



Brussels, 21.12.2016
COM(2016) 811 final

2016/0406 (CNS)

Proposal for a

COUNCIL DIRECTIVE

amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold

{SWD(2016) 457 final}

{SWD(2016) 458 final}

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

On 7 April 2016, the Commission adopted the VAT Action Plan¹ which presents objectives and measures to modernise the EU VAT system. It builds on the work carried out since the Communication on the future of VAT² that followed the large consultation process initiated by the Commission with its Green Paper on the future of VAT³.

The creation of a robust single European VAT area is one of the key actions announced by the Commission in its Action Plan. It will require the setting up of the definitive VAT system for intra-EU business-to-business (B2B) cross-border trade in order to replace the current system which was intended to be transitional.

As agreed by the European Parliament and the Council, this definitive VAT system will be based on the principle of taxation in the country of destination of the goods (the so called “destination principle”) whereas the current system is based on exemption of supplies of goods in the Member State of departure. Therefore, the Commission announced its intention to present a legislative proposal in 2017 for the definitive VAT system for cross-border trade based on this “taxation” option.

However, since preparing, adopting and implementing such a major change is likely to take some time, the Commission recognized the need to work in parallel on other initiatives, in particular on urgent measures to tackle VAT fraud and, subsequently, the VAT gap, the difference between the expected VAT revenue and the VAT actually collected by tax authorities. This VAT gap has reached an alarming level of nearly EUR 160 billion⁴ of which cross-border fraud accounts for about EUR 50 billion of revenue loss each year⁵.

As one of these urgent measures, the Commission considered, upon request of certain Member States, the possibility of allowing these Member States to implement a temporary generalised reverse charge mechanism (GRCM) that would derogate from one of the general principles of the VAT Directive⁶, which is the fractionated payment. To that end, the Commission agreed to thoroughly assess the political, legal and economic implications of such a temporary GRCM before presenting its conclusions.

This in depth analysis at technical level of a GRCM, with an invoice threshold of EUR 10 000, has been carried out and presented during the ECOFIN meeting of 17 June 2016. In the context of a political agreement on the overall anti-fraud policy within the EU, the Commission made the following statement to the ECOFIN Minutes: *"The Commission commits to present, before the end of the year, a legislative proposal allowing individual*

¹ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT - Towards a single EU VAT area - Time to decide (COM(2016)148 final of 7.4.2016).

² Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT - Towards a simpler, more robust and efficient VAT system tailored to the single market (COM(2011) 851 of 6.12.2011).

³ Green paper on the future of VAT - Towards a simpler, more robust and efficient VAT system (COM(2010) 695 of 1.12.2010).

⁴ CASE, *Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report*

⁵ Ernst & Young, *Implementing the 'destination principle' to intra-EU B2B supplies of goods: 2015 Final Report*.

⁶ 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)

Member States to derogate from the common system of value added tax so as to apply a generalised reverse charge mechanism to domestic supplies above a defined threshold and preserving the Internal Market."

- **Consistency with existing policy provisions in the policy area**

The purpose of the legislative proposal is limited in scope and in time and is without prejudice to the development of the definitive VAT system based upon the taxation of cross-border supplies.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The Directive amends the VAT Directive on the basis of Article 113 of the Treaty on the Functioning of the European Union.

Because of its derogation from the fundamental principle of the fractioned payments, a specific legal basis for such a temporary application of a GRM to goods and services above a certain threshold is the best way forward and is in line with the VAT Action Plan.

- **Subsidiarity (for non-exclusive competence)**

According to the principle of subsidiarity, as set out in Article 5(3) of the Treaty on European Union (TEU), action at EU level may only be taken if the envisaged aims cannot be achieved sufficiently by the Member States alone and can therefore, by reason of the scale or effects of the proposed actions, be better achieved by the EU.

