



Special scheme for small enterprises under the VAT Directive 2006/112/EC - Options for review

Final Report
Volume I

Written by Deloitte
May 2017

Deloitte.



EUROPEAN COMMISSION

Directorate-General for Taxation and Customs Union
Directorate C — Indirect Taxation and Tax Administration
Unit C1 — Value Added Tax

Contact:

E-mail: TAXUD-UNIT-C1@ec.europa.eu
European Commission
B-1049 Brussels

Special scheme for small enterprises under the VAT Directive 2006/112/EC - Options for review

Final Report
Volume I

**EUROPE DIRECT is a service to help you find answers
to your questions about the European Union**

Freephone number (*):
00 800 6 7 8 9 10 11

(* The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you)

LEGAL NOTICE

This document has been prepared for the European Commission however it reflects the views only of the authors, and the Commission cannot be held responsible for any use which may be made of the information contained therein.

More information on the European Union is available on the Internet (<http://www.europa.eu>).

Luxembourg: Publications Office of the European Union, 2017

KP-06-17-210-EN-N
ISBN 978-92-79-74378-8
doi:10.2778/883512

© European Union, 2017
Reproduction is authorised provided the source is acknowledged.

Abstract

SMEs are the backbone of the European economy and thus have a specific focus in EU policy. The EU's current SME policy places great emphasis on the reduction of compliance costs on businesses and their free access to markets. The Single Market access and business burdens are intricately linked to their tax treatment, including the application of VAT to SMEs.

Under the VAT Directive, Member States can adopt specific schemes and measures to reduce administrative burdens on SMEs. Regarded as territorial and unsuitable for trade in a cross-border environment and given recent developments in taxation at destination and the proposal for modernising VAT for e-Commerce, an in-depth review of the special scheme for small enterprises ("SME schemes") and measures is appropriate.

This study analyses the functioning of the SME schemes and measures for SMEs against the backdrop of the SME environment. Based on findings from literature, tax authorities, businesses and experts, four policy options are formulated and assessed in accordance with European Commission Better Regulation Guidelines. Impacts of these options are reported on businesses, Member States of the EU and the wider economy.

Résumé

Les PME sont le pilier de l'économie européenne, c'est pourquoi elles font l'objet d'une attention particulière dans la politique de l'UE. L'actuelle politique des PME de l'UE met particulièrement l'accent sur la réduction des coûts de mise en conformité pour les entreprises et sur leur libre accès aux marchés. L'accès au marché intérieur et les contraintes des entreprises sont étroitement liés à leur régime fiscal, notamment à l'application de la TVA aux PME.

En vertu de la directive TVA, les États membres peuvent adopter des régimes et mesures spécifiques afin de réduire les charges administratives qui pèsent sur les PME. Considéré comme territorial et peu adapté au commerce dans un environnement transfrontalier et étant donné les récentes évolutions de la taxation à destination, ainsi que la proposition de modernisation de la TVA pour le commerce en ligne, le régime spécial pour les petites entreprises (« régimes PME ») doit faire l'objet d'un examen approfondi et de mesures.

Cette étude se penche sur le fonctionnement des régimes et des mesures en faveur des PME dans le contexte actuel. Sur la base de conclusions tirées de la littérature, d'autorités fiscales, d'entreprises et d'experts, quatre possibilités d'action sont formulées et évaluées en conformité avec les lignes directrices de la Commission pour l'amélioration de la réglementation (Better Regulation Guidelines). L'étude a mesuré les effets de ces possibilités d'action sur les entreprises, les États membres de l'UE et l'ensemble de l'économie.

Notice

The information and views set out in this report are those of the author(s) and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission's behalf may be held responsible for the use which may be made of the information contained therein.

Index of Abbreviations

B2B	Business-to-Business
B2C	Business-to-Consumer
CGE	Computable General Equilibrium
DG FISMA	Directorate-General for Financial Stability, Financial Services and Capital Markets Union
DG GROW	Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs
DG TAXUD	Directorate-General for Taxation and Customs Union
ESL	EU Sales Lists
FY	Financial Year
IA	Impact Assessment
MOSS	Mini One Stop Shop
OECD	Organisation for Economic Co-operation and Development
SCM	Standard Cost Model
SME	Small or Medium Enterprise
TBE	Telecommunications, Broadcasting and Electronic
VAT	Value Added Tax

Executive Summary

Context and approach

Small and Medium-sized Enterprises (SMEs)¹ represent the majority of active businesses in the EU, representing around 98%² of all businesses. The VAT Directive³ has enabled Member States, since the introduction of a harmonised VAT regime in the EU, to apply special schemes and measures aimed at eliminating or reducing the administrative burden of VAT on ‘small enterprises’. The Member States have made extensive use of this possibility and of the freedom granted by the VAT Directive in respect of the design of the special schemes. This has resulted in a **heterogeneous patchwork** of different national SME schemes accompanied by a varied set of administrative simplifications for the SMEs.

New developments in the VAT environment, underpinned by the fundamental move to taxation at the place of destination, have led the Commission to consider it timely to carry out a study on the **functioning of the special VAT schemes and measures under the VAT Directive**. The evaluation of the implementation and application of the 2015 place of supply rules for TBE services⁴ made clear that the confrontation of SMEs (and particularly micro-businesses) with foreign VAT regimes creates a significant burden for SMEs and limits their access to the Single Market. This highlights the lack of specific measures designed to reduce the burden(s) for SMEs. A first step was taken with the proposal on Modernising VAT for cross-border e-commerce (hereinafter ‘the e-Commerce proposal’)⁵, where a common EU SME threshold regime is foreseen. At the same time, the need for a comprehensive review of the VAT treatment of SMEs was also noted in the Commission Communication on Upgrading the Single Market⁶, and in the Commission’s VAT Action Plan⁷.

This report analyses the current situation of SMEs in the EU and the special SME schemes and measures currently applicable in the Member States under the possibilities offered by the VAT Directive. Against a status quo scenario that already incorporates the effects of the measures of the e-Commerce proposal, the study considers a number of changes to the most widely used SME scheme, the SME exemption scheme. These changes concern the extension of the SME exemption to supplies made by businesses established outside the Member State of taxation, to incorporate into the scheme and streamline the administrative simplification measures for SMEs, to treat occasional

¹ For the purpose of the study, a specific definition of SMEs is adopted, which refers only to businesses with an annual turnover not exceeding EUR 2 million. These businesses are referred to as micro-businesses in the EU Recommendation 2003/361 EC: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003H0361&from=EN>, consulted on 4 January 2017.

² Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

⁴ SWD(2016) 382 final and European Commission (2016), VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 3, prepared by Deloitte, available at:

https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot3.pdf

⁵ Commission proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods (COM(2016) 757).

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_757_en.pdf consulted on 6 January 2017.

⁶ Communication on Upgrading the Single Market: more opportunities for people and business (COM(2015) 550),

<https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-550-EN-F1-1.PDF> consulted on 3 January 2017.

⁷ Communication on an action plan on VAT (COM(2016) 148),

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_en.pdf consulted on 4 January 2017.

traders as non-taxable persons and to introduce transition measures for SMEs growing beyond the SME schemes in order to alleviate the “threshold effect”. The objectives are to reduce the administrative burden for SMEs, to reduce distortions between locally established SMEs and SMEs from other EU Member States and to contribute to an environment that is conducive to SMEs growth (in the context of the 2020 Strategy).

The options assessed in this report were formulated following a design process that took into consideration inputs from stakeholders, the European Commission and other policy initiatives in the field of EU VAT. The process first involved obtaining a view on the current problems and then deriving the policy objectives and appropriate policy options.

The policy options were assessed with regard to their financial and economic impacts through a number of tools devised for quantitative and qualitative analysis. Data gathering tools consisted of desk research, interviewing businesses and tax authorities in selected Member States, facilitating and attending stakeholder workshops and an IPSOS MORI survey of SMEs in a number of Member States.

For the analysis of the data, a Standard Cost Model (SCM) and Computable General Equilibrium (CGE) Model were applied to measure the administrative burden of businesses and the magnitude of effects on SME growth arising from the functioning of the SME schemes, respectively.

Problem assessment

Overall situation of SMEs in the EU

The analysis of the overall situation of SMEs in the EU shows that SMEs constitute the vast majority of businesses in the EU and this is consistent across Member States. Moreover, most Member States have a large proportion of nano-businesses (less than EUR 5 000 annual turnover). SMEs activities are mainly found in the wholesale and retail trade, construction and professional, scientific and technical activities sectors, with the smallest businesses active in real estate or the provision of financial or administrative support services.

Despite representing around 98% of businesses, SMEs only generate 15% of turnover and 25% of net VAT revenues in the EU.⁸ The smallest businesses (those with less than EUR 50 000 turnover, representing 69% of all businesses in the EU) produce a negligible or even negative amount of VAT revenue. These businesses are also the ones that are most likely eligible for a special VAT scheme under the current legislation.

Compliance with VAT obligations under the standard VAT regime places a disproportionate burden on SMEs compared to larger businesses, as the costs of complying with VAT obligations are regressive. Therefore, given the prominent place of SMEs in the EU, the existence of special VAT schemes for SMEs is well justified.

Functioning of the SME schemes

In recognition of the importance of SMEs in the EU, the VAT Directive sets out special provisions for “small enterprises” which allow Member States to give exemptions and graduated relief for supplies made by these businesses, to set up simplified procedures for charging and collecting VAT and to

⁸ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

foresee other measures and schemes to support SMEs. The table below indicates the adoption rate of such measures by the Member States, for the most important SME VAT schemes:

SME exemption	SME graduated relief	SME flat rate scheme	Cash accounting scheme
26	3	8	24

A common denominator of the SME schemes is that the schemes and most of the special measures are optional for eligible businesses, who can opt out and adopt the standard VAT regime if they wish to do so. Another key characteristic is that the eligibility for the SME schemes depends on a threshold based on the businesses' turnover (or in specific regimes the net annual VAT payable).

The most common scheme applied is the **SME exemption scheme**, under which SMEs are exempt from the obligation to charge VAT and have no right to deduct input VAT. Neither can they indicate VAT on their invoices. That is why the exemption is mainly attractive for SMEs providing B2C supplies as their customers, in any case, have no right to deduct the input VAT included in the price of the supply. In many Member States businesses that are under the SME exemption scheme also benefit from a wide range of simplification measures, including relief from registering for VAT purposes and filing periodical VAT returns.

Overall, based on the take-up rate of the scheme among businesses and the reduction in VAT compliance costs⁹, the SME exemption scheme can be considered as an effective measure. However, non-established businesses cannot benefit from the scheme for supplies which are taxable outside their own Member State, hence producing a significant burden and distortion for SMEs expanding their business across borders.

As a variation of the SME exemption scheme, **graduated relief schemes** provide a tax benefit but not a full relief, and are mainly used in Member States where no exemption is available. Overall, the VAT graduated relief scheme is not perceived as an effective measure, which is supported by the fact that it has only been implemented in three Member States and the estimated take up rate in those Member States is not high. Yet, based on the fieldwork undertaken in one Member State, it can still provide reduced compliance costs to businesses.

The functioning of the **VAT flat rate** and **cash accounting schemes** is perceived as varying in effectiveness across the Member States. In particular, both schemes result in a higher average compliance cost compared to the normal VAT regime.

Many Member States have implemented **additional simplifications** to lower the administrative burden for taxpayers, with a focus on SMEs, such as annual recapitulative statements, annual accounting and VAT returns and simplified reporting. These simplifications are very diverse in their nature and application and it was difficult to draw an overall assessment of their effectiveness. However, tax authorities are generally satisfied in terms of their effectiveness as there is less administration and audit from their side. Businesses also consider them as generally positive, especially when it concerns reducing the periodicity of returns.

Main problems identified in the SME schemes

⁹ Based on data gathered from interviews with businesses and accountants in four Member States (i.e., Estonia, France, Italy and Romania), compliance costs are reduced by up to 60% compared to the costs incurred by businesses in the normal regime (i.e. not applying any special scheme or simplification measure).

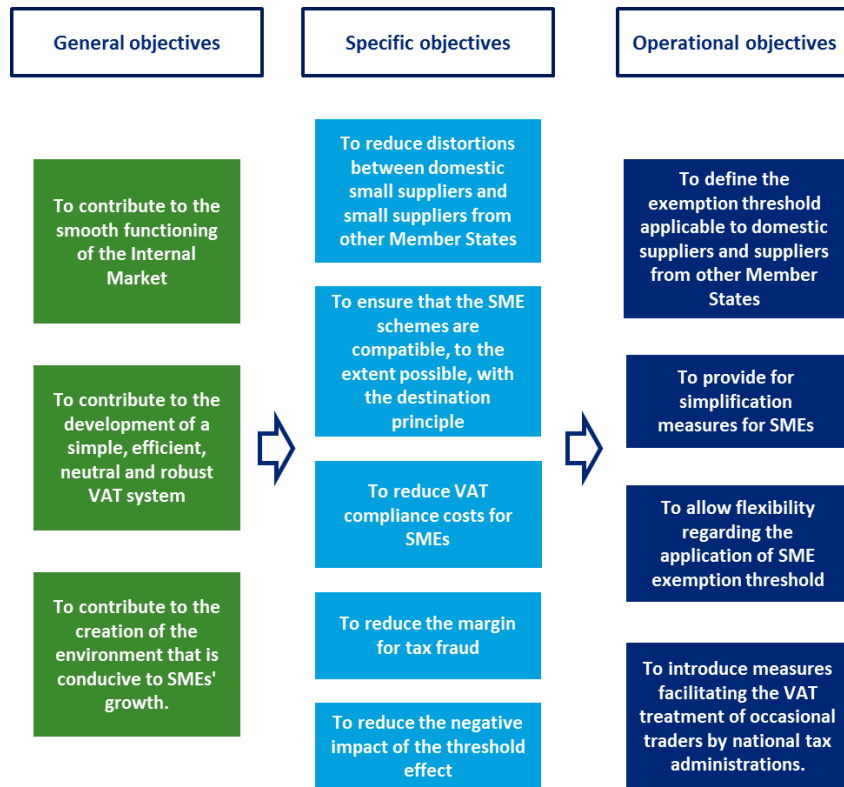
Based on the analysis of the existing SME schemes, focus was placed on the SME exemption scheme as it is the most commonly used and the most effective scheme. The problems with the current functioning of these schemes are summarised below:

- Firstly, SMEs **lack resources** allowing them to comply with complex administrative obligations, thus depending heavily on tax advisors and accountants to handle their VAT related obligations. They also suffer most from a lack of knowledge and information when confronted with VAT obligations in other Member States.
- Strict **territorial limitation** of the VAT exemption has a negative impact on the competitive situation of suppliers established in other Member States compared to that of domestic suppliers of goods and services. Those issues are set to increase with the shift towards taxation at destination. Small enterprises having had no VAT obligations in their own Member State (because they were able to make use of the SME exemption) will have to charge VAT in the Member State of their customer without having access to the exemption from which their competitors established in that Member State can benefit.
- The **digitalisation and development** of new trends in trading, such as e-Commerce and the sharing economy, has led to the rise of occasional traders, where there is uncertainty as to whether their limited activity constitutes an economic activity for VAT purposes, and who are also frequently active across borders.
- Another feature complicating the cross-border application of the SME exemption scheme is the **complex design and diversity** of national SME schemes, mainly due to the different adoption of simplification measures accompanying the SME exemption scheme. This, as well as the threshold effect whereby SMEs are confronted with an exponential increase of VAT obligations when they grow beyond the eligibility threshold for the SME exemption scheme, is placing disproportionate compliance burdens for SMEs in comparison to large businesses.

From the perspective of Member States' tax authorities, due to the possibility to define the threshold and the administrative obligations under the SME exemption scheme on a national level, the VAT revenue loss inherent to the exemption scheme can be managed and the SME schemes, combined with a move to automation and digitalisation, allow Member States to reduce their administrative costs and maintain an appropriate level of control.

Policy Objectives and Options for Policy Intervention

A clear formulation of the general, specific and operational objectives of the policy intervention is important for setting out the political priorities and aims for action. Policy options are developed with a view to addressing the problems in line with the policy objectives. The figure below presents the policy objectives in relation to the identified problems.



Based on the problem assessment and policy objectives, four policy options were designed:

- **Option 1:** Baseline scenario (status quo with measures from the e-Commerce proposal¹⁰);
- **Option 2:** SME exemption scheme extended to supplies from other Member States and including streamlined simplification measures;
- **Option 3:** Option 2 plus mandatory treatment of occasional traders as non-taxable persons;
- **Option 4:** Option 3 plus measures for transition period reducing the negative impact of the 'threshold effect'.

The table below provides an overview of the key features of the different policy options.

Feature	Option 1 (baseline scenario)	Option 2	Option 3	Option 4
Territoriality	Applies to businesses established in a Member State	Applies to all EU businesses	Applies to all EU businesses (except occasional traders)	Applies to all EU businesses (except occasional traders)
Threshold level	Set nationally	Set nationally	Set nationally	Set nationally
Threshold basis	Turnover taxable in the Member State	Turnover taxable in the Member State (including supplies into the Member State)	Turnover taxable in the Member State (including supplies into the Member State)	Turnover taxable in the Member State (including supplies into the Member State)
Optionality	Optional for Member States and for	Optional for Member States and for	Optional for Member States and for businesses; not	Optional for Member States and for businesses; not

¹⁰ Ibid.

Feature	Option 1 (baseline scenario)	Option 2	Option 3	Option 4
	businesses	businesses	applicable to occasional traders	applicable to occasional traders
Tax benefit	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold
Simplifications	None in the SME exemption scheme, but in practice optionally applied with SME scheme	Minimum level of simplified registration, VAT return and invoicing for businesses eligible for SME exemption scheme (including when opting out). Abolished B2C invoicing within the scheme. Member States can offer further relief.	In addition to option 2 : Full relief from VAT obligations for occasional traders.	Same as option 3.
Additional measures	Includes common EU threshold of EUR 10 000 for cross-border B2C supplies, below which the business may apply domestic VAT rules, including SME exemption scheme ¹¹	Common EU threshold. Member State can introduce threshold for overall turnover for non-established SMEs.	In addition to option 2 : Mandatory treatment of occasional traders as non-taxable persons	In addition to option 3 : Flexible SME exemption scheme threshold for 1 year or until exceeding by 50%, whichever is met first
Main advantages	Continuation of existing regime and simplification for cross-border B2C trade provided by common EU threshold	Reduces cross-border distortions; brings simplifications into the SME exemption scheme, extends simplifications to businesses opting out of the scheme	In addition to option 2: Occasional traders are exempt from all VAT obligations; More certainty in tax treatment of occasional traders for businesses and tax authorities Reduction of administrative costs of tax authorities	In addition to options 2 and 3: Potential reduction of threshold effect for businesses, thus encouraging their growth
Main disadvantages	Continuation of identified problems, likely to increase in future. Review of SME exemption scheme as part of move to a destination-based system	less flexibility in choice of simplification measures for Member State (i.e. required to provide at least minimum simplifications); Potential new simplification processes complicating the system by adding special measures	In addition to option 2: Occasional traders cannot register for VAT and deduct input VAT, unless they prove non-eligibility Complexity for tax authorities to legislate and control the measure	In addition to options 2 and 3: Negative impact on VAT revenue of Member States. May increase the complexity of VAT system and compliance control

¹¹ Ibid.

Assessment of the Policy Options

Results from the impact assessment show that the most important impact of making changes to the SME schemes is the **reduction of compliance costs for SMEs**. Compared to the baseline scenario, all policy options reduce the compliance costs for businesses, though to a different extent. Under the baseline scenario, the approximately 32 million businesses with annual turnover below EUR 100 000 investigated in the study have a compliance cost equaling EUR 67.9 billion, which is reduced to between EUR 58.6 and 56.1 billion depending on the options.

- Through the simplification package and the extension of the SME exemption scheme to non-established businesses, **Option 2** impacts directly on the compliance costs of all businesses, trading domestically as well as cross-border. The reduction in compliance costs ranges from 8% to 22%, depending on the extent to which Member States simplify or increase the VAT-related obligations of SMEs, as they may wish to gain better control of businesses within the scheme once it is opened to non-established businesses. SMEs currently opting into the exemption scheme may see an increase in their compliance costs if the extension of the scheme to non-domestic businesses leads to more Member States introducing registration or reporting obligations.
- Under **Option 3**, the loss of VAT-related obligations for occasional traders no longer treated as taxable persons leads to an overall reduction of 17% in compliance costs compared to the baseline. About 6.4 million businesses are estimated to be impacted by this option which reduces their VAT compliance burden to zero, 60% of which were already exempt from VAT under the SME exemption scheme domestically.
- The transitional period offered under **Option 4**, which allows SMEs to remain within the SME exemption scheme for a limited period of time, leads to a reduction in compliance costs of 18% compared to the baseline. About 255 000 businesses are estimated to be impacted by this additional measure; however the impact is only temporary.

As a consequence of the administrative cost reduction, the **options are equally** expected to **increase SMEs' cross-border trading activity**, which positively impacts on GDP, aggregate output, output of impacted SMEs, labour productivity, consumer demand and prices.

As all options include a broadening of the SME exemption, they have a **negative effect** on **VAT revenues** as they are expected to **decrease** with each option, although to different degrees. This impact however is minimal given that the overall VAT revenue contributed by SMEs at EU level is quite small.

With respect to **compliance and fraud**, all options have different effects, with **Option 4** being the **most positive**. This is due to the fact that the SMEs are allowed to temporarily exceed the threshold, reducing the threshold effect and the incentive for businesses to artificially stay below the threshold, and giving the chance to growing SMEs to adapt their compliance to the standard VAT regime in a gradual way.

Option 2 is the **least positive** in terms of compliance and fraud as it is deemed to make the system more complicated for the tax authorities to effectively control as foreign taxpayers will be allowed to benefit from an SME exemption scheme in the Member State of taxation. **Option 3 falls somewhat**

in between, with the exclusion of occasional traders expected to impact positively on compliance and also allowing the tax authorities to better focus their efforts.

The table below provides an overview of the impact of each option in comparison to the baseline scenario.

Type of impact	Impact in comparison to the baseline (% increase or decrease) ¹²		
	Option 2	Option 3	Option 4
Change in administrative burden for SMEs (%)	-14%	-17%	-18%
Change in administrative burden for SMEs (EUR/year)	-9.1 billion	-11.2 billion	-11.6 billion
Impact on VAT revenues (%)	-0.06%	-0.06% (-0.24% to +0.30%)	-0.24% (-0.48% to +0.28%)
Impact on VAT revenues (EUR/year)	-664.9 million	-3.1 billion to + 4.7 billion	-5 billion to + 2.8 billion
Impact on compliance and fraud	<ul style="list-style-type: none"> ➤ Increases complexity of scheme ➤ Challenging for Member States to monitor 	<ul style="list-style-type: none"> ➤ Reduces risk of sole traders being non-compliant 	<ul style="list-style-type: none"> ➤ Encourages voluntary compliance
Impact on GDP	0.07%	0.09%	0.09%
Impact on aggregate output	0.08%	0.10%	0.10%
Impact on output of impacted SMEs	9%	10.9%	16.1%
Impact on SMEs' cross-border trading activity	13.5%	13.5%	13.5%
Impact on labour productivity	0.09%	0.11%	0.11%
Impact on prices	-0.08%	-0.09%	-0.11%
Impact on consumer demand	0.09%	0.11%	0.12%

¹² Based on the "medium simplification" scenario. In the analysis, the level of simplification of administrative tasks in each policy option was estimated according to a low, medium and high level of simplification. Main reporting takes into account the costs of a medium simplification package.

