and train transport, in particular high speed trains, similar rules should be applied to transport within the EU irrespective of the means of transport involved.

3.7.2.2. Lack of harmonisation

While taxation of passenger transport is envisaged, Member States may continue to exempt such services by means of derogations. The potential combination of taxation and exemption increases the administrative burden on businesses, which first have to assess whether they need to charge VAT on the services supplied and, if so, must meet their obligations in each of the Member States on the territory of which they provide passenger transport services.

3.7.2.3. Complexity

Taxing international passenger transport services in proportion to the distances covered makes collection of the tax both difficult and impractical.

In an internal market without fiscal frontiers it implies that, for example, a coach company transporting tourists from Paris to Amsterdam needs to apply French, Belgian and Dutch VAT to each relevant part of the journey and pay the corresponding amount of VAT to the tax authority of each Member State concerned. For operators, this may be difficult to apply and is quite burdensome. The consideration paid by the customer needs to be split between the Member States crossed during the transport to allow for VAT to be paid in each Member State, unless some of them have decided to exempt the service.

There is a genuine risk that VAT is not accounted for, in particular where the transport is only crossing a Member State in which the operator is not established, not departing from or arriving there.

3.8. A possible way forward

Experience has shown that unless the place of taxation, the rates and the exemptions are addressed as a whole, little progress is likely. A piecemeal approach that would not ensure equal treatment of the different types of passenger transport, or of the operators providing it, offers no satisfactory solution.

3.8.1. Full taxation of passenger transport

Transport that takes place on the territory of a Member State, is consumed in the EU. This applies to both domestic and international passenger transport. It would therefore be consistent with VAT being a broadly based tax on consumption to move to full taxation. Where services are not provided in the public interest, there are no economic, social or other reasons to justify an exemption.

Putting an end to exemptions that are applicable to international passenger transport by air or sea only would ensure a level playing field. There would also be a synergy with other EU policies, notably the fight against climate change, where the transport sector is identified as an important source of CO_2 emissions.

It is difficult to imagine a review of the exemptions without also looking at the rules governing the place of taxation of transport services and the rates that may be applied. To identify solutions that are not only workable but also acceptable may be a challenge.

In taxing passenger transport, only transport linked to the EU territory should be targeted. Other than taxing passenger transport according to the distances covered, as envisaged under the current rules, alternatives such as the place of departure, the place of arrival, the place of the supplier or the place of the customer, separately or in combination, could be considered. It may also be that other alternatives could be identified.

The method chosen to tax passenger transport should in any event ensure that transport consumed within the EU is taxed whilst not influencing the proper functioning of the internal market.

Taxation could result in an increase in administrative burdens for those sectors which currently benefit from exemption, in particular where transport is carried out by non-EU operators. That may be overcome if transport operators are allowed to use the mechanism put in place for non-established suppliers of electronic services, telecommunications and broadcasting services[46].

3.8.2. *Full output exemption of passenger transport*

Taxing passenger transport is not without complication. That is particularly so with international passenger transport and may in part explain the exemption currently enjoyed by operators providing international passenger transport by air or by sea. This is less so with domestic transport which is therefore in many cases taxed.

If full taxation proves not to be an option, thought could perhaps be given to moving towards exempting international passenger transport regardless of the means of transport used. Whilst it is not in the nature of VAT, an output exemption may nevertheless be justified by the complexity of the tax. This would leave some consumption untaxed but at least it would ensure equal treatment between the different modes of transport.

An exemption would not necessarily conflict with other policies but its consequences should be carefully assessed.

Normally, businesses can only deduct VAT charged on input used for taxed activities. An output exemption for transport would therefore impact on the right of transport operators to deduct VAT paid on their purchases. This could lead to serious financial difficulties for businesses, such as considerable amounts of non-deductible VAT or cash-flow problems related to pre-financing substantial amounts of VAT, which would probably create great resistance from the businesses concerned.

3.8.3. *Taxation, or output exemption, of passenger transport combined with partial input exemption*

Given the level of investment needed in the transport sector, there may be valid reasons for exempting inputs. If found appropriate, the exemption would still need to be partial and target certain purchases only.

Should passenger transport be taxed, operators would be able to deduct input VAT. Paying VAT on the purchase of durable goods of significant value which are essential for carrying out transport, in particular means of transport, could, however, still have a non-negligible effect on the cash-flow of transport providers, who would need to pre-finance the tax.

---

[46] This mechanism, which is already in place for non-EU suppliers of electronic services, will from 1 January 2015 be extended to EU suppliers of electronic services, telecommunications and broadcasting services who are not established (see Articles 357 et seq. of the VAT Directive).

Should an output exemption be chosen, the lack of a right of deduction would mean that the VAT paid by transport operators becomes a real cost. This would increase the justification for an exemption for purchases made by transport operators.

In both situations — taxation or exemption — equal treatment should be ensured. Should such an input exemption be put in place, it would therefore need to be applied to all transport sectors (air, sea, land).

Topic 4.

4. DEDUCTIONS

4.1. The current legal framework

The right of deduction is a key factor in ensuring that the VAT system is neutral, relieving taxable persons of the VAT paid on their input so that the tax, after collection in stages, is ultimately borne by final consumers.

The main rules on deductions are set out in Articles 167 to 192 of the VAT Directive. These cover the time when VAT becomes deductible, the scope of the right of deduction, restrictions, and how the right of deduction is exercised.

Regarding restrictions on the right of deduction, Article 176 of the VAT Directive (previously Article 17(6) of the Sixth VAT Directive) stipulates that ‘the Council, acting unanimously on the basis of a Commission proposal, shall determine the expenditure in respect of which VAT shall not be deductible’. Moreover, it contains a provision allowing Member States to retain all the exclusions provided for under their national laws at 1 January 1979 or on the date of their accession for the Member States which acceded to the EU after that date.

Besides these main provisions, there are two Directives on the refund of VAT to taxable persons who are not established in the Member State in which they incur VAT on goods and services or on their import of goods:

– Council Directive 2008/9/EC, laying down rules for the refund of VAT to taxable persons not established in the Member State of refund but established in another member State;

– The Thirteenth Council Directive (86/560/EEC), on arrangements for the refund of VAT to taxable persons not established in the European Union.

4.2. Historical overview

Several legislative initiatives have been taken in the past to review the rules on deduction.

A first attempt to harmonise the restrictions on the right of deduction was made in 1982 with the so-called Twelfth Directive[47] proposal. However, this proposal was never adopted.

Under the SLIM (Simplifying Legislation for the Internal Market) initiative in 1997, the working party set up to examine VAT obligations recommended examining ways and means of radically reforming the refund procedures laid down in the then applicable Eighth VAT Directive for non-established EU traders. At that time, the Commission took the view that significant simplification could only be reached by replacing the refund system by a ‘cross-border deduction’, i.e. a system that allows

---

[47] COM(82) 870.

EU taxable persons to deduct VAT incurred in another Member State where they are not established by setting it off, in his own VAT return in the Member State of establishment, against the amount of VAT due for which they are liable. The Commission's proposal for such a reform, presented in 1998,[48] again included a section on expenditure not eligible for a full VAT deduction with a view to approximating national rules. This proposal was, again, never adopted.

Under its VAT strategy launched in 2000 and updated in 2003, the Commission proposed broad simplification comprising six concrete measures which included two items on deduction/refund: the replacement of the refund system for non-established EU taxable persons and harmonisation of the scope of goods and services for which Member States may apply restrictions on the right to deduct[49]. The new refund system, entirely electronic but still based on a system of actual refund by the Member State where the VAT was incurred, entered into force on 1 January 2010. The part related to restrictions on the right of deduction is still on the table at the Council.

In 2007, the Commission proposed, amongst other items, a Directive which included rules to refine the right of deduction's basic rule that a taxable person may deduct VAT on input only in so far as the goods and services are used for transactions that give rise to deduction. Under ECJ case law, there was no way of preventing taxable persons from allocating mixed-use goods (used for both business and non-business purposes) wholly to business assets and deducting the whole amount of VAT immediately and in full, insofar as private use was subsequently taxed as a service over time. This created considerable unjustified cash-flow advantages for the taxable persons concerned, especially in relation to immovable property. The purpose of the new Directive[50], which was adopted in 2009 and will take effect from 1 January 2011, is to restrict upfront deduction to effective business use. At the same time, a correction mechanism should take fluctuations between business and private (non-business) use into account.

4.3. Evaluation of the current legislation or policy: positive aspects and specific shortcomings

The principle of neutrality requires full deductibility of the VAT on goods and services which are used for taxed economic activities. VAT on goods and services obtained for non-business use (private or out-of-scope activities) or exempt activities (with the exception of exempt activities giving rise to a right of deduction like intra-EU supplies of goods or exports) is not deductible. Respecting this requirement is sometimes problematic in those cases where goods and services are used for multiple purposes (taxed activities, exempt activities and non-business purposes) and changes in this use occur during the economic lifetime of the good or service.

Restrictions on deduction should in principle apply in situations where goods and services are used for business/non-business purposes and determining the effective proportion between the two could create major difficulties for the trader (sometimes

[48] COM(1998) 377.

[49] COM(2004) 728.

[50] Council Directive 2009/162/EU of 22 December 2009 amending various provisions of Directive 2006/112/EC on the common system of value added tax (OJ L 10, 15.1.2010, p. 14).

impossible to make in practice) and could be impossible to verify by the tax authorities.

4.3.1. *Use of goods and services both for exempt activities and activities giving rise to a right of deduction*

Recital 39 of the VAT Directive states that 'the rules governing deductions should be harmonised to the extent that they affect the actual amounts collected. The deductible proportion should be calculated in a similar manner in all the Member States'.

The rules which the Member States must follow in achieving that objective are set out in Articles 173 to 175 of the Directive. Unfortunately they provide only limited guidance and consequently Member States have gone their own way in implementing them. Although it is notable that the VAT Directive only requires that the calculation should be established in 'a similar manner' (which does not mean the same manner), there is clearly an expectation that the actual amount collected should be harmonised for similar operations in different Member States and that differences in the computation of deductible VAT should not lead to competitive imbalances.

The ECJ has provided some limited guidance which, if followed, might be expected to deliver a more harmonised approach.

Beyond that, however, the evidence points to considerable variations in the methodologies imposed or accepted by Member States and, more worryingly, the actual rates of input VAT recovery. A study carried out for the Commission[51] confirmed this, attributing the variations in recovery rates to the availability of an option to tax, differing business mixes, differences in the scope of the exemptions in national law and finally concessional arrangements or interpretations which are not always documented in national legislation. In the latter instance, it is not easy to verify that such arrangements are in conformity with EU law[52]. In addition, differences in the computational rules adopted largely on their initiative by different Member States, notwithstanding the *First National Bank of Chicago* judgment, will always give different recovery rates (e.g. using gross margin or gross interest will result in a wide variation in outcomes).

The consequences of non-harmonisation are particularly troublesome when an exemption involves commercial activities. The recovery rate determines the tax actually borne by, for instance a banking or an insurance institution. Non-harmonisation therefore creates competitive imbalances between operators and may possibly become a vehicle for tax competition between Member States. It is probable that for many institutions non-recoverable VAT may currently be the most significant tax they pay, even if the lack of transparency makes it difficult to say this with any certainty.

---

[51] *Survey on the recovery of input VAT in the financial sector*, IBFD December 2006.

[52] Where the arrangements with the tax authority are more favourable than might be expected under the VAT Directive, the beneficiary will never complain of course and the authorities will not be inclined to disclose the details to the Commission, perhaps on the grounds of commercial confidentiality.

4.3.2. *Provisions dealing with the non-business (private use) of business assets; adjustments and corrections*

The Directive adopted on 22 December 2009 provides specific rules on exercising the right of deduction in the light of the principle that deduction arises only in so far as goods and services are used for a business activity.

Problems had at first arisen in relation to the initial exercise of the right of deduction for immovable property not exclusively used for business purposes. Once allocated to business assets, even where business use was minimal the total amount of VAT could be deducted upfront and private use would be output taxed via the ‘full cost’ valuation rules over a period of (in some cases) up to 20 years, creating (unjustified) cash-flow advantages.

The 2009 Directive, firstly, restricts the initial exercise of the right of deduction for immovable property to effective business use; immediate and full deduction in the case of mixed use is therefore no longer possible.

Secondly, it introduces a ‘correction’ mechanism’ in addition to the existing system of adjustment for capital goods.

In order for the adjustment system to be applicable, a person must first acquire capital goods as a taxable person and allocate them to business assets. Fluctuations during the adjustment period between taxed business use (giving rise to a right of deduction) and exempt business use (not giving rise to a right of deduction) are taken into account via the adjustment system.

However, no specific comparable parallel rules catering for a similar division between business and non-business use of assets were available. Although non-business (private) use of a business asset was to be taxed as a deemed service (under Article 26 of the VAT Directive), there was no adjustment mechanism in favour of the taxable person if business use increased beyond the initial business use.

If, under the new rules on forced apportionment, an asset were seen as being partly allocated to non-business use (where the taxable person was previously free to allocate mixed-use goods entirely to business assets) no adjustment of the tax relating to the non-business part in favour of the taxable person was allowed.

Therefore, the new rules are intended to deal with this problem via a ‘correction’ system (in relation to increase/decrease of business and non-business use) by analogy with the adjustment system and by excluding the otherwise applicable output tax rules in the case of a subsequent decrease in business use (Article 26 of the VAT Directive).

Thirdly, particularly in comparison with the original Commission proposal, the scope of the Directive was extended, via an option for the Member States, to all goods forming part of business assets.

As this legislation will come into effect from 1 January 2011, it is too early to assess its effects, but some observations may be made.

The option of extending the scope of these provisions will lead to further de-harmonisation. As the text refers to 'business assets as they (i.e. the Member States) specify', this new rule will have a different scope of application in each Member State and might create further distortions of competition within the Internal Market. It remains to be seen whether Member States will extend the rules to e.g. non-capital goods.

For the new correction mechanism, reference is made to the principles of the adjustment system via a general reference to Articles 184 to 192 of the VAT Directive and 'as applied in the respective Member State'. Any differences in the current adjustment systems between the Member States will therefore extend to the new correction system. Because of the general reference to all articles on adjustment, Member States have some discretion in applying the new rules, e.g. the possibility to permit administrative simplifications (see Article 189 of the VAT Directive).

4.3.3. Restrictions on the right of deduction

Article 176 of the VAT Directive as set out above is the legal base for most of the restrictions currently applied in the Member States. Besides that provision, restrictions can be also based on the following:

- Each Member State may, for cyclical or economic reasons, totally or partly exclude all or some capital goods or other goods from the system of deduction after consulting the VAT Committee (Article 177 of the VAT Directive).
- The Council may grant individual derogations on the right of deduction to any Member State insofar as these measures are intended to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance (Article 395 of the VAT Directive).

4.3.3.1. Positive aspects

Flat-rate restrictions on the deduction of input VAT for expenses covering mixed private and business use (cars, restaurants and mobile phones) simplify matters both for the taxpayer and the tax administration.

Flat-rate restrictions are a simple way of apportioning business and non-business use, in that the flat rate deduction allowed should generally reflect the effective proportion of business use. It has to be accepted that a flat-rate proportion can never correspond to each individual case, and that there will be winners and losers when applying such a mechanism.

Flat-rate restrictions go beyond their objective of simplification when the proportion no longer corresponds to the economic reality (for instance, if VAT related to car expenses is fully excluded from the right of deduction).

Positive effects of, probably, most rules that derogate from the general principle are that individual Member States can maintain existing national situations which are economically or even culturally accepted or desired (standstill), can react quickly to fluctuations or crisis situations in the national economy (exclusions for cyclical or economic reasons), can simplify VAT collection for taxable persons and/or the tax

administration in difficult situations and can apply measures to combat tax evasion and avoidance at short notice (through individual derogations).

4.3.3.2. Shortcomings

- Any restriction of the right of deduction in relation to strictly business expenditure affects the neutrality of the VAT system and should therefore be avoided. At the same time, it affects the principle that VAT should be a consumption tax.

- As exceptions exist on a national basis, taxable persons operating in different Member States have to deal with different sets of rules. For example, it makes cross-border refunds (see further) more complicated within the EU as different (sub)-codes have to be used to cover all existing different situations in the respective Member States.

- The standstill provision in Article 176 implies that new or previously abolished restrictions cannot be (re)introduced. This results in Member States having unequal rights in this respect.

4.3.4. The time when the right to deduct arises

The right of deduction arises at the time the deductible tax becomes chargeable. That means that a customer is, in principle, entitled to deduct the VAT as soon as the supply is made on his next VAT return, whether or not he has paid for the supply.

This rule creates a cash flow advantage for late payers, the burden of which is in fact borne by the suppliers, for instance SMEs that may be unable to impose reasonable terms of payment on their customers but who have to pay the VAT immediately to the Treasury. While this rule is neutral for the State, it is doubtful whether its effects on the supplier and the customer are consistent with the principle of neutrality.

Allowing businesses, particularly small ones, to pay the VAT only when they have received payment would constitute a solution already permitted under the VAT Directive (see Article 66(b)). Several Member States allow this option with in addition a derogation to postpone the right of deduction of businesses opting for such a scheme (the so-called cash accounting scheme).

This scheme enables such taxable persons to apply a simple rule based on the date of payment for their input and output transactions, to determine at what point they must exercise their right to deduct VAT and pay the tax to the revenue authorities. For such taxpayers, the scheme simplifies the formalities and may, furthermore, give them a cash-flow advantage, particularly if most of their expenditure is not liable to VAT (e.g. salaries) or they have to accept lengthy payment terms from their customers but cannot impose similar payment terms on their suppliers.

However, this scheme could lead to unwanted effects: discrimination against suppliers who have opted for the scheme, because it indirectly deprives their customers to the right to deduct the VAT immediately as they can under the common rules.

This problem could be tackled by granting all customers of a 'cash accounter' the right to deduct the VAT as soon as the supply has been made or the invoice issued and therefore by separating the chargeability of the VAT from the time of its deduction. The cost in terms of cash flow would then be incurred by the State. However, allowing a 'cash accounter' to issue, for instance, an invoice for an account, without having to pay the VAT stated, while authorising the customer to deduct it immediately, could lead to abuse or avoidance between persons that have close ties, for example.

The solution might therefore be to make it a general rule that the VAT becomes chargeable when payment for the supply is received by the supplier with the customer having the right to deduct at the same time.

Such a rule would be perfectly neutral for most stakeholders: the supplier, the customer and the State. The only losers would generally be customers who are able to impose lengthy credit terms on their suppliers. They would no longer benefit from the cash-flow advantage resulting from the period between the time when they can deduct VAT and the later time when they have to pay the VAT to the supplier. However, if a customer has no right to deduct VAT, the State would have to wait until the customer pays the invoice before it collects the VAT. Nevertheless, in both cases, the supplier would no longer suffer the cost of late payment to the benefit of the State and/or his customer.

More broadly, basing the VAT system on payment and therefore reducing the time between payment of the VAT and remittance to the Treasury may limit losses from supplier insolvencies. It would also allow more modern means of collecting VAT to be put in place with the objective of preventing fraud due to the concealment of sales and reducing the administrative cost to both businesses and the tax administration. For instance, a VAT system based on payment would facilitate the setting up of a scheme where the customer would pay the VAT directly to the Treasury while at the same time paying for his purchase by credit card or credit transfer (see point 5.4.1 of the green paper). By adapting banking payments through SEPA, it might be possible to pay the net amount to the supplier and the VAT to the tax authority, at the same time and in a single payment transaction.

However, the cash accounting system in itself cannot be seen as an effective solution to major abuses such as carousel fraud. In general, the fraudster demanding a VAT refund complies and is able to prove that the goods acquired were actually paid for. Thus, cash accounting could represent a more neutral system providing some assistance to SMEs in terms of cash flow advantages and, to some extent, could limit VAT losses due to insolvencies. But to counter fraud, an additional and more far-reaching measure would be needed such as imposing conditions on the right of deduction itself.