Member States could not act individually since the application by individual Member States of a GRM cannot be considered as a 'normal derogation' within the meaning of Article 395 of the VAT Directive as it entails a fundamental change to the VAT system. Therefore, the possibility for individual Member States to apply a GRM requires a proposal by the Commission to amend the VAT Directive in order to allow for such a derogating system. The proposal still leaves a high degree of subsidiarity to Member States as the application of the mechanism is voluntary and each Member State can decide whether to request the derogation or not, provided the criteria are fulfilled.

- **Proportionality**

Because of its optional and temporary character, the measure is proportionate to the aim which is to combat fraud in certain Member States who do not have the administrative capacity to effectively tackle it or are confronted with a strong increase of VAT fraud. The granting of the GRM is subject to pre-defined criteria aiming to limit the scope of the measure to Member States which are particularly affected by carousel fraud. In this context, a VAT gap excess of 5 percentage points above the EU median and a carousel fraud level within a Member States' total VAT gap of more than 25% are considered as reasonable and representative criteria in order to identify those Member States which are more than averagely affected. In addition, because of the uncertainty of the effects of the measure as regards fraud shifting, a Member State having a common border with a Member State that applies the GRM, should also be authorised to apply the GRM under certain conditions.

However, the impact on the internal market should be closely monitored. To that end, in a safeguard clause the Commission should be empowered to repeal, without retroactive effect, derogations in case the impact on the internal market would be negative.

- **Choice of the instrument**

A Directive is proposed in view of amending the VAT Directive.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Stakeholder consultations**

No particular stakeholder consultation was carried out.

The open public consultation on the 'Green Paper on the future of VAT' - Towards a simpler, more robust and efficient VAT system" COM(2010)695), which resulted in around 1700 contributions, provided the Commission with a clear understanding of the problems and possible solutions, including on the aspects of reverse charge. Further details are set out in Annex 2 of the impact assessment.

Tax administrations and business representatives have discussed the issue during a meeting of the Group on the Future of VAT (GFV) and the VAT Expert Group (VEG) in February 2016 which provided the Commission with a comprehensive view of the opinions on the possible implementation and application of such a system.

- **Collection and use of expertise**

The VEG, which assists and advises the European Commission on VAT matters in view of the preparation of legislative acts and other policy initiatives, was, as mentioned, consulted in February 2016.

In its opinion of 28 June 2016 the REFIT Platform called for a simpler and more basic VAT regime in the EU, highlighting in particular the barriers to the internal market and regulatory burden created⁷.

Many opinions adopted by business federations and scientific publications were taken into account.

- **Impact assessment**

The impact assessment was submitted to the Regulatory Scrutiny Board for a first time on 27 September 2016 and a meeting took place on 26 October 2016. On the basis of the opinion of the Board, a new draft was submitted to the Board which gave a positive opinion on 28 November 2016 with recommendations, notably to include a best case and worst case scenario⁸ (see also annex 1 of the impact assessment accompanying this proposal).

The impact assessment identified, as preferred option, a derogation to apply the GRM by certain Member States fulfilling pre-defined criteria, on a voluntary basis and to all goods and services with an invoice threshold of more than EUR 10 000. This option offers a short term solution to Member States particularly affected by carousel fraud. It minimises negative impacts on the internal market by limiting fraud shifting between Member States. A safeguard clause is foreseen in case of negative impacts on the internal market.

⁷ http://ec.europa.eu/smart-regulation/refit/refit-platform/docs/recommendations/opinion_taxation_1a.pdf

⁸ The executive summary sheet is available at the following link:
http://ec.europa.eu/smart-regulation/impact/ia_carried_out/cia_2016_en.htm

4. OTHER ELEMENTS

The proposal includes a sunset clause.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 113 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the European Economic and Social Committee,

Acting in accordance with a special legislative procedure,

Whereas:

- (1) In its VAT Action Plan⁹, the Commission announced its intentions to come forward with a proposal for a definitive value added tax (VAT) regime for cross-border business-to-business trade between Member States on the basis of the taxation of cross-border supplies of goods and services.
- (2) Given the current level of VAT fraud and the fact that not all Member States are equally affected by this fraud, and given the fact that it will take several years for the definitive VAT regime to be implemented, some urgent and specific measures may be necessary.
- (3) In this context, certain Member States have asked to be allowed to implement a temporary generalised reverse charge mechanism (hereinafter 'GRCM') with a certain threshold per invoice which would derogate from one of the general principles of the current VAT system, as regards the fractionated payment system, in order to address endemic carousel fraud. Carousel fraud finds notably its root in the current exemption for intra-community supplies that allows for goods to be obtained VAT-free. A number of traders engage subsequently in tax fraud by not paying to the tax authorities the VAT received from their customers. Those customers, however, being in receipt of valid invoices, remain entitled to a tax deduction. The same goods can be supplied several times by including again exempt intra-community supplies. Similar carousel fraud can also occur when services are supplied. By designating the taxable person to whom the goods or services are supplied as the person liable for the VAT, the derogation would remove the opportunity to engage in that form of tax fraud.

⁹ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT - Towards a single EU VAT area - Time to decide (COM(2016)148 final of 7.4.2016).

- (4) In order to limit the risk of fraud shifting between Member States, all Member States that fulfil certain criteria as regards their fraud level, in particular in relation to carousel fraud, and who are able to establish that other control measures are not sufficient to combat that fraud, should be allowed to use a GRCM.
- (5) In addition, also bordering Member States that encounter a serious risk of shift of fraud to their territory, because of the authorisation of that mechanism in another Member State, should be allowed to use the GRCM, where other control measures would be insufficient to combat that risk of fraud.
- (6) If Member States choose to apply the GRCM, they should apply it to all supplies of goods and services above a defined threshold per invoice. The GRCM should not be restricted to any specific sector.
- (7) Member States choosing to apply the GRCM should introduce specific electronic reporting obligations on taxable persons so as to ensure the effective functioning and monitoring of the application of the GRCM. They should detect and prevent all new forms of tax fraud.
- (8) In order to assess the effect of the application of the GRCM on fraudulent activities in a transparent manner, pre-defined evaluation criteria should be established by those Member States as to enable an assessment of the level of fraud before and after the application of the GRCM.
- (9) In order to ensure uniform conditions for the implementation of this Directive, implementing powers should be conferred on the Commission as regards granting the authorisation to the requesting Member State in order to introduce the GRCM.
- (10) Member States choosing to apply the GRCM should request the Commission to authorise the application of the GRCM and provide relevant information in order to enable the Commission to assess that request. Where necessary, the Commission should be able to request additional information.
- (11) Given the unexpected effects that such a GRCM might have on the functioning of the internal market because of the possible shift of fraud to other Member States that do not apply it, the Commission should be able, as a safeguard measure, to repeal all implementing decisions approving the application of the GRCM.
- (12) In view of the uncertain effects that such a mechanism might have, it should be limited in time.
- (13) To closely monitor the impact on the internal market, all Member States should, in case the GRCM is used at least in one Member State, present reports to the Commission as to enable an assessment of the impact on the fraud, the compliance costs for businesses and a shift in fraudulent activities due to the application of the GRCM.
- (14) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

The following Article 199c is inserted in Directive 2006/112/EC:

Article 199c

1. Until 30 June 2022 a Member State may, as a Generalised Reverse Charge Mechanism (GRCM), provide that the person liable for payment of VAT is the taxable person to whom supplies of goods and services are made above a threshold of EUR 10 000 per invoice, by derogation from Article 193.

A Member State wishing to introduce the GRCM shall comply with the following conditions:

- (a) it has a VAT gap, expressed as a percentage of the VAT Total Tax Liability, of at least 5 percentage points above the Community median VAT gap;
- (b) it has a carousel fraud level within its total VAT gap of more than 25%;
- (c) it establishes that other control measures are not sufficient to combat carousel fraud on its territory.