Conclusion

The growing cross-border activity of SMEs as a consequence of the digitalisation and new trading patterns based on technological developments, as well as the fundamental move to taxation at the place of destination in EU VAT, make it inevitable to adapt and streamline the national SME schemes based on Articles 281 and 282 of the VAT Directive.

The experience of the 2015 changes to the place of supply rules for TBE services and the planned abolition of the distance selling thresholds for B2C cross-border supplies of goods will lead to a much increased confrontation of SMEs with foreign VAT regimes. While the provision of a specific EU common threshold for e-Commerce and the availability of the current MOSS and future OSS (reflected in the baseline scenario of Option 1) will allow mitigating the administrative burden inherent to the taxation in multiple Member States of destination, SMEs and particularly micro-businesses need further and more tailored policy initiatives.

For SMEs, the main problem with the current VAT system remains to be the compliance costs. This is partly addressed by the exemption. However, as the SME exemption is mainly attractive for SMEs providing B2C supplies, the exemption does not answer the concerns of SMEs supplying B2B and those who while having small turnover, exceed the exemption threshold applicable in their country. That is why any review of the SME exemption scheme should be accompanied with streamlining of simplification measures for SMEs. The policy options for the review have been constructed on the basis of this conclusion.

As can be noted in the following table, the policy options respond to the policy objectives for the current intervention which were formulated during the study based on EU policy priorities and documents such as the Europe 2020 Strategy, the Small Business Act, the Single Market Strategy and the recent EU VAT Action Plan:

Specific Objectives	Option 1	Option 2	Option 3	Option 4
To reduce distortions between domestic small suppliers and small suppliers from other Member States		✓✓✓	✓✓✓	✓✓✓
To ensure that the SME schemes are compatible, to the extent possible, with the destination principle		✓✓✓	✓✓✓	✓✓✓
To reduce VAT compliance costs for SMEs		✓	✓✓	✓✓✓
To reduce the margin for tax fraud			✓	✓✓
To reduce the negative impact of the 'threshold effect'				✓✓

Option 4 in combining the features of the other options and adding the temporary extension of the regime in case of exceeding the threshold, meets all of the policy objectives. Adopting such a framework where SMEs can opt into, to the extent they respect the threshold levels defined at

Member State level, will allow a significant reduction of administrative burden and of distortion for SMEs, particularly those active across borders, while also reducing the negative threshold effect inherent to most current SME exemption regimes. The impact on Member States' VAT revenues is relatively low and can be mitigated as Member States hold the power to change the threshold.

Synthèse

Contexte et approche

Les petites et moyennes entreprises (PME)¹³ représentent la majorité des entreprises actives dans l'UE, soit près de 98 %¹⁴ de toutes les entreprises. La directive TVA¹⁵ a permis aux États membres, depuis l'introduction d'un régime de TVA harmonisé à travers l'Europe, d'appliquer des mesures et des régimes spéciaux destinés à éliminer ou réduire la charge administrative de la TVA sur les « petites entreprises ». Les États membres ont largement eu recours à la possibilité et à la liberté accordées par la directive TVA en ce qui concerne l'élaboration de régimes spéciaux. Tout cela a donné lieu à un véritable **patchwork** de différents régimes nationaux en faveur des PME accompagnés de différentes séries de simplifications administratives pour ces PME.

Les nouvelles évolutions dans le domaine de la TVA, renforcées par l'avancée fondamentale vers la taxation à destination, ont conduit la Commission à envisager de mener rapidement une étude sur le **fonctionnement des régimes et des mesures spécifiques en matière de TVA en vertu de la directive TVA**. L'évaluation de la mise en œuvre et de l'application des règles concernant le lieu de prestation des services de télécommunications, de radiodiffusion et de télévision et services électroniques¹⁶ en 2015 a clairement révélé que les PME (et en particulier les microentreprises) confrontées aux régimes de TVA étrangers subissaient une charge significative et voyaient leur accès au marché unique limité. Cela met en lumière l'absence de mesures spécifiques destinées à diminuer le(s) charge(s) pour les PME. La proposition de modernisation de la TVA dans le cadre du commerce électronique transfrontière (ci-après « la proposition relative au commerce électronique »)¹⁷, dans laquelle est prévu un seuil de régime européen commun, a constitué une première étape. Dans le même temps, la Commission a pris acte du besoin d'un examen complet du régime de TVA applicable aux PME dans sa communication de la Commission visant à améliorer le marché unique¹⁸ et dans son plan d'action sur la TVA¹⁹.

¹³ Aux fins de cette étude, une définition spécifique des PME est adoptée. Elle fait uniquement référence aux entreprises dont le chiffre d'affaires ne dépasse pas 2 millions EUR. Ces entreprises sont qualifiées de microentreprises dans la recommandation de la Commission 2003/361/CE : <http://eur-lex.europa.eu/legal-content/FR/TXT/PDF/?uri=CELEX:32003H0361&from=FR>, consulté le 4 janvier 2017.

¹⁴ Estimations dérivées des données obtenues auprès des autorités fiscales et de sources publiques. Voir Volume II, annexes B, C et D pour les détails.

¹⁵ Directive 2006/112/CE du Conseil du 28 novembre 2006 relative au système commun de taxe sur la valeur ajoutée.

¹⁶ SWD(2016) 382 final et Commission européenne (2016), aspects de la TVA liés au commerce électronique transfrontière – aspects pour la modernisation – Lot 3, élaboré par Deloitte, disponible sous :

https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot3.pdf

¹⁷ Proposition de la Commission de directive du Conseil modifiant la directive 2006/112/CE et la directive 2009/132/CE en ce qui concerne certaines obligations en matière de taxe sur la valeur ajoutée applicables aux prestations de services et aux ventes à distance de biens (COM(2016) 757).

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_757_fr.pdf consulté le 6 janvier 2017.

¹⁸ Communication « améliorer le marché unique : de nouvelles opportunités pour les citoyens et les entreprises » (COM(2015) 550),

<https://ec.europa.eu/transparency/reqdoc/rep/1/2015/FR/1-2015-550-FR-F1-1.PDF> consulté le 3 janvier 2017.

¹⁹ Communication concernant un plan d'action sur la TVA (COM(2016) 148),

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_fr.pdf consulté le 4 janvier 2017.

Ce rapport analyse la situation actuelle des PME dans l'UE et les mesures et régimes spéciaux actuellement applicables aux PME dans les États membres en vertu des possibilités offertes par la directive TVA. Face à un statu quo qui intègre déjà les effets des mesures de la proposition relative au commerce électronique, l'étude prend en compte un certain nombre de modifications au régime en faveur des PME le plus couramment utilisé : le régime d'exonération en faveur des PME. Ces modifications concernent notamment l'étendue de l'exonération en faveur des PME aux prestations effectuées par les entreprises établies en dehors de l'État membre d'imposition afin de l'intégrer dans le régime et de rationaliser les mesures de simplification administrative pour les PME. Ensuite, il s'est agi de considérer des commerçants occasionnels comme des personnes non imposables et d'introduire des mesures de transition pour les PME évoluant en dehors des régimes en faveur des PME afin d'atténuer l'« effet de seuil ». Les objectifs consistent à réduire la charge administrative pour les PME, à réduire les distorsions entre les PME établies localement et celles provenant d'autres États membres, ainsi qu'à contribuer à construire un environnement propice à la croissance des PME (dans le contexte de la stratégie à l'horizon 2020).

Les possibilités examinées dans ce rapport ont été formulées selon un processus participatif qui prend en compte les contributions des parties prenantes, de la Commission européenne et d'autres initiatives politiques dans le domaine de la TVA dans l'UE. Le processus a tout d'abord consisté à obtenir un aperçu des problèmes actuels et ensuite les objectifs politiques et les actions politiques appropriées qui en découlent.

Les actions politiques ont été évaluées au regard de leurs incidences financière et économique à travers un grand nombre d'outils élaborés aux fins d'une analyse quantitative et qualitative. Les outils de collecte de données consistaient en une recherche documentaire, en une consultation des entreprises et des autorités fiscales dans les États membres sélectionnés, mais aussi à faciliter et à participer aux ateliers des parties prenantes, ainsi qu'à une enquête menée par IPSOS MORI auprès des PME dans plusieurs États membres.

Pour l'analyse des données, la méthode des coûts standards (MCS) et le modèle d'équilibre général calculable (EGC) ont été appliqués afin de mesurer respectivement la charge administrative des entreprises et l'ampleur de son effet sur la croissance des PME en raison du fonctionnement des régimes en faveur des PME.

Évaluation du problème

Situation globale des PME dans l'UE

L'analyse de la situation globale des PME dans l'UE montre que les PME incarnent la grande majorité des entreprises dans l'UE, et ce, de manière constante dans les États membres. En outre, la plupart des États membres ont une proportion importante de nano-entreprises (chiffre d'affaires inférieur à 5000 EUR par an). Les activités des PME se concentrent principalement sur le commerce de gros et de détail, dans la construction, ainsi que dans les activités des secteurs technique, scientifique et professionnel, tandis que les plus petites entreprises exercent dans le domaine de l'immobilier ou dans les services de soutien administratif et financier.

Bien qu'elles représentent 98 % des entreprises, les PME ne génèrent un chiffre d'affaires que de 15 % et des recettes nettes de TVA de 25 % dans l'UE.²⁰ Les plus petites entreprises (celles dont le

²⁰ Estimations dérivées des données obtenues auprès des autorités fiscales et de sources publiques. Voir Volume II, annexes B, C et D pour les détails.

chiffre d'affaires est inférieur à 50 000 EUR, soit 69 % de toutes les entreprises de l'UE) génèrent des recettes de TVA négligeables, voire négatives. Ces entreprises sont également les plus susceptibles d'être éligibles pour un régime spécial de TVA au titre de la législation en vigueur.

Le respect des obligations en matière de TVA en vertu du régime standard de TVA impose une charge disproportionnée aux PME par rapport aux plus grandes entreprises car les coûts liés à la mise en conformité à la TVA sont régressifs. Par conséquent, étant donné la place importante des PME dans l'Europe, l'existence de régimes de TVA spéciaux pour les PME est bien justifiée.

Fonctionnement du régime en faveur des PME

En reconnaissance de l'importance des PME dans l'UE, la directive TVA fixe des dispositions spéciales pour les « petites entreprises » qui autorisent les États membres à délivrer des exemptions et des atténuations dégressives pour les prestations effectuées par les entreprises, mais aussi à mettre en place des procédures simplifiées afin d'appliquer et de collecter la TVA et à prévoir d'autres mesures et régimes de soutien aux PME. Le tableau ci-dessous indique le rythme d'adoption de ces mesures par État membre, pour les régimes de TVA les plus importants en faveur des PME :

Exemption en faveur des PME	Atténuations dégressives en faveur des PME	Régime forfaitaire en faveur des PME	Système de comptabilité de caisse
26	3	8	24

Le dénominateur commun des régimes en faveur de PME réside dans le fait que les régimes, ainsi que la plupart des mesures particulières, sont optionnels pour les entreprises éligibles, qui peuvent en sortir et suivre le régime de TVA standard si elles le souhaitent. Parmi les autres caractéristiques principales, l'éligibilité aux régimes en faveur des PME dépend d'un seuil qui repose sur le chiffre d'affaires des entreprises (ou, dans des régimes particuliers, la TVA annuelle nette due).

Le régime le plus fréquent appliqué est le **régime d'exemption en faveur des PME**, au titre duquel les PME sont exemptées de l'obligation d'appliquer la TVA et n'ont pas le droit de percevoir la TVA. Elles ne peuvent pas non plus renseigner le montant de la TVA sur leurs factures. Pour cette raison, l'exemption est particulièrement attrayante pour les PME qui s'adressent directement au consommateur (B2C), puisque leurs clients, dans tous les cas, n'ont pas le droit de déduire la TVA incluse dans le prix de la prestation. Dans de nombreux États membres, les entreprises soumises au régime d'exemption en faveur des PME bénéficient également d'un large éventail de mesures de simplifications, notamment l'exonération de l'enregistrement à la TVA et le fait de remplir les déclarations de TVA périodiques.

De manière générale, sur la base du taux de souscription au régime parmi les entreprises et sur la réduction des coûts de mise en conformité à la TVA²¹, le régime d'exemption en faveur des PME peut être considéré comme une mesure efficace. Toutefois, les entreprises non établies ne peuvent bénéficier de ce régime pour les livraisons imposables en dehors de leur État membre, ce qui génère par conséquent une charge et une distorsion pour les PME qui élargissent leurs activités au-delà de leurs frontières.

²¹ Sur la base des données récoltées auprès des entreprises et des comptables de quatre États membres (à savoir : l'Estonie, la France, l'Italie et la Roumanie), les coûts de mise en conformité sont réduits de près de 60 % par rapport aux coûts encourus par les entreprises sous le régime normal (à savoir, les entreprises qui n'appliquent pas de mesures de simplification ou de régime particulier).

Comme variante du régime d'exemption en faveur des PME, les régimes d'atténuations dégressives fournissent des avantages fiscaux, mais pas une atténuation complète, et sont principalement appliqués dans les États membres où aucune exemption n'est possible. De manière générale, le régime d'atténuations dégressives de la TVA n'est pas considéré comme une mesure efficace. Il n'a d'ailleurs été mis en œuvre que dans trois États membres et le taux de souscription dans lesdits États n'est pas élevé. Néanmoins, le travail de terrain effectué dans un État membre démontre qu'il permet tout de même de réduire les coûts de mise en conformité pour les entreprises.

Le **régime forfaitaire** et le **système de comptabilité de caisse** font preuve d'une efficacité jugée variable dans les États membres. Plus particulièrement, ces régimes entraînent des coûts de mise en conformité plus élevés en moyenne par rapport au régime de TVA normal.

De nombreux États membres ont mis en œuvre des **simplifications supplémentaires** destinées à réduire la charge administrative des contribuables et avec un accent particulier mis sur les PME, par exemple par des déclarations annuelles récapitulatives, des comptes annuels ainsi que des déclarations de TVA et des rapports simplifiés. Ces simplifications se différencient grandement par leur nature et leur application. Il a été difficile de réaliser une évaluation générale de leur efficacité. Toutefois, les autorités fiscales sont globalement satisfaites de ces simplifications en matière d'efficacité, étant donné que moins de démarches administratives et d'audits sont nécessaires dans leur chef. Les entreprises les considèrent également comme positives, de manière globale, en particulier en ce qui concerne la réduction de la périodicité des déclarations.

Problèmes principaux mis en évidence dans les régimes en faveur des PME

Sur la base de l'analyse des régimes en faveur des PME en vigueur, l'accent a été mis sur le régime d'exemption en faveur des PME, puisqu'il s'agit du régime le plus utilisé et le plus efficace. Les problèmes relatifs au fonctionnement actuel de ces régimes sont résumés ci-après :

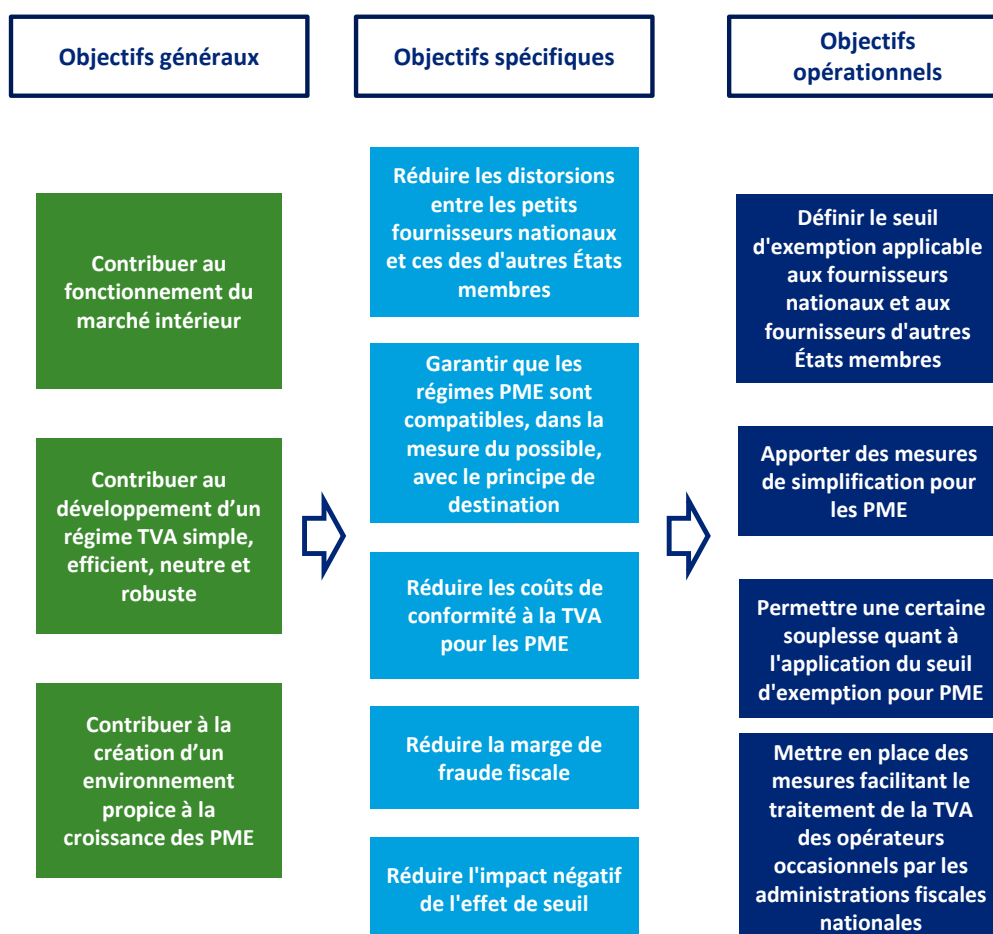
- Premièrement, les PME **manquent de ressources** leur permettant de se conformer aux obligations administratives complexes. Elles dépendent donc lourdement des conseillers fiscaux et des comptables pour gérer les obligations en matière de TVA. Elles souffrent également lourdement d'un manque de connaissances et d'informations lorsqu'elles sont confrontées aux obligations en matière de TVA dans d'autres États membres.
- La **limitation territoriale** stricte de l'exemption à la TVA a une incidence négative sur la situation compétitive des fournisseurs établis dans d'autres États membres par rapport à celle des fournisseurs locaux de biens et services. Ces problèmes sont destinés à s'amplifier avec le glissement de l'imposition à destination. Les petites entreprises qui n'ont pas été soumises aux obligations en matière de TVA dans leur État membre (parce qu'elles pouvaient avoir recours à l'exemption en faveur des PME) devront appliquer la TVA dans l'État membre de leur client sans avoir accès à l'exemption à laquelle leurs concurrents établis dans l'État membre peuvent bénéficier.
- La **numérisation et l'évolution** de nouvelles tendances dans le commerce, telles que le commerce en ligne et l'économie collaborative, ont mené à l'avènement de commerçants occasionnels, pour lesquels il existe une incertitude quant à savoir si leur activité limitée constitue une activité économique aux fins de la TVA, et qui sont aussi souvent actifs au-delà des frontières.
- Un autre élément qui complique l'application transfrontalière du régime d'exemption en faveur des PME est la **diversité et la structure complexe** des régimes nationaux en faveur des PME, principalement en raison des différentes adoptions de mesures de simplification

accompagnant le régime d'exemption en faveur des PME. Tout comme l'effet de seuil à cause duquel les PME sont confrontées, avec une croissance exponentielle, aux obligations en matière de TVA lorsqu'elles dépassent le seuil d'éligibilité au régime d'exemption en faveur des PME, cet élément fait peser une charge disproportionnée de mise en conformité sur les PME par rapport aux grandes entreprises.

Du point de vue des autorités fiscales des États membres, en raison de la possibilité de définir le seuil et les obligations administratives en vertu du régime d'exemption en faveur des PME au niveau national, la perte de recettes de TVA inhérente au régime d'exemption peut être gérée et les régimes en faveur des PME, associés à l'avancée vers la robotisation et la numérisation, permet aux États membres de réduire leurs coûts administratifs et de maintenir un niveau de contrôle adéquat.

Objectifs et moyens d'action pour une intervention politique

Une formulation claire des objectifs généraux, spécifiques et opérationnels de l'intervention politique est importante afin d'établir les priorités politiques et les objectifs d'action. Les moyens d'action sont élaborés dans le but de répondre aux problèmes conformément aux objectifs. Les chiffres ci-dessous présentent les objectifs relatifs aux problèmes mis en évidence.



Sur la base de l'évaluation du problème et des objectifs, quatre moyens d'action (options) ont été élaborés :

- **Moyen 1** : scénario de référence (statu quo et mesures issues de la proposition relative au commerce en ligne²²) ;
- **Moyen 2** : régime d'exemption en faveur des PME étendu aux livraisons en provenance des autres États membres, comprenant des mesures de simplifications rationalisées ;
- **Moyen 3** : moyen 2 accompagné d'un régime obligatoire destiné aux commerçants occasionnels en tant que personnes non imposables ;
- **Moyen 4** : moyen 3 accompagné de mesures pour une période de transition en réduisant l'incidence négative de l'« effet de seuil ».

Le tableau ci-dessous fournit un aperçu des caractéristiques clés des différents moyens d'action.

Caractéristique	Moyen 1 (scénario de référence)	Moyen 2	Moyen 3	Moyen 4
Territorialité	S'applique aux entreprises établies dans un État membre	S'applique à toutes les entreprises de l'UE	s'applique à toutes les entreprises de l'UE (à l'exception des commerçants occasionnels)	s'applique à toutes les entreprises de l'UE (à l'exception des commerçants occasionnels)
Effet de seuil	Fixé au niveau national	Fixé au niveau national	Fixé au niveau national	Fixé au niveau national
Base du seuil	Chiffre d'affaires dans l'État membre	Chiffre d'affaires dans l'État membre (incluant les livraisons dans l'État membre)	Chiffre d'affaires dans l'État membre (incluant les livraisons dans l'État membre)	Chiffre d'affaires dans l'État membre (incluant les livraisons dans l'État membre)
Libre choix	Facultatif pour les États membres et les entreprises	Facultatif pour les États membres et les entreprises	Facultatif pour les États membres et les entreprises, ne s'applique pas aux commerçants occasionnels	Facultatif pour les États membres et les entreprises, ne s'applique pas aux commerçants occasionnels
Avantage fiscal	Exemption de la TVA pour les prestations sous le seuil	Exemption de la TVA pour les prestations sous le seuil	Exemption de la TVA pour les prestations sous le seuil	Exemption de la TVA pour les prestations sous le seuil
Simplifications	Aucune dans le régime d'exemption en faveur des PME, mais s'applique en pratique avec le régime en faveur des PME de manière facultative	Niveau minimum d'enregistrement simplifié, déclaration de TVA et factures pour entreprises éligibles au régime d'exemption en faveur des PME (même lorsqu'elles se retirent). Factures au client supprimées dans le régime. Les États membres peuvent offrir plus d'avantages.	En plus du moyen 2 : Exemption totale des obligations en matière de TVA pour les commerçants occasionnels.	Identique au moyen 3.
Mesures	Inclure un seuil européen commun de	Seuil européen	En plus du moyen 2 :	En plus du moyen 3 :

²² Ibid.