4.3.5. *Refunds to non-established EU operators (Directive 2008/9/EC)*

On 1 January 2010, the refund system of the Eighth VAT Directive[53] was replaced by a new and entirely electronic refund system for non-established EU taxable persons. The previous paper-based system was considered burdensome to both businesses and tax administrations, was characterised by increasing failure to comply with time limits and had become out of date. For tax administrations, each refund required physical processing — stamping and returning invoices and import documents — but lacked effective means of verification. In reality, the available information often allowed only the applicant's status as a taxable person and the conformity of the invoice or document to be checked. Member States of refund could not verify the division between taxed, exempt or out-of-scope supplies or the way the deduction was made (pro rata or by actual attribution).

The new system sought to deal with a number of administrative problems, both for businesses and tax administrations, and to enhance the position of claimants. In practice, a claim is introduced via the web portal of the Member State of establishment of the taxable person and sent over, after certain checks have been made, to the Member State where the VAT was incurred (the Member State of refund), which then has to decide whether the claim is eligible and, where appropriate, to refund the VAT to the claimant.

4.3.5.1. Positive effects

Because of the implementation problems, any positive effects have been overshadowed by the rather serious technical problems in certain Member States. Further analysis would be required to determine whether and to what extent expectations in terms of speed (because of the electronic procedure), efficiency (introduction of the claim via the web portal of the claimant's Member State, reduction of language problems via maximum use of codes), and improvement of the taxpayers' status (granting interest in cases of late payment) have been met.

4.3.5.2. Shortcomings

Although the EU components of the IT system were set up satisfactorily, a number of problems occurred in the Member States:

- The late, incorrect or non-transposition of EU legislation resulted in the late opening of national web portals (sometimes up to five months after 1 January 2010); discrimination against non-established agents; limits on the number of invoices; incorrect treatment of VAT groups (multiple VAT numbers), and other problems.

- There were problems with and unnecessary restrictions on the proper functioning of the national web portals in relation to e.g. opening times, accepted formats and absence of batch uploads.

---

[53] Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in the territory of the country (OJ L 331 of 27.12.1979, p. 11).

- The text of the Directive contained a number of options (e.g. use of language, use of codes for business activity, use of codes for sectors of activity), a few shortcomings (the principle of using direct contacts between the Member State of refund and the non-established applicant for several routine messages which could easily have been routed through the common IT system) and very few provisions enabling the Commission to adopt common implementing provisions.

To avoid such situations in future, lessons should be drawn from the problems experienced in setting up the system. However, a proper assessment of the shortcomings of the system can only be made once it is running properly.

Some of these shortcomings are addressed in the recent Commission proposal[54] on extending the deadline for cross-border refunds, as it also contains new rules aimed at granting the Commission the necessary powers to standardise the technical details needed for such a Pan-European scheme to work properly.

4.3.6. Refunds to non-EU operators (Thirteenth Directive 86/560/EEC)

The Thirteenth Directive, on refunding VAT to taxable persons that are not established in the Union[55], has never been amended since its adoption. The system is still entirely paper-based. Unlike the refund system for EU taxable persons that are established in another Member State, this Directive leaves a lot of discretion to Member States. In particular, Member States may make the VAT refunds conditional upon the granting by non-EU states of comparable advantages regarding turnover taxes (the so-called reciprocity clause). Member States also decide the practical arrangements for claiming these refunds, e.g. time limits or minimum amounts. Eligibility for refunds is determined according to the Member States’ domestic rules on VAT deductions, although certain expenditure may be excluded or certain conditions imposed.

4.3.6.1. Positive effects

With the refund system for taxable persons not established in the Union, the EU seeks to guarantee the principle of neutrality of VAT as a consumption tax in international trade, destined to accrue to the state or jurisdiction where consumption takes place.

4.3.6.2. Shortcomings

Reciprocity can generally be arranged in different ways: via formal bilateral agreements between states or via a unilateral decision by a state to recognise a number of countries as having a comparable VAT or indirect tax system under which comparable advantages are granted to an EU Member State. The result is that the reciprocity conditions are not applied uniformly across the EU, which results in the same non-EU country being treated differently according to the conditions agreed by individual Member States.

---

[54] COM (2010) 381.

[55] Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in the Community (OJ L 326 of 21.11 1986, p. 40).

4.4. Possible ways forward

4.4.1. Mixed use of goods and services

This is an important area of concern. The amending Directive adopted in December 2009 brings a partial solution to a specific problem which the Commission indeed considered it necessary to address in the short term.

A more fundamental review of the provisions governing the scope of the right of deduction, proportional deduction and adjustments would seem necessary.

The difficulties encountered in Council when discussing the 2009 Directive already gives an indication of the complexity of such a task.

A less far-reaching approach would be to further harmonise the scope and details of the new rules laid down by the new Directive, thereby reducing the optional aspect of the Directive.

Another more targeted option would be to launch a more general review of the adjustment rules (Articles 184–192 of the VAT Directive).

4.4.2. Restrictions on the right of deduction

A first option would be to define in a harmonised way those goods and services for which Member States may impose restrictions. The proportion of the restriction could be decided by the Member States taking into account their national situation. This would be in line with the existing proposal which is still on the table at the Council.

A more ambitious option would be fully harmonise the restrictions, leaving Member States no discretion in this area.

4.4.3. The time when the right to deduct arises

The advantages and disadvantages of changing the time when the right of deduction arises in terms of cash flow for businesses and tax authorities, fraud prevention, and the impact on accounting obligations could be further examined.

4.4.4. Refunds to non-established EU operators (Directive 2008/9/EC)

The benefits of the newly introduced system can only be measured once it is functioning smoothly. The Commission still believes in its merits and is convinced that the current difficulties can be resolved.

Nevertheless, the ultimate simplification would still be a cross-border deduction mechanism via the VAT declaration of the taxable person in his Member State of establishment, as proposed in 1997.

Additionally, a fully worked out one stop shop mechanism (see point 5.3.4.1 of the Green Paper), allowing taxpayers to declare output VAT but also to exercise the right of deduction on the VAT return could replace the refund procedure.

4.4.5. *Refunds to non-EU operators (Thirteenth Directive 86/560/EEC)*

In order to enhance neutrality in international trade between the EU and non-EU countries, one option could be to define reciprocity at EU level.

Another could be to examine whether additional conditionality clauses (e.g. on exchange of information as regards VAT/GST) should be used.

A more ambitious approach would be to introduce an electronic procedure, similar to that recently implemented for non-established EU operators, with a single portal managed by the Commission.

Topic 5.

5. INTERNATIONAL SERVICES

5.1. Current position

The need to address issues relating to the supply of services across the EU's external border is a relatively recent development in the history of the common system of VAT. In all probability, those who framed the original legislation did not consider cross-border services to be of any great economic interest, especially where non-EU countries were involved. For a long time, the rules on the place of supply of B2B services were seen as sufficient to deal with all likely eventualities.

The arrival of online electronic commerce changed this, confirming that few things in life are really written in stone. The development of an online B2C market brought new problems for VAT and, in particular, left a fledgling European industry at a serious competitive disadvantage. The so-called e-services VAT Directive[56] rectified this and, in so doing, broke new ground by setting up simplified, streamlined compliance procedures for service suppliers established in non-EU countries that made taxable supplies to EU consumers.

These e-commerce services are, however, only one part of a larger phenomenon. Changes in technology, greater deregulation, innovative business models and the general impact of globalisation have resulted in enormous changes in the economic significance of internationally traded services and intangibles, putting pressure in turn on international aspects of the VAT system.

In order to address such issues, the Commission has engaged with the OECD in a process to develop international norms for VAT-type taxes based on taxation according to the rules applicable in the jurisdiction of consumption. These will have no impact on the rules for intra-EU transactions. In this context, therefore, the term 'international' refers to transactions which involve both the EU and one or more non-EU counties.

Since VAT is an EU competence, the need for a coordinated EU approach is clear. Member States that participate in the OECD cannot enter into agreements with non-member countries on arrangements which might interfere with the rules laid down in the VAT Directive, even if such arrangements are limited to interpretative commentaries or guidelines. Coordination must also involve those Member States that are not members of the OECD.

The expectation of the OECD is that, over time, this process will yield a body of work broadly similar in status to the transfer pricing guidelines.

---

[56] Council Directive 2002/38/EC of 7 May 2002 amending and 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 (OJ 2002 L 128, p. 41).

5.2. Evaluation of issues being addressed and future progress

The work being pursued at the OECD falls under the heading of 'International VAT/GST Guidelines' and has to be seen as a long-term project. The intention is that once finalised, it will provide governments and taxpayers with recommendations on how cross-border supplies of services should be taxed.

In international trade in services, which can involve several jurisdictions, all potentially claiming the right to tax, taxation according to the destination principle should ensure tax neutrality and prevent distortion of competition.

The OECD has just completed a general public consultation on a draft second chapter of the Guidelines, dealing with customer location in the context of identifying the jurisdiction which has taxing rights. It is expected that this chapter will be finalised in the near future through a process of endorsement by the OECD's Committee on Fiscal Affairs.

Progress to date has, however, been largely achieved by avoiding more difficult issues such as tax avoidance and artificial arrangements. Currently, questions involving complex corporate structures, in particular branches, and more complex supplies are coming to the fore.

The need for a coordinated EU position in these negotiations is now becoming more important. It is the Commission's intention to deal with this via the VAT Committee, as and when the need arises.

As pointed out above the e-services VAT Directive has ensured from a legal point of view taxation of these services within the Member State of consumption. From the outset, it was acknowledged that this legislation relies heavily on voluntary compliance from the suppliers.

Bilateral agreements with non-EU countries or multilateral agreements covering VAT could provide a legal base for an exchange of information and, as far as the joint OECD/Council of Europe multilateral convention is concerned, even a legal base for the assistance in recovery of debts.

Because initially the e-services provisions were agreed for a limited period in time, little attention was given to this aspect. The adoption of the VAT package has now given these provisions a permanent character without addressing the outstanding issue of the control of these transactions.

It can be questioned whether such situation is acceptable in the long term. From 2015 similar provisions for ensuring taxation at destination will be extended to telecommunications and broadcasting services, and to similar intra-EU services. The EU legislation adopted for that purpose at EU level strengthened the administrative cooperation between Member States for these intra-EU transactions to ensure that the Member State of consumption has the capacity to audit these transactions.

This will stress the inequality in terms of control between EU and non EU traders in the same sector and subject to similar VAT rules.

Developing VAT administrative cooperation at international level is one potential way forward. The alternative, explored in certain non-EU jurisdictions, is to seek ways of collecting the VAT from the persons established within the EU, in this case the private person.

Topic 6.

6. THE LEGAL PROCESS

6.1. Current legal framework

The Council adopts provisions harmonising turnover taxes such as VAT to the extent necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition[57]. Such provisions must be adopted by unanimity and after consulting the European Parliament and the Economic and Social Committee. Adoption of any provision requires a proposal from the Commission, which has the right of initiative[58].

Amendments to a Commission proposal can be made by Council. Where these changes do not achieve the aims of the proposal or go beyond those aims, the Commission's only option is to withdraw its proposal.

While the Treaty prescribes no particular legal instrument, VAT has mainly been regulated by means of directives. A directive is binding upon each Member State to which it is addressed, but leaves the choice of form and methods to the national authorities, who transpose it into national legislation[59].

In the VAT Directive, which establishes the common system of VAT, the Council has reserved for itself the power to adopt implementing measures (Implementing Regulations). By its very nature, this procedure is limited in scope and may not be used to amend the VAT Directive. Since no power has been delegated to the Commission[60], all substantive changes therefore need to go through the normal legislative procedure, involving unanimous adoption by the Council.

6.2. Historical overview

The legislative procedure has remained the same over the years and, with the most recent accession, amendments to VAT legislation now need the unanimous support of 27 Member States. Although the voting regime was discussed, and indeed suggestions were made that certain administrative rules on VAT should not require unanimity, for instance invoicing rules, the Lisbon Treaty has brought no change in this respect.

However, areas of qualified majority voting have existed in VAT legislation. Derogations allowed under Article 13 of the Second VAT Directive could be approved by qualified voting if the measure simplified the procedure for charging

---

57 This follows from Article 113 of the Treaty on the Functioning of the European Union (TFEU).

58 The legislative procedure is laid down in Article 289 TFEU.

59 An outline of the legal acts that may be adopted by the EU can be found in Article 288 TFEU.

60 Under Article 290 TFEU, a legislative act may delegate to the Commission the powers to adopt non-legislative acts of general application to supplement or amend certain elements of the legislative act. The exercise of these powers is dealt with in a Communication from the Commission to the European Parliament and the Council: Implementation of Article 290 of the Treaty on the Functioning of the European Union (COM(2009) 673).

VAT or aimed to prevent fraud, provided the effect on competition between Member States was neutral.

The procedure for implementing measures for VAT was introduced as recently as 2004[61], with implementing powers being conferred on the Council[62]. An earlier proposal to confer such powers on the Commission, assisted by the VAT Committee[63], was not accepted by the Council given the use of qualified majority this would have involved[64].

For the first time, in 2005, the Council then agreed implementing measures as provided for in the VAT Directive which are binding and directly applicable in all Member States[65] These measures were derived from work undertaken by the VAT Committee, a consultative body made up of representatives of Member States with no legislative powers of its own.

6.3. Evaluation of current legislation or policy

6.3.1. Positive aspects

VAT is an important source of income for Member States and this explains the importance attached to the use of unanimity in this field. Unanimity serves to preserve the fiscal sovereignty of each Member State, which is a prerequisite for any sovereign State.

Subsidiarity dictates that legislation on VAT is only proposed if action at EU level is more effective than action taken at national, regional or local level. Such action must not go beyond what is necessary to achieve the objective set. Those are principles safeguarded through the use of directives, which not only leave much for Member States to decide but also provide for options and derogations.

Being a transaction-based tax, VAT is influenced by elements of civil legislation, property law and commercial law. The flexibility offered by the current framework is essential to accommodate differences in legal traditions across Member States.

---

[61] This change was introduced by Council Directive 2004/7/EC of 20 January 2004 amending Directive 77/388/EEC concerning the common system of value added tax, as regards conferment of implementing powers and the procedure for adopting derogations (OJ L 27, 30.1.2004, p. 44).

[62] Where uniform conditions for implementing legally binding EU acts are needed, those acts, under Article 291(2) TFEU, confer implementing powers on the Commission or, in duly justified specific cases, on the Council.

[63] Proposal for a Council Directive amending Directive 77/388/EEC on the common system of Value Added Tax (the Value Added Tax Committee) (COM(97) 325).

[64] According to the rules on comitology governed by Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission (OJ L 184, 17.7.1999, p. 23), the committee assisting the Commission always needs to act by qualified majority.

[65] Regulation (EC) No 1777/2005 laying down implementing measures for Directive 77/388/EEC on the common system of value added tax (OJ L 288, 29.10.2005, p. 1).

6.3.2. Shortcomings

6.3.2.1. The need for unanimity

The use of unanimity voting is still seen as an obstacle to real progress in improving the VAT system. The issues caused by the voting regime are only exacerbated with the accession of new Member States.

This obstacle may be overcome, although often at the price of the time it takes to reach a result, such as with the changes made to the place of supply of services[66] where it took almost five years to reach agreement. In some cases an agreement can only be reached at the price of including many options, as illustrated by the invoicing rules[67], which reduces the simplification benefits. In other cases the obstacle may, however, be so great that it stands in the way of progress, as with the proposal for a one stop shop to make it easier to comply with tax obligations EU-wide, which is still pending in the Council[68].

The need for unanimity, not only in those areas directly affecting the right of taxation of Member States but also beyond, increasingly stands in the way of reforming the tax system in depth and bringing it up-to-date. This is especially the case with implementing measures.

6.3.2.2. Flexibility causing complexity

Member States have great discretion because of the legal instrument chosen (a directive) combined with the fact that any legislation in the field of taxation needs to be adopted by unanimity (stipulated by the Treaty). This may also explain why the rules adopted at EU level are not always fully harmonised but leave a degree of flexibility.

Flexibility, however, comes at the expense of more uniform application of the common rules across the EU. This is exacerbated by the fact that each Member State is responsible for applying those rules within its territory.

However, businesses with EU-wide activities are repeatedly calling for more uniform application with a view to lowering their costs and remaining competitive, and SMEs may even refrain from cross-border transactions because of the complexities. This problem can be overcome through common implementing measures; the extent to which that particular procedure is used has been limited until now, but it is being used to facilitate the implementation of the new rules on the place of supply of services.

Given that unanimity by the Council is still required, even for the adoption of implementing measures, this remains a lengthy procedure. Moreover, there is a considerable risk that only the most basic measures may be agreed, leaving unsolved

---

66 To be found in Directive 2008/8/EC.

67 Council Directive 2010/45/EU of 13 July 2010 amending Directive 2006/112/EC on the common system of value added tax as regards the rules on invoicing (OJ L 189, 22.7.2010, p. 1).

68 Proposal for a Council Directive amending Directive 77/388/EEC with a view to simplifying value added tax obligations (COM(2004) 728).

the most sensitive issues on which there is disagreement, which are often the most important.

6.3.2.3. Differences in implementation and application

As Member States are responsible for the implementation and application of the common VAT rules, they are given much discretion in this respect. When these rules change, Member States are, however, often left without much guidance on the implications of the legislation adopted.

This leaves the potential for differences in application of the rules across the EU resulting in increased costs for businesses wanting to operate outside their own Member State and an obstacle to the single market. In certain situations, such differences also carry the risk of double taxation or non-taxation.

Any difference there may be between Member States can be caused not only by the way in which EU VAT legislation is transposed into national law but also by differences of interpretation of the factual situation. In the absence of a mechanism to deal with such matters, the only recourse for businesses is to go to court.

6.4. Possible ways forward

When attempting to identify possible solutions, it is necessary to keep in mind existing constraints. To imagine that changes to the main EU VAT legislation could be adopted by qualified majority must for example be ruled out given that unanimity is prescribed by the Lisbon Treaty. Such a constraint does not, however, extend to implementing measures, where there could be scope for change.

6.4.1. What type of legislation: legal instrument to consider

VAT is far from harmonised and the use of directives is a contributing factor. To the extent that this affects the internal market, it does present a problem.

To better ensure that the rules governing VAT are harmonised, thought could be given to using regulations instead. These offer the advantage of being binding in their entirety and directly applicable in all Member States.

A regulation would not allow for options or derogations as is currently the case and if the VAT Directive were to be transformed into a regulation it would therefore require much effort and good will.

If such a shift is to be justified, it may be that the use of regulations would have to be limited to those areas of VAT where the need for harmonised rules is evident, such as the place of taxation. Another example could be the refund procedure for EU non-established businesses, where a Pan-European IT system requires fully standardised rules to function properly.

6.4.2. Preparing legislation: the role of stakeholders

When drawing up a proposal, the Commission generally discusses it with Member States through a working group. The Commission also engages in consultation with

the stakeholders[69] and the public consultation makes up part of the impact assessment.

To strengthen the dialogue, it could perhaps be useful to put in place a permanent EU business group. Such a group could serve as a forum where, in discussions with stakeholders, problems with EU legislation may be identified and draft proposals examined. The group could also be used to follow up on legislation once adopted.

6.4.3. Legislation to be adopted: ensuring the best outcome

Before the Commission proposes any substantive initiatives, an impact assessment is drafted[70]. In consultation with businesses, it looks at the advantages and disadvantages of the different policy options and assesses their potential impact.

Although, with a view to improving the quality of EU legislation, each institution is committed to assessing the impact of its proposals or amendments[71], the Council has yet to rise to the challenge. This may in part be due to the confidentiality inherent in any negotiation.

There is a need to strike a balance between safeguarding confidentiality and involving stakeholders so as to ensure that, prior to adoption, the Council assesses the impact of any substantial changes it intends to make to proposals presented by the Commission.