The Member State shall attach to the request referred to in paragraph 4 the calculation of the VAT gap according to the method and figures available in the latest report on the VAT gap published by the Commission.

2. Until 30 June 2022, a Member State may provide that the person liable for payment of VAT is the taxable person to whom supplies of goods and services are made above a threshold of EUR 10 000 per invoice where this Member State:

- (a) has a common border with a Member State that is authorised to apply the GRCM;
- (b) establishes that a serious risk of shift of fraud towards its territory exists because of the authorisation of the GRCM to that Member State;
- (c) establishes that other control measures are not sufficient to combat fraud on its territory.

3. Member States that apply the GRCM shall establish appropriate and effective electronic reporting obligations on all taxable persons and, in particular, on taxable persons who supply or receive the goods or services to which this mechanism applies.

4. Member States wishing to apply the GRCM shall submit a request to the Commission and provide the following information:

- (a) a detailed justification that the conditions referred to in paragraph 1 or 2 are fulfilled;
- (b) the starting date of the application of the GRCM and the period to be covered by it;
- (c) actions to be taken to inform taxable persons of the introduction of the application of the GRCM;
- (d) a detailed description of the accompanying measures referred to in paragraph 3.

If the Commission considers it does not have all the necessary information, it shall request additional information within one month of receipt of the request. The requesting Member State shall submit the required information within a month of receipt of the notification.

5. The Commission shall, at the latest three months after it has received all the necessary information, adopt an implementing decision confirming that the request complies with the requirements referred to in paragraph 4 and authorise the requesting

Member State to apply the GRCM. In case where the requirements are not fulfilled, it shall adopt an implementing decision rejecting the request.

6. In case of considerable negative impact on the internal market, the Commission shall repeal all the implementing decisions referred to in paragraph 5, at the earliest six months after the entry into force of the first implementing decision authorising a Member State to apply the GRCM.

Considerable negative impact shall be considered established, where the following conditions are fulfilled:

- (a) more than one Member State, not applying the GRCM referred to in paragraphs 1 and 2, informs the Commission of an increase of VAT fraud on its territory due to the GRCM;
- (b) the Commission establishes, including on the basis of the information provided by the Member States referred to in point (a), that such increase is directly linked with the application of such a mechanism in one or several Member States.

7. Member States applying the GRCM shall submit an interim report to the Commission no later than two years after the start of application of the GRCM. This report shall provide a detailed assessment of the effectiveness of the GRCM.

Three months after the end of the application of the GRCM, Member States applying the mechanism shall submit a final report on its overall impact.

8. Member States not applying the mechanism shall submit an interim report to the Commission as regards the impact in its territory of other Member States applying the GRCM no later than 30 June 2019, insofar the GRCM will have been applied for at least one year in one Member State by that date.

If at least one Member State applies the GRCM, Member States not applying the mechanism shall submit a final report to the Commission as regards the impact in its territory of other Member States having applied the GRCM no later than 30 September 2022.

9. In the reports referred to in paragraph 7, Member States shall assess the impact of the application of the GRCM on the basis of the following evaluation criteria:

- (a) the evolution of the VAT gap;
- (b) the evolution of the VAT fraud, notably carousel fraud and fraud at the retail level;
- (c) the evolution of the administrative burdens on taxable persons;
- (d) the evolution of administrative costs for the tax administration.

10. In the reports referred to in paragraph 8, Member States shall assess the impact of the application of the GRCM on the basis of the following evaluation criteria:

- (a) the evolution of the VAT gap;
- (b) the evolution of the VAT fraud, notably carousel fraud and fraud at the retail level;
- (c) shift of fraud from Member States applying or having applied the GRCM.'

Article 2

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply until 30 September 2022.

Article 3

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council
The President*