Caractéristique	Moyen 1 (scénario de référence)	Moyen 2	Moyen 3	Moyen 4
supplémentaires	10 000 EUR pour les prestations transfrontalières aux particuliers (B2C) sous lequel l'entreprise peut appliquer des règles locales en matière de TVA, notamment le régime d'exemption en faveur des PME ²³	commun. Un État membre peut introduire un seuil de chiffre d'affaires global pour les PME non établies.	régime obligatoire destiné aux commerçants occasionnels en tant que personnes non imposables	seuil de régime d'exemption flexible en faveur des PME d'un an ou jusqu'au dépassement de 50 % selon l'ordre d'apparition
Avantages principaux	Poursuite du régime existant et simplification pour le commerce transfrontalier aux particuliers fournis par un seuil commun européen.	Diminution des distorsions transfrontalières, simplifications au régime d'exemption en faveur des PME, élargissement des simplifications aux entreprises qui se retirent du régime.	En plus du moyen 2 : les commerçants occasionnels sont exemptés des obligations en matière de TVA. Plus de certitudes dans le régime fiscal de commerçants occasionnels pour les entreprises et les autorités fiscales. Réduction des coûts administratifs des autorités fiscales.	En plus des moyens 2 et 3 : réduction potentielle de l'effet de seuil pour les entreprises, encourageant ainsi leur croissance.
Principaux désavantages	Continuation des problèmes mis en évidence, potentielle aggravation à l'avenir. Examen du régime d'exemption en faveur des PME dans le cadre de l'avancée vers un système fondé sur la destination.	Moins de flexibilité dans le choix des mesures de simplification pour les États membres (devant fournir au moins des simplifications minimales) ; Nouveaux processus de simplification potentiels qui compliquent le système en ajoutant des mesures complémentaires particulières.	En plus du moyen 2 : les commerçants occasionnels ne peuvent s'enregistrer à la TVA et déduire la TVA appliquée, à moins de prouver leur non-éligibilité. Difficulté pour les autorités fiscales de légiférer et de contrôler la mesure.	En plus des moyens 2 et 3 : Effets négatifs sur les recettes de la TVA des États membres. Peut accroître la difficulté du système de TVA et le contrôle de conformité.

²³ Ibid.

Évaluation des moyens d'action

Les résultats de l'évaluation d'incidence montrent que les principaux effets des modifications apportées aux régimes en faveur des PME sont la réduction des **coûts de mise en conformité des PME**. Comparé au scénario de référence, tous les moyens d'action réduisent les coûts de mise en conformité pour les entreprises, mais à un degré différent. Dans le scénario de référence, les quelque 32 millions d'entreprises dont le chiffre d'affaires est inférieur à 100 000 EUR ayant été interrogées dans le cadre de l'étude ont des coûts de mise en conformité correspondants à 67,9 milliards EUR, réduits entre 58,6 et 56,1 milliards EUR selon les moyens d'action.

- Grâce aux mesures de simplification et à l'extension du régime d'exemption en faveur des PME non établies, le **moyen d'action 2** affecte directement les coûts de mise en conformité de toutes les entreprises, actives dans le commerce local et transfrontalier. La réduction des coûts de mise en conformité varie entre 8 et 22 % selon la mesure dans laquelle les États membres simplifient ou augmentent les obligations relatives à la TVA des PME, étant donné qu'ils peuvent souhaiter un meilleur contrôle sur les entreprises soumises au régime une fois celui-ci ouvert aux entreprises non établies. Les PME qui choisissent actuellement le régime d'exemption peuvent observer une augmentation de leurs coûts de mise en conformité si l'extension du régime aux entreprises étrangères mène à une augmentation des obligations d'enregistrement ou de communication de la part des États membres.
- Dans le **moyen d'action 3**, la perte d'obligations relatives à la TVA pour les commerçants occasionnels qui ne sont plus considérés comme des personnes non imposables mène à une réduction globale de 17 % des coûts de mise en conformité par rapport à la référence. On estime que près de 6,4 millions d'entreprises sont touchées par cette option qui réduit leur charge de mise en conformité à la TVA à zéro, 60 % d'entre elles étaient déjà exemptées de la TVA en vertu du régime d'exemption local en faveur des PME.
- La période de transition proposée dans le **moyen d'action 4**, qui autorise les PME à se maintenir dans le régime d'exemption en faveur des PME pendant un temps limité, conduit à une réduction des coûts de mise en conformité de 18 % par rapport à la référence. On estime que près de 255 000 entreprises sont concernées par cette mesure supplémentaire, même si les effets ne sont que temporaires.

En raison de la diminution du coût administratif, les **moyens d'action** doivent **tous** permettre **d'augmenter l'activité commerciale transfrontalière des PME**, ainsi que d'avoir un effet positif sur le PIB, la production globale, la production des PME concernées, la productivité du travail, la demande des consommateurs et les prix.

Étant donné que tous les moyens d'action proposent l'élargissement de l'exemption en faveur des PME, ils ont un **effet négatif** sur les **recettes de la TVA**, puisqu'ils doivent diminuer dans le cadre de chaque moyen d'action, dans une mesure différente cependant. Toutefois, l'effet est négligeable étant donné que les recettes globales de la TVA des PME à l'échelle européenne sont relativement faibles.

Concernant le **respect de la législation et la fraude**, tous les moyens d'action produisent des effets différents. Le **moyen 4** étant le **plus positif**. Cela s'explique par le fait que les PME sont temporairement autorisées à dépasser le seuil, ce qui réduit l'effet de seuil ainsi que la motivation des

entreprises à rester virtuellement en deçà du seuil et qui donne la chance aux PME en expansion d'adapter leur conformité au régime standard de TVA de manière progressive.

Le **moyen d'action 2** est le **moins positif** en matière de respect de la législation et de fraude, car on estime qu'il complique le système pour les autorités fiscales chargées du contrôle effectif, étant donné que les contribuables étrangers seront autorisés à bénéficier du régime d'exemption en faveur des PME dans l'État membre d'imposition. **Le moyen d'action 3 se situe à mi-chemin.** Il exclut les commerçants occasionnels dont les effets seraient positifs sur le respect de la législation, et il autorise les autorités fiscales à mieux concentrer leurs efforts.

Le tableau ci-dessous fournit un aperçu des effets de chaque moyen d'action comparé au scénario de référence.

Type d'effet	Effet comparé à la référence (% d'augmentation ou de diminution) ²⁴		
	Moyen 2	Moyen 3	Moyen 4
Modification de la charge administrative pour les PME (%)	-14 %	-17 %	-18 %
Modification de la charge administrative pour les PME (EUR/an)	-9,1 milliards	-11,2 milliards	-11,6 milliards
Effets sur les recettes de la TVA (%)	-0,06 %	-0,06 % (-0,24 % à + 0,30 %)	-0,24 % (-0,48% à + 0,28%)
Effets sur les recettes de la TVA (EUR/an)	-664,9 millions	-3,1 milliards à + 4,7 milliards	-5 milliards à + 2,8 milliards
Effets sur le respect de la législation et la fraude	<ul style="list-style-type: none"> ➤ Augmente la complexité du régime ➤ Difficultés pour les États membres de contrôler 	<ul style="list-style-type: none"> ➤ Réduction du risque que les commerçants uniques ne soient pas en conformité 	<ul style="list-style-type: none"> ➤ Encourage la mise en conformité volontaire
Effets sur le PIB	0,07 %	0,09 %	0,09 %
Effets sur la production globale	0,08 %	0,10 %	0,10 %
Effets sur la production des PME concernées	9 %	10,9 %	16,1 %
Effets sur l'activité commerciale transfrontalière des PME	13,5 %	13,5 %	13,5 %
Effets sur la productivité du travail	0,09 %	0,11 %	0,11 %

²⁴ Sur la base d'un scénario de « simplification moyenne ». Dans l'analyse, le niveau de simplification des tâches administratives proposé par chaque moyen d'action a été estimé selon un niveau de simplification faible, moyen ou élevé. Les informations principales prennent en compte les coûts des mesures de simplification moyennes.

Type d'effet	Effet comparé à la référence (% d'augmentation ou de diminution) ²⁴		
	Moyen 2	Moyen 3	Moyen 4
Effets sur les prix	-0,08 %	-0,09 %	-0,11 %
Effets sur la demande des consommateurs	0,09 %	0,11 %	0,12 %

Conclusion

La croissance de l'activité transfrontalière des PME résultant de la numérisation et des nouvelles tendances commerciales reposant sur les évolutions de la technologie, ainsi que l'avancée fondamentale de la taxation à destination de la TVA européenne rendent inévitable le fait de s'adapter et de rationaliser les régimes nationaux en faveur des PME sur la base des articles 281 et 282 de la directive TVA.

L'expérience obtenue à la suite des modifications de 2015 aux règles concernant le lieu de prestation des services de télécommunications, de radiodiffusion et de télévision et services électroniques et la suppression programmée des seuils en matière de vente à distance pour les livraisons transfrontalières de bien directement aux consommateurs mènera à une confrontation accrue des PME aux régimes de TVA. Malgré le seuil spécifique commun à l'UE pour le commerce en ligne et la disponibilité de l'actuel MOSS et du futur OSS (visibles dans le scénario de référence du moyen 1) qui permettront l'atténuation de la charge administrative inhérente à l'imposition dans de nombreux États membres de destination. Les PME et en particulier les microentreprises ont besoin d'autres initiatives qui soient plus adaptées.

Pour les PME, le problème principal avec le système de TVA actuel reste les coûts de mise en conformité. Ce problème est partiellement traité par l'exemption. Toutefois, étant donné que l'exemption en faveur des PME est principalement attrayante pour les PME qui s'adressent directement à leurs clients, l'exemption ne répond pas aux préoccupations des PME qui s'adressent aux autres entreprises, et à celles dont le chiffre d'affaires est peu élevé et qui dépassent le seuil d'exemption en vigueur dans leur pays. Pour cette raison, un examen du régime d'exemption en faveur des PME doit être accompagné d'une rationalisation des mesures de simplification pour les PME. Les moyens d'action pour l'examen ont été établis sur la base de cette conclusion.

Comme on peut le voir dans le tableau suivant, les moyens d'action répondent aux objectifs de la présente intervention formulée lors de l'étude fondée sur les priorités politiques de l'UE et des documents tels que la stratégie Europe 2020, le Small Business Act, la stratégie du marché unique et le récent plan d'action en matière de TVA de l'UE :

Objectifs spécifiques	Moyen 1:	Moyen 2:	Moyen 3:	Moyen 4:
Réduire les distorsions entre les petits fournisseurs locaux et les petits fournisseurs provenant d'autres États membres.		✓✓✓	✓✓✓	✓✓✓
Garantir que les régimes en faveur des PME sont compatibles, dans la mesure du possible, avec le principe de destination.		✓✓✓	✓✓✓	✓✓✓

Objectifs spécifiques	Moyen 1:	Moyen 2:	Moyen 3:	Moyen 4:
Réduire les coûts de mise en conformité à la TVA des PME.		✓	✓✓	✓✓✓
Réduire la marge pour la fraude fiscale.			✓	✓✓
Réduire les effets négatifs de l'« effet de seuil ».				✓✓

Le moyen d'action 4, en combinant les caractéristiques des autres moyens et en ajoutant l'extension temporaire du régime en cas de dépassement du seuil, atteint tous les objectifs. En adoptant un tel cadre dans lequel les PME peuvent s'inscrire, dans la mesure où ils respectent les niveaux du seuil définis à l'échelle de l'État membre, permettra une réduction significative de la charge administrative et des distorsions pour les PME, en particulier celles actives au-delà de leurs frontières, tout en réduisant l'effet de seuil négatif inhérent à la plupart des régimes actuels d'exemption en faveur des PME. Les effets sur les recettes de TVA des États membres sont relativement faibles et peuvent être atténués étant donné que les États membres détiennent le pouvoir de modifier le seuil.

Table of Contents

Executive Summary	xiii
Context and approach.....	xiii
Problem assessment	xiv
Policy Objectives and Options for Policy Intervention	xvi
Assessment of the Policy Options	xix
Conclusion	xxi
Synthèse	xxiii
Contexte et approche.....	xxiii
Évaluation du problème	xxiv
Objectifs et moyens d'action pour une intervention politique	xxvii
Évaluation des moyens d'action	xxx
Conclusion	xxxii
1 Introduction	1
1.1 Context	1
1.2 Objective and scope of the study	3
1.3 Structure of the report.....	5
2 Methodological Approach	6
2.1 Overall approach	6
2.2 Impact assessment approach.....	7
2.3 Data collection methods	9
2.4 Data analysis methods	10
2.4.1 Standard cost model	10
2.4.2 Economic modelling/computable general equilibrium (CGE) model.....	10
3 Overall situation for SMEs in the EU	12
3.1 Introduction	12
3.2 Activities of SMEs in the EU	13
3.3 Contribution of SMEs to turnover in the EU	15
3.4 VAT revenues generated by SMEs	18
3.5 VAT compliance costs for SMEs	22
3.6 Summary of overall situation for SMEs in the EU	27
4 Functioning of the SME schemes	28

4.1	Introduction: overview of the SME schemes	28
4.2	Analysis of current VAT special schemes for SMEs	33
4.2.1	SME exemption scheme	33
4.2.2	VAT graduated relief	58
4.2.3	VAT flat rate scheme	68
4.2.4	Cash accounting scheme	81
4.2.5	Other simplifications	92
4.3	Summary of functioning of the SME schemes	95
5	Problem assessment	102
5.1	Problem tree	102
5.2	External factors.....	104
5.2.1	Technological developments and new trends in trading	104
5.2.2	Evolution of the VAT system towards taxation at destination	106
5.2.3	Role of subsidiarity in the EU VAT policy development	108
5.2.4	Interplay with specific EU VAT legislative developments.....	109
5.2.5	Interplay with other EU or national legislation	112
5.3	Drivers	112
5.3.1	Drivers associated with the nature of SMEs	112
5.3.2	Drivers associated with the VAT framework	113
5.4	Problems.....	116
5.4.1	Compliance costs for SMEs	116
5.4.2	Distortion of competition for businesses operating cross-border	118
5.4.3	'Threshold effect' of exiting the SME schemes	119
5.4.4	VAT revenue loss	122
5.5	Effects.....	124
6	Development of policy options.....	126
6.1	Policy objectives	126
6.2	Policy options design.....	128
6.2.1	Background for the future policy changes to the VAT treatment of the SMEs.....	128
6.2.2	Elements of the policy options.....	130
6.2.3	Proposed policy options	131
7	Assessment of the policy options	160
7.1	Introduction to the impact assessment.....	160

7.2	Option 1: Baseline	161
7.2.1	Compliance costs for businesses.....	161
7.2.2	Administrative Costs for Member States.....	164
7.2.3	Compliance and fraud in Member States.....	164
7.3	Option 2: Extension of exemption threshold to supplies from other Member States and streamlined simplification measures	165
7.3.1	Structure and aim of the policy option.....	165
7.3.2	Impact on businesses.....	165
7.3.3	Impact on Member States	170
7.3.4	Impact on the wider economy	174
7.4	Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons 175	
7.4.1	Structure and aim of the policy option.....	175
7.4.2	Impact on businesses.....	176
7.4.3	Impact on Member States	177
7.4.4	Impact on the wider economy	181
7.5	Option 4: Option 3 plus measures for transition period reducing the negative impact of the 'threshold effect'	182
7.5.1	Structure and aim of the policy option.....	182
7.5.2	Impact on businesses.....	182
7.5.3	Impact on Member States	185
7.5.4	Impact on the wider economy	187
8	Conclusions	189
8.1.1	The SME environment and SME schemes	189
8.1.2	Problem Assessment	191
8.1.3	Assessment of the policy options.....	192
8.1.4	Overall Conclusions of the Study	199

LIST OF FIGURES

Figure 1 – Approach to the study	8
Figure 2 – Ratio of SMEs per inhabitant by Member State	13
Figure 3 – Distribution of businesses within turnover brackets for a selection of Member States and EU-average	14
Figure 4 – Distribution of businesses within turnover brackets by Member State	14
Figure 5 – Distribution of SMEs in the EU by sector of activity and turnover bracket	15
Figure 6 – Distribution of EU-wide businesses and EU-wide turnover by turnover bracket	16
Figure 7 – Average turnover of businesses in each turnover bracket	17
Figure 8 – Distribution of turnover in a selection of Member States and EU-average.....	17
Figure 9 – Distribution of turnover by Member State and turnover bracket.....	18
Figure 10 – Distribution of EU-wide gross and net VAT revenues by different size classes of businesses	19
Figure 11 – Distribution of the net VAT revenues generated by businesses of different size, by Member State.....	20
Figure 12 – Average net VAT revenue per business, for businesses with less than EUR 5 000 of turnover	21
Figure 13 – Net VAT revenue collected for every EUR 1 of gross VAT output declared, by Member State	22
Figure 14 – Average total annual VAT compliance costs for businesses in each size class found in the literature, by Member State.....	23
Figure 15 – VAT compliance costs per employee found in the literature, by Member State.....	24
Figure 16 – VAT compliance costs as a percentage of turnover found in the literature, by Member State	24
Figure 17 – VAT compliance burden (number of hours) in 2014 across Member States based on a medium sized business model company (PWC and World Bank).....	25
Figure 18 – Median of the VAT compliance costs estimated as a percentage of turnover for an average business in each Member State.....	26
Figure 19 – Example of VAT balance under normal VAT rules in a B2B context.....	34
Figure 20 – Example of VAT balance under normal VAT rules in a B2C context	35
Figure 21 – Example of VAT balance under the SME exemption scheme in a B2B context	35
Figure 22 – Example of VAT balance under the SME exemption scheme in a B2C context	36
Figure 23 – VAT exemption thresholds applied in relevant Member States (EUR).....	38
Figure 24 – Take-up rate of the SME exemption scheme by Member State.....	42
Figure 25 – Proportion of businesses exempted from paying VAT under the SME exemption scheme, and share of turnover generated by Member State	44

Figure 26 – Proportion of EU businesses selling to other EU countries by turnover bracket.....	45
Figure 27 – Proportion of SMEs trading cross-border	46
Figure 28 – Example of the functioning of graduated relief scheme in the Netherlands	59
Figure 29 – Thresholds for VAT graduated relief schemes (EUR)	60
Figure 30 – Flat rate thresholds applied in relevant Member States (EUR)	69
Figure 31 – Example of VAT balance under normal VAT rules	70
Figure 32 – Example of VAT balance under flat rate scheme	71
Figure 33 – Cash accounting thresholds applied in relevant Member States (EUR)	83
Figure 34 – Problem tree	103
Figure 35 – Policy objectives	127
Figure 36 – Example of common EU threshold for cross-border supplies of domestic suppliers	134
Figure 37 – Example of expanding SME exemption scheme threshold to cross-border supplies of domestic suppliers	141
Figure 38 – Example of expanding SME exemption threshold to supplies into the Member State of destination with optional common EU threshold in the Member State of establishment.....	143

LIST OF TABLES

Table 1 - Special VAT schemes applied in Member States.....	29
Table 2 – Applicable features of the SME exemption scheme per Member State	40
Table 3 – Annual compliance costs for businesses within and outside of the SME exemption scheme in selected Member States.....	49
Table 4 – EU average annual compliance costs for businesses within and outside of the SME exemption scheme	51
Table 5 – Average advisory fees within and outside the SME exemption scheme	53
Table 6 – Applicable features of the VAT graduated relief scheme per Member State	63
Table 7 – Annual compliance costs for businesses within and outside of the graduated relief scheme in Spain	65
Table 8 – Applicable features of the VAT flat rate scheme per Member State.....	74
Table 9 – Annual compliance costs for businesses within and outside of the VAT flat rate scheme in Belgium	75
Table 10 – EU average annual compliance costs for businesses within and outside of the flat rate scheme.....	77
Table 11 – Average advisory fees within and outside the VAT flat rate scheme.....	78
Table 12 – Applicable features of VAT cash accounting schemes per Member State.....	85

Table 13 – Annual compliance costs for businesses within and outside of the cash accounting scheme in selected Member States.....	88
Table 14 – EU average annual compliance costs for businesses within and outside of the cash accounting scheme	89
Table 15 – Average advisory fees within and outside the cash accounting scheme	90
Table 16 – Main characteristics of the SME schemes as implemented in Member States.....	98
Table 17 – List of proposed policy options.....	132
Table 18 – Key features of the SME exemption scheme in policy options.....	158
Table 19 – List of proposed policy options.....	160
Table 20 – EU average annual compliance costs for businesses within and outside of the SME exemption scheme (Baseline scenario)	162
Table 21 – Scenarios for streamlined simplification packages	167
Table 22 – Businesses’ compliance costs under policy option 2.....	168
Table 23 – Change in VAT revenue collected due to policy option 2 by Member State	170
Table 24 – Summary table of the wider economic impact of option 2	174
Table 25 – Businesses’ compliance costs under option 3 for businesses with less than EUR 100 000 of turnover, excluding occasional traders	176
Table 26 – Change in VAT revenue collected due to policy option 3 by Member State	178
Table 27 – Summary table of the wider economic impacts of Option 3	181
Table 28 – Businesses’ compliance costs under option 4	182
Table 29 – Proportion of businesses impacted by implementing a transition period to the SME exemption scheme, EU-level and by Member State.....	183
Table 30 – Impact of policy option 4 on VAT revenues collected, EU-level and by Member State....	185
Table 31 – Summary table of the wider economic impacts of option 4	187
Table 32 – Summary table of impacts on businesses of policy options 2-4.....	194
Table 33 – Summary table of impacts on VAT revenues of policy options 2-4	195
Table 34 – Summary table of the wider economic impacts of policy options 2-4.....	196
Table 35 – Summary of impacts of policy options 2, 3 and 4	197
Table 36 – Policy objectives vs policy options	198

1 Introduction

1.1 Context

Considered as the **backbone of the EU economy**, representing 98%²⁵ of all the businesses, small and medium-sized enterprises (hereinafter ‘SMEs’) have a specific focus in the EU. The EU’s current ambitious SME policy is based on the Small Business Act²⁶. The policy places great emphasis on the reduction of compliance costs on businesses and their free access to markets. The internal market access and compliance burdens are intricately linked to businesses tax treatment, including the application of VAT.

As mentioned, SMEs are considered as **important actors in economic growth**. However, due to their size and limited resources, they may be affected more by tax compliance burdens than other companies. The particularities of taxing SMEs have been the subject of many surveys and reports, for example by the OECD²⁷, the International Monetary Fund²⁸ and the World Bank²⁹.

The role of SMEs in the Single Market, especially their **participation in cross-border trade**, has drastically changed since the current special VAT schemes for SMEs were designed. At the time, the aim was to support small businesses largely active only in the domestic market. The overall digitalisation of the economy has **simplified access to other markets** and has also made access more economically feasible for smaller businesses. Thus, the existing VAT environment, which was designed for the domestic trade of businesses, may not be fit for purpose any more.