If no separate impact assessment is initiated by the Council, it could instead be argued that the impact assessment presented by the Commission should be extended to cover the changes contemplated by the Council. Time would obviously be needed if the Commission were to update its impact assessment. To be able to do so, it would also need to consult business about those changes. This would render the process more transparent.

6.4.4. Legislative powers: how to exercise them

There are situations where rapid action to amend legislation is crucial. This is perhaps best illustrated by recent events where, in certain sectors, widespread fraud was detected for which quick solutions were needed. To cater for this in future, there may be a need to look for a way in which action could be taken rapidly (this topic is further dealt with in topic 7).

On the other hand, to keep up with changes in the way business is conducted or in response to developments in technology, it is also important to update legislation without too much delay. It may for example be that, in response to new products appearing, the list of electronically supplied services would need to be adapted at regular intervals.

---

69 This is guided by the Commission communication *Towards a reinforced culture of consultation and dialogue — General principles and minimum standards for consultation of interested parties by the Commission* (COM(2002) 704).

70 http://ec.europa.eu/governance/impact/index_en.htm.

71 In the context of the Inter-Institutional Agreement on Better Lawmaking (IIA), the three institutions — the European Parliament, the Council and the Commission — have agreed on an inter-institutional 'Common Approach to Impact Assessment (IA)'.

Where quick solutions are needed, one response could be to delegate powers to enable the Commission, as a general measure, to supplement or amend certain points of law, as provided for under the Lisbon Treaty[72]. The Council, as the legislator, must decide to give the Commission this responsibility.

Any delegation, which must be for an agreed term, must be clear, precise and detailed. It grants the Commission quasi-legislative powers to be exercised autonomously, although consultation of representatives of Member States is envisaged. These powers may be revoked if the legislator so wishes. The legislator may also reserve the right of opposition, in which case the act is suspended to allow for objections.

Since such delegation may only cover non-essential elements, this would only offer a partial solution. More profound changes would in any event need to be dealt with directly by the Council.

6.4.5. *Common rules: ensuring uniform application*

To more efficiently overcome differences in application, thought could perhaps be given to introducing a procedure by which some or all implementing measures would be taken by the Commission. When such powers are conferred, the Commission is assisted in the exercise of its executive powers by a Committee (in this case, the VAT Committee) acting by qualified majority. This procedure would provide more safeguards not only to businesses but also to Member States, as in the absence of implementing measures there is a legal vacuum which only the European Court of Justice can fill.

In the area of excise, the Excise Committee, with a similar role to that of the VAT Committee, nevertheless has the ability to agree implementing measures in certain defined areas[73]. This approach could also be followed for VAT.

Consideration could also be given to the Commission producing guidance after legislation is adopted in Council and before implementation. The absence of any legal standing for such explanations has been the main reason for not taking such action until now but there are nevertheless other arguments in favour of taking a more proactive approach. Guidance available shortly after the adoption of new EU legal texts might be invaluable to taxable persons in understanding the changes. It would of course need to be made clear that such guidance was produced for information purposes only.

6.4.6. *Changes in legislation: allowing for the necessary amendments*

Ensuring that the relevant legislation is put in place well in advance of the entry into force of any changes is the key to a smooth transition. When it comes to directives which have to be implemented into national legislation by a certain date, this is the responsibility of each individual Member State. Often, if not always, the changes will enter into force on that same date.

---

[72] Article 290 TFEU.

[73] See Directive 2008/118 (previously Directive 92/12), in Articles 13(2), 29 and 34, all referring to Article 43 where the link is to comitology.

If instead, Member States were obliged to take steps to implement new rules well in advance of their entry into force, this would leave more time for affected businesses to prepare for the changes. It should make it easier for traders to apply the new rules. Another option could be to link the entry into force of new rules to the adoption of common implementing measures, with a deadline laid down.

Topic 7.

7. DEROGATIONS AND THE ABILITY TO REACT QUICKLY

7.1. History and references

The VAT Directive contains specific rules allowing for specific national measures to be taken in specific circumstances. These measures are generally referred to as 'derogations' and are based on Articles 395 and 396 of the VAT Directive.

In addition, reference should also be made to the so-called 'notified' derogation measures which, under Article 394 of the VAT Directive, Member States may retain if they were applicable at 1 January 1977, were notified to the Commission before 1 January 1978 and fulfil certain criteria.

Article 13 of the Second VAT Directive[74] allowed Member States, in 'exceptional circumstances', to adopt measures to simplify the charging of VAT or to prevent fraud. The Member State applying such a derogating measure had to inform all the other Member States and the Commission.

If there was an objection from the Commission or the other Member States within one month of notification, the Commission would, within three months, come forward with a suitable proposal.

If the measure was purely national, to simplify the charging of VAT or to prevent fraud, then the Council could agree the derogation by qualified majority voting. If the measure affected the principles of VAT, and particularly the neutrality of the system in relation to other Member States, then unanimity was required.

Conversely, Article 19 of the Second VAT Directive required the Commission to 'restrict progressively or to abolish measures adopted by Member States in derogation from this [common VAT] system'. The aim was to align national VAT systems in the interests of the common, now single, market.

Article 27 of the Sixth VAT Directive amended the derogation procedure. Member States were no longer allowed to notify derogating measures and await any objection but instead had to notify the Commission, which would then come forward with a proposal. The procedure for adopting derogations was 'tacit' insofar as a Member State or the Commission explicitly had to ask that the matter be raised at the Council within a period of two months after the Commission circulated the request and the accompanying documentation to the other Member States. After that period, the derogation was deemed to have been adopted.

---

[74] Second Council Directive of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes. Structure and procedures for application of the common system of value added tax (OJ 71, 14.4.1967, p. 1303–1312 (DE, FR, IT, NL); English special edition: Series I Chapter 1967, p. 16).

Currently, the procedure requires the Commission to propose an implementing Decision and unanimous adoption by the Council. This 'explicit' procedure has, however, only existed since 2004[75].

With the VAT Directive, the relevant legislation is now Article 395. This article stipulates that the Council, acting unanimously on a proposal from the Commission, may authorise a Member State to introduce special measures in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. To that end, a specific procedure is set out in that Article.

Article 396 of the VAT Directive, by analogy and according to the same procedure, allows a Member State to conclude an agreement with a non-EU country or an international body which contains derogations from the VAT Directive.

As certain derogations covering similar problems were granted to different Member States under different terms, the Council adopted a Commission proposal to incorporate certain measures into the VAT Directive via the so-called 'Rationalisation' Directive[76]. As some of the special measures had proved successful, particularly in the fight against tax avoidance and evasion, the Commission wished to allow all Member States to apply them without having to seek individual authorisations. At the same time, a number of individual derogations were repealed. Under this Directive, a derogating measure does not need to be granted individually; only the VAT Committee has to be informed of the national legislative measures.

7.2. The purpose of the derogation procedure

The purpose of the derogation procedure is to adopt (more) quickly certain specific measures that are needed in a specific national context in order to fight tax evasion or avoidance or to simplify the procedure for collecting VAT. Generally, derogating measures are time-limited to allow for a review after a period of time to evaluate whether the measure is still appropriate and needed.

The Commission's derogating proposals must not be far-reaching measures that provide for a substantial change to the VAT system and they must comply with the general principles of the EU law such as proportionality, equal treatment and legal certainty. In particular, any measure requested by a Member State must be justified, targeted at the specific objective and proportionate to the aims. It must therefore be 'necessary for the specific objective which it pursues and have the least possible effect on the objectives and principles of the [VAT] Directive'[77]. Where the Commission is not satisfied that a request meets these criteria, it issues a Communication informing the Member States that it considers an implementing Decision inappropriate.

---

75 Council Directive 2004/7/EC of 20 January 2004 amending Directive 77/388/EEC concerning the common system of value added tax, as regards conferment of implementing powers and the procedure for adopting derogations (OJ L 27 of 30.1.2004, p. 44).

76 Council Directive 2006/69/EC of 24 July 2006 amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion or avoidance, and repealing certain Decisions granting derogations (OJ L 221 of 12.8.2006, p. 9).

77 Case C-177/99, Ampafrance SA, case C-324/82, Commission v Belgium.

Derogation measures have been applied in very different fields of the VAT system such as territoriality, deemed supplies, use of the open market value, exemptions, cash accounting, recovery or refund of VAT, limitations to the right of deduction, persons liable for payment of the VAT (reverse charge) and special schemes[78].

7.3. Evaluation of the current legislation

7.3.1. Positive aspects

The main positive aspect is the flexibility the derogation procedure offers to the Member States to deal with specific situations of tax evasion or avoidance and difficult VAT collection issues within a reasonably short period through being authorised to implement a measure that is not covered by the VAT Directive. On an international level, it provides the same flexibility for a Member State to conclude agreements with non-EU countries and to fulfil its international obligations.

Businesses might benefit from simplification measures, such as cash accounting, which reduce burdens. They can also benefit from the removal of distortions of competition when fraudsters are prevented from gaining a market advantage through not paying the right amount of tax.

7.3.2. Shortcomings

Many of the derogations either have a legal base under Article 394 of the VAT Directive (by virtue of Member States having such a measure in place on 1 January 1977 and having notified the Commission of such measures before 1 January 1978) or were tacitly approved under the previous derogation procedure, which raises questions of transparency and equal treatment of Member States. Similar derogations would not necessarily be granted nowadays to other Member States, creating an unfair system relating in part to the time of accession of Member States. As it is not possible to revert back after a 'standstill' derogation is repealed, Member States might be tempted to 'freeze' the current legal situation even where they now make little or no use of the derogating measure.

Any derogating measure, by its very nature, affects the common VAT system and, subsequently, to varying degrees, the single market.

As these derogating measures are generally applied on a national basis, taxable persons operating in different Member States have to deal with different sets of rules. Even similar derogations in different Member States may differ as regards their scope or conditions or the obligations of the taxable persons concerned.

The temporary nature of the derogating measure affects the overall stability of the tax system and could create a feeling of lack of legal certainty for taxable persons who

[78] As the number of derogations changes constantly, see the following webpage for an overview of existing derogations: http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/table_derogations/index_en.htm. As this list is generally updated once a year (and currently reflects the situation on 31 December 2009), reference is, in addition, made to the following webpage where this year's derogations (amongst other legislation) are published: http://ec.europa.eu/taxation_customs/common/legislation/legislation/taxation/index_en.htm.

first have to adjust to a new system and then have to revert back to the previous system later. Compliance costs can subsequently be considerable.

The number of derogation requests remains high (and is even increasing), and derogations are more and more requested in cases where the issue at stake is not really specific to one or two Member States and may therefore be perceived as a means to circumvent ongoing (but blocked) negotiations in the Council by introducing a derogation request within the field of the Commission proposal. This could even endanger the negotiations and, ultimately, call into question the need to adopt the proposal for a Directive which nonetheless offers additional guarantees such as common and equal rules for Member States and businesses and the adoption of which gives a voice to the European Parliament and the Economic and Social Committee.

Derogating measures can bring a short-term solution but could have an effect on the overall VAT system in the longer run. For example the (increased) use of the domestic reverse charge mechanism could be a short-term solution to stop carousel and missing trader fraud in a particular sector and in a particular Member State but could also lead in the medium term to a shift in fraud to other sectors, to the retail trade or to other Member States; and its overall effectiveness could therefore be questioned. Such continual derogation requests may therefore be seen as unsuitable, endless and unsustainable short-term solutions when more fundamental changes to the Directive are needed.

The impact of the national measures is not assessed in a way which is comparable to other EU decisions. Derogation requests are not subject to an impact assessment by the Member States and often have no ex post evaluation. For instance, the effect of a reverse charge mechanism in one Member State on VAT revenues in another Member State is not subject to any impact assessment, as would be normal for other Commission proposals.

Although usually short in comparison with the adoption of a Directive, the period needed for the adoption of a Council Decision is typically eight months, which is still too long for Member States needing a measure implemented quickly to tackle fraud.

Recent experience with VAT fraud in the emission trading sector, in particular, has drawn attention to that major constraint. The Article 395 procedure has indeed proven not to be sufficiently flexible and efficient in case of sudden major fraud attacks requiring an immediate national legislative reaction. Because of the considerable impact on VAT receipts, Member States found themselves in a position where they had to take unilateral measures, whilst being aware that these measures were not in line with the VAT Directive.

7.4. Possible ways forward

A comprehensive evaluation of the current individual derogations could pave the way for common rules to be adopted in order to provide, first, the same options to all Member States and, second, comparable conditions of application to businesses (e.g. similar to the aim of the Rationalisation Directive, or to the situation as regards cash accounting).

In case of a duly justified request demonstrating the existence of serious fraud risks in a specific Member State which could lead to irreparable damage and which require immediate action not in line with the VAT Directive, a possible way forward would be to enable the Commission to authorise that Member State, within a few days, to take the necessary measures.

Such an authorisation would be limited in time (e.g. six months) and could involve the Member States through the VAT Committee either immediately or at a later stage in order to extend the measures to, for instance, one year. In the mean time, the request would follow the normal procedure referred to in Article 395 of the VAT Directive.

The legal process for this urgent and protective authorisation clearly needs to be further investigated. Launching this rethink seems, however, inevitable after the recent VAT fraud experiences.

Topic 8.

8. VAT RATES

8.1. Current legal framework

The basic rules concerning VAT rates set out in the VAT Directive are simple. Articles 96 and 97 require Member States to apply a standard rate of at least 15 %. In addition, Articles 98 and 99 stipulate that Member States may opt to apply one or two reduced rates of not less than 5 % to a restricted list of goods and services eligible for a reduced VAT rate (Annex III to the VAT Directive). In this respect, Member States remain free to apply a reduced rate to a whole category or to restrict its application to (even a very small) part of it.

However, this simple structure, which applies to all Member States, is complicated by a multitude of derogations (zero rates, super-reduced rates[79], individual reduced rates, parking rates[80], etc) laid down in Articles 102 to 129.

Some of these derogations apply until the entry into force of the adoption of definitive arrangements based on taxation in the Member State of origin. However, not all Member States can take advantage of them.

Other temporary derogations provided to individual Member States result from the accession negotiations and contain a fixed end date.

8.2. Historical overview

The current VAT rates structure is still based on the principles of the Directive[81] adopted by the Council in 1992, as part of the package of measures considered necessary for the abolition of controls at tax frontiers and the creation of the internal market.

Since then, the standard rate and reduced rates have been dealt with separately.

8.2.1. STANDARD RATE

The level of the standard rate has to be decided by the Council at regular intervals. Since 1992, the minimum standard rate of 15 % has been extended four times and applies until 31 December 2010. Each time, the Council has renewed its political statement for the Council minutes mentioning Member States' efforts to avoid widening the 10 percentage point span between the lowest and highest rates applied. This demonstrates the continued concerns of Member States about distortions between high and low rate countries and the possible budgetary effects of different levels of VAT rates.

---

79 The super-reduced rate is any rate less than 5 % but higher than 0 %.

80 A parking rate is a rate applied to goods and services not included in Annex III to which certain Member States applied reduced, super reduced or zero rates at 1 January 1991.

81 Directive 92/77/EEC of 19 October 1992 supplementing the common system of VAT and amending Directive 77/388/EEC (approximation of VAT rates) (OJ L 316 , 31.10.1992, p. 1).

8.2.2. REDUCED RATES

8.2.2.1. The labour-intensive services experiment

As a follow up to the conclusions of the European Council of 11 and 12 December 1998 on combating unemployment, the Commission presented a proposal[82] to enable those Member States which so desired to experiment with the operation and impact, in terms of job creation, of a reduction in the VAT rates on labour-intensive services which were not exposed to cross-border competition.

The provisions allowing for this experiment, adopted in 1999, were extended four times mainly to ensure continuity and certainty for the sectors that benefitted from the reduced rate, but also to include new Member States wishing to participate in the experiment while awaiting more general proposals concerning reduced rates of VAT.

8.2.2.2. The need for an overall assessment of the scope of reduced rates

In February 2006, the European Council asked the Commission to present an overall assessment report on the impact of reduced VAT rates in terms of job creation, economic growth and the proper functioning of the internal market, on the basis of a study carried out by an independent economic think-tank.

The study, awarded to Copenhagen Economics[83], revealed that a single VAT rate is by far the best policy choice from a purely economic point of view. A move towards more uniform rates thus has considerable advantages as it would reduce distortions in the functioning of the internal market and simplify the rules, and thus reduce compliance costs for traders.

However, there may be specific economic benefits from operating a reduced rate in carefully targeted sectors using many low-skilled workers financed, for example, by higher VAT rates elsewhere. It can create permanent employment gains, but the overall gains are likely to be minor. Lower VAT rates can result in economic growth if they can induce consumers to spend less time on do-it-yourself activities and more time on their ordinary job or hobbies. For (certain) locally supplied services such a shift could take place.

In addition, the study makes a strong case that reduced VAT rates create significant compliance costs for business and tax authorities, partly at least because of the interpretations which often have to be made in borderline cases.

The study also stresses that, often, other alternative policy tools, such as direct subsidies for particular activities, might be more efficient than reduced VAT to achieve environmental, social, cultural, economic, etc., policy objectives with fewer costs. These subsidy schemes may be better targeted, better designed to avoid

---

[82] COM(1999) 62 final (OJ C 102, 13.4.1999, p. 10).

[83] Study by Copenhagen Economics ApS, Nyropsgade 13/1, DK-1602 Copenhagen (2007) on the reduced rates of VAT applied to goods and services in the EU Member States, available on the Commission's website at the following address: http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/economic_studies/index_en.htm.

negative spill over effects at EU level and, generally speaking, may be more transparent.

8.2.2.3. The agreement reached on reduced rates in 2009

The Council considered that the debate on the reduced VAT rates had already run since the presentation of Commission's 2003 proposal and it was time to close it. After long and thorough discussion, the debate in the Council on the overall system of reduced VAT rates was thus concluded with the unanimous political agreement of 10 March 2009[84].

This political agreement was formalised in Directive 2009/47/EC of 5 May 2009, which considerably restrained the Commission's proposal. It mainly allows — on a permanent basis — the optional use of reduced rates of VAT for certain labour-intensive local services, including restaurant services.

8.3. The way forward

The average level of rates has tended to increase since 2000. The increase was marginal in 2000-2002 but then, after a period of constancy, there was a sharp rise in 2009-2010 as some Member States adopted drastic revenue-raising measures during the crisis. The increase is visible in the standard rate and to a lesser extent in the reduced rate.

This phenomenon prompts the following observations:

- If the upward trend in the standard rate in the Member States were to continue, the question arises whether the minimum level of 15% laid down in the VAT Directive should not be increased in line with that trend.

- The ongoing increase in the standard VAT rate is an incentive for certain economic sectors to push for a reduced rate. Even now a number of sectors are making repeated requests for inclusion in Annex III on the grounds that they are also essential goods or services, like health prevention, children welfare, security clothes and services, etc.

- Article 99 of the VAT Directive sets out the principle that reduced rates are fixed at a level which is high enough to ensure that taxable persons, in general, do not end up in a constant repayment situation when offsetting their deductible VAT (with expenses at the standard rate) against their VAT due (at a reduced rate). Increasing the minimum level of the reduced rate, set at 5% in the VAT Directive, might be a way to uphold this principle.

The guiding principles of any potential review of VAT rates should be rationalisation, simplification and consistency.

A list of goods and services for which a reduced rate would be compulsory in all Member States would be a good way of upholding these principles.

[84] Council (Economic and Financial Affairs) political agreement of 10 March 2009 on reduced VAT rates: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/106576.pdf.

But even a short and optional list of reduced rates would be a major step forward compared with the current situation.

Simplification and rationalisation would specifically require clearer EU-wide definitions of the categories in the list, whether it is compulsory or optional. If it were optional, the option should cover the whole category, not just parts of it.