²⁵ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

²⁶ The Small Business act for Europe: https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en

²⁷ E.g. OECD, Taxation of SMEs in OECD and G20 countries, 5 September 2015, http://www.oecd-ilibrary.org/taxation/taxation-of-smes-in-oecd-and-g20-countries_9789264243507-en consulted on 4 January 2017 ; and OECD, International Tax Dialogue: Key issues and debates in VAT, SME taxation and the tax treatment of the financial sector, 2013, <http://oecd.org/tax/tax-global/ITD-publication-decade-sharing-experiences.pdf> consulted on 4 January 2017.

²⁸ E.g. Keen , M.(IMF) and Mintz J. (2004), the Optimal threshold for a Value-Added Tax, Journal of Public Economics, (3-4), pp. 559-576.

²⁹ E.g. Engelshalk M, Small business taxation in transition countries, World Bank 2005 <http://documents.worldbank.org/curated/en/151041468331754316/pdf/351090Business0taxation0SME0paper1ME2.pdf> consulted on 4 January 2017.

It is therefore important to review the **current VAT environment for SMEs**, particularly the special VAT schemes and measures (hereinafter ‘SME schemes’), to ensure that it provides necessary

For the purpose of this study, a specific definition of SMEs is adopted, which includes businesses with an annual turnover not exceeding EUR 2 million, i.e. micro-businesses according to the EU Recommendation 2003/361.

support to start-ups and other SMEs, without internal distortive effects or barriers to trade. This is even more important with the gradual change towards taxation at destination introduced to some extent already through iterations of the VAT Package in 2010³⁰ and in particular in 2015^{31, 32}. Such need for a review of the VAT treatment of SMEs is noted in the Commission Communication on Upgrading the Single Market³³, as well as in the VAT Action Plan³⁴.

Within the specific framework of VAT, the **VAT Directive³⁵ enables Member States to take into account the particularities of SMEs**. More specifically, based on Articles 281 and 282 of the VAT Directive, Member States that encounter difficulties in applying the normal VAT arrangements to such SMEs, may opt to apply the following measures:

- A **simplified procedure**, such as a flat rate scheme, for charging and collecting VAT provided that they do not lead to a reduction thereof.
- **Exemptions or graduated tax relief** in relation to the supply of goods and services made by SMEs. In order to determine whether a SME is entitled to apply such an arrangement, turnover is used as a criterion.

Although these optional provisions in the VAT Directive recognise both the ‘special status’ of SMEs concerning VAT as well as the freedom of Member States to apply a relief regime that fits best with their national requirements and possibilities, these optional provisions have some **important consequences**.

The first consequence of these special schemes is the **negative impact** on the **VAT revenue collected** by the Member States. However, given the importance of SMEs for economic growth, most Member States seem to be willing to forfeit a (limited) part of the VAT revenue to support them

Secondly, the application of these relief measures may **distort competition** between businesses qualifying for the special scheme(s) and businesses that do not qualify. As acknowledged by the OECD, these measures may furthermore create an incentive for certain businesses (especially in B2C trade) to restrict their sales (i.e. to ‘stay below the threshold’) in order to not forgo the competitive

³⁰ The first phase of the VAT Packages in 2010 introduced new place of supply of services rules for VAT in the EU and new intra-EU VAT refund processes.

³¹ From 2015, supplies of telecommunications, broadcasting and electronically supplied services made by EU suppliers to private individuals and non-business customers were taxable in the Member State of the customer.

³² Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services.

³³ Communication on Upgrading the Single Market: more opportunities for people and business (COM(2015) 550): <https://ec.europa.eu/transparency/regdoc/rep/1/2015/EN/1-2015-550-EN-F1-1.PDF> consulted on 3 January 2017.

³⁴ Communication on an action plan on VAT (COM(2016)/148):

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_en.pdf consulted on 4 January 2017.

³⁵ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

advantage of being tax exempt or granted tax relief.³⁶ Such an effect would be contrary to the objective of the SME policy to encourage the growth of SMEs. However, certain businesses (especially in B2B trade) may instead prefer to voluntarily opt out of the SME exemption to benefit from input VAT deduction.

In addition, the optional regimes in the VAT Directive for SMEs also lead to a **lack of a harmonised approach** among Member States. In its *Communication on the future of VAT*, the Commission recognised that the different approaches among Member States imply a form of complexity, extra compliance costs and legal uncertainty, which could impact SMEs more than other businesses as they do not always have the necessary resources to deal with this.³⁷ These tax considerations could have a dissuasive effect on SMEs to develop their cross-border activities. Hence, the lack of a harmonised approach with regard to SMEs can be considered as an impediment to the full realisation of the Single Market.

Within this legal framework, the Commission has already undertaken several initiatives which will also provide relief to SMEs. For example, the Commission has proposed a **standard VAT declaration form** for cross-border trading businesses³⁸ and setting up an **EU VAT information portal**³⁹. Furthermore, since January 2013, **simplified rules on VAT invoicing** make VAT payments considerably simpler for businesses.⁴⁰ Small businesses are also allowed to adopt a cash accounting regime as from 2013.⁴¹ Lastly, the **Mini One-Stop-Shop (MOSS)** system which is currently applied in the framework of the taxation of telecommunications, broadcasting and electronic services, but is proposed to be expanded also to cross-border supplies of goods⁴², has already had a positive impact on the compliance burdens that SMEs were faced with after the 2015 place of supply changes ensuring taxation in the country of consumption. Although these initiatives are beneficial to SMEs, they do not amend Articles 281 and 282 of the VAT Directive and their impact on SMEs and businesses more generally.

In order to ensure a simpler, more robust and efficient VAT system, the current special VAT schemes for SMEs should be analysed taking into account both the particularities of SMEs (e.g. limited amount of resources) and the fundamental principles of the European VAT system (such as smooth functioning of the Single Market).

1.2 Objective and scope of the study

This document is the Final Report for the study '**Special scheme for small enterprises under the VAT Directive 2006/112/EC - Options for review**' (the VAT Directive 2006/112/EC will be referred to as 'VAT Directive' hereinafter) commissioned to Deloitte by the European Commission Directorate General for Taxations and Customs Union (DG TAXUD).

³⁶ OECD, Survey on the taxation of small and medium-sized enterprises, 25 September 2007, p. 13.

³⁷ European Commission, 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, Brussels 6 December 2011, COM(2011) 851 final.

³⁸ Although the proposal (COM(2013) 721) was withdrawn by the Commission in 2016 due to lack of progress in the Council.

³⁹ See: https://ec.europa.eu/taxation_customs/business/vat_en

⁴⁰ European Commission Press release: 'New VAT rules to make life easier for businesses from 1st January 2013', Brussels, 17 December 2012, available: http://europa.eu/rapid/press-release_IP-12-1377_en.htm.

⁴¹ European Commission, Memo: 'Top 10 most burdensome EU laws for small and medium-sized enterprises: how the Commission is helping SMEs', Brussels, 7 March 2013, available: http://europa.eu/rapid/press-release_MEMO-13-168_en.htm.

⁴² Ibid., see:

https://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en.

This report builds upon previous reports submitted to the Commission by Deloitte, namely the First and Second Interim Reports and Draft Final Report. Overall, this report is a result of all data collection and analysis completed during the study period, including meetings and exchanges with the Commission.

The primary data collection for the study occurred between January 2016 and October 2016. Adjustments to SME schemes in the Member States (e.g. introduction of schemes or changing of thresholds) after this period (up to April 2017) were included in the description of the functioning of the SME schemes (Section 4). These adjustments however are not included in the calculations for the impact assessment or economic modelling.

1.3 Structure of the report

This report has the following structure:

- ✔ **Section 2** presents the understanding and approach adopted for the study;
- ✔ **Section 3** describes the overall situation for SMEs in the EU;
- ✔ **Section 4** presents the functioning of SME schemes across the EU;
- ✔ **Section 5** contains the problem assessment
- ✔ **Section 6** presents the proposed policy options as well as the problem assessment and policy objectives leading to the identification of the options;
- ✔ **Section 7** contains the preliminary impact assessment of the proposed policy options;
- ✔ **Section 8** presents the study conclusions.

A separate volume (Volume II), contains a number of annexes, namely:

- ✔ **Annex A:** Overview of SME schemes;
- ✔ **Annex B:** Data received from Tax Authorities;
- ✔ **Annex C:** Estimation methodology;
- ✔ **Annex D:** Country-specific estimates;
- ✔ **Annex E:** Ipsos MORI Surveys;
- ✔ **Annex F:** VAT compliance costs estimation – literature review;
- ✔ **Annex G:** Standard Cost Model;
- ✔ **Annex H:** Elements of policy options;
- ✔ **Annex I:** Methodological note for the analysis of the options;
- ✔ **Annex J:** Assessment of the policy options – compliance costs;
- ✔ **Annex K:** CGE model;
- ✔ **Annex L:** Bibliography.

2 Methodological Approach

This section provides a general overview of the methodology applied for this study.

2.1 Overall approach

The study was carried out in three parts. The first part looked at the current situation for SMEs in the EU and the functioning of the SME schemes in the Member States. This analysis, which was carried out with data provided by national tax authorities, VAT experts in each Member State and desk research, provided a **picture of the current environment for SMEs**. This picture includes the contributions of SMEs to EU-wide turnover and VAT revenues as well as the ways that the current SME schemes are applied in practice and by which Member States. It also identifies the effectiveness of each type of scheme in terms of their main advantages and disadvantages. An analysis of the application of schemes in a sample of eight Member States also allowed for identification of compliance costs of the schemes.⁴³

The second part of the study involved the **development of potential options for review** of the SME schemes. Building on the analysis of the current schemes (i.e. status quo), problems and policy objectives were identified for design of the policy options.

Finally, these options were assessed in terms of their **costs and benefits** for business, Member States and the wider economy. This analysis was carried out through two tools: the standard cost model (SCM) and computable general equilibrium (CGE) model. More detail on these models and the analysis carried out is contained in Volume II (Annex I – Methodological note). The impact assessment approach is also explained in the section below (Section 2.2).

It should be noted that the **definition of an SME adopted by this study deviates from the definition included in the Commission Recommendation of 6 May 2003**, which sets definitions for micro, small and medium-sized enterprises based on staff headcount and financial thresholds (annual turnover and annual balance sheet total)⁴⁴. Contrary to the Recommendation, which defines SMEs as enterprises with fewer than 250 persons and with an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million, this study only looks at enterprises with an annual turnover not exceeding EUR 2 million. This approach is more consistent with the Recommendation's definition of a micro-enterprise (Article 2(3)).

⁴³ The Member States included in the sample were the UK, Belgium, Poland, Romania, Italy, Spain, France and Estonia.

⁴⁴ Commission Recommendation 2003/261/EC, available:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:en:PDF>.

To enhance the accuracy of the analysis, data was collected on SMEs according to their annual turnover within the following turnover brackets:

- ☒ EUR 500 001 – EUR 2 000 000;
- ☒ EUR 100 001 – EUR 500 000;
- ☒ EUR 50 001 – EUR 100 000;
- ☒ EUR 5 001 – EUR 50 000;
- ☒ Does not exceed EUR 5 000.

This granular information was important for the analysis of the policy options, in particular for the analysis of the impacts with regard to changing the VAT exemption threshold, since it allowed for the identification of businesses affected and the revenues at stake under each option.

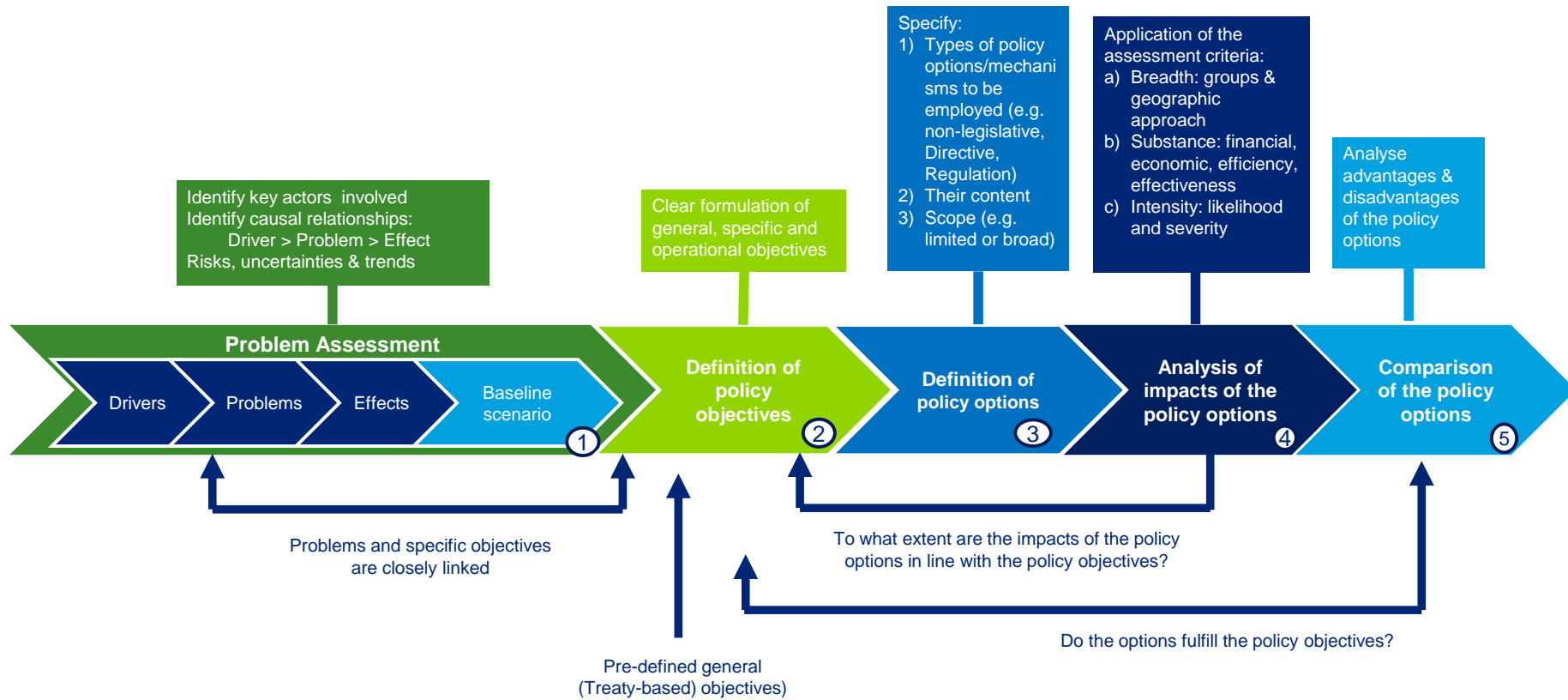
The data collection period occurred between January 2016 and October 2016. Adjustments to SME schemes in the Member States (e.g. introduction of schemes or changing of thresholds) after this period (up to March 2017) were updated in the analysis of the schemes but were not included in the calculations for the impact assessment or economic modelling.

2.2 Impact assessment approach

The approach to this study is in line with steps contained in the Commission's Better Regulation Guidelines⁴⁵. The standard approach to the impact assessment is tailored to best respond to the general and specific aspects of the study.

⁴⁵ European Commission Better Regulation Guidelines, available: http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm.

Figure 1 – Approach to the study



Source: Deloitte elaboration of Better Regulation Guidelines

The approach comprises the following steps (see Figure 1):

Step 1 – Problem assessment: this step identifies the problems, their drivers and effects as well as the causal relationship between these. Establishing causal links is imperative in order to develop a robust problem assessment, on the one hand, and to ensure that the policy options are defined in such a way that they address the actual challenges, on the other hand.

Step 2 – Definition of policy objectives: this step elaborates a clear formulation of the general, specific and operational objectives of the policy intervention. A clear definition of the policy objectives is important, as they set out the political priorities and aims for action in the relevant field.

Step 3 – Development of policy options: this step consists of establishing the relevant policy options that are most likely to achieve the policy objectives and address the problems. This includes a clear specification (for each of the policy options) of the type of policy options and mechanisms to implement them, their content, the scope, etc. Policy option development was carried out in consultation with the Commission, stakeholders and experts.

Step 4 – Analysis of impacts of policy options: this step focuses on assessing the expected impacts of the selected policy options. The aim of this step is to assess impacts across the main policy dimensions (financial, economic, social, geographical, legal and environmental) as well as potential trade-offs and synergies.

Step 5 – Comparison of policy options: this step focuses on comparing the policy options with the status quo (Option 1) based on their relative strengths and weaknesses. The aim of the comparison is to provide an overview of the impacts of each policy option with respect to the status quo based on a common set of indicators.

2.3 Data collection methods

A number of different methods were adopted for the collection of data to feed the study, namely desk research, surveys, interviews and workshops.

Desk research was conducted throughout the study in order to make use of all available secondary sources of data. A full list of sources consulted are contained in Volume II, Annex L.

A **survey** was sent to **Member State tax authorities** to collect quantitative data on (among others) the number of SMEs within each turnover bracket in the Member State as well as data related to the application of the special schemes applied.

A **survey** was also completed by **VAT experts** in each Member State with regard to more qualitative elements of the schemes including their functioning, advantages, disadvantages etc.

An Ipsos MORI **survey of 500 SMEs** in four markets each: Austria, Italy, Poland and the UK was conducted to fill gaps on business turnover, VAT obligations and cross-border trading behaviours.

Interviews were conducted with officials of the European Commission, representatives of business associations, Member State tax authorities as well as SMEs themselves to gather qualitative in-depth information on the functioning of the scheme and potential options for change.

Finally, an **interactive workshop** was held with business association representatives for defining the current problems and potential policy objectives.

Throughout the study, a number of regular and ad hoc meetings were conducted with the Commission for discussion on methodological aspects and findings. Further, all data was overseen by VAT experts for the duration of the study.

2.4 Data analysis methods

2.4.1 Standard cost model

The quantification of the **administrative burden for businesses** under the different options is a very important element for the quantification of the financial impacts of policy options. Consistently with the Better Regulation Guidelines, the Standard Cost model (SCM) methodology was used as the primary tool for quantifying the impacts on the administrative costs of businesses.

Standard cost model:

Administrative burden = Time*Price*Quantity (amount x frequency)

Time: The time spent by the citizen or the employee in the enterprises to comply with an information obligation (IO)

Price: The standard cost to apply to the time spent according to the level of the employee who performs the IO

Quantity: The number of IOs to perform per year and their frequency (e.g. monthly, yearly)

It is important to note the distinction between administrative costs and compliance costs. As per the Better Regulation Toolbox, the administrative costs of businesses are defined as the costs incurred in **meeting legal obligations**.⁴⁶ Businesses may, however, experience additional costs that are not strictly due to the legal obligation (for example the monitoring of the VAT exemption threshold is a cost most VAT exempt businesses bear). The administrative costs and these additional costs are collectively referred to as **compliance costs** for businesses.

Full details on the SCM analysis can be found in Volume II, Annex G.

2.4.2 Economic modelling/computable general equilibrium (CGE) model

In order to assess the wider economic impacts of each policy option a CGE model was used to estimate the effects at the European level. A CGE model of the EU has been developed to support a separate project investigating the economic impacts of the change to the VAT treatment of e-commerce. This model was adapted and extended in order to specifically focus on the contribution of SMEs to the EU economy and on the potential impacts of the policy options. The inputs to the model will be varied based on the policy options in terms of:

⁴⁶ Better Regulation Toolbox: 'Definition of administrative costs and administrative burden', p. 360, available: http://ec.europa.eu/smart-regulation/guidelines/docs/br_toolbox_en.pdf.

- **A change in VAT revenues.** The change in VAT revenues following from each policy option will be estimated and inputted into the model as it may impact government spending and/or investment. The dynamic general equilibrium model will estimate how these changes may flow through the wider economy.
- **A change in the administrative burden faced by SMEs.** This will appear in the dynamic general equilibrium model as a change in the proportion of time/labour allocated to VAT compliance activities, which will in turn affect average labour productivity and will flow through to impact prices, demand and final consumption.
- **A change in the economic activity of SMEs.** As per the above, the model will calculate the impact on the wider economy of businesses increasing or decreasing their activities.
- **A change in cross-border trade by SMEs.** The model will assess the impact of an increase or decrease in cross-border trade activities by SMEs and how this flows through to the wider economy.

Full details on the CGE model can be found in Volume II, Annex K. By comparing the economic outcomes under the different options with respect to policy option 1, the merits of the different options will be assessed.

3 Overall situation for SMEs in the EU

This section describes the current situation of a selection of SMEs in the EU and their contribution to the economy. SMEs, defined as businesses with turnover of up to EUR 2 000 000, make up about 98% of businesses across the EU and contribute about 15% of total turnover generated in the EU.⁴⁷ Among those SMEs, 69% have turnover of less than EUR 50 000⁴⁸: these are the businesses that are most likely to take advantage of SME schemes and are therefore the focus of the study.

3.1 Introduction

To understand and evaluate the VAT system for SMEs in the EU it is first necessary to understand the activities of such businesses and the contribution that they make to the EU economy and to the VAT revenues of Member States. Thus, this section provides an overview of SMEs across the EU in terms of their **contribution to the number of businesses, the turnover and VAT revenues generated**.

The estimates presented throughout this section are based primarily on **data shared by tax authorities** in each Member State. It should be noted that data was not provided by all tax authorities and that for some Member States the data was either incomplete or provided under different classifications. In such cases the missing data was estimated based on other sources, including through:

- Extrapolation based on data provided for other Member States;
- Estimation based on other sources, including Eurostat and Mint Global; and
- Estimation based on an Ipsos MORI survey conducted in four Member States: Austria, Italy, Poland and the UK.

This section presents the final estimates obtained while full details of the approach are provided in the Annexes of Volume II.

- **Annex B** reports the raw data directly received from tax authorities;
- **Annex C** describes the estimation approach in cases for which the data is missing or incomplete; and
- **Annex D** presents the detail, country-by-country, of the final estimates obtained.

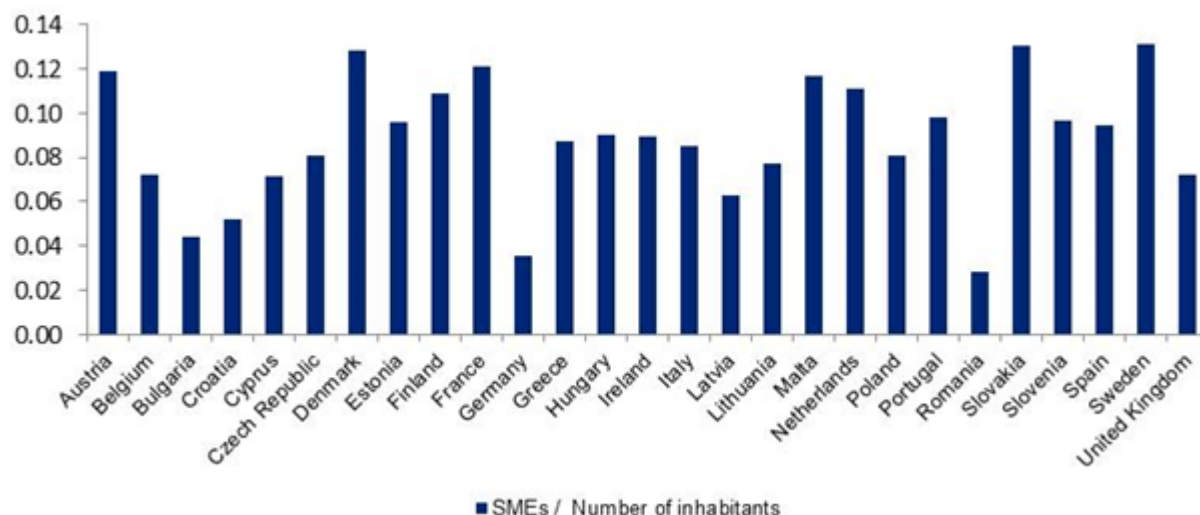
⁴⁷ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

⁴⁸ Ibid

3.2 Activities of SMEs in the EU

Across the EU, businesses with turnover below EUR 2 000 000 represent a significant part of economic activity and are prevalent within the population. Figure 2 shows that in some Member States, there may be up to 0.13 active SMEs for every inhabitant. This varies across Member States, with Northern countries such as Denmark, Slovakia and Sweden seeming to be most effective at fostering SMEs, with a ratio of inhabitants per SME between of around 1.3.

Figure 2 – Ratio of SMEs per inhabitant by Member State⁴⁹



Source: Deloitte estimates based on data obtained from tax authorities and public sources and Eurostat estimates of population by country⁵⁰. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country-specific final estimates on the number of SMEs.

While the number of SMEs relative to the population varies across Member States, it is consistently found that **SMEs make up the vast majority of businesses**. In addition, about 69% of all businesses have turnover of less than EUR 50 000.⁵¹ The distribution of businesses within the smallest turnover brackets is more variable across Member States, with, for example, businesses with less than EUR 5 000 of turnover representing 18% of businesses in Italy compared to 66% in the Czech Republic as shown in the figure below.⁵² The proportion of businesses with turnover below EUR 50 000 also varies from 49% in Belgium to 84% in Slovakia. The share of SMEs amongst all businesses is less variable across countries, from 96% in Belgium to 99% in Slovakia.⁵³

⁴⁹ Luxembourg is excluded as the data provided by tax authorities did not allow classifying businesses between SMEs and non-SMEs, and revealed that the distribution of businesses in Luxembourg was significantly different from the EU-average to obtain robust estimates. See Volume II, Annex C for details.

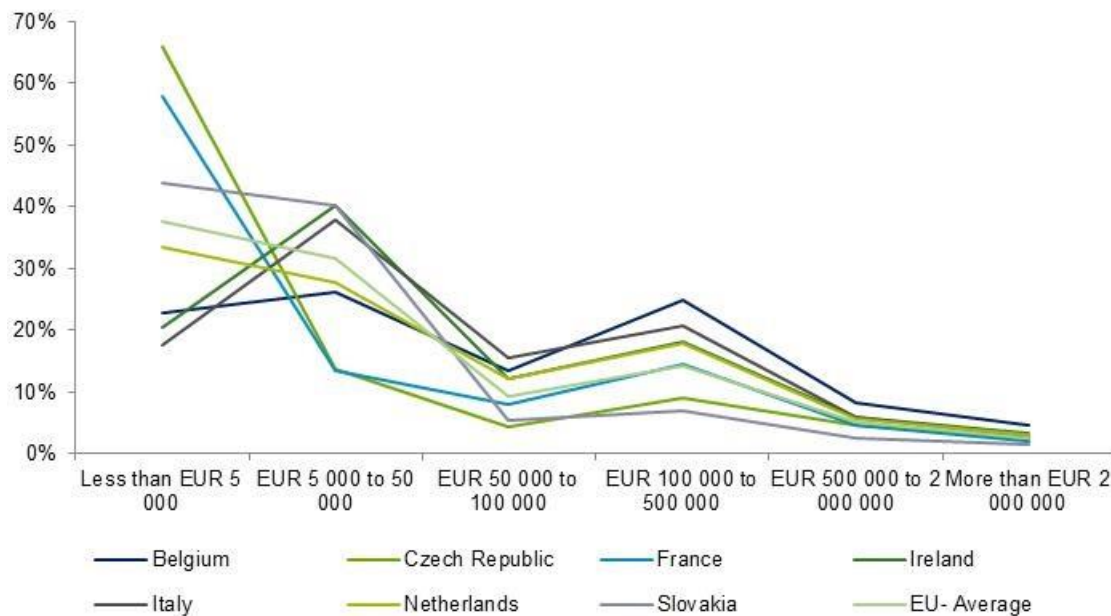
⁵⁰ Eurostat data: Population (Demography, Migration and Projections) <http://ec.europa.eu/eurostat/web/population-demography-migration-projections/population-data>, 2015 estimates.

⁵¹ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

⁵² Ibid.

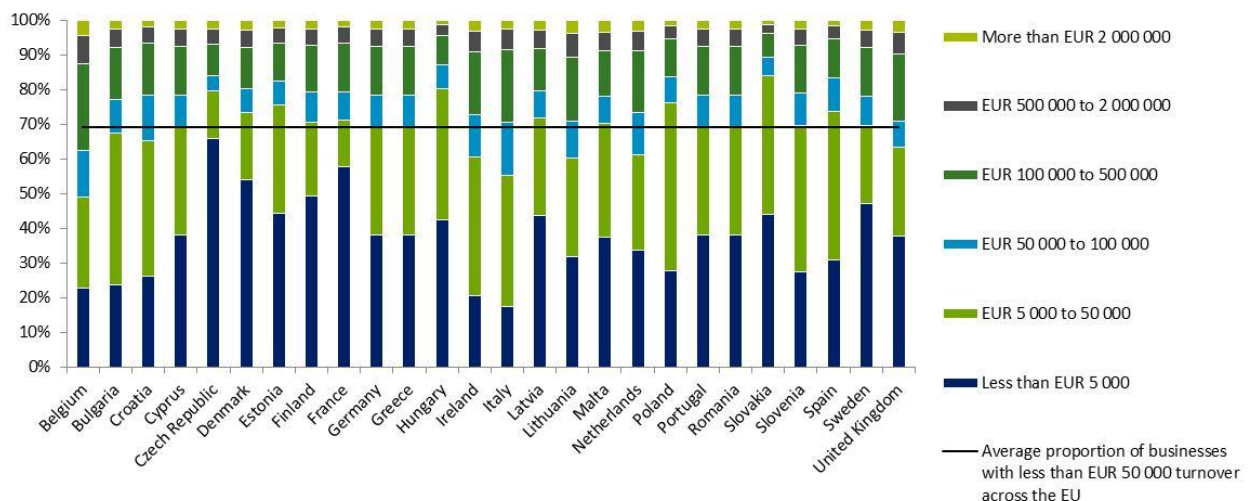
⁵³ Ibid.

Figure 3 – Distribution of businesses within turnover brackets for a selection of Member States and EU-average



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country specific final estimates.

Figure 4 – Distribution of businesses within turnover brackets by Member State⁵⁴



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country specific final estimates.

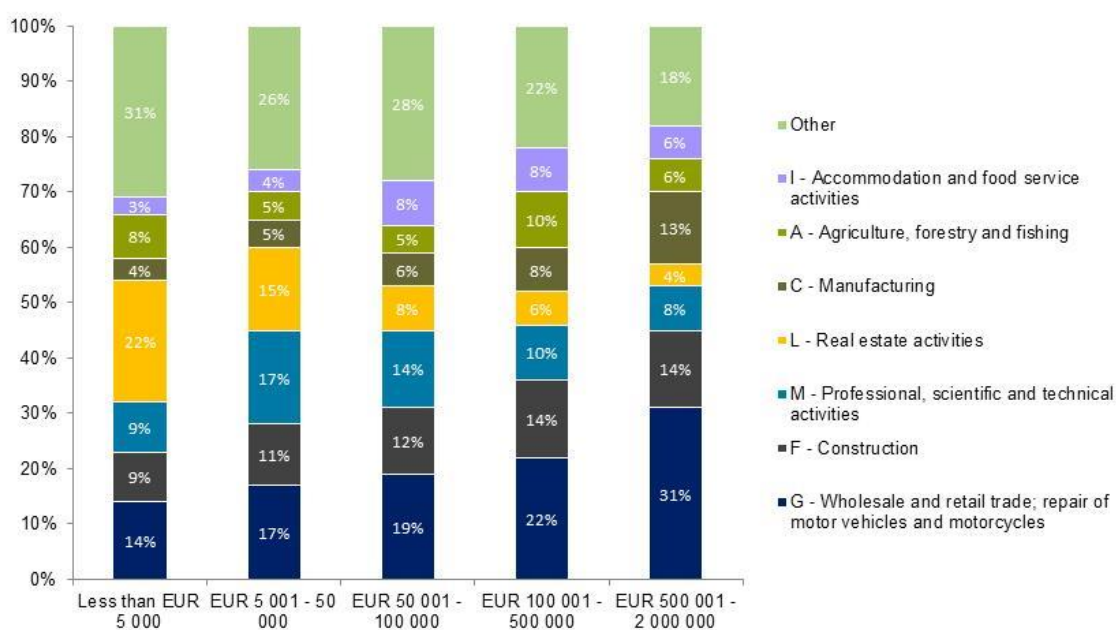
Most Member States have a large proportion of **nano-businesses** with less than EUR 5 000 of turnover. Fieldwork interviews have revealed that these are often individuals carrying out economic activities outside of their main employment, for example occasional traders selling products online.

⁵⁴ Austria and Luxembourg are excluded as the data provided by tax authorities did not allow classifying the businesses within turnover brackets. The information received revealed that these two countries were outliers compared to the EU average and robust estimates could not be obtained. See Volume II, Annex C for details.

However, despite the large proportion these businesses represent, there is more uncertainty surrounding these figures since such enterprises are less likely to be captured in company registrations or VAT statistics, and the information is largely reliant on individuals declaring this income in their personal tax returns.⁵⁵ For example, in Denmark and Poland detailed data was only available for those businesses that were VAT-registered.⁵⁶ The number of exempted businesses was therefore estimated and included in the estimates reported above. Details of the calculations can be found in Volume II, Annex C.

Turning to the **activities of SMEs**, these businesses mainly operate in the Wholesale and Retail Trade sector, the Construction sector and the Professional, Scientific and Technical activities sectors. The smallest businesses in the EU are disproportionately found within real estate – including rental and operations of property – or in such categories as the provision of financial advisory services or administrative support services. However, this is mainly driven by the large number of businesses of this size and in the real estate sector in France. More details on the country-specific estimates can be found in Volume II, Annex B.

Figure 5 – Distribution of SMEs in the EU by sector of activity and turnover bracket⁵⁷



Source: Deloitte estimates based on data obtained from surveys to tax authorities

3.3 Contribution of SMEs to turnover in the EU

While SMEs make up an overwhelming majority of businesses in the EU they contribute a **minority of the total turnover generated in the EU**. Despite representing about 98% of businesses, SMEs in the EU generate only 15% of the turnover.⁵⁸ Among the smallest enterprises with turnover of less than

⁵⁵ Although businesses may be exempt from VAT registration, they may instead become subject to income tax.

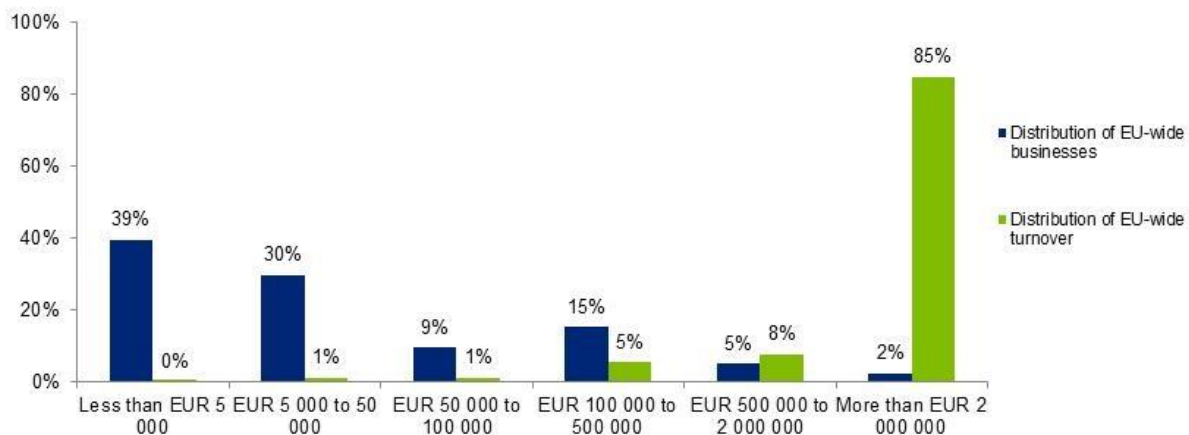
⁵⁶ This is also the case for Sweden, however no VAT exemption existed in Sweden at the time of data collection, hence at that time all businesses had to be VAT-registered.

⁵⁷ This is based on data received from the following Member States: Belgium, Bulgaria, Czech Republic, Finland, France, Hungary, Ireland, Italy, Lithuania, Slovakia and Slovenia.

⁵⁸ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

EUR 50 000 this effect becomes more pronounced: such businesses make up 69% of businesses and generate only about 1% of the total turnover in the EU.⁵⁹

Figure 6 – Distribution of EU-wide businesses and EU-wide turnover by turnover bracket⁶⁰



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country specific final estimates.

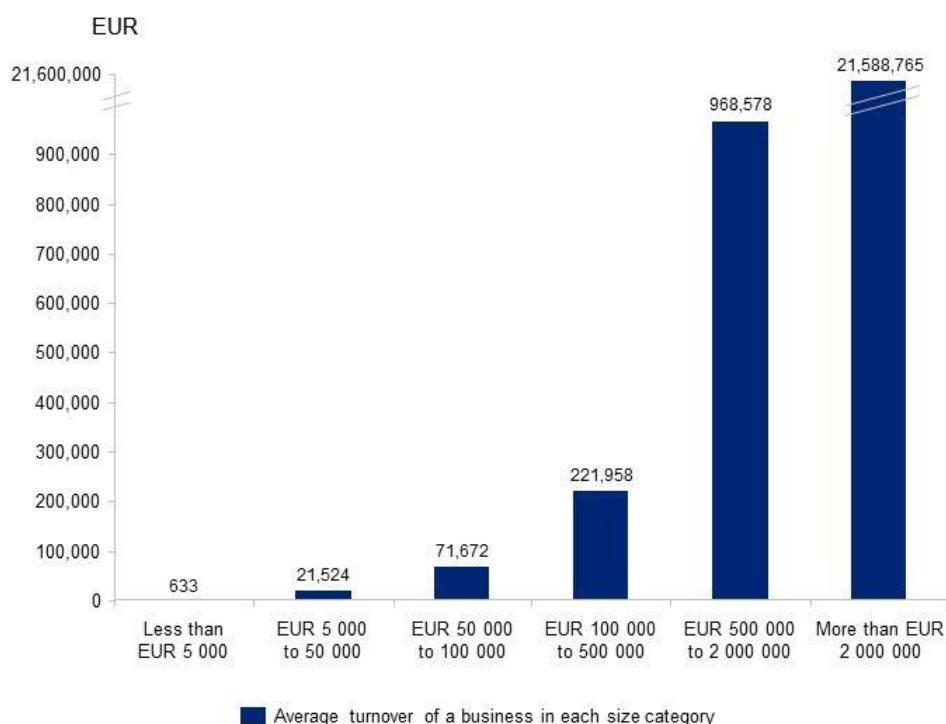
This is unsurprising given the average turnover by businesses in each bracket: the smallest SMEs with turnover of less than EUR 5 000 generate on average a turnover of just EUR 633 annually, compared to over EUR 21 million generated by the average business with turnover over EUR 2 million.⁶¹

⁵⁹ Ibid.

⁶⁰ Austria and Luxembourg are excluded as the data provided by tax authorities did not allow classifying the businesses within turnover brackets. The information received revealed that these two countries were outliers compared to the EU average and robust estimates could not be obtained. Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

⁶¹ Ibid.

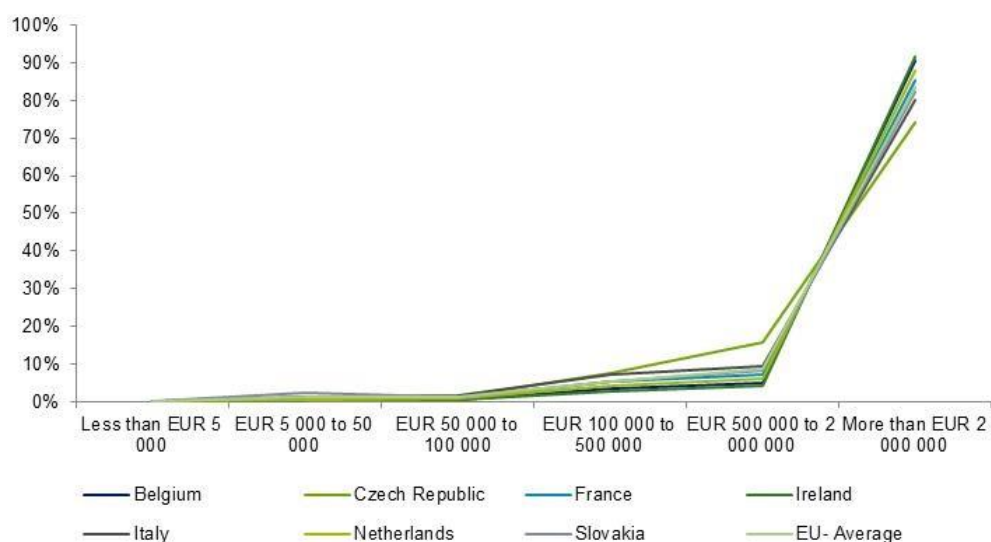
Figure 7 – Average turnover of businesses in each turnover bracket



Source: Deloitte estimates. See Volume II, Annexes B and C for details.

This trend is consistent across Member States, with businesses with turnover below EUR 50 000 representing at most 3% of the overall turnover generated in countries such as Slovakia, and as little as 0.4% in Belgium. In addition, across all Member States, the largest firms contribute over 75% of turnover.⁶²

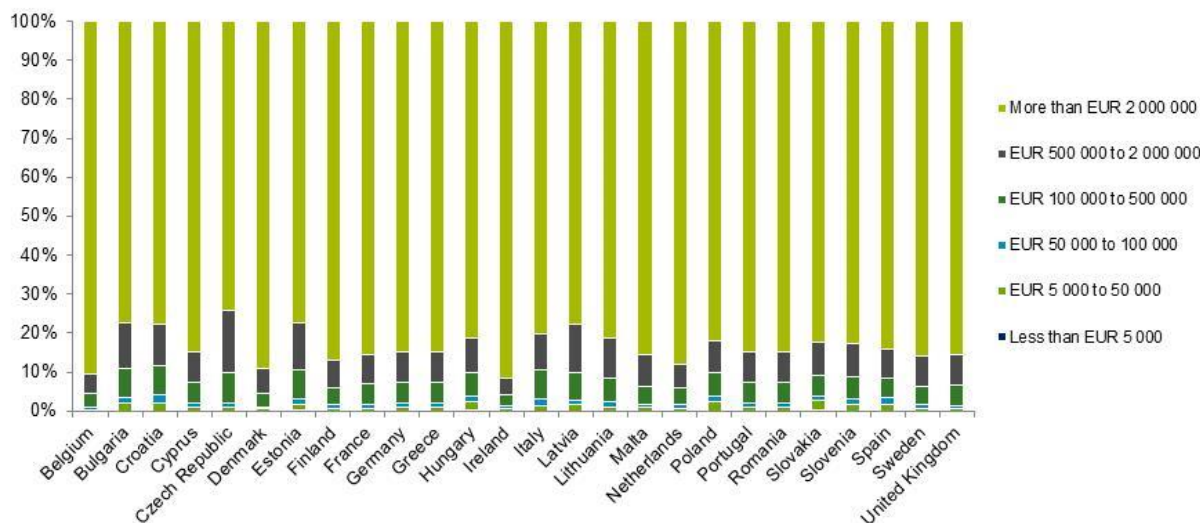
Figure 8 – Distribution of turnover in a selection of Member States and EU-average



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations.

⁶² Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

Figure 9 – Distribution of turnover by Member State and turnover bracket⁶³



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations.

3.4 VAT revenues generated by SMEs

The evidence presented above on the number and turnover of SMEs shows that despite making up 98% of enterprises SMEs contribute only 15%, of total turnover.⁶⁴ A similar pattern is observed in the data on VAT revenues: SMEs generate about 19% and 25% of the gross and net VAT revenues respectively.⁶⁵ Gross VAT revenue refers to the output VAT declared by businesses on their sales, while net VAT revenue is the amount actually collected by tax authorities after the VAT paid on inputs has been recovered by businesses. The fact that SMEs' share of net VAT revenues exceeds their share of total turnover may be due to a combination of factors, such as large corporations exporting to non-EU countries and hence not contributing to VAT revenues on a substantial part of their turnover, or those companies operating in exempted sectors (e.g. financial services and insurance companies).⁶⁶

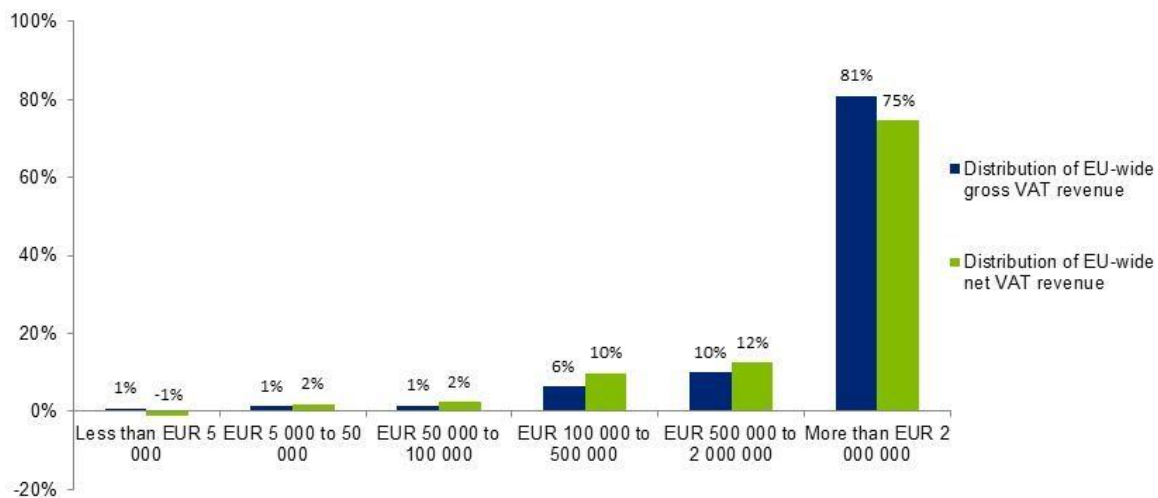
⁶³ Austria and Luxembourg are excluded as the data provided by tax authorities did not allow to classify the businesses within turnover brackets. The information received revealed that these two countries were outliers compared to the EU average and robust estimates could not be obtained.

⁶⁴ A contribution which could increase if more small businesses enter the economy due to the move towards digitalisation, making it easier to start a business.