Consistency would mean that comparable products are subject to the same VAT rate and the way the product is 'delivered', specifically the use of modern technology, should not affect the VAT rate applied to it. This is in particular the case for cultural products and services which can be distributed online and offline (through physical support). Currently Member States may apply a reduced VAT rate to certain cultural products or services but have to apply the standard VAT rate to competing online services, such as books/e-books or film downloads/cinema tickets, even if they are based on the same cultural content and have the same social purposes. The 'Digital Agenda for Europe' stipulates that the challenges of convergence between the online and the physical environment should be addressed in all reviews of public policy, including tax matters, to stimulate the widespread development and utilisation of the Internet and related goods and services.[85]

As regards the goods and services to be retained on the (compulsory or alternatively short and optional) list of reduced rates, it should be pointed out that the use of reduced rates is often advocated for health, cultural and environmental reasons.

From a health perspective, access, availability and acceptability of food stuffs largely determine the diets of European Citizens. Given the impact of unhealthy consumption patterns on public health and Member States' budgets, taxation could be used to pro-actively promote healthy diets.

Some cultural goods and services benefit from a reduced VAT rate at the discretion of Member States. These are goods and services which from a political and social point of view have special characteristics, notably the support of cultural diversity. It is in Europe's interest – and in line with Europe 2020 – to promote cultural content and access to cultural content which will raise the average education level. Tax instruments have a clear impact on these policies' objectives.

There are also strong arguments that integrating environmental aspects into taxation can encourage consumers and producers to switch to more environmentally-favourable products by adjusting price structures. The current VAT system does not recognise this phenomenon. Broadening the objectives of VAT by linking it to sustainable consumption would be in line with the recent Commission initiatives aiming at achieving a resource efficient economy which is one of the key flagship initiatives of the EU 2020 Strategy. Changing price structure can help to shift demand towards less polluting and more resource- and energy-efficient products. It will also encourage further research into the development and innovation of more environmentally-favourable goods.

---

[85] The Digital Agenda for Europe is one of the Europe 2020 flagships, COM(2010)245.

Market based instruments (including taxes) can be one of the most effective (and efficient) policy tools to change behaviour, in place of or complementing direct regulation and many examples exist across the world.

In the short term, providing traders with appropriate and reliable information through an online database on the rates applicable within the EU could be envisaged with a view to facilitating compliance for those businesses wanting to take full advantage of the single market.

As the level and structure of VAT rates differ considerably between Member States, businesses which carry out supplies of goods or services taxable in Member States where they are not established have to look for reliable information on the rates applicable. The process of information-gathering might be particularly expensive and burdensome, especially for SMEs.

Setting up such a database would require a commitment from the Member States to provide official, accurate and detailed information on the VAT rates to be applied on their territory at frequent intervals. Indeed, taking into account the Member States' discretion in setting VAT rates, only they can provide the detailed information required and ensure it is up to date. The Commission could, however, lend technical and practical support.

Topic 9.

9. THE COMMISSION ACTION PROGRAMME FOR REDUCING ADMINISTRATIVE BURDENS AND STREAMLINING VAT OBLIGATIONS

9.1. Introduction

The regulatory environment in which businesses operate influences their competitiveness and their ability to grow and create jobs. The Commission is committed to developing a better regulatory environment for businesses; one that is simple, understandable, effective and enforceable.

Amongst the primary objectives of the 'Better Regulation' agenda is the aim to reduce administrative burdens by 25 % by 2012. Thirteen priority areas were selected, including VAT legislation.

To help in this process, on 31 August 2007 the Commission set up a 'High Level Group of Independent Stakeholders' to advise on carrying out the Action Programme, with initially a three-year mandate, now extended until 31 December 2012. On 13 September 2007, Edmund Stoiber, the former Minister-President of Bavaria, was appointed as Chairman of the group.

9.2. The Commission's Communication on an action programme for reducing administrative burdens

The work followed analysis by a consortium, a group of external contractors undertaking studies for the Commission, and was carried out in three distinct stages. These are detailed below along with the corresponding links.

(1) Mapping of information obligations (IOs) stemming directly from VAT legislation (Directive 2006/112/EC) — Tax Law (VAT)[86]

(2) Measuring the cost of compliance with information obligations — Tax Law (VAT)[87]

(3) Reduction recommendations — Tax Law (VAT)[88]

A Communication was issued on 22 October 2009 along with an Annex (COM(2009) 544 final Annex) detailing the results so far on the reduction of administrative burdens by sector and providing recommendations for future action. The details of the VAT recommendations can be found on pages 81 to 91 of the Annex and, as mentioned in the Green Paper, relate to measures 6 to 15. Recommendations 1 to 5 and 16 have either been adopted by the Council or proposed by the Commission.

---

[86] http://wcmcom-ec-europa-eu-wip.wcmvue.cec.eu.int:8080/enterprise/policies/better-regulation/administrative-burdens/priority-areas/tax/index_en.htm

[87] http://ec.europa.eu/enterprise/policies/better-regulation/files/abst09_taxlaw_en.pdf

[88] http://ec.europa.eu/enterprise/policies/better-regulation/documents/ab_studies_2009_en.htm (click on Tax Law in the list under '2. Reduction Recommendations')

Recommendations 6 to 15 in the Annex to the Communication (COM(2009) 544 final) are reproduced below.

Abolishing annual summary VAT returns (Recommendation 6)

The VAT Directive allows Member States to require that taxable persons submit an annual summary VAT return, containing the information provided in the periodic VAT returns and where necessary adjusting it. However, most of the information required on these returns is redundant or could be better obtained in other ways. Some Member States do not require them. Abolishing annual summary VAT returns could be part of the options under review.

Businesses would no longer have to submit summary annual returns. They would make corrections or amendments in the periodic returns, as practiced in those Member States which do not require an annual summary return.

Reducing the frequency of the periodic VAT return (Recommendation 7)

Taxable persons are required to submit a periodic VAT return (Article 250 of the VAT Directive) in which they set out all the information needed to calculate the VAT chargeable and the deductions to be made. The most common frequencies used by Member States are monthly and quarterly. Frequencies could be harmonised, revised downwards and based on turnover thresholds. The frequency could be annual for enterprises with a turnover of up to EUR 500 000, quarterly for those with a turnover of up to EUR 2.5 million and monthly for those above that threshold. Businesses would, however, be allowed to opt for more frequent submission.

Changing the frequency could reduce the number of VAT returns. Businesses would therefore spend less on consolidating VAT accounts, compiling the return and checking or correcting mistakes.

Simplifying the proof required for the VAT export exemption (Recommendation 8)

Taxable persons applying the VAT export exemption are required to prove to their tax authorities that they have dispatched the goods outside the European Union. The burden of providing this proof depends on the number and type of documents required. The export document, drawn up for customs purposes, could normally be regarded as sufficient proof of exportation. It could be sent by the customs authorities to the VAT authorities via the electronic information exchange system.

Paperwork related to the application for a VAT export exemption would significantly be reduced.

Abolishing the intra-EU acquisitions listing (Recommendation 9)

The VAT Directive allows Member States to require that taxable persons submit a list of acquisitions of goods or transactions from sellers established in other Member States. However, tax authorities could obtain the information provided by this listing from other sources, such as the intra-EU supplies listing or the VAT Information Exchange System.

Abolishing 'nil' intra-EU sales listings (Recommendation 10)

The VAT Directive requires taxable persons to file lists of all supplies made to taxable persons in other Member States. Member States may require the list to be submitted even for periods in which no intra-EU supplies took place. Businesses perceive this as irritating.

Businesses could be exempted from intra-EU supplies listings for periods in which they made no intra-EU supplies. Tax authorities could deduce the fact that there were no supplies from the periodic VAT return.

Introducing a real-time VAT collection system (Recommendation 11)

The current system of VAT collection is invoice- (not settlement-) based and requires businesses to use significant resources to comply with their VAT obligations. VAT payment and refund would be changed to the point at which payment is settled in real time through the banking system. This would automate most of the things that businesses currently have to do to comply with VAT legislation.

All taxable persons would be affected by this measure, notably with regard to the submission of VAT returns and listings and the bookkeeping and consolidation activities required to calculate the VAT amount due.

Facilitating use of the power of attorney to submit VAT returns and listings (Recommendation 12)

Use of the power of attorney to submit VAT returns and listings is currently restricted, limiting the way businesses use external tax consultants. In so far as these limitations stem from national measures implementing EU law, the Commission could consider a soft-law approach to disseminate best practice in this area and have more Member States opting for a lighter implementation approach.

SMEs, which are most likely to make extensive use of external VAT consultants, would benefit most from this measure. They could grant limited powers of attorney. They could also appoint several persons separately as authorised to sign VAT returns and sales listings.

Increasing the use of e-government solutions (Recommendation 13)

The VAT Directive allows and partly provides for the various VAT returns and lists to be submitted in electronic form to tax authorities. Uptake of this option, however, varies between Member States and is low in some. Identifying best practice in the Member States and encouraging others to adopt it would increase the use of e-government solutions.

More businesses would benefit from the cost savings made by switching from a paper to electronic communication with tax authorities.

Incorporating VAT registration into general business registration (Recommendation 14)

Taxable persons are obliged to inform the tax authorities when they begin their activity as taxable persons. Some Member States have incorporated this VAT registration into the general business registration. The Commission could promote this practice in more Member States by disseminating the insights gained so far.

Enterprises would no longer have to communicate the same information to different authorities, which creates unnecessary cost and irritation. In particular, it would make it easier to set up a new business.

Harmonising measures to combat VAT fraud in line with best practice (Recommendation 15)

The VAT Directive allows Member States to impose such obligations on taxable persons as are deemed necessary to ensure the correct collection of VAT and to prevent tax evasion. These obligations are the source of major differences for businesses engaged in intra-EU trade, so harmonising them could be envisaged.

All business would profit from more efficient, less burdensome anti-fraud obligations. Businesses conducting intra-EU trade would also benefit from having the same obligations in all Member States in which they operate.

9.3. Additional recommendations suggested by the High Level Group

In addition, the High Level Group of independent stakeholders recently published on 22 October 2010 an opinion on further VAT reduction recommendations[89]. The opinion suggests two further recommendations in addition to those mentioned above:

'(42) The VAT package entered into force on 1 January 2010. Even though the package has simplified cross-border Business to Business (B2B) services to some extent, it also leads to new and unnecessary administrative burdens. Sellers and buyers have to report cross border sales and acquisition already in the same period the service was supplied. This obligation is impossible to meet for business as no information is available for booking at that time at the purchaser's end of the transaction and the company providing the service cannot access information on the services provided at such short notice. The HLG urges the Commission to initiate changes as the present rules cannot be applied. The Commission is prepared to look at the chargeability to tax for cross border supplies of services in the forthcoming Green Paper.

Furthermore, stakeholders underline the high level of compliance cost arising from the package. One example is that the VAT package has increased the number of businesses obliged to submit periodic VAT statements on top of their normal VAT returns. Business are required to submit periodic VAT statements from the first euro of supply of services B2B cross border and the periodic statement requires specification of the sale for each buyer, identified by VAT registration number. This is an increased reporting obligation and increase of the administrative burdens for business. The HLG urges the Commission to investigate the possibility of

---

[89] The web page of the High Level Group of Independent Stakeholders on Administrative Burdens - http://ec.europa.eu/enterprise/policies/better-regulation/administrative-burdens/high-level-group/index_en.htm

introducing a threshold for business with minor amounts of cross border turnover or other means of simplification to avoid excessive information obligations that may otherwise discourage small business from starting to trade cross border.'

9.4. General comment on the recommendations

It is important to point out that these recommendations result from suggestions tabled by stakeholders and the advice given by the High Level Group of Independent Stakeholders on Administrative Burdens. Other opinions from the High Level Group can be found on their website[90].

These recommendations are still under consideration by the Commission, meaning that their feasibility and appropriateness are being reviewed. In particular, they need to be balanced with the tax authorities' duty to ensure proper collection of VAT and with the need to audit taxpayers efficiently.

9.5. Other obligations imposed by Member States (Article 273 of the VAT Directive)

The consortium's reduction recommendations and the opinion of the High Level Group concentrate on obligations in the VAT Directive that specify the nature of information to be provided, for instance the VAT declaration or recapitulative statement.

However, in addition, the consortium identified other instances in which the VAT Directive does not specify the information obligation (IO) but allows Member States to do so: so-called 'implicit IOs'. A good example is Article 273, which allows Member States to impose other obligations to ensure correct collection of VAT and to prevent evasion, without specifying what those obligations might be.

9.5.1. Work of the consortium

The information on implicit VAT information obligations can be found at the address below[91] and was provided by the same consortium that mapped the information obligations specified in the Directive.

The consortium concentrated on Article 273, since that is the legal base for most of the additional obligations that increase burdens on business. It made recommendations on the additional obligations and measured the benefit of reducing the resulting administrative burden.

Its main findings can be summarised as follows:

Transposition of the Directive resulted in a great variety of national IOs across the 27 Member States. This is specifically the case for the implicit IOs resulting from Article 273. Furthermore, in the latter case the IOs often apply in very few Member States.

---

[90] Idem

[91] http://ec.europa.eu/enterprise/policies/better-regulation/files/abst09_taxlaw_implicit.zip.

The total administrative cost resulting from the selected implicit IOs is put at approximately EUR 1 405 million, spread over 392 national IOs.

The number of IOs under Article 273 has been assessed at 208. The cost of complying with these obligations is calculated at EUR 682 million.

Extracts from the recommendations on obligations under Article 273, along with the burden reduction potential, are reproduced below. They are classed according to:

- Limited application — only one or two Member States apply the obligation
- Reporting obligations
- Drafting obligations
- Storage for inspection obligations
- Notification obligations
- Record-keeping obligations
- Other types of obligations

9.5.2. *Recommendations reproduced from the consortium's report*

Only the main recommendation for each class of obligation is reproduced. A full list of recommendations can be found in the consortium's report.

Information obligations with a very low transposition variable — only one or two Member States impose the obligation (Report section 3.4.2)

During this study, national VAT experts have identified certain IOs implemented in only one or a few Member States which create an extremely high burden for the national taxpayers or a certain target group.

In general, the fact that IOs stemming from Article 273 are only implemented in one or a few Member States, raises questions regarding the necessity of those IOs for the fight against fraud.

Therefore we recommend to abolish all of these types of IOs resulting in a reduction of administrative burden EUR 23 700 139.

Reporting obligations (section 3.4.3)

Obligation to report transactions with local registered VAT taxable persons (Recommendation 101)

Current reduction ideas resulting from this study can be summarised as follows:

- Abolishment of the IO;
- Abolishment of the obligation to file 'nil' listings;

- Abolishment of the obligation to send the relevant invoices to the VAT authorities;

- Encourage the use of e Government solutions by implementing user -friendly, uniform and easy accessible applications;

- Introduction of a specific reporting threshold per supplier/customer.

The point of view of the VAT experts in this respect is however that this IO should be abolished. This is substantiated by the recent abolition of this obligation in Italy. Research showed that the tax authorities make only little use of these listings and even have other means at their disposal to obtain the same information. Hence, the IO appears not to be essential from a VAT audit point of view, whereas it generates significant costs for the VAT taxpayers. Therefore it could be considered to introduce a provision in Council Directive 2006/112/EC whereby Member States are prohibited to impose measures in the framework of this IO.

Costs caused by this IO, assessed at EUR 279 566 576 will be reduced to zero.

Drafting obligations (Report section 3.4.4)

Obligation to draft and issue a document when the goods are dispatched in the framework of a sale on trial or a sale on consignment (Recommendation 103)

The obligation to draft and issue a document when the goods are dispatched in the framework of a sale on trial or a sale on consignment, in addition to a regular invoice, is experienced highly irritating by businesses. Hence, both the content to be mentioned and the data to b e collected with respect to these documents are in general quite similar.

Besides as means of control on the VAT treatment applied (account for VAT due and deduct VAT), tax authorities use this document in order to follow the flow of goods. In order to reduce the administrative burden resulting from this IO the abolishment of this IO could be considered.

Costs caused by this IO, assessed at EUR 2 953 870 could be reduced to zero.

Storage for inspection obligations (Report section 3.4.5)

Obligation to store the confirmation that a credit note was received by the addressee (Recommendation 102)

The obligation to store the confirmation that a credit note was received by the addressee in order to substantiate the VAT adjustments, is considered highly irritating from a business point of view. Moreover, this IO creates a financial burden since the adjustments of VAT paid can only be carried out once the confirmation receipt has been received.

Consequently, the burdens caused by this IO are disproportionate to its purpose, i.e. creating an audit trail for VAT adjustments. The VAT adjustments can sufficiently be substantiated by means of the mere existence and storage of a credit note. This viewpoint is founded by the fact that this approach is applied in most Member States. Based on these considerations, this IO should be abolished.

Costs caused by this IO, assessed at EUR 3 059 990 will be reduced to zero.

Notification obligations (Report section 3.4.6)

Obligation to notify the tax authorities in case of change of the VAT return regime

Even though the notification of the change in the VAT return regime in principle does not have to be submitted on a regular basis, it is often regarded as burdensome, especially where the change in VAT return regime is compulsory. Hence, in the latter case, the VAT authorities should be able to extract the necessary information from their system. In these cases, the IO is excessive and should be abolished.

When the VAT taxpayer can opt for a change in the VAT return regime, the notification should be performed by means of a written letter (standard or freely chosen format). In this respect, it could be considered to harmonise on an EU-level the maximum requirements which should appear on the document. More specifically, the name, address and VAT identification number and a detailed justification of the option should suffice. Furthermore the e -filing of this request should be possible.

Costs caused by this IO, assessed at EUR 2 501 484 could be reduced with 60 %.

Keeping registers obligation (Report section 3.4.7)

Obligation to keep a record of capital goods (Recommendation 103)

In order to create an audit trail for the capital goods of a business during the term of revision, some Member States impose an obligation on VAT taxable persons to keep a record of capital goods. From a VAT expert point of view, this IO can be substantiated by its purpose, and in practice is experienced as a part of the accounting procedure. However, given the significant differences between the information requirements in national VAT law, it should be considered to determine the maximum information requirements to be reported in the record in the Council Directive.

Taking into account the purpose of the record, the following maximum requirements could be imposed:

- a specification of the capital good;
- a reference to the purchase invoice;
- the date on which the right of deduction has arisen (e.g. date of purchase);
- amount of VAT paid and deducted;
- the ratio of VAT deduction (if applicable).

Costs caused by this IO, assessed at EUR 214 060 406 could be reduced with 20 %.

Other Information Obligations stemming from Article 273 Council Directive 2006/112/EC (Report section 3.4.8)

Obligation to provide information to the tax authorities upon their request (Recommendation 101)

Currently, the national VAT law of most Member States contains a general IO which requires taxpayers to provide information to the tax authorities upon their request. There are no specifications regarding the kind of information, the time frame in which the information should be provided, etc. This lack of specification creates an irritation factor and administrative burden for taxpayers.

Following reduction proposals were assessed by the national VAT experts:

- A clear indication in the Directive of a minimum time frame which the taxpayer is granted in order to gather the information requested;

- A clear indication in the Directive of the type of information that the VAT authorities are allowed to request;

- The implementation of an obligation for the tax authorities to provide a written request that provides a clear and detailed description of the information requested;

- The implementation of the possibility for the taxable person to file a request to extend the period granted to gather the requested information.

Costs caused by this IO, assessed at EUR 64 241 071 could be reduced with 30 %.

9.5.3. General comment on these recommendations

The comment made under point 9.4 about the need to balance these recommendations stemming from stakeholders with the needs of tax administrations for carrying out their tasks properly is equally valid for this second set of recommendations.

9.6. An alternative way forward: a maximum list of standardised obligations in Article 273

The work carried out by the consortium on Article 273 IOs has highlighted the great variation between Member States and, as a consequence, the difficulty and complexity of complying with VAT law, especially for businesses trading in many Member States.

Efforts could be made to follow up the individual recommendations.

An alternative approach, which would deal with these recommendations in a more systematic way, could be to define a maximum list of standardised obligations in the VAT Directive. Member States would be free to impose any of these obligations.

Such an approach would provide businesses with a degree of certainty, since they would know what VAT obligations could be imposed on them.

Only in very specific and targeted cases where Member States require extra reporting obligations to combat tax evasion or avoidance would Member States need to seek a derogation under Article 395 of the Directive. In their request, Member States would need to state the reasons why the obligations set out in the maximum list were not sufficient.

This approach, of a maximum list of pre-defined obligations, would give businesses the chance to establish accounting and reporting IT systems and processes for VAT purposes that cover all their obligations across the EU. This would allow reporting obligations for VAT to be standardised across the European Union and help reduce the burden on business.

9.7. A standardised EU VAT declaration

As well as standardising the obligations Member States can impose under Article 273, consideration could equally be given to having an EU standard VAT declaration.

Agreed information corresponding to numbered boxes on the VAT return would have to be provided. So, for instance, box 1 would be VAT on standard rate supplies, box 2 VAT on reduced rate supplies, etc. The VAT return would be available in all EU languages with common definitions of what was to be included in each box. Thus, for instance, a business in Greece could use its own language to complete an EU VAT return for a VAT declaration to be submitted in Finland which, since the information supplied in each box was identical throughout the EU, would allow the Finnish tax authorities to correctly interpret the declaration.

Given the difference between the number of boxes on VAT returns between Member States, agreement would need to be reached on how many boxes should be filled in. There could be a minimum number of boxes, providing information that all Member States require, and other boxes requiring supplementary information could be imposed should they be demanded by certain Member States. However, leaving certain VAT return boxes optional would limit the burden reduction for business, although providing more information upfront could limit additional queries from tax administrations. A finite list of boxes to be filled in for all Member States would of course achieve better burden reductions for business.

Consideration could be given to whether all businesses should be allowed to fill in a standard EU VAT return. Non-established businesses or businesses that trade in several Member States through fixed establishments or groups of companies operating across the EU through subsidiaries in each Member State might find it advantageous, especially if their accounting and finance functions are centralised, to complete standard EU VAT returns in each Member State rather than submitting different national VAT returns sometimes completed in an unknown language. In any case, for Member States with less information demanded on a national VAT return than on an EU VAT return, allowing businesses the option to submit either one should not pose too much of a problem. The same would not be true for Member States that have a national VAT return requiring information in excess of the EU return.

The advantages for businesses would be that they could create standard accounting reports that would provide the information on an EU VAT return and thereby satisfy the information requirements of all Member States. Moreover, they could work and report in their own language.

To some extent, a common VAT return will exist from 2015 for the 'mini- one stop shop', whereby non-established businesses making B2C suppliers to customers in another Member State will be able to submit a VAT declaration in the Member State where they are established for supplies of telecoms, broadcasting and e-services taxable in other Member States.

Although the VAT declaration for the mini- one stop shop would be limited to certain services and only for supplies made, not for any right to deduct, it will still contain information on supplies at different rates, in different Member States and from a business with VAT identification numbers in several Member States. This information will need to be harmonised at EU level to allow Member States to exchange the data. This harmonisation could be then used as a basis for devising an EU VAT return.

The 'full' one stop shop concept as set out in topic 11 requires harmonisation of the content of the VAT return submitted via this mechanism.

A standard VAT declaration could also allow Member States to exchange data more easily and swiftly. The information requested from tax administrations would not have to be extracted and compiled to fulfil the request and the tax administration could target the information needed (box numbers) based on the standard EU VAT return.

An EU VAT return would allow a Member State requiring some basic information about a taxpayer in another Member State to define precisely the information they needed, which would speed up the exchange of information and free up resources for dealing with more complex administrative queries.

Topic 10.

10. SMALL BUSINESSES

10.1. Current legal framework

The VAT Directive allows Member States to provide for a special scheme for small enterprises. The simplified scheme may be either an exemption from VAT or, for instance, a flat-rate or graduated system.

Under a flat-rate scheme the business is allowed typically to pay VAT at a set percentage of its turnover depending usually on the business activity. In return the business is exempted from charging and reclaiming VAT on a transaction basis. Introducing any such flat-rate scheme requires the VAT Committee to be consulted and given reasons why the normal VAT arrangements would be difficult to apply to these small businesses because of their activities or structure. Member States differ in their use of this option and the schemes they set up are primarily designed for traders with domestic operations only.

Graduated tax relief may, for instance, mean allowing a business to pay no VAT below a given threshold but to pay an increasing percentage of the VAT due above that threshold until at a certain level all the VAT is paid and no relief is given.

Member States may provide for a scheme whereby businesses with an annual turnover below a certain threshold are entitled to exemption from VAT. Any business choosing to be exempt from charging VAT on the supplies it makes is not allowed a right of deduction. Exemption from VAT is the most widely used scheme in the EU for small enterprises.

The VAT Directive also provides Member States with an optional common flat-rate scheme for farmers. Although it is not strictly limited to small businesses, it is designed for cases where applying the normal VAT arrangements to farmers is likely to give rise to difficulties. When a farmer applies for this flat-rate scheme, he is no longer covered by the normal VAT rules: he may not deduct the VAT paid on his inputs and he may be released from obligations relating to the payment of tax, invoicing, declarations and accounting. To make up for the VAT paid on inputs which cannot be deducted, flat-rate compensation (calculated by each Member States on the basis of macro-economic statistics) is paid.

10.2. The exemption scheme

10.2.1. History and references

The special scheme for small enterprises was laid down in Article 14 of the Second VAT Directive[92] which allows Member States 'to apply to small undertakings,

[92] Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax (OJ 71, 14.4.1967, p. 1303).

whose subjection to the normal system of value added tax would meet with difficulties the special system best suited to national requirements and possibilities'.

The Sixth VAT Directive[93] set out further details and rules as regards the application of a special scheme for small enterprises. It included thresholds for using the scheme, the calculation of businesses' annual turnover, limitation of the right to deduct if the VAT exemption was used and a provision allowing businesses to opt for the normal tax regime.

In 1992, under Council Directive 92/111/EEC, the special scheme was adapted to exclude new means of transport and supplies by a non-established taxable person. With the recast of the Sixth VAT Directive in 2006 the special scheme for small enterprises was brought together in Chapter 1 of Title XII of the VAT Directive[94].

Member States which acceded before 1 January 1978 and which opted to introduce a special small enterprise scheme under Article 14 of the Second VAT Directive may retain it (Article 284(1) of the VAT Directive). Those Member States which, at 17 May 1977, exempted taxable persons whose annual turnover was less than the equivalent in national currency of 5 000 European units of account, at the conversion rate on that date, may raise the ceiling to up to EUR 5 000 (Article 284(2) of the VAT Directive), while Member States which exempted taxable persons whose annual turnover was equal to or higher than that amount may raise the ceiling to maintain the value of the exemption in real terms (Article 286 of the VAT Directive). Member States which have not exercised the option may exempt taxable persons with an annual turnover of up to EUR 5 000 or the equivalent in national currency (Article 285 of the VAT Directive).

Member States which acceded after 1 January 1978 may exempt taxable persons whose annual turnover is no higher than the amount set on the day of their accession. Varying from one Member State to another (from EUR 10 000 to EUR 37 000), this ceiling is equal to the equivalent in national currency at the conversion rate on the day of their accession of the amounts referred to, for each Member State, in Article 287, points (1)–(18) of the VAT Directive.

In addition, three Member States, Italy, Latvia and Poland, also have a derogation, limited in time, under Article 395 of the VAT Directive, allowing them to apply an annual turnover threshold to exempt small businesses greater than that allowed to them under the VAT Directive.

The result of these rules, set at different times, is that, for primarily historical reasons, Member States have different thresholds they may apply to exempt small businesses from VAT (see table for the thresholds in the Member States[95]).

---

93 Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ L 145, 13.6.1977, p. 1).

94 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

95 http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_annexi.pdf.

In 2004 the Commission came forward with a proposal[96] to allow all Member States to set an annual turnover threshold no higher than EUR 100 000 under which businesses could be exempted from VAT. The amount could be increased in line with inflation to maintain the equivalent value as of 1 July 2006. The Commission proposal remains on the table at the Council, although it was last discussed in the Council in 2007.

10.2.2. Evaluation of the exemption scheme

10.2.2.1. The level of the threshold

The annual turnover threshold that Member States may set for the special scheme for small enterprises differs. Certain Member States are restricted to a ceiling of EUR 5 000 while others have a ceiling of almost EUR 80 000. Some can increase the amount in line with inflation and others cannot.

These different thresholds have arisen from historical reasons based largely on when Member States joined the EU and whether they applied any threshold at a particular moment in time. Even those Member States that would like to increase the threshold are hindered in doing so. Certain Member States have asked for and received derogations to increase their thresholds but this can only be seen as a short-term measure which, in any case, does not provide a long-term solution that is fair to all Member States.

For those Member States that have a high maximum threshold, the special scheme for small enterprises offers a degree of flexibility as they have greater freedom to set the annual turnover to achieve the right balance of collection and control costs set against the extra revenue. This may be one threshold or, as is the case in several Member States, different thresholds e.g. according to the type of supply, so there could be some differentiation between suppliers of goods and services.

Those Member States legally bound to a low threshold do not have this flexibility.

10.2.2.2. Administrative burden and compliance costs

The main purpose of the scheme for small enterprises is to reduce the administrative burden of VAT, which weighs more heavily on them because of the scale of their activities.

Article 272(1)(d) of the VAT Directive allows Member States to exclude businesses covered by the exemption for small enterprises from certain or all of the obligations covered in Chapters 2 to 6 of Title XI of the VAT Directive. This includes invoices, storage of invoices, VAT declarations and certain obligations in relation to recapitulative statements.

The extent of the exemption from certain obligations is determined by each Member State and will vary across the EU.

---

[96] Proposal for a Council Directive amending Directive 77/388/EEC with a view to simplifying value added tax obligations (COM(2004) 728 final).

The advantage for small businesses of being exempt from VAT is increased if Member States also release them from VAT obligations such as invoicing. So for instance, while the business may in any case issue an invoice to provide evidence of a supply of goods or services and to demand payment, the VAT rules on invoicing may include conditions on the content, the time of issue, outsourcing and so forth, which would impose additional invoicing burdens.

There are advantages too for the Member State. Notwithstanding making small businesses more competitive, the cost of collection and control by the Member States of typically small VAT payments may be seen as not cost efficient. In any case the VAT revenue forgone by the Treasury is only the VAT on the margin.

10.2.2.3. The exemption scheme and cross-border transactions

Supplies by non-established small businesses

One of the primary drawbacks of the scheme for small enterprises is that it is limited to supplies in the Member State in which the business is established (Article 283(1)(c) of the VAT Directive). Thus an established business with an annual turnover below that set by the Member State for the special scheme for small businesses may exempt from VAT the supply in that Member State but the same supply to the same customer by a non-established business with a similar annual turnover may have to be charged with VAT. Moreover, even if that non-established business were covered by the small business scheme in the Member State where it was established, it might in any case have to charge VAT in the other Member States.

The matter of different treatment between an established and non-established business has now gone before the ECJ for a ruling[97]. On 26 October 2010, the Court gave its ruling.

The conclusion was that the annual turnover of a business used to determine if the threshold is exceeded ‘must be interpreted as meaning that the term 'annual turnover' refers to the turnover generated by an undertaking in one year in the Member State in which it is established‘. The income of a business in relation to supplies taxable in another Member State should therefore be excluded.

It should be added that as the rules are interpreted as excluding from annual turnover supplies that are taxable in a Member State where the supplier is not established the definition of what is a small enterprise in the EU could be seen as distorted. For example, a business that has supplies of only EUR 10 000 in its Member State of establishment but has supplies taxable in another Member State of, say, EUR 5 000 000 would still be eligible for the scheme for small enterprises in the Member State where it is established.

Conversely a small business with minor supplies in a Member State where it is not established would not be eligible for the small business scheme. A situation could therefore arise where a large business is eligible for the special scheme for small enterprises because very few of its supplies are taxable in the Member State where it

[97] Case C-97/09, *Ingrid Schmelz* v *Finanzamt Waldviertel.*

is established whilst a small business, by being non-established in that Member State, could not use the special scheme.

Intra-EU supplies made by and made to exempt small businesses

Member States are not required to identify taxable persons that have no right to deduct VAT (Article 214(1)(a) of the VAT Directive). Since businesses opting to use the special scheme for small enterprises have no right to deduct (Article 289 of the VAT Directive) they are not required to be identified for VAT.

Nevertheless, for a small business acquiring goods supplied from another Member State, a threshold is set by the Member State of destination above which an intra-EU acquisition is subject to VAT. In this case there is an obligation to register for VAT, complete a VAT declaration and pay the VAT to the tax authority. The threshold set by Member States must be at least EUR 10 000, which is indeed the case for most Member States although in certain cases the amount is higher.

Supplies made by small businesses under the exemption scheme are excluded from the exemption for intra-EU supplies of goods. This can make it difficult for the recipient to know whether the exemption is a result of the supplier being under the small business scheme or is a result of an intra-EU supply. The difference is that only the latter requires an intra-EU acquisition.

There is thus a difference between a small business making a cross-border supply of goods and a small business receiving goods. So, depending on the thresholds set by each Member State, a small business may not make an exempt intra-EU supply but for a similar value a small business receiving supplies is required to make an intra-EU acquisition.

Differences between goods and services

As from 1 January 2010, Article 214 of the VAT Directive was amended to require VAT identification for all businesses making and receiving supplies of services across borders for which the customer is liable for payment of the VAT under the reverse charge procedure (Article 196 of the VAT Directive). This is the case irrespective of the value of the supply and includes businesses under the special scheme for small enterprises.

Thus different thresholds for goods supplied and received across borders and the absence of a threshold for services complicates trade for small businesses.

10.3. The way forward

10.3.1. The exemption scheme

The current schemes are aimed principally at the very smallest businesses that have a turnover typically equivalent to the income of an individual worker or even less. Clearly, it makes sense to remove or simplify the VAT obligations of these very smallest businesses as much as possible, when the VAT revenue collected is negligible.

The following ideas could be considered when reviewing the current provision in the VAT Directive concerning the exemption scheme.

10.3.1.1. Compulsory scheme for Member States

The current special scheme allows Member States to choose to use such a scheme and then to also determine the threshold, up to a maximum level.

A minimum compulsory level across the EU, with Member States having the option of applying a higher threshold, would create a more level playing field for all small businesses and make a significant contribution to reducing burdens on business.

10.3.1.2. A common threshold for the small business scheme

As was proposed by the Commission in 2004 to remedy the inequality of Member States having different thresholds for historical reasons, one solution could be to allow all Member States to set a threshold up to an agreed maximum level. The Commission proposed that the maximum threshold be EUR 100 000.

A common maximum threshold would give consideration to the relative purchasing power in each Member State. A threshold for small businesses in one Member State may be considered too high or too low in another Member State.

10.3.1.3. A threshold based on EU annual turnover

Calculation of annual threshold is based on supplies only in the Member State where the business is established. Within the single market it would be more appropriate if annual turnover were based on the total value of EU taxed transactions.

10.3.1.4. Allow small businesses to be regarded as non-taxable persons

There are currently certain rules that apply to all taxable persons, such as the place of supply of services, but equally there are specific rules for taxable persons under the small business scheme such as for intra-EU supplies and acquisitions of goods. This all adds complexity to the scheme and increases burdens on small businesses.

A possible solution is to treat taxable persons under the small business scheme as non-taxable persons. This would mean that the VAT obligations would in general not apply with the possible exception of Article 248, which allows Member States to require non-taxable persons to store invoices they receive. It would mean that small businesses using the special scheme for small enterprises would be treated similarly to a private individual.

For control purposes, Member States may still want certain obligations to be met. A scheme which applies a threshold should allow some means for business turnover to be checked against that threshold, so the obligation to issue and keep invoices could be advantageous to the Member State. Equally, notification of which businesses are being treated as non-taxable persons through some identification system may be beneficial to the Member States.

Thus some balance may be needed between the imposition of certain obligations on the business and the need to help small businesses by reducing their administrative burden.

10.3.2. A simplification scheme other than the exemption scheme

Many businesses that have an annual turnover higher than the thresholds set by Member States are still classed in the EU as micro-enterprises (annual turnover less than EUR 2 000 000). The invoicing Directive (2010/45/EU) has now introduced an option for Member States to introduce a cash accounting scheme for businesses with an annual turnover below this threshold. Consideration could be given to offering a such businesses a small business scheme as well.

This could include measures such as a flat-rate scheme where a set percentage of turnover is paid to the tax authorities rather than payment based on recording the difference between all the sales and purchases in a given period along with all the necessary adjustments.

Another alternative is a graduated tax, whereby the amount of VAT paid is reduced according to specific predefined criteria such as turnover. In this way the small business is compensated for the relatively higher collection and reporting costs compared to a larger business.

In terms of specific actions to reduce compliance costs for these businesses, the measures suggested under the Better Regulation Agenda (see topic 9) are intended to benefit all taxable persons. The question therefore arises whether there is still room for specific relief from certain obligations which would not be covered by the broader framework of that Agenda.

10.3.3. The farmers scheme

VAT is a general consumption tax and it is therefore questionable whether special schemes targeting one specific sector should be envisaged. On the other hand, if there are valid reasons for a sectoral approach, then the optional nature of the scheme becomes questionable.

Topic 11.

11. A ONE STOP SHOP SYSTEM

11.1. The concept of a one stop shop

The concept of a one stop shop system is simple: taxable persons taking part in transactions subject to VAT in different Member States can meet all the VAT obligations for those transactions in a single Member State.

While they meet all their obligations in one State, the transaction itself is taxed according to the rules (e.g. on rates, exemptions, and deduction) of the Member State where the transaction is located for VAT purposes.

This concept could be refined in various ways: it could be limited to certain categories of taxpayers, to certain types of transactions or to meeting certain VAT obligations only.

11.2. Historical overview

As a general rule, taxable persons carrying out taxable transactions for which they are liable to pay tax in more than one Member State have to meet VAT obligations (identification, VAT returns, and payment) in each of these Member States. Member States have considerable freedom to decide on these obligations (e.g. on the identification process, and on what must be included in VAT returns and how often they must be submitted) which makes it that much more complicated to set up cross-border operations.

A first exception to this general rule was introduced in July 2003 with the special scheme for taxpayers outside the EU supplying electronic services to non-taxable persons. The aim was to facilitate compliance for non-EU e-commerce operators as much as possible.

With the adoption of the so-called VAT package, from 1 January 2015 this scheme will cover all EU and non-EU operators supplying telecoms, broadcasting and electronic services.

Moreover, from 1 January 2010, a one stop shop system was introduced for refunding VAT incurred by EU businesses in Member States where they are not established. Although there have been problems with national implementation, the Commission remains convinced of the merits of this approach.

By contrast, the Council has not yet been able to reach agreement on a broader one stop shop system, as contained in the proposal presented by the Commission in October 2004, with a view to simplifying VAT obligations. An expanded one stop shop was a major feature of this comprehensive simplification proposal and would greatly simplify formalities for a large number of SMEs (e.g. distance sellers). This proposal is still on the table at the Council but has not been taken up by recent Presidencies.

11.3. Evaluation

The benefits of the one stop shop concept as a simplification measure has generally been recognised by business. However, the scope of the systems so far agreed is limited and targeted.

The system introduced in July 2003, which will be extended in 2015, is limited to certain categories of transactions. In addition, it covers only output transactions; it does not allow deduction of input VAT by offsetting it on the return submitted via the one stop shop. The refund mechanism is also limited to a specific situation.

As a result, particularly after 2015, an EU taxable person who uses the one stop shop to supply telecom, broadcasting and electronic services will have to make use of a different one stop shop to obtain a refund of the input VAT on those output transactions. This will reduce the simplification benefits of the first system from the outset, since it will still be simpler to deduct input VAT by offsetting the amounts on the VAT return than to apply for a refund.

The concept as envisaged in the Commission proposal of 2004 covered both outputs and inputs. It was widely supported by business federations representing large, medium-sized and small companies.