⁶⁵ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

⁶⁶ SMEs' larger contribution to VAT revenues than to turnover should, in theory, not depend on where they are placed in the supply chain as selling to B2B firms or to final consumers should not, as a standalone fact, impact the amount of VAT paid.

Figure 10 – Distribution of EU-wide gross and net VAT revenues by different size classes of businesses⁶⁷

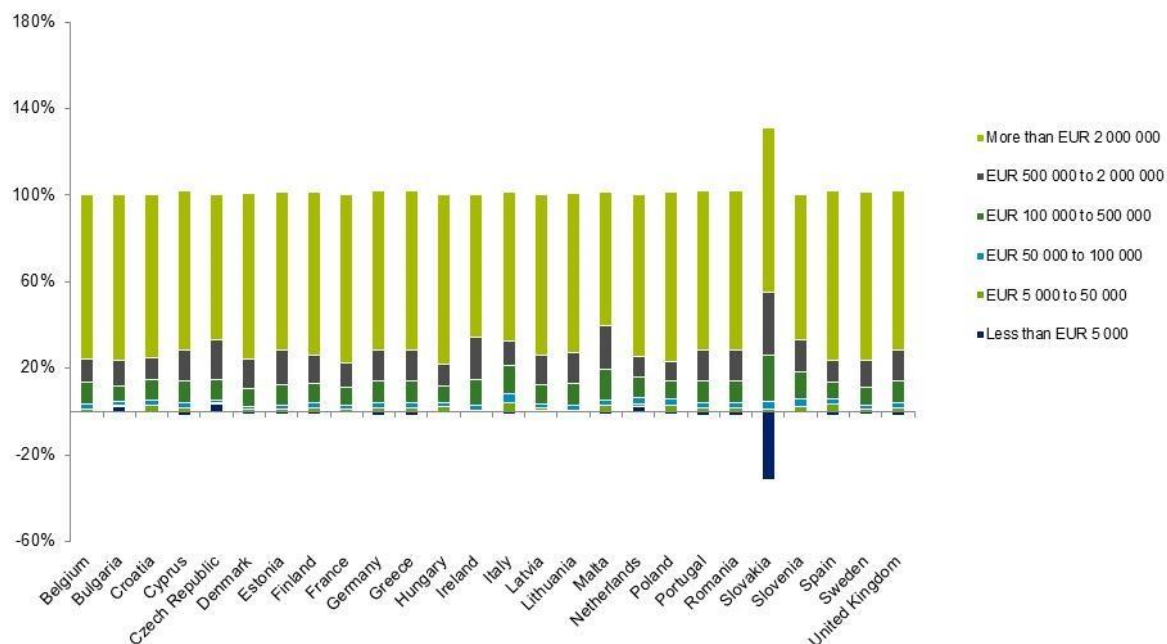


Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country specific final estimates.

Despite some variation in the net VAT revenue distribution amongst smallest businesses, this is generally consistent across Member States, with almost all net VAT revenues being generated by businesses with over EUR 50 000 of turnover.

⁶⁷ Austria and Luxembourg are excluded as the data provided by tax authorities did not allow to classify the businesses within turnover brackets. The information received revealed that these two countries were outliers compared to the EU average and robust estimates could not be obtained.

Figure 11 – Distribution of the net VAT revenues generated by businesses of different size, by Member State⁶⁸



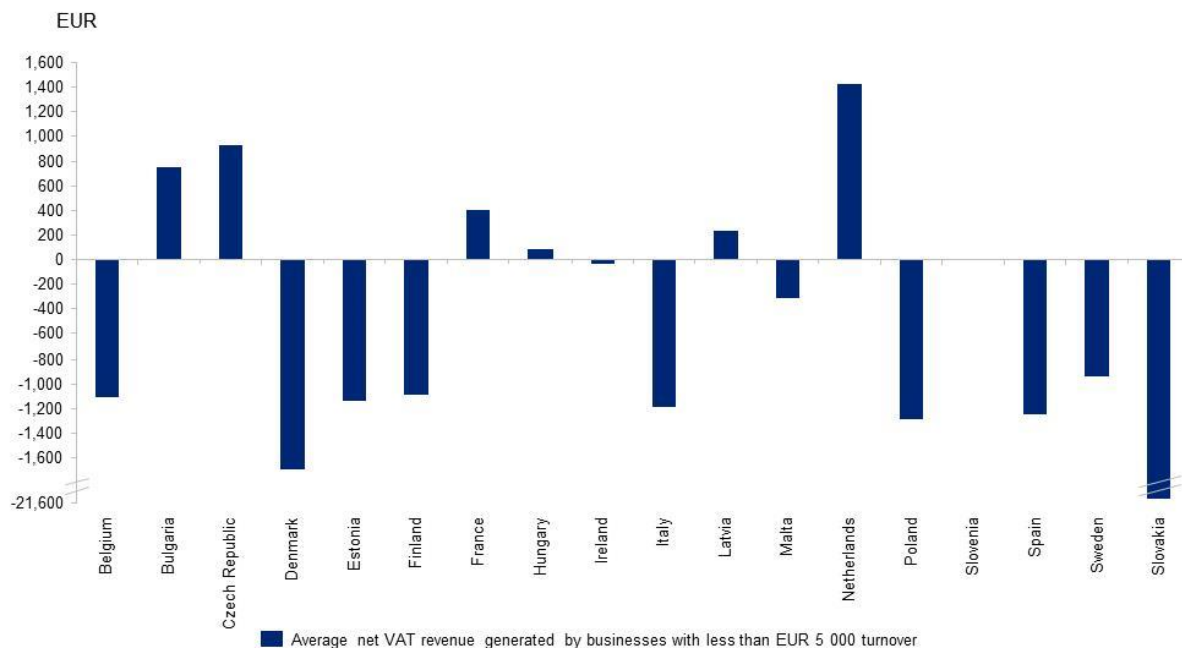
Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Volume II, Annex D for the country specific final estimates.

As seen in the above figure and as highlighted by the data provided by tax authorities presented below, in many Member States businesses with less than EUR 5 000 of turnover actually generate negative net VAT revenues. The overall share of net positive VAT revenue can therefore exceed 100%, to compensate for the negative contribution of small businesses (i.e. the sum of the positive contributions to VAT revenues can be greater than the overall amount collected).⁶⁹ This is the case in the majority of countries for which tax authorities data was received, with Slovakia standing out for the magnitude of VAT inputs recovered by the smallest enterprises. The figure below presents the average net VAT revenue generated by businesses with less than EUR 5 000 of turnover, for those Member States which provided this data.

⁶⁸ Austria and Luxembourg are excluded as the data provided by tax authorities did not allow to classify the businesses within turnover brackets. The information received revealed that these two countries were outliers compared to the EU average and robust estimates could not be obtained.

⁶⁹ For example, if in a Member State the overall amount of net VAT revenue is EUR 10 million and a group of businesses generates – EUR 200 000 of net VAT revenues, these represent – EUR 200 000 / EUR 10 000 000 = - 2% of the overall revenues. The sum of the positive contributions must therefore be EUR 10 200 000 so that the overall net VAT revenue collected is indeed EUR 10 000 000. The contribution of the group of businesses generating positive net VAT revenues to the overall amount is therefore EUR 10 200 000 / EUR 10 000 000 = 102%.

Figure 12 – Average net VAT revenue per business, for businesses with less than EUR 5 000 of turnover



Source: Deloitte estimates based on data obtained from surveys to tax authorities.

Negative net VAT revenues (as illustrated for some Member States above) could be explained by two factors:

- Initial investments made by new businesses (including local subsidiaries of large firms and start-ups) that have yet to record any sales and/or that may not stay in business for a sufficiently long period to recover initial investment; or
- The fact that businesses eligible for and subject to the SME exemption scheme are not allowed to recover VAT on their inputs. Since these exemption schemes are optional, the businesses choosing to register for the common regime may do so because they have more input VAT to recover than output VAT to pay to tax authorities, leading to overall negative net VAT revenues from these businesses.

Based on **fieldwork interviews**, both these phenomena are reported to occur regularly across the EU. While it is therefore common to observe negative net VAT revenues generated by businesses with less than EUR 5 000 of turnover, the reason for the proportionately high negative net revenues observed in Slovakia is not clear. The tax authorities were contacted to obtain more context on these values, however they were unable to clarify whether they were due to either factor outlined above.

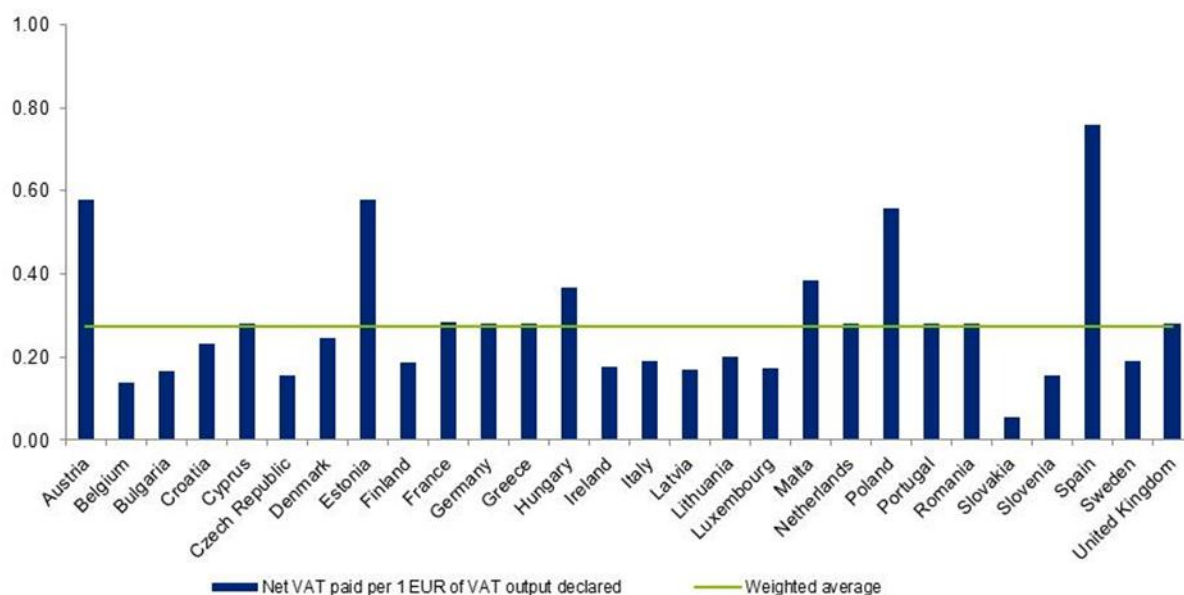
Because most businesses of different sizes can recover VAT paid on their inputs, the output VAT declared to tax authorities does not align with the net revenues collected. On average in the EU, across businesses of different size, for every EUR 1 of gross VAT output declared:

- EUR 0.72 is reclaimed through VAT paid on inputs; and
- EUR 0.28 is retained by tax authorities.

This ratio of net/gross VAT revenue varies however across Member States, from EUR 0.06 of net VAT collected for every EUR 1 of gross VAT declared in Slovakia, to EUR 0.76 in Spain. The

observed differences can again be due to a number of factors, such as the number of start-ups within the country (which would drive the ratio down as these businesses tend to recover relatively more VAT paid on inputs), or the industry focus of businesses (for example, export/intra-EU supply focussed industry with 0% VAT on output and full deduction of input increases the ratio, also, the more businesses operating in services, which tend to have less inputs, the higher the ratio would be).

Figure 13 – Net VAT revenue collected for every EUR 1 of gross VAT output declared, by Member State



Source: Deloitte estimates based on data obtained from surveys to tax authorities.

3.5 VAT compliance costs for SMEs

As explained before, SMEs generate a small proportion of the national turnover in their Member States, and only about a quarter of the net VAT revenues, however they make up a vast majority of businesses. As such, to the extent that VAT registration and submission constitute fixed costs, these businesses may also incur a disproportionately large share of compliance costs relative to the VAT revenues that they generate.

While a number of studies have been carried out to obtain estimates of VAT compliance costs, they are limited in terms of their coverage of European countries, the granularity of estimates, the use of recent data, and the methodologies used. Details on the studies found from a literature review and the estimates calculated in these studies can be found in Annex F. The results obtained broadly fall into three main categories:

- ❑ Estimates of the actual monetary cost of complying with VAT for a business⁷⁰;
- ❑ Estimates of the cost of complying with VAT as a percentage of turnover or relative to the number of employees⁷¹; and

⁷⁰ Estimates for these are available for Croatia, Denmark, Germany, Ireland, Netherlands, Sweden and the United Kingdom.

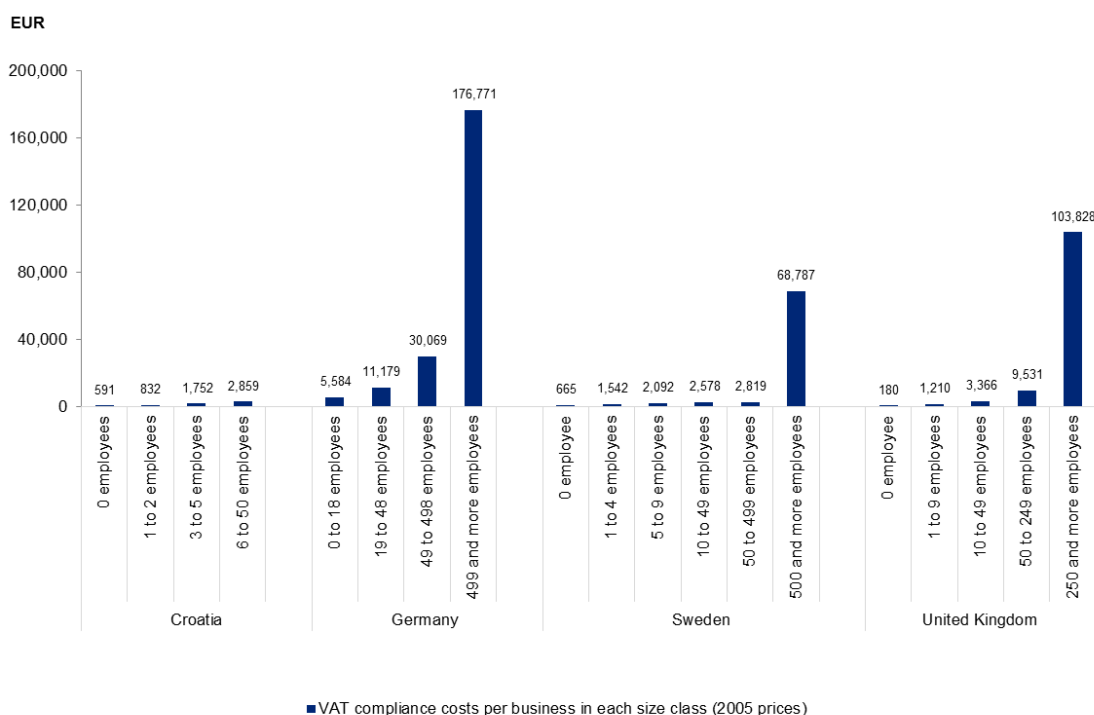
⁷¹ Estimates for these have been found for Germany, Sweden, Slovenia and the United Kingdom.

▣ Estimates of the hours spent complying with VAT.⁷²

While the methodologies and coverage of businesses differ (some studies focus on SMEs while other give estimates for an average business in the overall economy), the results consistently show that total compliance costs increase with a business' size; however this increase is less than proportionate with turnover, meaning that the compliance burden falls relatively more heavily on small businesses.

Figure 14 below shows the total VAT compliance costs by turnover bracket for four Member States.

Figure 14 – Average total annual VAT compliance costs for businesses in each size class found in the literature, by Member State⁷³



Source: Deloitte estimates based on studies found in the literature. See Volume II, Annex F for details.

For the smallest businesses, with no employees, the yearly compliance costs are estimated to range from between EUR 180 to EUR 665 (2005 prices). Adjusting this to 2014 prices, this amounts to between about EUR 220 and EUR 780. A comparison with the data on average net VAT revenues generated by the smallest businesses indicates that the administrative burden faced by businesses may therefore exceed the revenues generated for a significant proportion of businesses.

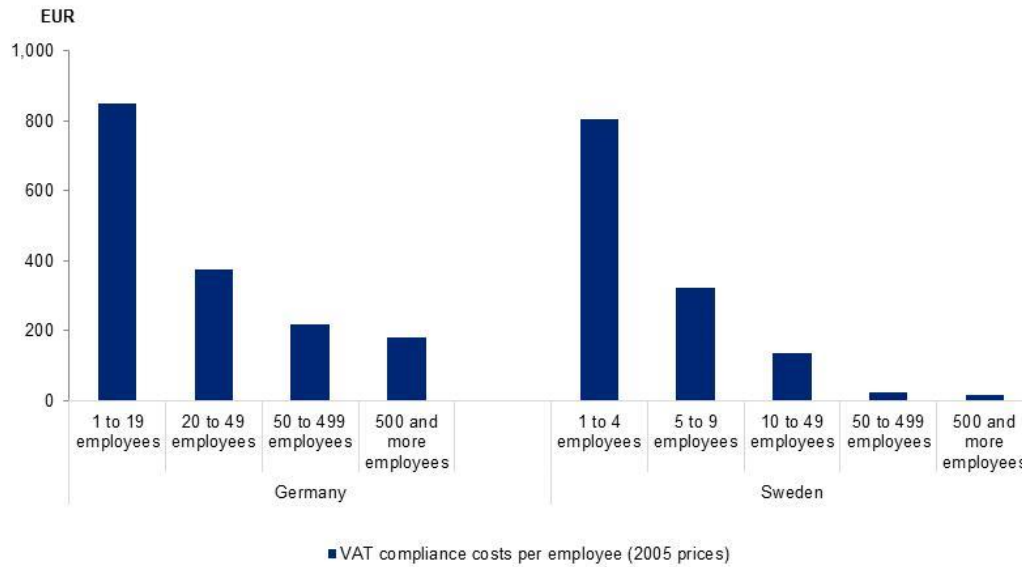
In addition to considering total VAT compliance costs faced by businesses it is also useful to consider how these costs compare to the number of employees or the turnover of enterprises and hence their impact on the viability of the business. Studies which present this information have consistently found

⁷² Estimates for these are available for all 28 Member States.

⁷³ Only Member States for which estimates were found in the literature are depicted here.

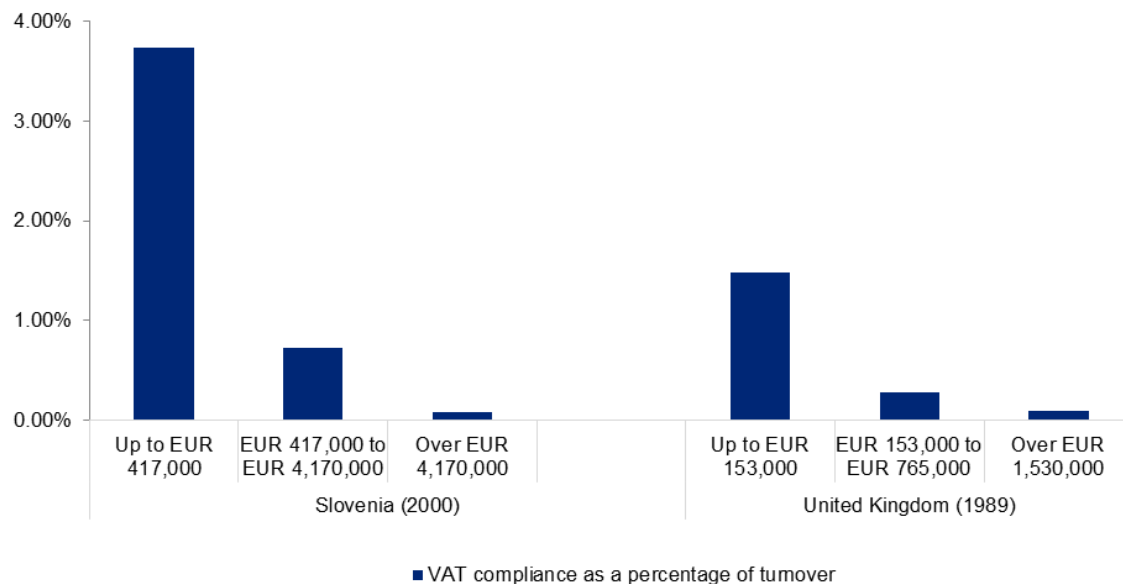
that the costs of complying with VAT are regressive⁷⁴: they affect small businesses significantly more than large ones, as shown in Figure 15 and Figure 16 below.

Figure 15 – VAT compliance costs per employee found in the literature, by Member State⁷⁵



Source: Deloitte estimates based on studies found in the literature. See Volume II, Annex F for details.

Figure 16 – VAT compliance costs as a percentage of turnover found in the literature, by Member State⁷⁶



Source: Deloitte estimates based on studies found in the literature. See Volume II, Annex F for details.

⁷⁴ See Barbone et al (2012) at p. 18, available: <http://icepp.gsu.edu/files/2015/03/ispwp1222.pdf>.

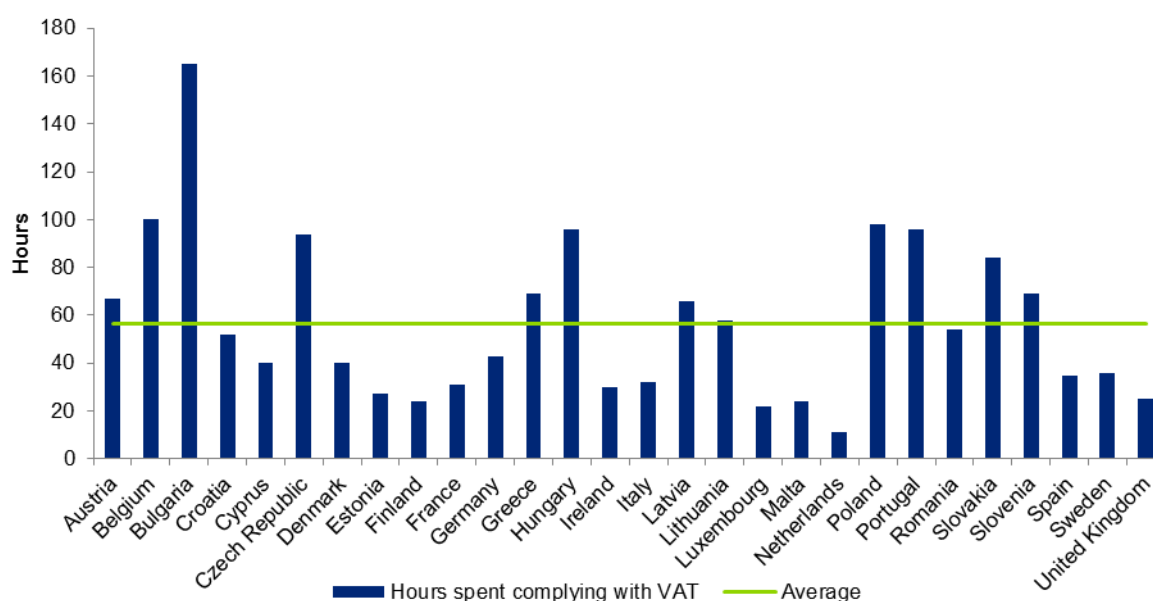
⁷⁵ Only Member States for which estimates were found in the literature are depicted here.

⁷⁶ Ibid.

The fact that VAT compliance costs impact small businesses disproportionately more than large ones demonstrates the rationale for schemes intended to reduce the compliance burden for SMEs; the question of how effective these schemes are cannot be answered based on the studies reported here, but is addressed through the standard cost model in Section 4.2 of the report (more details are in Volume II, Annex G).

In addition to these studies, PwC and the World Bank publish a time series of the VAT burden for EU countries in terms of the number of hours spent on compliance, which can be used to compare the compliance burden across markets.⁷⁷ These estimates are produced by national tax experts based on a model company scenario that is structured on a set of financial statements and assumptions about the number and cost of transactions relating to tax compliance over the year. The costs are reported in hours per year required to prepare, file and pay consumption taxes.⁷⁸ Figure 17 below shows the number of hours spent complying with VAT across the 28 Member States in 2014, as reported by the World Bank.

Figure 17 – VAT compliance burden (number of hours) in 2014 across Member States based on a medium sized business model company (PwC and World Bank)



Source: PwC and World Bank, *Paying Taxes 2016*, Table A3.3: Time to comply, page 137

While the estimates found on VAT compliance costs for an average business vary widely across studies and Member States, they can be used as a basis to obtain indicative figures of VAT compliance costs across the EU. An overview of the methodology followed to obtain estimates for all Member States is presented below, while the detailed calculations are presented in Volume II, Annex F:

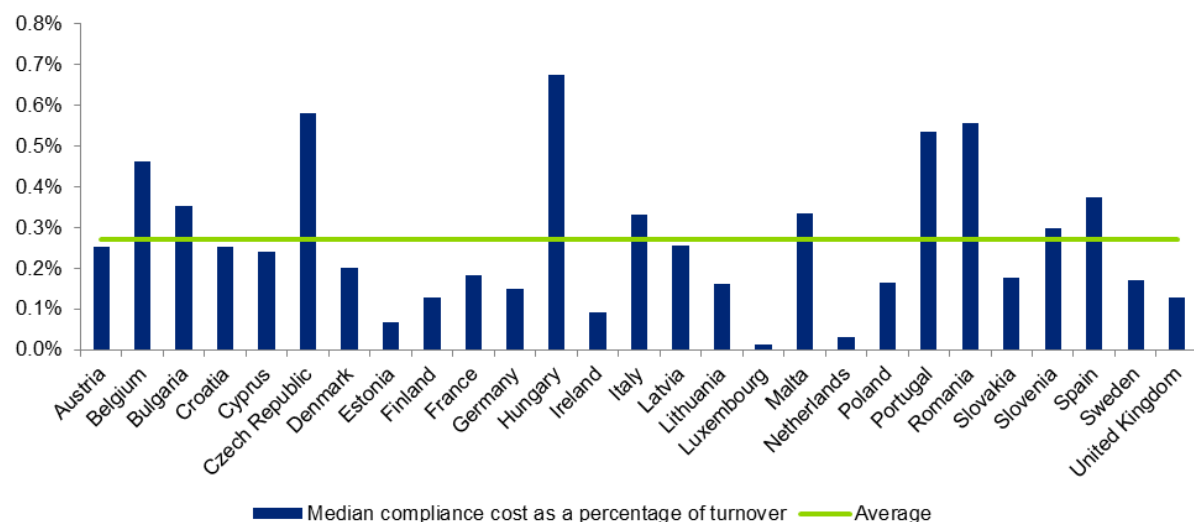
⁷⁷ PwC and World Bank, *Paying Taxes 2008 to 2016*.

⁷⁸ For the purpose of this report, consumption taxes are assumed to reflect VAT in the EU.

- Some of the studies presented in Volume II, Annex F reported VAT compliance costs which were used to calculate an average VAT compliance cost per business in several Member States.⁷⁹
- Since the studies were conducted at different points in time, the estimates provided are adjusted to 2014 estimates, accounting for the change in labour costs and the time spent complying with VAT using:
 - Eurostat data on average hourly labour cost per Member State over time;⁸⁰ and
 - PwC and World Bank’s data presented above on the hours spent complying with VAT per Member State.⁸¹
- Using these Eurostat and PwC and World Bank datasets, an index of how compliance costs compare across countries is calculated. It is then used to obtain estimates of VAT compliance costs in all Member States, taking the studies’ estimates as a basis for the calculation.

The above methodology gives a range of estimates for the monetary value of average VAT compliance costs per business in each Member State.⁸² However, comparing the monetary estimates across Member States implies that countries with low labour costs will appear to impose a lower compliance burden on its businesses, even if significant time is allocated to VAT obligations. The estimates obtained are therefore presented as a percentage of average business turnover. The average turnover of a business in each Member State is calculated using Eurostat datasets on the total turnover generated by businesses, divided by the number of businesses in a given country.⁸³

Figure 18 – Median of the VAT compliance costs estimated as a percentage of turnover for an average business in each Member State.



Source: Deloitte estimates. See Volume II, Annex F for details.

⁷⁹ To ensure comparability of the estimates, only the studies which provided evidence on the average cost per business in the whole economy, as opposed to focusing on a certain group of businesses. This is the case for 5 studies. See Annex F for details.

⁸⁰ See: http://ec.europa.eu/eurostat/statistics-explained/index.php/Hourly_labour_costs.

⁸¹ PwC and World Bank, Paying Taxes 2008 to 2016.

⁸² A range rather than single point estimates is calculated to reflect the differences in the estimates obtained based on the World Bank data and the ones found in the literature. More details can be found in Annex F.

⁸³ Eurostat Structural Business Statistics, 2014. This data is not available for Greece which is therefore excluded from the calculations.

The results obtained show that the Czech Republic, Hungary, Portugal and Romania impose the highest VAT compliance burden on their businesses, while Luxembourg and Netherlands impose the lowest.

However, the robustness of the estimates should be carefully considered as they present some limitations. As stressed by Chittenden (2002), comparing tax compliance cost estimates across countries raises substantial issues of consistency related to differences in the methodologies used, tax systems and tax populations, time periods studied, sample frames and response rates.⁸⁴ While these concerns are not all relevant for the World Bank and PwC studies, which apply the same methodology for all countries and do so in the same time frame, the estimates obtained from the literature are subject to these limitations.

Given the limitation in obtaining comparable estimates, these should therefore be considered alongside the estimates from the SCM to present a broader picture of the compliance burden facing businesses. In particular, the SCM analysis can be used to understand how different obligations contribute to the overall burden and therefore the potential impacts of the proposed policy changes. These estimates are presented in Section 4.2 and in Volume II, Annex G.

3.6 Summary of overall situation for SMEs in the EU

The data received from tax authorities, combined with private and public data sources, have revealed that SMEs represent a majority of active businesses in the EU, and this is consistent across Member States. However, despite representing around 98% of businesses, they only generate 15% of turnover and 25% of net VAT revenues. This difference is even more striking for the smallest businesses: those with less than EUR 50 000 of turnover represent about 69% of all businesses, but generate less than 1% of the EU-wide turnover, and a negligible or even negative amount of net VAT revenue.⁸⁵

SMEs however face disproportionate VAT compliance costs compared to larger businesses. To the extent that VAT compliance represents a fixed cost (see Section 4.2 for a more detailed analysis of the structure of compliance costs between fixed and variable costs), it may discourage market entry for businesses and impair growth across the EU. This motivates the presence of measures to lighten the compliance burden imposed on SMEs, and justifies the existence of special schemes for VAT, especially the combined application of exemption and simplification measures.

⁸⁴ In addition, an average turnover per business is used to derive estimates, while turnover may in reality vary a lot by businesses' size in each Member State.

⁸⁵ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

4 Functioning of the SME schemes

This section describes the status quo regarding VAT for SMEs. It includes a description of the different schemes as well as observations with respect to their take-up and functioning. The purpose is to provide a clear outline containing a description of the existing measures and a comparison of these measures in all Member States. This is used as a first building block to develop the policy options for a review of the SME schemes.

4.1 Introduction: overview of the SME schemes

As mentioned above, SMEs represent 98% of all businesses⁸⁶ and provide two-thirds of private sector employment within the EU⁸⁷. The Commission therefore considers SMEs to be the backbone of the EU economy.⁸⁸

In recognition of the importance of SMEs to the EU, the VAT Directive sets out special provisions for small enterprises which cover:

- Simplified procedures for charging and collecting VAT, including flat rate schemes⁸⁹;
- Exemptions⁹⁰ or graduated relief⁹¹ for the supply of goods and services by these businesses;
- Other measures or schemes to support SMEs, such as the cash accounting scheme⁹².

These provisions are optional and applied at the discretion of the individual Member States with reference to their national requirements⁹³.

With respect to **simplified procedures**, the purpose is to **reduce the administrative burden** (i.e. the cost of administrative tasks to comply with legislative obligations) as opposed to the tax burden (i.e. amount of tax paid to tax authorities).

⁸⁶ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

⁸⁷ See: <http://ec.europa.eu/growth/smes/>

⁸⁸ A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change – Political Guidelines for the next European Commission, Opening Statement by Jean-Claude Juncker in the European Parliament, 15 July 2014, https://ec.europa.eu/priorities/sites/beta-political/files/juncker-political-guidelines_en.pdf, consulted on 20 June 2016.

⁸⁹ Under the flat-rate scheme, businesses are allowed to account for VAT in a simplified way. Several options are possible: (1) the SME covered by the scheme accounts for VAT due based on a specific basis or a different taxable base than outgoing supplies (e.g. number of bags of flour purchased by a baker or weight of the purchased coffee); or (2) the SME covered by the scheme accounts for VAT applying the special lower flat rate; or (3) a combination of both.

⁹⁰ The SME exemption scheme allows an SME to exempt its turnover from VAT, thus reducing the tax burden (but also the compliance cost to calculate the taxes). The downside is generally that there is no right to recover input VAT.

⁹¹ Graduated relief is a form of partial SME exemption which allows the SME to be gradually subjected to VAT and its obligations.

⁹² The cash accounting scheme is a SME special measure which allows a business to account for and pay VAT on the basis of cash (or other consideration) paid and (possibly) received, rather than on an accrual (invoice) basis. As a result, VAT becomes chargeable on sales only where cash has been received by the trader and input tax can be claimed only when the cash has been paid upon a purchase. Cash accounting can be applied also only on output VAT.

⁹³ Note that the flat-rate scheme for farmers is not included in the scope of the study, although it also provides support to SMEs.

By contrast, the SME **exemption** schemes and **graduated relief** reduce the level of tax collected by the national tax authorities. Given the importance of SMEs for economic growth, most Member States seem to be willing to forfeit a (limited) part of the VAT revenue.

Additionally, Member States have the option to combine the SME exemption and graduated relief schemes with simplified obligations⁹⁴. Member States often make use of this option. It means that when businesses qualify for these regimes, additional simplification measures are provided. These could be in terms of bookkeeping or invoicing for example.

Special VAT schemes for SMEs applied in 28 Member States

The below table provides an overview of the VAT schemes for SMEs applied in all 28 Member States.

Table 1 - Special VAT schemes applied in Member States

Country	SME exemption	SME graduated relief	SME flat-rate scheme	Cash accounting scheme
Austria	✓	✗	✗	✓
Belgium	✓	✗	✓	✗
Bulgaria	✓	✗	✗	✓
Cyprus	✓	✗	✓	✓
Croatia	✓	✗	✗	✓
Czech Republic	✓	✗	✗	✗
Denmark	✓	✗	✗	✗
Estonia	✓	✗	✗	✓
Finland	✓	✓	✗	✓ ⁹⁵
France	✓	✗	✗	✗
Germany	✓	✗	✓	✓
Greece	✓	✗	✓	✓
Hungary	✓	✗	✗	✓
Ireland	✓	✗	✗	✓

⁹⁴ Based on Article 272 of the VAT Directive.

⁹⁵ Finland introduced a cash accounting scheme from 1 January 2017, [https://www.vero.fi/en-US/Tax_Administration/Changes2017/Legislative_changes_affecting_taxes_in_2\(40836\)](https://www.vero.fi/en-US/Tax_Administration/Changes2017/Legislative_changes_affecting_taxes_in_2(40836)).

Country	SME exemption	SME graduated relief	SME flat-rate scheme	Cash accounting scheme
Italy	✓	✗	✗	✓
Latvia	✓	✗	✗	✓
Lithuania	✓	✗	✗	✓
Luxembourg	✓	✗	✗	✓
Malta	✓	✗	✓	✓
Netherlands	✗	✓	✗	✓
Poland	✓	✗	✓	✓
Portugal	✓	✗	✗	✓
Romania	✓	✗	✗	✓
Spain	✗	✓	✓	✓
Sweden	✓ ⁹⁶	✗	✗	✓
Slovakia	✓	✗	✗	✓
Slovenia	✓	✗	✗	✓
UK	✓	✗	✓	✓
Total	26	3	8	24

Source: Deloitte Tax Network Survey (conducted in March-April 2016)

The above table presents an **interesting interplay** between the schemes. The following findings are of particular interest:

- When analysing the interaction between the SME exemption scheme and SME graduated relief, it becomes apparent that both Member States that did not implement the SME exemption, implemented the graduated relief scheme. In other words: in cases where a Member State has not introduced the SME exemption scheme, the administrative burden is reduced partially via the SME graduated relief scheme. This suggests that almost all Member States consider that there is a need to reduce the tax burden for SMEs, although they do not necessarily agree on the method.

⁹⁶ Sweden introduced a SME exemption scheme from 1 January 2017, <https://data.riksdagen.se/fil/BABBC8C1-C310-432D-9C10-08801D44891F>.

- The rest of the schemes are less interconnected: there seems to be no direct link between the implementation of the SME flat rate scheme or cash accounting scheme and the other schemes.

It is important to note that most of the current SME measures described below are **optional in applicability**, both by the Member State and businesses. Moreover, Member States have significant flexibility in **scoping and designing** the national schemes. The underlying provisions relating to special schemes for SMEs are contained within the VAT Directive and reference is made to this where appropriate.

Most burdensome obligations

In order to develop policy options for changes in the current SME schemes and remediate existing hurdles for SMEs, it is important to identify the most burdensome obligations for SMEs.

According to the survey conducted among a network of VAT experts, and substantiated by studies on the topic⁹⁷, **VAT reporting** is one of the most burdensome VAT obligations in general, and particularly so for SMEs. Reporting normally includes:

- The preparation and submission of periodical VAT returns (mostly either monthly or quarterly);
- The keeping of records in relation to the filing;
- Filing Intrastat returns (which is often perceived as a VAT obligation, whilst being a system for collecting statistical data on the trade of goods between Member States)⁹⁸; and
- Filing EU Sales Lists⁹⁹.

Member States may also impose **additional reporting obligations**, such as sales and purchase annexes, a breakdown for each line of the VAT return in the level of detail of individual invoices or even the provision of invoices exceeding a certain amount. These obligations are often implemented for auditing purposes and place an additional burden on businesses.

VAT registration is also highlighted by the VAT expert network as a burdensome obligation, especially for non-established businesses. The VAT registration process is generally a formalistic process and may require the preparation of a number of documents, such as submitting by-laws, excerpts of the trade register, a certificate of the status of VAT taxable person, etc.

Invoicing requirements and a series of divergent obligations were also mentioned by the same experts as placing an administrative burden on businesses.

Other simplifications

Although cash accounting and the flat-rate schemes generally aim to simplify administrative obligations for businesses, Member States can also introduce **additional simplification measures**. The VAT Directive allows Member States that have implemented the SME exemption schemes to grant businesses either a discharge of their VAT obligations or to simplify them. These simplifications can apply broadly to **registration, invoicing, accounting** and the **filing of returns** (Article 272(1)(d))

⁹⁷ See Tax Administration 2015 (OECD), Comparative Information on OECD and other Advanced and Emerging Technologies, p.311, which quotes further studies from the FTA and HMRC.

⁹⁸ This constitutes an obligation to provide statistical information on goods flows between EU Member States which is collected.

⁹⁹ EU Sales List is, in the VAT Directive, referred to as recapitulative statement. It constitutes a report of all of the intra-EU supplies of goods and services made by a business from a certain EU Member State to another during a given period.

of the VAT Directive). These could consist of **annual accounting** (filing reports on an annual basis instead of monthly/quarterly), **keeping simplified records** (instead of compliant purchase and sales journals) and **invoicing**, etc.

Further simplifications can be provided, for example, on the grounds of Articles 269 and 270 or 271 of the VAT Directive, which allow Member States to extend the period for filing EU Sales Lists, or Article 252, allowing an extended period for VAT returns (up to one year).

Other simplifications mentioned by the VAT expert network are: implementing a standard input VAT deduction (or input VAT flat rate thus avoiding having to calculate deductible VAT) and domestic reverse charge (avoiding having to account for input VAT).

Interaction of the measures with other SME policy measures

The Commission's **VAT policy** is in line with other SME policy measures at European and national level. The Commission's policy in support of SMEs, described on the European Small Business Portal¹⁰⁰, is laid down in the Small Business Act¹⁰¹ and focuses on the following broad areas:

- Creation of a business friendly environment;
- Promotion of entrepreneurship;
- Improvements to access to new markets and internationalisation;
- Facilitation of access to finance;
- Support for competitiveness and innovation;
- Provision of the key support networks and information for SMEs.

As such, the Commission is keen to create a **favourable business environment**, by cutting red tape and harmonising rules relating to company law, contract law, accounting and public procurement. It designs its policies according to the principle "Think Small First" laid down in the Small Business Act.

The policy of the Commission is further illustrated by the project the Commission conducted on reducing the **administrative burden stemming from EU legislation**¹⁰² and its Regulatory Fitness and Performance Programme (REFIT).¹⁰³ REFIT works to make EU law simpler and to reduce regulatory costs, thus contributing to a clear, stable and predictable regulatory framework. Among other benefits, it has provided for a simpler legal framework around electronic VAT invoicing, a measure benefiting many businesses, and in particular small businesses.

All of the above described measures are consistent with each other in their objectives, although examining their effectiveness is outside of the scope of this study.

This conclusion also holds for the measures taken with respect to the Single Market Act¹⁰⁴, the project on enforcement of outstanding claims by SMEs operating across borders¹⁰⁵ and standardisation of products¹⁰⁶.

¹⁰⁰ See European Small Business Portal, available: http://ec.europa.eu/small-business/most-of-market/environment-business/index_en.htm#page1-2, consulted on 18 May 2016.

¹⁰¹ The Small Business Act is an overarching framework for the EU policy on Small and Medium Enterprises. See: https://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act_en, consulted on 21 July 2016.

¹⁰² See: http://ec.europa.eu/dgs/secretariat_general/admin_burden/result_burden/result_burden_en.htm, consulted on 21 July 2016.

¹⁰³ European Commission REFIT Platform, available: https://ec.europa.eu/info/law/law-making-process/overview-law-making-process/evaluating-and-improving-existing-laws/reducing-0_en.

¹⁰⁴ Single Market Act, available: http://ec.europa.eu/growth/single-market/smact/index_en.htm, consulted on 18 May 2016.

¹⁰⁵ Project on enforcement of outstanding claims by SMEs operating across borders (2013 - 2014), available: http://ec.europa.eu/growth/smes/support/cross-border-enforcement/index_en.htm, consulted on 18 May 2016.

At national level, SME policies are generally aligned with the EU SME policies as these have been agreed and adopted by the Member States, either by implementing directives locally or by applying relevant regulations.

Member State national policies also reflect the objectives and features of the EU SME policy. The Belgian government, for example, has in its government agreement stated that it will incentivise SMEs to hire people by reinforcing and reducing the contributions due when hiring the first three employees.¹⁰⁷ The French government has also taken steps to help SMEs grow, allowing a grant for SMEs hiring employees, which led to the creation of 350 000 jobs in less than 6 months.¹⁰⁸ The previous UK government also made it cheaper for businesses to employ young people, by abolishing national insurance contributions for under 21 year olds on earnings up to EUR 975 (GBP 813) per week¹⁰⁹.

These different measures are aligned with the VAT special schemes for SMEs and no major evidence of contradiction has been identified.

4.2 Analysis of current VAT special schemes for SMEs

Below the analysis of the current VAT schemes that are specifically aimed for use by SMEs is presented. The special VAT schemes analysed are:

- The **SME exemption** scheme;
- **VAT graduated relief**;
- The VAT **flat rate** scheme ; and
- The **cash accounting** scheme.

Finally, **additional simplifications** implemented by Member States are briefly described. For each of the schemes, we present a description of the scheme, followed by a quantitative analysis on take-up, an analysis of the compliance costs, and evidence concerning the effectiveness of the scheme.

4.2.1 SME exemption scheme

Description of the scheme

Under the **SME exemption scheme**, a business established in the concerned Member State, whose turnover does not exceed the specified threshold, is exempt from VAT, unless deciding to opt out of the scheme.

¹⁰⁶ Standardisation and SMEs, See: http://ec.europa.eu/growth/smes/access-to-markets/standardisation/index_en.htm , consulted on 18 May 2016.

¹⁰⁷ Belgian government agreement (federal regeerakkoord/accord de gouvernement), http://www.premier.be/sites/default/files/articles/Accord_de_Gouvernement_-_Regeerakkoord.pdf , consulted on 15 June 2016.

¹⁰⁸ Report of the Council of Ministers of 1 June 2016 (in French), <http://www.gouvernement.fr/conseil-des-ministres/2016-06-01/point-sur-la-mise-en-uvre-du-dispositif-embauche-pme-> , consulted on 15 June 2016.

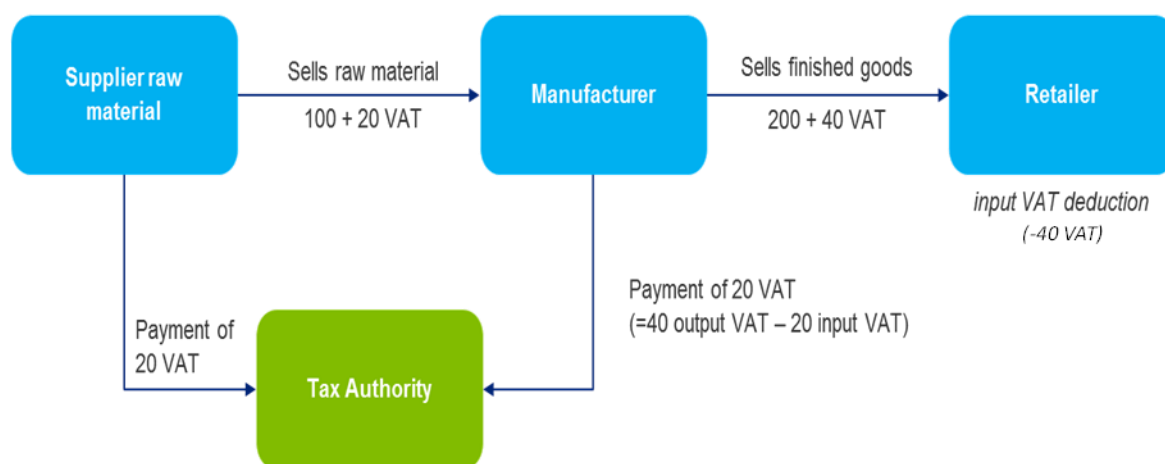
¹⁰⁹ HMRC (2014) Abolition of employer National Insurance contributions for under 21s: employer guide, available: <https://www.gov.uk/government/publications/employer-national-insurance-contributions-for-under-21s/abolition-of-employer-national-insurance-contributions-for-under-21s-employer-guide>, consulted on 4 January 2017.