It therefore comes as no surprise that one of the recommendations made by the 'High Level Group of Independent stakeholders' chaired by Mr. Stoïber (see topic 9), was the setting up of a wide one stop shop.

11.4. Possible way forward

In the current VAT system, the one stop shop concept still deserves consideration as a legitimate tool to help traders comply with their VAT obligations on operations in different Member States.

The concept as proposed in 2004 clearly needs revisiting, taking into account notably the changes in the 'place of supply' rules and the features of the one stop shop resulting from the adoption of the VAT package and the changes to the rules on administrative cooperation between Member States.

11.4.1. Potential scope of the one stop shop system

The one stop shop proposed in 2004 was intended to cover all transactions for which a taxable person becomes liable in a Member State in which he is not established. This covers both B2B and B2C transactions.

The risk of providing new scope for missing trader fraud by including B2B transactions was a major issue of debate.

Changing the general rule for determining the place of supply for B2B services (from the place of establishment of the supplier to the place of establishment of the customer) should reduce the number of situations where a taxable person becomes liable for VAT on B2B transactions in a Member State where he is not established. Other changes to the place of supply of B2B services which are either in force or

coming into force on 1 January 2011 reduce the number of such situations even further.

One could, therefore, consider restricting the one stop shop to B2C transactions. The remaining situations in which a non-established trader becomes liable for VAT on B2B transactions could be systematically subject to the reverse charge procedure, which appears to be the simplest. After the adoption of the VAT package, many Member States decided to go down that road.

Even restricting the scope to B2C transactions, these would mainly concern distance selling, supplies involving installation or assembly, work on immovable property, sales at exhibitions and fairs, markets, sales on board aircraft and removals.

What should be avoided at all costs is to have taxpayers confronted with a situation where — in relation to a Member State in which they are not established — they could use the one stop shop for certain transactions but still be required to register and fulfil VAT obligations outside the one stop shop for some other category of transactions.

11.4.2. Registration under a one stop shop concept

The fact that registration in one Member State would automatically have effects for the other Member States was another point of concern during the discussions on the proposal.

This is a valid point which, however, is also valid for intra-EU trade to a certain extent. When deciding how to treat the supply for VAT purposes, the supplier will largely rely on whether the customer has a VAT number or not.

This is why the recently adopted Council Regulation 904/2010 on administrative cooperation and combating fraud in the field of VAT[98] introduces new provisions requiring Member States to carry out certain checks and assessments during the registration process. Member States must also inform the SCAC Committee of the national measures taken. The objective of informing the SCAC is to give other Member States sufficient confidence in its national procedures.

A comparable approach could therefore be developed for taxable persons wanting to make use of the one stop shop.

Another approach could be based on a system in which Member States are consulted on the need to identify a taxable person under a one stop shop.

11.4.3. VAT return

A 'multi-country' return form with harmonised content would be needed. This return could consist of a number of 'electronic pages' (one page for each Member State) and the taxable person in question would fill in the relevant pages. The level of detail required in relation to VAT rates would have to be decided by each Member State of

[98] OJ L 268, 12.10.2010, p. 1

consumption. Each page could automatically display the VAT rates applying in the Member State in question.

The VAT return to be submitted in the supplier's Member State of establishment could be included or not (however, see topic 9, point 9.5). In the latter case, the introduction of the one stop system would not necessarily entail wholesale harmonisation of obligations in the Member State of establishment, which would be difficult to achieve in any event.

11.4.4. The right of deduction

Under the one stop shop system proposed in 2004, a taxable person could exercise its right of deduction by entering the relevant amounts in the 'electronic page' of the Member State under which VAT had been charged.

Consequently, deductions would be made according to the rules of the Member State of purchase.

11.4.5. Payment and repayment

Under the 2004 proposal, it was envisaged that the taxable person would make the payment directly to the national account of each Member State of consumption in the currency of that country.

Under the existing system for e-commerce transactions, which will be extended on 1 January 2015, there is only a single payment to make. It seems therefore more logical to go with that principle in the future.

If the one stop shop covered deductions, the return could, in exceptional cases, result in a credit. A system of carryover or repayment would have to be introduced for that purpose.

11.4.6. Providing information to taxable persons

Although the one stop shop system would replace 27 different rules on identification, returns and payment of VAT, it does not standardise the taxation rules proper (rates, exemptions, restrictions on the right to deduct input VAT).

The introduction of such a system would therefore have to be accompanied by an efficient system of informing taxable persons about the rules applicable in each Member State.

In particular, computerised access to the VAT rates of all Member States needs further investigation. Such access would be easier to introduce if Member States could agree to base their rates on a common classification of goods and services.

11.4.7. Control by the tax authorities

The introduction of a one stop shop should not affect the ability of the Member State of taxation to ensure that the tax is paid.

The situation would be comparable to the current situation of a taxable person who is directly registered (but not established) in a Member State because he carries out distance sales above the threshold to that Member State.

The recently adopted Council Regulation 904/2010 on administrative cooperation and combating fraud in the field of VAT contains specific and more stringent provision for cooperation between Member States on transactions for which the Member State of establishment of the supplier and the Member State of taxation are different.

By introducing these provisions, which come into force on 1 January 2015, the Council recognised the need for closer cooperation between tax authorities. The transactions covered by these provisions would be typical candidates for the one stop shop concept.

The one stop shop concept should not reduce any Member State's control capabilities. Even if the general principles relating to national responsibilities for control were to remain the same under a one stop system, it would be appropriate to improve procedures by giving priority where possible to simultaneous controls.

In addition, it would greatly encourage voluntary compliance with obligations, as companies would be able to discharge all their obligations through one national administration and in their own language.

11.4.8. Taxation of intra-EU supplies of goods and services

The above factors are described in the context of the current VAT system.

However, as stated in point 4.2.3 of the Green Paper on the future of VAT, a well functioning one stop shop system is also a prerequisite of a VAT system in which intra-EU supplies of goods and services are taxed at destination.

In such a VAT system, unlike the present one, a one stop shop concept should not be limited to B2C transactions but should include B2B transactions, too. It would be an essential instrument for dealing with all VAT liabilities in Member States other than that of establishment of the supplier.

The other information set out above remains valid, although the scope for control by the tax authorities, and the instruments available for exchanging information and other forms of administrative cooperation would certainly need careful reconsideration in such a system.

Topic 12.

12. ADAPTING THE VAT SYSTEM TO LARGE AND PAN-EUROPEAN BUSINESSES

12.1. Background

There are few provisions in the VAT Directive specific to pan-EU or other large businesses. However, the Directive does allow such companies both to streamline their VAT compliance and to manage the creation of non-recoverable VAT in operations. These measures could be seen as contributing to the efficiency of their operations.

For activities conducted entirely with one Member State, the Directive provides a number of instruments which such businesses can use and which, in addition to limiting VAT obligations, have the effect of reducing the burden of non-deductible VAT where this arises from transactions with subsidiaries, partners or other associated parties. These include VAT grouping and cost sharing consortia[99]. Similar effects, albeit limited to supplies of services, can result from the particular VAT treatment of such transactions between various branches of a Pan-European business situated in different Member States.

12.2. Evaluation of current legislation and policy

12.2.1. Intra-EU transactions in services within the same legal entity

There is a fundamental break in consistency in the VAT treatment of transactions in services between the various parts of a commercial organisation where these extend to more than one Member State, depending on the legal structure it has assumed. This break hinges on whether these are parts of the same legal entity (branches) or are themselves legally independent (subsidiaries or other combinations, whether based on a controlling or non-controlling interest). The most important difference between the two categories is that where an organisation takes the form of several branches, fixed establishments or divisions it will be considered as a single entity for VAT purposes in line with the 'FCE' judgment[100].

The European Court of Justice (ECJ) concluded that the various establishments of a single legal entity cannot be treated as individual taxable persons and as a result, there can be no supply for VAT purposes between them.

In 2003, the Commission proposed amending the Directive to clarify that services rendered between the various establishments of a single legal entity are not to be treated as supplies for VAT purposes[101]. This was merely to confirm the Commission's own view and that of the great majority of Member States, and to establish legal certainty and a consistent interpretation.

---

[99] But this can now be extended to cross-border scenarios — see below.
[100] Case C-210/04, FCE Bank.
[101] COM(2003) 822.

In the event, the Council could not see its way to a consensus on the proposal. The Gordian knot was, however, presently resolved by the FCE judgment. The result is seen as benefiting business, bringing VAT into line with the more general regulatory climate, which is one of reducing obstacles to consolidation and deepening in critical industries.

The continued deepening of the single market puts a new spotlight on the VAT treatment of such structures and transactions. Many businesses operate in more than one Member State and large European companies seek to establish effective Pan-European business structures. Moreover, by 2007 services represented just over 70 % of gross value added in the European Union. The development of the Societas Europaea adds a further dimension (SE)[102].

If the services were subject to VAT, the tax would generally be accounted for by the recipient under the reverse charge mechanism. Besides reducing administrative burdens such as recapitulative statements, this special treatment may result in an advantage where the business is not entitled to deduct VAT in full.

12.2.1.1. Positive effects

Not taxing transactions involving services between various parts of the same legal entity, even when these are in different Member States, is consistent with the principle that activities carried out by part of a single legal person for the benefit of other parts of the same legal person cannot be treated as a transaction subject to VAT. It might also be seen as consistent with the principle of freedom of establishment within the EU, since an internal border between those parts does not undermine that favourable treatment. The outcome is conducive to the exploitation of single market opportunities for those businesses which have the appropriate legal structure.

There is also a strong pragmatic argument supporting the non-taxation of intra-EU transactions in services between the various parts of the same entity: it prevents such businesses from incurring non-recoverable VAT. Financial and insurance institutions, in particular, are not usually entitled to deduct VAT incurred on their inputs except where these are used for the purposes of rendering services to customers established outside the EU. This leads to accumulating and cascading tax, with the exempt supplier's non-deductible input VAT being absorbed in the cost structure but ultimately reflected in the price charged for exempt services to fully taxable customers who would otherwise recover this tax. This goes against the principle that VAT should be neutral: VAT is a tax on final consumption of goods and services which relieves businesses of the burden of VAT incurred in the process of production and distribution of these goods and services. Preventing businesses from incurring non-recoverable VAT cannot but be regarded in a positive light.

---

[102] Council Regulation (EC) No 2157/2001 of 8 October 2001. The registered office of the SE is in the Member State where it has its central administration, that is to say its true centre of operations. SEs are, however, subject to VAT obligations in any Member State where they have a fixed establishment.

12.2.1.2. Possible shortcomings

In FCE, the ECJ limited its answers to situations where the entities involved are established in the EU. This leaves unanswered the question of what is the correct treatment when a branch is established in a non-EU country or where a company with its headquarters outside the EU has branches that are fixed establishments in an EU Member State.

Some Member States are of the view that the provision of services within the same legal entity never falls within the scope of VAT and that therefore these operations do not constitute taxable transactions, no matter where the various constituent parts of the entity are located.

There is a defensible argument that the ECJ's logic in FCE points towards such a conclusion. The practical problem here, however, is that it opens up a leak in the VAT system, whereby an institution acquiring services in a non-EU country can re-route them to an establishment in the EU without incurring any EU VAT. Where the non-EU country is one which regards cross-border transactions between branches as within the scope of their VAT (or similar tax), the institution may even be able to recover non-EU-country input tax if supply to an EU branch is considered an export.

Even for entities entirely within the EU, the risks of distortion persist. Under the current rules and practice, it is possible to channel services to Member States in which, either because of the way in which the law is interpreted or because of concessional schemes, the rate of input tax recovery is high, and subsequently reroute them, without any charge to VAT, to branches of the same entity in a Member State with a low rate of input tax recovery.

Such distortion of the input tax incurred by companies clearly distorts competition between similar businesses in different Member States but also *vis-à-vis* competing businesses in the same Member State whose corporate structure does not give them any such flexibility.

An additional consequence of the current situation is that whilst the supply of services between the different establishments of a single entity in different Member States is outside the scope of VAT, this does not apply to transactions involving goods. Taken in isolation, it is difficult to rationalise this situation.

12.2.2. Grouping provisions

Article 11 of the VAT Directive provides Member States with an option to introduce VAT grouping schemes into their national legislation and regard two or more persons established in that Member State who, while legally independent, are closely bound to one another by financial, economic and organisational links, as a single taxable person for VAT purposes.

Member States who wish to exercise this option must consult the VAT Committee first and may adopt any measures needed to prevent tax evasion or avoidance arising from the use of this option.

In the search for clarity, the Commission recently published a Communication on the interpretation of Article 11[103] with the objective of securing more uniform application of the measures on VAT grouping schemes and giving guidance to the increasing number of Member States which are introducing them[104].

The Commission stressed in particular that if a Member State opts for group registration, the effect of the arrangement is restricted to its own jurisdiction and only generates benefits with respect to transactions that are carried out between taxable persons established there (through a fixed establishment or a seat), without covering their foreign establishments.

12.2.2.1. Positive effects

VAT grouping may simplify administration for a commercial group of companies because transactions between the individual members of the group are not subject to VAT and are ignored for VAT purposes. This also reduces the negative consequences for cash flow within the group.

Group registration may also have a positive effect on the members' administrative burden because, instead of filing separate VAT returns, they can file a single return. It also prevents members of the group who have a VAT claim on the tax authorities from having to await repayment. Such members can simply offset their claim against the VAT liabilities of the other members of the group.

In practice, since transactions between the members of the group are ignored, group registration is particularly beneficial to groups consisting of companies with a partial right to deduct input tax because no VAT is charged on taxable intra-group supplies of services or goods (in particular those with mainly in-house added value) used for the non-taxable transactions of another member of the group. Moreover, a common and average 'pro-rata' can also reduce the amount of irrecoverable input VAT as regards goods or services used both for taxable and non-taxable transactions.

12.2.2.2. Possible shortcomings

Given the advantages a VAT group can offer to certain businesses, unequal and inconsistent implementation across the EU may produce results which run counter to the principle of fiscal neutrality and represent a source of fiscal competition between Member States detrimental to businesses.

---

[103] Communication from the Commission to the Council and the European Parliament on the VAT group option provided for in Article 11 of Council Directive 2006/112/EC on the common system of value added tax, COM (2009) 325 final, 2 July 2009.

[104] The national arrangements currently applicable vary substantially and, in some cases at least, seem to take rather loose approaches to conformity with the Directive. The Commission has launched infringement proceedings against seven Member States because of their failure to meet their obligations with regard to VAT groupings. For the Netherlands, Ireland, Finland, the UK, the Czech Republic and Denmark, the problem identified is that they allow non-taxable persons to join a VAT group, contrary to the provisions of the VAT Directive. There are proceedings against Sweden and Finland because they limit the VAT grouping system to financial and insurance services. The Directive does not allow such limitation. The proceedings against the Netherlands also cover failure to notify the VAT Committee of changes to the application of their VAT grouping scheme.

It therefore seems questionable, firstly, that grouping arrangements are an option for Member States. That does not take away, secondly, from the imperative need for a level playing field even among those who choose otherwise. Largely because of the piecemeal and uncoordinated process of implementation by Member States, the existing range of grouping schemes does not always assure this outcome.

The shortcomings identified in the Communication (and of course in the recently launched infringement proceedings) do not of themselves negate the value of the scheme in so far as Member States take the necessary steps to correct them.

It is, however, of interest that an appreciable, if declining, number of Member States see no reason to implement this provision. The Commission has never investigated the reasons for this, but there is at least the perception in some cases that VAT grouping is difficult to administer and control, poses risks to revenue security and does not deliver proportional benefits. These concerns are not, however, universally shared and it is relevant that Member States may adopt whatever measures are needed to prevent mischief.

As a result of the deepening of the single market, many businesses, in particular large European companies, operate in more than one Member State through either branches or subsidiaries. This has resulted in an increasing proportion of cross-border transactions being carried out within the same group of companies. However, these groups have to deal with up to 27 different sets of rules and special reporting obligations for those internal transactions, only because they are cross-border.

A taxable person, in particular a parent company, cannot extend the scope of the VAT group and the benefits of simpler formalities beyond a domestic border and include fixed establishments or subsidiaries situated in other Member States. That difference in treatment between domestic and cross-border intra-group transactions discourages the latter and the development of businesses across the EU. This is not in line with the requirements of a well functioning single market.

12.2.3. Cost sharing arrangements

Article 132(1)(f) of the VAT Directive provides an exemption for ‘the supply of services by independent groups of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition’.

This provision is intended to create relief from VAT in a situation where a group of businesses come together in what might be called a system of ‘cooperative self-supply’, in circumstances in which a single business which had the resources to conduct the activity in-house would be able to so do without incurring any VAT.

The rationale for this exemption is of at least as much importance as its practical effects. The legislators intended to mitigate the burden of VAT which taxable persons engaged in exempt activities would incur on outsourcing services to third-

party service providers. It is the arrangement itself which is to be seen as in the public interest rather than the individual services which the arrangement delivers.

The Directive in the provision quoted above lists five conditions, four of which are relatively clear and should not give rise to any implementation problems for Member States. The condition relating to the absence of distortion of competition is, however, a possible exception.

It would not be rational, however, to interpret this condition in such a restrictive manner so to make its application impossible. It is a natural and entirely foreseeable consequence of such an arrangement that the individual consortium members will no longer be in the market for such services (to the extent to which they receive these services under the cost sharing arrangement) so this cannot in itself give rise to a distortion of competition in the sense intended by the legislators.

Although their effects might be perceived as being the same, VAT grouping and cost sharing arrangements have a different scope and different target groups. Cost sharing arrangements are only aimed at reducing the VAT costs of services rendered to their members. Those members have in common that, in view of their activities, they have no or a limited right to deduct input VAT. VAT grouping, on the other hand, is aimed in particular at eliminating the financing of VAT on intra-group transactions for both goods and services. The members of such a group may have a full, limited or no right to deduct input VAT. There is, however, no obstacle to the inclusion of Article 11 VAT groupings and members of such groups in a cost-sharing arrangement.

12.2.3.1. Positive effects

The exemption for cost sharing arrangements is in practice a wide ranging and efficient way for taxable persons engaged in exempt activities to reduce their VAT costs on services. Without that exemption, the outsourced services would generate non-deductible VAT. This would lead to an accumulation of the tax at subsequent stages of the process of production and distribution of taxable goods and services. That exemption also enables taxable persons engaged in exempt activities to take advantage of economies of scale and specialisation by outsourcing services on the basis of covering costs in cooperation with similar enterprises and without creating additional input VAT on these services.

The cost sharing exemption can, unlike a VAT group, embrace cross-border scenarios, with activities and members situated in more than one Member State. What is important is that the activity is exempt, not where it takes place. Correspondingly, there is of course no obligation to avail of the exemption in circumstances where the members carry out non-taxable activities only.

The arrangement does not, however, have to be limited to members' exempt activities but may embrace the supply of services for both taxed and exempt activities. Nor is there any obstacle to the supply, by a group of undertakings of the kind referred to, of services to third parties, provided that those services (in so far as they are not covered by another exemption) are taxed in the normal way.

12.2.3.2. Possible shortcomings

Although Article 132(1)(f) seems sufficiently clear, Member States appear to interpret it differently in practice even to the extent that some completely fail to implement it. This is regrettable given the rationale for this exemption and its practical effects. That should yield a powerful impetus for universal and uniform implementation.

The Commission has had to insist that the provision be applied in as uniform a manner as possible. This is the only possible way to avoid divergence in the application of the VAT system from one Member State to another, an outcome which would be inimical to fair competition.

That some Member States have totally neglected to implement cost sharing has to be seen as a serious and fundamental shortcoming. Other shortcomings include failure to observe that no right of deduction can arise in respect of goods and services used to generate services exempt under this provision. Even more inimical to correct, uniform application would be any national implementing measures which purport to interpose a right for members of the consortium to deduct input tax in so far as they make exempt supplies themselves.

12.3. Possible ways forward

12.3.1. Intra-EU supplies within the same legal entity

Taxable self-supply of services

In order to correct distortions of competition, Member States might consider more widespread application of Article 27 of the VAT Directive, which allows them to treat as a supply of services for consideration any supply by a taxable person of a service for the purposes of his business where the VAT on such a service, were it supplied by another taxable person, would not be wholly deductible.

This provision is not widely used today and was probably conceived to deal with a limited set of circumstances and domestic situations. Wider, cross-border application would raise some technical issues and require uniform and sound application. In order to deal with the risk of double taxation or tax-cascading, the application of what is deemed self-supply to cross-border services (in an FCE-type scenario) would require a corresponding right to deduct input tax elsewhere or, alternatively, limitation of the tax on the deemed self-supply to the part of the value of the services that had not yet effectively been subject to VAT elsewhere.

The question of course arises as to whether the result might simply be excessively complicated and be seen as disproportionate in the search for neutrality. Where a decision is taken to bring transactions between branches in different tax jurisdictions within the scope of VAT in order to restrict opportunities for mischief, this should perhaps be limited to transactions involving non-EU countries. One technical issue which has been raised is that as transactions between related parts of the same legal entity are not always on the basis of invoices, it might be difficult to apply the tax consistently. Countries which tax such transactions usually do this on the basis of

consistency with transfer pricing rules, a solution which seems to work well in practice.

Extending special treatment to intra-EU supplies of goods within the same entity

A parallel way forward which could constitute a major simplification would be to also consider the supplies of goods between branches, currently deemed to be intra-EU supply of goods, as outside the scope of VAT. Extending the scope of Article 27 to supplies of goods as well as services in order to prevent distortion of competition could also be considered.

12.3.2. Offering the option of VAT grouping to businesses and extending its territorial scope

In order to ensure a real level playing field across the single market and among businesses, consideration should be given to making VAT grouping compulsory or an option for taxable persons instead of an option for Member States, given the significant advantages of such a scheme.

The issue of pan-EU VAT groupings with harmonised conditions is one which always recurs. It is not without its logic, e.g. it would restore neutrality between different business structures such as a holding/subsidiary structure and a headquarter/branch one and greatly reduce the administrative burdens of large pan-EU businesses.

12.3.3. Ensuring more uniform application of cost sharing arrangements

A particular public initiative, similar to that launched for VAT grouping, focusing on interpretation of Article 132(1)(f), could ensure more general and uniform application of this provision and give guidance to the Member States and the relevant businesses.

Topic 13.

13. SYNERGIES WITH OTHER LEGISLATION - CUSTOMS LEGISLATION

With the adoption of the Modernised Customs Code (Regulation 450/2008 of the European Parliament and of the Council of 23 April 2008) and the electronic customs decision (Decision 70/2008/EC of the European Parliament and of the Council of 15 January 2008 on a paperless environment for customs and trade), the European Union committed itself to major simplification and modernisation of customs procedures by 2013.

Several of these changes will have a strong impact on import VAT collection in so far as the customs declaration is currently the basis for calculating import VAT.

The most important change in this context is the introduction of centralised clearance. Under Article 106 of the Modernised Customs Code, customs authorities may authorise importers to both declare and pay customs duties to the local customs administration of their establishment (Member State of authorisation), irrespective of where the goods are physically imported and where they are transported to within the EU. In such cases, the customs debt will be deemed to be incurred in the Member State of authorisation.

However, under the VAT legislation in force, importers would still have to assess and pay VAT in the Member State of actual importation.

Given that the aim of centralised clearance is to facilitate business obligations by reducing administrative burdens for trusted operators, a change in current import VAT procedures should be considered. A public consultation[105] has therefore recently been launched in order to receive the views of all stakeholders on the best way forward in this respect. An assessment of the impact of the different options set out in the consultation document is also being carried out.

In addition, possibly in combination with centralised clearance, the Modernised Customs Code has also foreseen the self-assessment of customs duties. Under Article 116 of the Code, importers may be excused from lodging any customs declaration and allowed to declare and pay their duties periodically to their Member State of authorisation instead. This will inevitably have an impact on import VAT collection, which is still based on the customs declaration.

There might be other areas where synergies will have to be built between customs and VAT legislation and feedback from stakeholders will be useful in this context. At the same time, it should be stressed that the fundamental objectives of the two are not the same. While customs legislation is now more focused on security and safety than on its traditional fiscal function, one of the main objectives of the EU VAT system is to ensure stable revenues.

---

105 http://ec.europa.eu/taxation_customs/common/consultations/customs/customs_clearance_2010_en.htm.

Topic 14.

14. REVIEWING THE WAY VAT IS COLLECTED

14.1. Background

A study was carried out for the Commission by Reckon to quantify and analyse the VAT gap in the EU 25 Member States[106]. For 2006, the VAT gap, which is the difference between the theoretical VAT liability for the economy as a whole and actual VAT receipts, was estimated at EUR 106 billion or about 12% of the theoretical VAT liability.

The VAT gap includes VAT uncollected due to the inherent risk of fraud in the current VAT system but also covers other elements like legal avoidance and unpaid VAT liability due to insolvencies.

The size of the VAT gap is one good reason to take a critical look at the way VAT is collected in the EU.

Under the VAT system as it is currently applied in the EU, businesses act as unpaid tax collectors. At regular intervals, taxable persons have to calculate the amount of VAT they have to pay to or to get back from the Treasury.

For this (self-) assessment, taxpayers calculate, for each tax period, the VAT due on their outgoing transactions and the VAT they can claim back on their incoming transactions, and the balance between the two amounts. This balance is either what the taxable person has to pay to the Treasury or what the Treasury owes to the taxable person for the period in question.

In its VAT return, the taxable person has to provide some general figures to the tax authorities about the assessment, but will not usually have to provide documentary evidence of the figures when the VAT return is sent.

The collection of VAT is therefore primarily based on a self-assessment system.

Verification by the tax authorities mostly happens ex post and this can lead to adjustments of the VAT initially declared by the taxable person.

Although this system gives the tax administrations an easy way of collecting the tax (the taxpayer collects the VAT on its behalf), it also has a number of disadvantages:

- it relies heavily on taxpayers' compliance;
- the data sent to the tax authorities in the VAT return allows only very basic control checks;

[106] http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/combating_tax_fraud/reckon_report_sep2009.pdf.

- therefore, it is also vulnerable to fraudulent behaviour that can only be detected during a later audit or through an efficient and timely risk management system;
- finally, it is often difficult to collect the VAT after the event, as the taxable person might in the meantime have disappeared, or gone bankrupt, etc.

This way of collecting VAT has not changed substantially since VAT was introduced in the EU. The content of VAT returns might have been refined, and their electronic submission facilitated. The data is also processed and used much more for risk management purposes now, allowing audits to be better targeted.

Recent developments in technology might, however, offer new opportunities for collecting VAT, opportunities that did not exist when the common VAT system was introduced. Furthermore, it is now easier for tax administrations to handle large amounts of data than it was at the time the common VAT system was introduced. Tax administrations also need much quicker access to data in order to react rapidly to new fraud threats and to secure VAT revenue.

It is against this background that the Commission decided to order a study on the feasibility of alternative methods for improving and simplifying the collection of VAT by means of modern technologies and/or financial intermediaries.

14.2. The results of the study

The first task was to draw up an inventory of alternative VAT collection models. After a high level assessment of these alternatives, 4 models were selected for further analysis.

14.2.1. The four models analysed as part of the study

The **split payment model** is a model in which the purchaser pays the VAT to a blocked VAT bank account which can only be used by the supplier for paying VAT to his suppliers' blocked VAT bank account. The advantage of this model is that, in an early stage of the VAT collection process, the VAT collected is physically transferred to a blocked VAT bank account with the tax authorities' bank. This model allows the tax authorities to monitor and block funds on the VAT bank accounts and prevent taxable persons from disappearing with VAT funds paid to them.

The **central VAT monitoring database model** is a model whereby all invoice data is sent to a central VAT monitoring database. The way VAT is paid to the State is unchanged but the scope for real-time auditing and fraud investigation by the tax authority is increased. This model can only work if e-invoicing is made obligatory for B2B transactions and if the data contained in e-invoices is actively mined by the tax authorities.

The **data warehouse model** is a model whereby the taxable person uploads predefined transaction data structured in an agreed format into a secured VAT data warehouse maintained by the taxable person. The data to be archived in the VAT data warehouse could be based on the Standard Audit File for Tax (SAF-T) as laid down in OECD Guidance. Data should include invoice data, proof of delivery and

payment data, i.e. all data needed for a VAT audit. The tax authority would be given direct access to those transaction data of a taxable person in this VAT data warehouse. If necessary, the tax authority could pull out the data as needed to perform real-time VAT monitoring and to mitigate risks of VAT fraud. The tax authority would only have direct access to the set of data that is stored and uploaded by the taxable person into the secured VAT data warehouse either every 24 hours or upon the tax authority's request.

The **certified taxable person model** is a model wherein a taxable person's VAT compliance process and internal controls are certified. In order to be certified, the taxable person must have an '*Internal Control Framework*' that includes a '*VAT Control Framework*' covering people, processes and technology (systems). Where an ICF is in place, the taxable person carries out a '*risk self-assessment*' of all its control and monitor functions and is in a position to provide a statement, known as an '*in control statement*', in relation to those functions. With an '*in control statement*', a management board affirms that it is in control of the processes taking place in its business. If the taxable person is in a position to detect any meaningful risks and to report them to the tax authority, the role of the tax authority can change to that of assessing the monitoring system of the taxable person itself, rather than intrusive auditing.

14.2.2. The assessment of the models

The study included a high-level quantitative assessment of the costs and benefits of the four models, regardless of which stakeholders would eventually bear the burdens or reap the benefits.

The consultant encountered several data issues (data which were lacking, data from different sources which were contradictory, available data related to different years or based on different calculation methods or definitions). A number of assumptions had to be made in order to overcome these problems.

The consultant points out that the results of the study are therefore merely indicative. Nevertheless, since the calculations for each model are based on the same data and assumptions, the lack of data quality should not greatly influence the major preliminary conclusions that can be drawn from this assessment.

14.2.3. Conclusions and recommendations

The assessment shows that, in a timeframe of about 20 years, the benefits that all four models would generate in reducing the VAT gap should be substantially higher than the investment and operational costs. It means that all four models have the potential to reduce the VAT gap.

The data warehouse model has the greatest estimated benefits, as it includes all transactions by all taxable persons (B2B and B2C) and would allow for nearly real-time auditing. When tax authorities can efficiently audit transactions promptly, the potential benefits are larger than for the split payment model and the central VAT monitoring database model, as these models only include B2B transactions.

The split payment model requires more time to become fully operational. Hence the benefits are only accounted from 2020 onwards.

The certified taxable person model has the lowest benefits of the four models because of its limited capability to reduce missing trader intra-EU fraud and other components of the VAT gap (e.g. insolvencies).

One model on its own might not be sufficient. A combination of models that tackles both tracing transactions on a real-time or nearly real-time basis (the data warehouse model) and offers the ability to block funds for some transactions (the split payment model) seems to offer the greatest prospects of success. Additional assurance can be gained from further monitoring transactions and enhanced control requirements (e.g. by means of certification requirements for certain types of businesses).

The consultant concludes, therefore, that a combination of the split payment model with a limited version of the data warehouse model, i.e. a model where data is produced in a standard format but without direct access in a data warehouse, offers the best combination for reducing the VAT gap while keeping the estimated costs as low as possible.

14.3. The way forward

The study's conclusions and recommendations are the result of independent work carried out by PWC and do not necessarily reflect the opinions or position of the European Commission.

Moreover, the study is an initial assessment of the feasibility of changing the way VAT is currently collected.

It does have the benefit of indicating that new ways of collecting VAT are worth analysing further.

The study has recently been finalised, so it has not been discussed yet with any stakeholders. For instance, the banking sector has not yet been consulted on its potential role in split payment.

The Green Paper, however, provides a good opportunity to collect reactions to the four models at an early stage.

Clearly further investigation is necessary, and in its report (see page 252) PWC makes some recommendations on the next step to take.

Topic 15.

15. PROTECTING BONA FIDE TRADERS AGAINST POTENTIAL INVOLVEMENT IN VAT FRAUD

15.1. Background

One of the advantages attached to a VAT system, in comparison to a sales tax system, is its self-policing character. Firstly, with the system of fractionated payment, any supplier who is tempted not to declare to the Treasury the VAT on his sales runs a high risk, compared with what is often a small reward (e.g. the margin between the output VAT less the input VAT), particularly for supplies of goods, on which it is difficult to recover the input VAT without declaring the corresponding output transactions. Secondly, each trader has an incentive to obtain a proper invoice from his supplier in order to be able to deduct the input VAT. The supplier is then encouraged to declare the VAT to the Treasury, since his customer could be required to provide the tax administration with the invoice, so the transaction can be effectively checked by matching the VAT deducted by the customer with the VAT declared by the supplier.

However, there is no absolute guarantee that the supplier will actually pay the Treasury the VAT he received from his customer. This is particularly the case if the chain of fractionated payments is broken and the supplier is able to acquire goods or services free of VAT, via an intra-EU acquisition or under the reverse charge procedure, and resell them. In that case, 'stealing' all the VAT charged to the customer because no input tax was paid, might be worth the risk.

To allow Member States to tackle this kind of fraud, the ECJ introduced a link between the customer's right to deduct input VAT and the supplier's payment of the VAT to the Treasury and so tried to put new responsibilities onto the shoulders of customers. If the tax administration is able to prove that the customer knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT (the so-called 'knowledge test', see C-439/04 Axel Kittel), the tax administration can refuse that taxable person the right to deduct the VAT incurred on that purchase.

With the 'knowledge test' and therefore the risk for a time, which could be several years, of being held indirectly liable for fraud committed by somebody else, compliant businesses have to take 'every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud'. Trying to fulfil this requirement for each transaction with each supplier in the course of normal business could be very burdensome with, moreover, no guarantee that it would satisfy the tax administration or national courts. Taxable persons therefore suffer from a lack of legal certainty.

On the other hand, without using extensive resources tax administrations could find it very difficult to prove that the customer in each transaction carried out by the fraudster knew or should have known that his purchase was connected with fraud.

The measure envisaged below, an 'optional reverse payment', could perhaps iron out those difficulties whilst increasing the positive effects of the link introduced by the Court in B2B transactions.

15.2. The 'optional reverse payment' system

A supplier usually has to fulfil two main obligations: being liable for payment of VAT to the tax authorities and paying the VAT when submitting the VAT return. Under the 'optional reverse payment' system, the customer could choose to take on the second obligation and pay the tax directly. The idea is to give the customer an option with advantages that might be worth the extra formalities: no particular checks of the supplier required and no risk of being denied the right to deduct input VAT later on.

Under this system, put simply, when receiving an invoice, the customer would have a choice: paying the supplier the total amount charged including VAT or paying the VAT directly to the tax authorities, with a few details added (the invoice number, the supplier's and customer's VAT identification numbers and possibly the taxable amount) and paying the remaining net amount to the supplier.

This system has similarities with the first model (split payment) set out in point 5.4.1 of the Green Paper (see also topic 14 on reviewing the way VAT is collected). However, the split payment model completely overhauls the way VAT is collected while reverse payment is different in scope and objective, as it would be simpler and optional and therefore used only in specific circumstances.

15.2.1. How would the customer opt for reverse payment?

The only way to opt for reverse payment would be by actually making the VAT payment to the tax authorities. Neither a commitment made by the customer in an agreement or contract with the supplier nor a mere declaration to the tax administration would be legally considered as making use of the option. Therefore, if, in such cases, despite his commitment, the customer did not actually pay the VAT to the Treasury, the supplier would remain obliged to pay the VAT.

In practice, payment would be made as simple as possible by using common modern solutions already used by tax authorities for the payment of taxes (payment online via credit card, money transfer, direct debit, etc.) or via financial intermediaries such as banks. Some information would be given at the same time: the invoice number, the VAT numbers of the supplier and of the customer and possibly the taxable amount.

By adapting banking payments through SEPA, it might be possible to pay the net amount to the supplier and the VAT to the tax authority at the same time and by a single payment transaction (e.g. by credit card or credit transfer), while providing the same information as before. For instance, when making a purchase in a shop and paying by credit card, the customer, prompted by the credit card device, could choose to pay the VAT directly to the Treasury and the net amount to the store.

In any event, as in certain Member States, payment in cash to the tax authorities could not be excluded a priori. In that case, the tax authorities would themselves

enter the information in the IT system, which would then be used to notify the supplier and probably give a receipt to the customer.

15.2.2. How would the supplier be informed?

The 'reverse' payment could be checked either via access to a VAT account held by the tax administration in the name of the supplier, showing online and in real time all reverse payments made by his customers, or via a tax administration portal confirming the payment.

It could also be envisaged that the total in reverse payments received by the Treasury during a certain period (e.g. a month or a quarter) would be written directly on the next VAT return related to this period (pre-filled VAT return).

15.2.3. Consequences of the use of the option regarding VAT legislation?

For the customer

Since the VAT would have been paid directly to the Treasury, the customer could not be held liable for non-payment and therefore, be denied the right of deduction. The right to deduct input VAT would remain subject to the normal rules contained in the VAT Directive, e.g. that the goods or services are used for taxed transactions and for business purposes by the taxable person. The rules on pro rata calculations would continue to apply.

Therefore, the customer would no longer have to carry out checks to pass the 'knowledge test'.

As regards the obligation to pay the supplier, the part of the debt corresponding to the VAT directly paid to the Treasury would be considered paid.

For the supplier

The supplier would remain liable for payment of the VAT but would not have to make the payment; i.e. he would be obliged to pay the VAT in due time until the customer, by paying the tax directly, released him from this obligation. If the supplier had in the mean time paid the Treasury, (because the VAT declaration was due before the invoice fell due), the supplier would be repaid immediately by the Treasury or, more simply, by means of a credit on his next VAT return.

The tax authorities would hold the evidence that the customer had paid the VAT directly to the Treasury. The supplier would easily be able to obtain and keep such evidence for his own records or accounts (via electronic statements from the Treasury, like bank statements, for instance).

This means that, in contrast to a reverse charge, reverse payment would always leave the supplier responsible for meeting any obligations linked to his liability (e.g. submitting a VAT return, issuing a complete invoice with the taxable amount per rate or exemption, the VAT rate and the VAT amount payable). In particular, he would remain liable for deciding the appropriate VAT treatment for the transaction that he has carried out (applying any exemptions, selecting the rate, calculating the taxable amount and the VAT etc.). With this option, the supplier would only be released

from the obligation of paying the VAT for this particular transaction with the next VAT return.

Since the customer would already have provided the information to the Treasury, it could be thought that the supplier would not have to list 'reverse payment' transactions on his VAT return at all. But it seems more appropriate to take reverse payments into account only in calculating the final amount to be paid on the regular VAT return (although the template would have to be changed slightly). So the supplier would still declare all supplies on the VAT return, calculate the VAT due and — this would be the only new thing — deduct the amount of VAT directly paid by his customers from the total VAT amount due to the Treasury. The latter information would be provided by the tax administration (via its website, a dedicated portal for each taxable person, e-mails, a pre-filled return with a special box, etc.). The reasons for still listing reverse payment transactions are that, firstly, a return almost identical to the normal one would be easier to manage for the supplier and, secondly, a return listing all the transactions carried out could still be needed particularly for pro-rata calculations.

If the supplier gives a large payment period to this customer, the current VAT system mainly based on the time of the supply would not be problematic with the reverse payment. A supplier who had already declared and paid the VAT would be entitled to an immediate refund from the tax authorities based on the evidence of the customer's VAT payment that they already held. A simple way would be to automatically deduct the VAT paid directly by the customers from the total VAT due by the supplier on the next VAT return following the reverse payment.

The customer's option to pay the VAT would not affect his obligations to the supplier unless they both decided otherwise in the contract. However, as pointed out above, once the customer actually remitted the VAT to the Treasury, it would be considered paid and the supplier would have no claim on the VAT amount in the invoice.

15.3. Advantages

A general advantage of the optional reverse payment is that there are no substantial changes to the VAT system. All the basic principles are maintained e.g. the chargeability of tax, the right of deduction, reporting obligations, the person liable etc. The only change is that when a reverse payment is made the supplier no longer has to pay the VAT, which has been paid by the customer: if he has already paid it, it must be swiftly and easily repaid.

In practice, of course, customers and suppliers will, in general, be the same taxable person: businesses buy and sell. The distinction is made here to highlight the advantages and disadvantages for the parties in a single transaction. Bear in mind, too, that, like the disadvantages described below, the following is only a rough evaluation of the possible effects of this option in terms of legal certainty, administrative burdens and cash flow, and (for the Treasury), fraud.

15.3.1. *For the customer*

Legal certainty: the customer would no longer be held liable later for any fraud committed by the supplier.

Administrative burden: the customer would no longer have to check the supplier's compliance.

Cash flow: No effect on cash flow. When required to pay, instead of paying the VAT to the supplier (or factor), the customer would remit the VAT directly to the Treasury at the same time.

15.3.2. *For the supplier*

Administrative burden: the supplier would no longer have to pay the Treasury the VAT directly remitted by the customer.

15.3.3. *For the Treasury*

Fraud: The Treasury would benefit from reduced fraud in B2B transactions. Compliant traders would tend to use the system for suspect suppliers (new ones, or those selling products susceptible to fraud) or as a general policy in order to avoid risk.

Experience has shown that pinpointing new sectors used by fraudsters in B2B transactions in good time is difficult for the tax authorities. Businesses are often aware of new signs of fraud in their own sector before the tax authorities (for instance, the appearance of unknown traders selling at unexpectedly low prices). An optional reverse payment system would therefore be very efficient. Compliant traders would spontaneously use the system to protect themselves and prevent any risk arising when the tax administration finally reacted. A new trend in the use of the option in a particular sector would not only prevent fraud but alert the tax administration.

In addition, reverse payment would provide the administration with additional information on a transaction-by-transaction basis. This information would allow the tax administration to detect more easily any suspect traders that might go missing, for instance those subject to a high proportion of reverse payments compared with similar suppliers or to detect traders concealing a part of their sales, by matching this information with the VAT returns submitted.

Administrative burden: Certain resources dedicated to detecting fraud in B2B transactions (notably MTIC fraud) could be used for other purposes.

Cash flow: Reverse payment would provide the administration with real-time payment of VAT when the customer pays for the supply before the next VAT return is submitted by the supplier. If payment is delayed, the supplier pays the VAT as at present, on the next VAT return. However, VAT paid by a customer making use of reverse payment might be refunded to the supplier only with the following VAT return. That would give the Treasury an additional cash-flow advantage.

15.4. Disadvantages

From the point of view of both the customer and the supplier, this option might have an impact on relations between them and therefore on business in general. This might be seen a priori as a disadvantage.

To be precise, this option would add a new topic or factor in commercial negotiations between the parties alongside a quite similar issue, the terms of payment. However, adding this option (for instance, a commitment from the customer to use or not use the option) to the factors to be discussed in order to reach a satisfactory deal could also be seen as an advantage by one or both parties.

A customer making use of the optional reverse payment could also be seen as signalling mistrust in his supplier. It would certainly indicate a desire to offload the risk of being later denied the right of deduction. However, this also happens when a customer insists on paying on delivery of the goods or supply of the service, or when a supplier asks for immediate payment and refuses credit. These traders show that they do not really trust their contractors and their ability or willingness to pay later or carry out the supply or, more simply, that they do not want to bear any risk. Adding other benefits for customers using reverse payment for purchases, for instance swifter refund by the Treasury in case of repayment position, could make the use of the option more neutral and ordinary.

15.4.1. For the customer

Administrative burden: The customer wishing to pay in this way would have to make an additional payment to the Treasury and to provide certain information. However, this burden would be easily smoothed by allowing online declaration and payment or provision of this information with the credit transfer; it would be even better to adapt SEPA arrangements to allow the customer to pay the VAT to the Treasury, with all the information needed, and the net amount to the supplier, all through a single payment (credit transfer or credit card).

15.4.2. For the supplier

Cash flow: under the current system for charging VAT, based on the date of supply, reverse payment would be disadvantageous for suppliers who are paid immediately and thus keep the VAT until their next VAT return. Where payment is deferred, the VAT paid by the customer making use of reverse payment might be refunded to the supplier only on the following VAT return (which is a simpler solution for both the Treasury and the supplier).

Refund position: It may well be that a supplier who normally pays VAT to the Treasury will become a ‘repayment trader’. The conditions for refunding VAT can be stricter, sometimes requiring extra information or additional control, and there is always a risk of delays in repayment. However, someone who becomes a repayment trader because of reverse payments would be easily identified by the tax administration. Since the situation was clearly justified, the request should be better and more rapidly managed than those of traders who are in that situation for other reasons requiring further analysis (intra-EU supplies or exports). Moreover, it could

be laid down that if a supplier uses reverse payment when purchasing, it could obtain a swifter refund of the corresponding VAT.

Administrative burden: Monitoring the payment of invoices issued without upfront payment would be more complicated. For each invoice, any supplier who has not engaged a factor to manage outstanding invoices checks his bank accounts or cheques received. If the customer has paid only the net amount, he would also have to check his Treasury account.

15.4.3. *For the Treasury*

Set-up costs: Whilst many, if not all, tax administrations keep a computerised record of the accounts of taxable persons with certain data available online to them (VAT returns submitted, VAT due, payments made, interest charges, etc), they will also need to provide them with online access to the information provided by customers using the option and the corresponding payments made. However, the customer could also provide the supplier with proof of the use of the option in order to justify paying the net amount only. Tax administrations will also need to provide customers wishing to make use of the option via credit card or direct debit (at least until SEPA arrangements are adapted if possible) with an appropriate online payment application. A suitable way would be to adapt the current systems used for paying the VAT online. In any event, all of this will require specific investment.

Managing the data: The number of invoices issued in the EU is estimated at around 30 billion. Although this includes B2C invoices (50 %), exempt supplies, etc., and not all invoices will be subject to reverse payments, it could be that several million invoices will be subject to reverse payment. It requires a certain level of resources to maintain a database involving millions of transactions.

Errors in payment, cancellation of the invoice or issuance of credit note: These events could possibly be seen as more difficult to manage both by the tax administration and the parties to the transaction with reverse payment. However, it should be provided that, as at present, the identity of the person paying the VAT in the first place would have no bearing on the way these situations are tackled.

For instance, if the reverse payment is lower than the VAT charged, the supplier would be obliged to pay the remainder to the Treasury. If the reverse payment is higher than the VAT charged, the difference having automatically been credited to the supplier’s Treasury account, he would be obliged to repay his customer. In case of cancellation or a credit note, the supplier is obliged to repay the corresponding net amount and the VAT to the customer (a customer that has deducted this VAT will also have to repay it on its next VAT return). The supplier would ask the tax administration for repayment via, as is often the case, the VAT return, for instance.

15.5. Conclusion

This option would allow compliant businesses to be released from certain administrative burdens and to obtain legal certainty where they feel this is needed. Fraudsters would have less chance of committing fraud and the Treasury could benefit from fraud reduction in B2B transactions, in particular so-called ‘missing trader fraud’. In allowing B2B fraud to be tackled in connection with intra-EU

supplies with very little change to the current basic principles of VAT, this measure seems promising.

However, one could consider that such a measure could work better or give additional advantages if fine-tuned or combined with other solutions:

- The reverse payment option would have to be exercised earlier — i.e. before payment for the supply — and for a limited period of time, for instance, between the time of the supply and the deadline to be met by the supplier for submitting the corresponding VAT return. It would, however, be simpler to handle the option with a VAT system based on payments for the chargeability of VAT.

- Besides a universal option, one could envisage a compulsory system targeting customers purchasing certain well defined goods or services susceptible to fraud or customers in particular situations (exporters, public bodies), if necessary with a high threshold per transaction.

- To counterbalance the optional reverse payment offered to customers, the link between the right of deduction and actual payment of VAT by the supplier could be tightened where the customer does not make use of the option. That could be achieved either by strengthening the 'knowledge test' with new enforcement means for the tax administrations by, for instance, transferring the burden of proof to the taxable person in certain cases or by automatically refusing the right of deduction in cases of non-payment targeted on very risky and sizeable transactions.

Topic 16.

16. EFFICIENT AND MODERN ADMINISTRATION OF THE VAT SYSTEM

16.1. Background

In March 2007, the Commission held a 'VAT fraud conference' to give European businesses the opportunity to express their views. One general conclusion drawn from the conference was that businesses and tax authorities share an interest in combating fraud and traders are willing to assist tax administrations in this task. Improving communication between businesses and tax authorities was seen as a major factor. There was also a clear statement about the disproportionate costs to businesses of divergent national reporting requirements.

In its Communication of December 2008[107] the Commission presented a short-term action plan for combating VAT fraud. It also suggested reflecting on a longer-term approach that could take into account technological developments and new strategies for compliance and monitoring, all with the aim of reducing the involvement of tax authorities and easing the administrative burden on business.

Initial discussions on new strategies for compliance and monitoring took place in January 2009 at the Fiscalis seminar on 'VAT fraud: a common concern for businesses and tax administrations' in Amsterdam (NL). Most participants welcomed the Commission's suggestion of setting up an ad hoc working group involving tax authorities and representatives of large, medium-sized and small enterprises.

The Business Expert Group[108] was recently set up (March 2010). Its objective is to explore how the relationship between tax payers and tax administrations in terms of VAT obligations can result in a smoother functioning of the present VAT system in the EU. The findings will be used for discussions with the Member States and further policy development.

16.2. Evaluation of current policy on tax administration

16.2.1. Tax administration and the functioning of the internal market

Tax administration[109] is about the measures, procedures or tools that a tax authority applies and develops to efficiently administer and manage a tax from the 'chargeable event' ('*fait générateur*') to payment of the correct amount of tax. For VAT, this process also includes VAT deduction and refund. Tax administration covers , inter

---

[107] Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee on a coordinated strategy to improve the fight against VAT fraud in the European Union, 1 December 2008, COM(2008) 807 final.

[108] See the Commission expert group register No EO 2457 http://ec.europa.eu/transparency/regexpert/detail.cfm?ref=2457.

[109] Conceptual aspects of tax administration are not addressed in this paper, which is more about concrete action as a segment of public administration policy (modernisation and efficiency). However, international tax forums consider this new field as an important and promising part of tax policy. The OECD Forum on Tax Administration (FTA) has published a lot of studies on the different components of this policy. See http://www.oecd.org/dataoecd/2/46/42419552.pdf.

alia, the organisation of the collection systems (resources and methods), relations with taxpayers including taxpayers' obligations, rights and assistance (compliance), audit, risk assessment, planning and controls to prevent and fight fraud.

Tax administration is mainly a national responsibility of the Member States and the subsidiarity principle is therefore highly important. Consequently, when drafting legislative proposals the Commission has to balance carefully the need for an EU approach and respect for national structures and the practices of tax administrations. However, differences in national procedures considerably increase business compliance costs, particularly as a result of up to 27 different types of reporting obligations. Moreover, recent — uncoordinated — efforts by Member States to prevent and tackle VAT fraud have given rise to new obligations and further widened the gap between the 27 national practices of the tax administrations.

Consequently tax administration and the lack of a harmonised approach have an impact on the functioning of the internal market. The Court of Auditors also insisted on this point in its 2008 Annual Report[110] on VAT 'own resources'.

The way Member States apply VAT legislation, the way they cooperate in exchanging data to collect VAT and the procedures and tools they develop to prevent and fight fraud is of common interest to all Member States. Moreover, it directly affects businesses, which not only expect fair competition (neutrality) but also legal certainty, simplicity, effectiveness, fairness and flexibility.

16.2.2. Weaknesses of the current system

Up to now, most of the work done has dealt with preventing and fighting fraud. It involved only tax authorities and addressed specific issues of tax administration with a view to enhancing the efficiency of controls and audit. For instance, some interesting materials have been drafted in the Fiscalis project groups on best practice among tax authorities in the field of e-audit, risk management[111], etc.

Furthermore as the Amsterdam Conference[112] demonstrated, a more comprehensive approach — 'horizontal monitoring' — could be a useful way of making tax collection more efficient and reducing the tax gap. The idea of achieving greater compliance by means of enhanced cooperation between taxpayers and the tax administration is being explored by a number of countries within and outside the European Union. Their policies may have different names such as 'horizontal monitoring', or 'client relationships', but they all aim to promote partnerships based on mutual respect and cooperation between the taxpayer and the tax administration.

---

[110] In its audit work for the 2008 Annual Report, the European Court of Auditors took the view that data collection for the reports should become one of the means of ensuring uniform application of the VAT Directive across all Member States plus equal treatment of all taxpayers. See Article 12 of Council Regulation 1553/89.

[111] See the risk management guide for Tax administrations: http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/gen_overview/risk_management_guide_for_tax_administrations_en.pdf

[112] 'VAT fraud: A common concern for businesses and tax administrations'. This conference organised by Dutch tax authorities took place in 2009 under the Fiscalis programme. See: http://ec.europa.eu/taxation_customs/taxation/vat/vat_conferences/article_5467_en.htm.

On the one hand, businesses want tax administrations to keep an open mind as regards their specific situation. On the other hand, tax administrations want transparency that ensures effective tax collection at the right time. Partnerships are promoted in which traders work closely with tax administrations and in return obtain a decrease in the administrative burden — so both sides gain. As a result, tax administrations are able to allocate more resources to targeting non-compliant behaviour.

For the time being this 'horizontal' approach has not been put forward as part of the EU's VAT policy. It would require VAT stakeholders other than tax authorities to be involved. It means that taxpayers (all categories, small, medium-sized and large businesses) and intermediaries (financial institutions, tax advisors, fiscal representatives) would be asked to contribute valuable experience and suggest changes making for better practical implementation of the VAT rules. This move has just started with the launch of the Business Expert Group.

The expert group only consists of representatives of business and Commission services . Member States' tax administrations are not involved at this first stage. The expert group should deal with wider issues of tax administration, such as horizontal monitoring and compliance issues, which will require a dialogue with Member States' tax administrations.

Apart from the Business Expert Group there is no specific EU-wide forum where tax administration issues as such can be discussed. In effect, bodies ensuring the governance of the VAT system, such as the VAT Committee for VAT legislation and the SCAC committee for administrative cooperation, are attended only by tax authorities' representatives and have mandates which do not cover the full remit of tax administration.

At the same time, difficulties have arisen in the practical implementation of some of the new measures in recent VAT legislation. The lack of homogeneous practices or administrative requirements for the same operation between Member States particularly affects businesses involved in cross-border supplies. Moreover, different application of the VAT rules has detrimental consequences not only for operators but for tax authorities in different Member States.

IT issues are also heavily involved in these new measures. As it appears that some of the specific difficulties that have occurred involve reliance on accurate and timely data both from taxpayers and from tax authorities in other Member States, these issues could also be addressed in this tax administration context.

16.3. Possible improvements to the system

Improvements to the system do not necessarily have to result from changes in legislation. 'Soft policy' aimed at creating a wide spread consensus and exchanging best practices could be an alternative approach.

Apart from trying to further harmonise reporting obligations in the legislation itself[113], the Commission could take a more proactive approach to tax administration policy. This can be done in different ways and through different means. The following suggestions are not exhaustive:

(1) To start with, the Commission could set up a discussion forum open to representatives of VAT stakeholders, allowing an exchange of views with the tax authorities. It would be a proper means of holding a structured, permanent dialogue in which all tax administration issues of interest to tax authorities and businesses could be discussed.

(2) In addition, the Commission could be a key facilitator in pooling best practice on all other tax administration issues that effect businesses. Pooling best practice and drafting guidelines could contribute to streamlining administrative practices and abolishing unnecessary obligations on businesses. In particular, a tax administration platform could be set up under FISCALIS.

(3) EU policy on voluntary compliance could be developed to improve the relationship between tax authorities and businesses in the Member States.

As most voluntary compliance strategies are about building trust between taxpayers and tax authorities, the balance between the rights and obligations of taxpayers, on the one hand, and tax authorities, on the other, is the key to making tax collection more efficient and to preventing and fighting fraud, while at the same time minimising the burden on trade.

Legal certainty is also essential for both sides. Tax authorities need to guarantee that all their services apply the EU VAT rules in a uniform way, both internally and cross border. The rules applied by Member States should not lead to cases of no taxation or double taxation. Businesses, on the other hand, need to know exactly what they have to do in order to comply with the rules laid down in the various Member States where they conduct business, including the documentation they need to provide in order to prove their entitlement to an exemption or to show they acted in good faith.

The need for specific arrangements for this and their legal effects would have to be considered. For instance, consideration could be given to how to apply the concept of ‘partnerships’ (specific agreements between tax administrations and taxpayers) at EU level.

(4) Since IT support also plays a major role in the implementation of VAT rules, it is essential to examine how to ensure better interoperability of the systems to facilitate automatic transfer of information directly from taxpayers to the tax authorities and vice versa (see, for instance, work on the standard e-audit file[114]). Discussions could also focus on a proper time frame, the investment required and working methods for introducing such new IT systems, both in businesses and in the tax authorities, together with the critical need to limit, as far as possible, any additional costs on

[113] See, for instance, Report on the application of Article 263 of the VAT Directive 2006/112/EC (Council Directive 2008/117/EC of 16 December 2008 amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions).

[114] Guidance note for the Standard Audit file http://www.oecd.org/dataoecd/13/45/34910263.pdf.

either side. Any reflection in this field could also include ways to enhance cross-border exchange of information between tax administrations, thus reducing the duplication of reporting obligations for businesses operating in different Member States. Furthermore, it could be worth investigating whether a specific software could be developed jointly by some Member States, possibly with EU financial support[115], with a view to putting it subsequently at the disposal of all Member States.

(5) The Commission has also a responsibility to create the conditions for smooth implementation of EU rules in the Member States, by ensuring transparency and effective communication with all stakeholders. A lot has already been done in this field. However, this policy of improving transparency and providing up-to-date, accessible information to users could be worked out in conjunction with all stakeholders. (New initiatives could for example include drafting explanatory notes and FAQs and further developing e-learning tools).

(6) The economic operators and other stakeholders (including national judges dealing with VAT cases) need also to be aware of recent changes in legislation and potential gaps. Raising awareness on specific VAT issues can contribute to better implementation of the rules and neutrality and fairness between operators. The Fiscalis programme[116] is one way of meeting these needs. However, given the complexity of VAT legislation, at EU and national level, a network of legal experts in this field could provide efficient support for the Commission and Member States (reports on practical issues, comparative studies targeted at the Member States, training materials, etc.).

16.4. Conclusion

The approach detailed above is to support the proper implementation of EU tax legislation with a 'soft policy' instrument. It is mostly about improving dialogue and the relationship between taxpayers and tax authorities, through a new space for discussion and for exchanges of experience and good practices.

In a difficult economic situation where fiscal consolidation and long-term financial sustainability are at stake, the Commission could propose to mutualise some resources for more efficient and fair tax collection in the EU. Building a relationship of trust and transparency between stakeholders should become a priority in work on compliance and on preventing and fighting fraud.

The work carried out by the Business Expert Group could help to explore voluntary compliance strategies and other tax administration issues of interest to business. The outcome of the Green Paper consultation should also feed into this process. In this context a discussion forum should be set up, to involve all stakeholders in the debate, too. As far reaching harmonisation of tax obligations is not a feasible short-term option, a Fiscalis platform on tax administration, pooling best practice and drafting

[115] One example of this is the ECEyes software developed by the Swedish tax administration with support from the Fiscalis programme and made available free to the tax administrations of other Member States.

[116] Decision No 1482/2007/EC of the European Parliament and of the Council of 11 December 2007 establishing a Community programme to improve the operation of taxation systems in the internal market.

guidelines, could help streamline administrative practices and abolish unnecessary obligations on businesses and tax administrations.