The basis for the exemption is **Articles 282 to 292** of the VAT Directive, which foresee an option for Member States to exempt taxable persons whose annual turnover does not exceed set limits specified in the Directive (which in many cases are Member State specific, depending on when the Member State entered the EU or on a later derogation).¹¹⁰ Member States have the right to set the level of national VAT threshold (up to EUR 5 000 or higher based on an individual agreement), balancing the administrative costs of VAT collection and the potential VAT revenue, as well as the overall tax burden, compliance control needs and fraud risks in the local context. However, once the national VAT exemption threshold is set, it is difficult and time consuming to change it (e.g. to correct it by inflation), as any change would need to be again approved at the EU level. Regular threshold correction by inflation is not generally allowed by the VAT Directive, however there is a specific exception (Article 286) for the Member States that applied the SME exemption scheme in May 1977 with a threshold equal to or higher than 5 000 European units of account (such as the UK).

This scheme may also be referred to as the **VAT collection or registration threshold**, as many Member States combine the exemption scheme with additional simplification measures, based on Article 272 of the VAT Directive. These additional simplifications can relate to the obligation to register for VAT and also any other on-going compliance and record keeping requirements (for tax purposes).

The figure below provides an example of the VAT balance under the normal VAT rules.

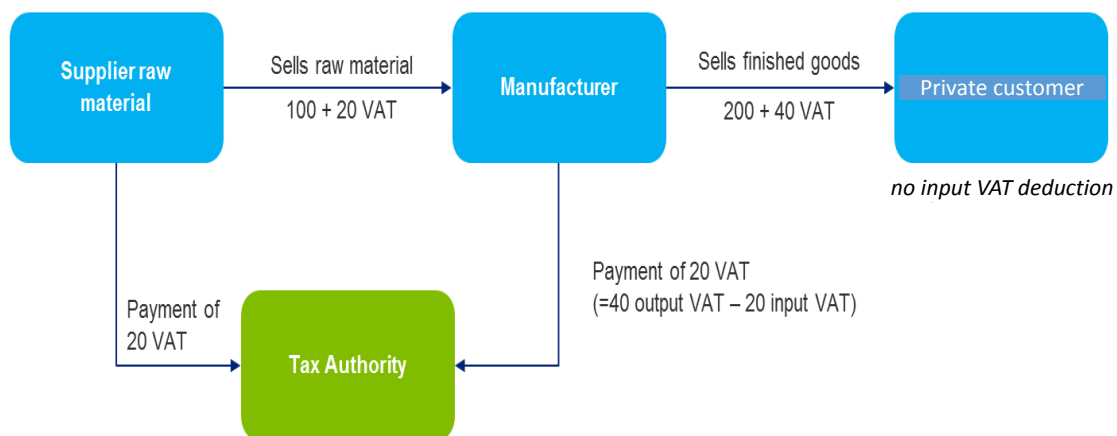
Figure 19 – Example of VAT balance under normal VAT rules in a B2B context



Source: Deloitte elaboration

¹¹⁰ See articles 284 to 287 of the VAT Directive for more details.

Figure 20 – Example of VAT balance under normal VAT rules in a B2C context



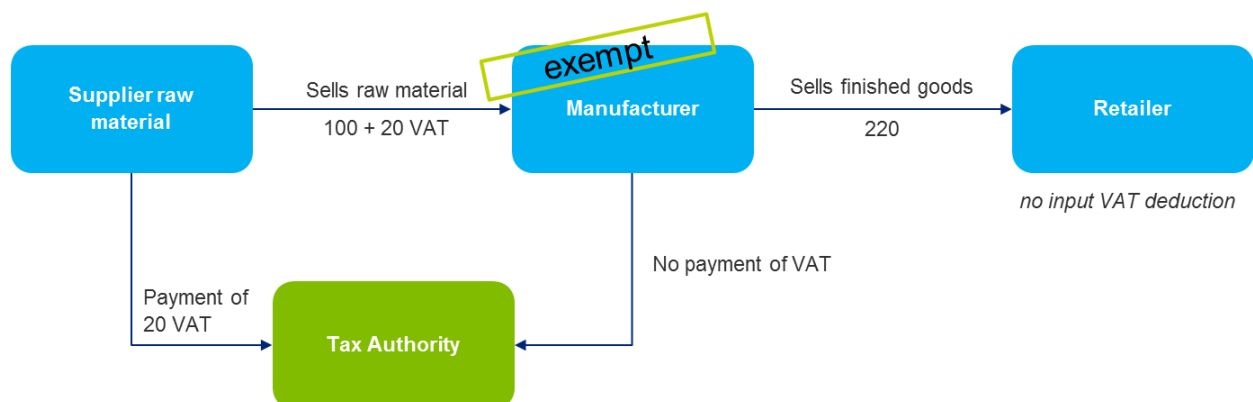
Source: Deloitte elaboration

In the first example (Figure 18), a supplier of raw material sells the raw material to a manufacturer for a price of EUR 100 adding 20% VAT resulting in VAT due of EUR 20. The supplier pays EUR 20 to the tax authorities. The manufacturer sells the finished goods for a price of EUR 200 adding 20% VAT resulting in VAT due of EUR 40. Since the manufacturer can deduct the VAT paid to the supplier, on balance, the manufacturer pays EUR 20 to the tax authorities (40 minus 20).

In the second example (Figure 20), a private customer is buying the goods. The EUR 40 VAT will not be deductible. If the client was a retailer, the EUR 40 VAT would be recoverable and thus deductible from the VAT on its own sales.

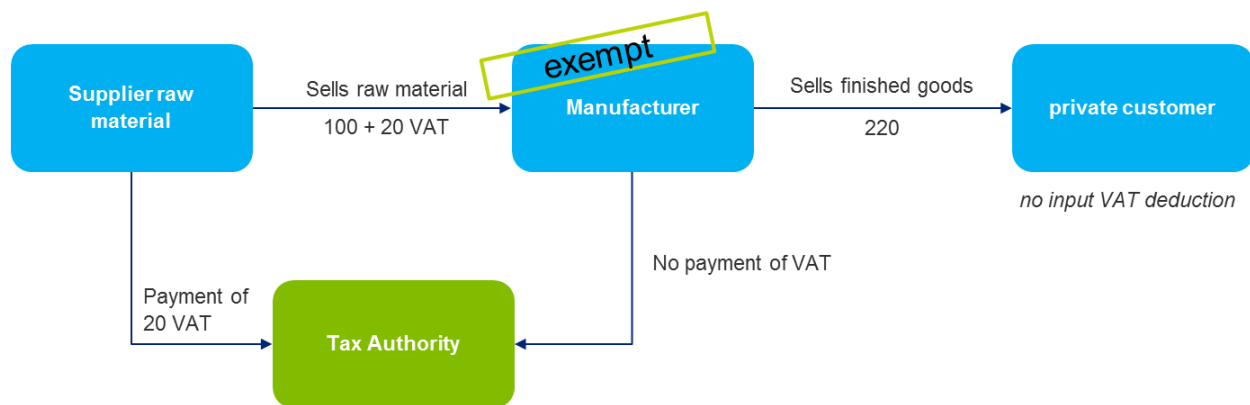
The following two figures illustrate the application of the SME exemption scheme in the transactions explained above:

Figure 21 – Example of VAT balance under the SME exemption scheme in a B2B context



Source: Deloitte elaboration

Figure 22 – Example of VAT balance under the SME exemption scheme in a B2C context



Source: Deloitte elaboration

As shown in the above examples (Figure 21 and Figure 22), if the manufacturer was VAT exempt under the SME exemption scheme, the manufacturer's costs become EUR 120, and not EUR 100 as under normal VAT rules (Figure 19 and Figure 20), as the manufacturer would have **no right to deduct input VAT**. The costs for the manufacturer are thus EUR 20 higher in the SME exemption scheme than under normal circumstances. The manufacturer would sell the finished goods without adding any VAT. However, if the manufacturer wishes to retain the same margin, the sales price must increase by the extra cost to EUR 220. The increased sales price hides the additional VAT cost.

The fact that an exempt SME is not adding VAT to the sales price (which however contains the hidden VAT cost) becomes an issue if the manufacturer **supplies to a non-exempt business customer** (Figure 21), because such customer would usually have the right to deduct the input VAT, while now it is an actual cost for that business, as there is no separate (deductible) VAT. In other words, opting out of the SME exemption scheme can give a competitive advantage to the SME supplier, as it enables business customers to deduct input VAT and as a result benefit from a lower purchase cost (EUR 200 instead of EUR 220).

In contrast, the SME exemption scheme may still be beneficial for the manufacturer despite the increased costs of non-deductible input VAT, as it **enables the manufacturer to offer a lower price**. Assuming the business wishes to keep its margin of EUR 100, it will invoice the goods for EUR 220. This amount is lower than the invoiced amount which the manufacturer would apply when it is not applying the SME exemption scheme (i.e. EUR 240). This benefits the customers who cannot recover VAT, as well as having the potential to decrease the administrative burden of the SME.

As a conclusion, the **potential benefit of the SME exemption scheme depends on the nature of the customers of the SME**. The scheme is more beneficial where most of the customers are final consumers with no VAT deduction right.

In these examples (Figure 21 and Figure 22), the supplier of raw materials still owes EUR 20 to the tax authorities, but, since the manufacturer applies an exemption, there is no VAT due on its sales. As a result, there is a revenue loss for the tax authorities. Additionally, the tax authorities may experience decreased transparency because of the simplifications usually attached to the SME exemption scheme (such as relief from the obligation to register for VAT, see Table 2 below). Nevertheless, tax authorities may benefit from a lowered administrative burden.

Application in the EU

As shown by Table 1, 26 Member States have implemented the SME exemption scheme, making it the **most widely implemented SME measure** provided for in the VAT Directive.

The few Member States that decided not to implement the SME exemption scheme did this either because the application of such a scheme is not in line with their fiscal policy¹¹¹ or because they have implemented other measures (e.g. graduated relief)¹¹², making the exemption less necessary.

The practical application of the scheme varies substantially in the different Member States, depending on how widely they have attached additional simplification measures to the SME exemption scheme. For example, about two-thirds of the Member States do not require the business to register for VAT purposes (thus keeping the businesses applying the SME exemption scheme fully out of the VAT system), while the other one-third apply the exemption, but require businesses to register for VAT¹¹³.

VAT exemption thresholds

For the SME exemption scheme to apply, the business' turnover must remain below a predefined threshold (see Figure 23 below). The threshold is calculated on the turnover of the business, excluding certain transactions (Article 288 of the VAT Directive).

To calculate whether a business has exceeded the threshold, the following transactions should be added up:

- The value of supplies of goods and services, in so far as they are taxed;
- Certain transactions that are VAT exempt, but grant a right to recover input VAT;
- The value of exempt real estate transactions, financial transactions as provided in the VAT Directive and insurance services, unless those transactions are ancillary transactions.

Disposals of tangible or intangible capital assets of an enterprise are not taken into account.

The **level of the threshold varies substantially across the EU** and mostly reflects the Member States' fiscal policy, fiscal culture¹¹⁴ and/or can be related to other legislation (such as taxes on income). Denmark used to apply the lowest threshold of all EU Member States: a business' turnover cannot exceed approximately EUR 6 700¹¹⁵ for the SME exemption to apply, however from 1 January 2017 Sweden has the lowest threshold of approximately EUR 3 155¹¹⁶. The UK, on the other hand, has the highest threshold: businesses with a turnover not exceeding approximately EUR 104 000 in financial year 2014-2015 can benefit from the exemption¹¹⁷. It is worth noting that the UK threshold is reviewed annually and increased for inflation, based on Article 286 of the VAT Directive.

As regular threshold increases by **inflation** are not generally allowed by the VAT Directive, thresholds will lose value in real terms over the years. As an example, Estonia has decided to raise the threshold

¹¹¹ This was the case for Sweden, which as a country greatly values fiscal equality, as is the case for other Scandinavian countries. These countries usually have low or no thresholds. However, as mentioned, Sweden implemented the scheme from 1 January 2017.

¹¹² This is the case for the Netherlands and Spain; they implemented the graduated relief scheme instead.

¹¹³ Belgium has now combined the two approaches (from August 2016), it requires generally businesses to register for VAT, except specific categories (taxable persons active in sharing economy) that don't need to register when below EUR 5 000 threshold.

¹¹⁴ For example, Denmark applies a low threshold as the country greatly values fiscal equality.

¹¹⁵ Exchange rate ECB January 2016; original amount DKK 50 000.

¹¹⁶ Exchange rate ECB January 2017, original amount SEK 30 000.

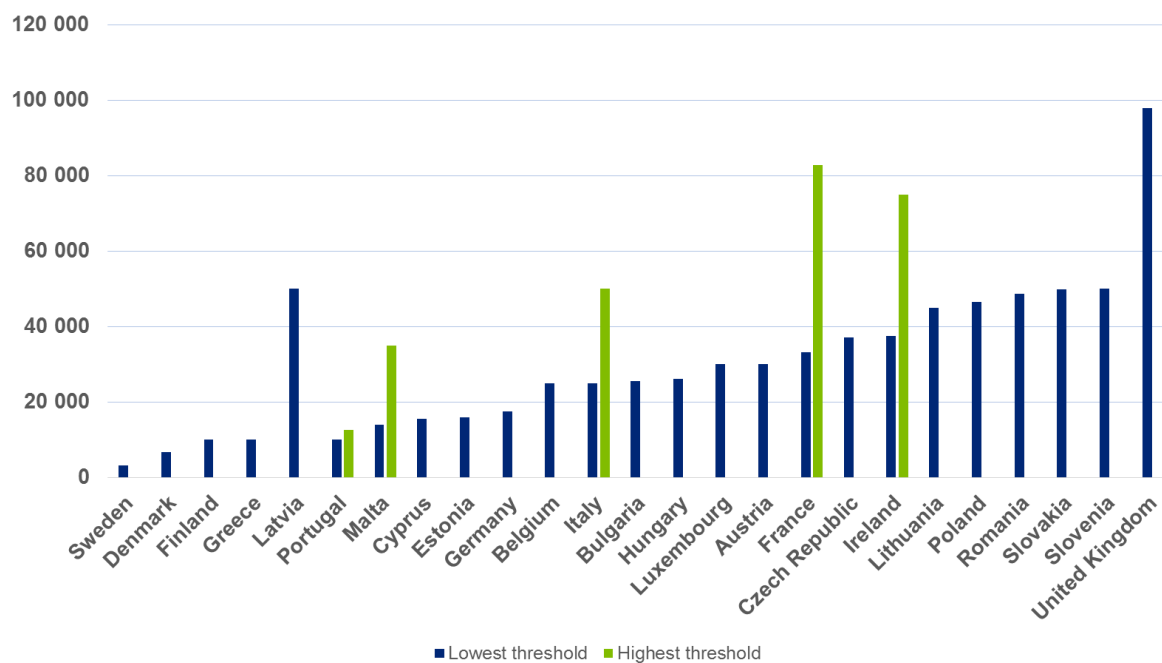
¹¹⁷ GBP 82 000 according to the average GBP/EUR exchange rate over last 5 years
<https://www.oanda.com/lang/de/currency/historical-rates/>, consulted on 20 May 2016.

from EUR 16 000 to EUR 40 000 from 1 January 2018, partly because the threshold of EUR 16 000, set 21 years ago in 1995, has lost value in real terms near 6.7 times.¹¹⁸

The UK also applies a form of **flexible threshold**. This means that a business may still be exempted from VAT registration if it exceeds the threshold temporarily, provided it can explain in writing why it thinks its turnover will not again exceed the threshold in the next 12 months. The business must apply for this exemption with the tax authorities. Similarly, in Belgium, there is an administrative tolerance, allowing businesses to temporarily exceed the threshold by 10%. Figure 23 below provides an overview of the applicable thresholds in all 26 Member States applying the SME exemption. SME exemption thresholds are generally located between EUR 20 000 and EUR 45 000, with the notable exception of the UK which has a very high threshold.

Some Member States apply **multiple thresholds**, depending on the sector (e.g. Italy¹¹⁹) or the type of transactions (e.g. France¹²⁰ and Ireland¹²¹). In these cases, the minimum and maximum threshold amount appears in the diagram.¹²²

Figure 23 – VAT exemption thresholds applied in relevant Member States (EUR)



Source: Deloitte compilation of data on thresholds available on DG TAXUD website (April 2017)¹²³

¹¹⁸ According to information from the Estonian Ministry of Finance, the EUR 16 000 threshold equalled to 8.8 average annual salaries in 1995, but now equals only to 1.3 average annual salaries.

¹¹⁹ Thresholds vary from EUR 25 000 to EUR 50 000, depending on the sector. The threshold for the sale agent sector is EUR 25 000 and for the wholesale and trader sector and the accommodation services and catering sector is EUR 50 000. Additionally, the labour costs borne by the business cannot exceed EUR 5 000 and the total cost, before depreciation, of depreciable goods at year-end, cannot exceed EUR 20 000.

¹²⁰ First, France has a general scheme which was updated on 14 February 2017. In this case, the thresholds are EUR 82 800 (for goods, food sold to be consumed on or off the premises and provision of accommodation), and EUR 33 100 (for other services). Special thresholds exist for lawyers, performing artists, and authors and other artists (EUR 42 900). Specific rules apply when the threshold is exceeded and for new businesses. This is not applicable to specific transactions, such as those taxable by option and real estate transactions.

¹²¹ Different thresholds, depending on whether the transaction concerns goods or services.

¹²² All amounts were converted to EUR using the exchange rate as published by the European Central Bank for 21 February 2017.

It is interesting to note that from August 2016 Belgium introduced a variation of the SME exemption scheme, with two thresholds (EUR 5 000 and EUR 25 000) applying in parallel. Businesses exceeding the EUR 5 000 registration threshold can still benefit from the EUR 25 000 SME exemption threshold. The lower threshold will be adjusted for inflation annually¹²⁴. The lower registration threshold targets specifically occasional traders active in the sharing economy and aims to relieve natural persons performing local services through peer-to-peer platforms from the obligation to register for VAT purposes, as well as from the obligation to charge VAT.

Functioning of the SME exemption scheme

The following elements are usually features of the SME exemption scheme (together with the most commonly added simplification measures):

- The main feature is that the businesses under the scheme are **exempt from the obligation to charge VAT** and have no right to deduct input VAT on purchased goods and services.¹²⁵ This is the case in all 26 national implementations of the scheme. Additionally, in all Member States, businesses can opt-out of the scheme and, as such, voluntarily charge VAT on their supplies accompanied by voluntary VAT registration.
- In principle, the scheme **applies mainly to domestically taxed transactions** i.e. supplies that are taxable in the Member State where the business is established¹²⁶. Thus, the business may still have VAT obligations in the case of intra-EU acquisitions, imports or provision (or receipt) of services to/from other Member States, in which case the normal rules apply as if the business benefiting from the SME exemption scheme was a business in the standard VAT regime. The difference with a business in the standard VAT regime is that whenever the exempt business is liable for the payment of VAT (e.g. on imports or intra-EU acquisitions), it is not able to recover this VAT as input VAT.
- Additionally, **non-established taxable persons mostly cannot benefit from the scheme**.¹²⁷
- In most countries, businesses are exempt from the obligation to register for VAT purposes.
- Mostly, SMEs applying the scheme are also exempt from filing periodical VAT returns, relieved from issuing VAT invoices (even when required to register) and in two-thirds of the cases, they can also benefit from simplified accounting obligations¹²⁸.

Table 2 below shows an overview of how the SME exemption scheme functions in all Member States which have implemented it. It is based on a survey conducted with the Deloitte tax expert network.

¹²³ Available:

http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/traders/vat_community/vat_in_ec_a_nnexi.pdf

¹²⁴ See Program Law of 1 July 2016, Belgian Official Gazette of 4 July 2016.

¹²⁵ Some countries inserted the rule that if the exempt company charges VAT on an invoice, it becomes liable to pay the VAT. This is a reflection of the safeguard laid down in article 203 VAT Directive, which provides that “*VAT shall be payable by any person who enters the VAT on an invoice*”.

¹²⁶ However, according to the place of supply rules, this includes also export, intra-EU B2B supplies and B2C distance sales of goods under distance sales thresholds (if applied).

¹²⁷ This is the case for 84% of the national implemented schemes. This is in line with the VAT Directive, since Article 283(1)(c) excludes non-established taxable persons from the SME exemption scheme.

¹²⁸ For example, there is no obligation to keep detailed journals or only an obligation to keep one single journal instead of a purchase and sales journal.

Table 2 – Applicable features of the SME exemption scheme per Member State

Member State	Exemption from charging VAT on supplies	Requirement to register for VAT purposes	Requirement to register for other purposes ¹²⁹	Obligation to submit periodical VAT returns	Simplified accounting obligations	Obligation to issue VAT invoices
Austria	✓	✗	✓	✗	✓	✗
Belgium	✓	✓	✓	✗	✓	✓
Bulgaria	✓	✗	✓	✗	✗	✗
Cyprus	✓	✗	✓	✗	✗	✗
Croatia	✓	✗	✓	✗	✗	✓
Czech Republic	✓	✗	✗	✗	✗	✗
Denmark	✓	✗	✓	✗	✓	✗
Estonia	✓	✗	✓	✗	✓	✗
Finland	✓	✗	✓	✗	✓	✗
France	✓	✗	✓	✗	✓	✓
Germany	✓	✓	✓	✗	✓	✗
Greece	✓	✓	✓	✗	✗	✓
Hungary	✓	✓	✓	✗	✗	✓
Ireland	✓	✗	✓	✗	✓	✗

¹²⁹ Such as for commercial or other tax purposes (e.g. corporate or income tax).

Member State	Exemption from charging VAT on supplies	Requirement to register for VAT purposes	Requirement to register for other purposes ¹²⁹	Obligation to submit periodical VAT returns	Simplified accounting obligations	Obligation to issue VAT invoices
Italy	✓	✓	✓	✗	✓	✓
Latvia	✓	✗	✗	✗	✓	✗
Lithuania	✓	✗	✓	✗	✗	✗
Luxembourg	✓	✓	✓	✗	✓	✓
Malta	✓	✓	✓	✗*	✓	✓
The Netherlands	no SME exemption scheme, but SME graduated relief to reduce tax burden					
Poland	✓	✗	✓	✗*	✓	✗
Portugal	✓	✓	✓	✗	✓	✓
Romania	✓	✗	✓	✗	✗	✗
Slovenia	✓	✗	✓	✗	✓	✗
Slovakia	✓	✗	✓	✗	✗	✗
Spain	no SME exemption scheme, but SME graduated relief, flat rate scheme and cash accounting to tackle the tax and administrative burden					
Sweden	✓	✗	✓	✗	✓	✗
UK	✓	✗	✓	✗	✓	✗

* Note: Malta: Released from obligation to submit periodical VAT returns if turnover below EUR 7 000. Poland: Released from obligation to submit periodical VAT returns depends.

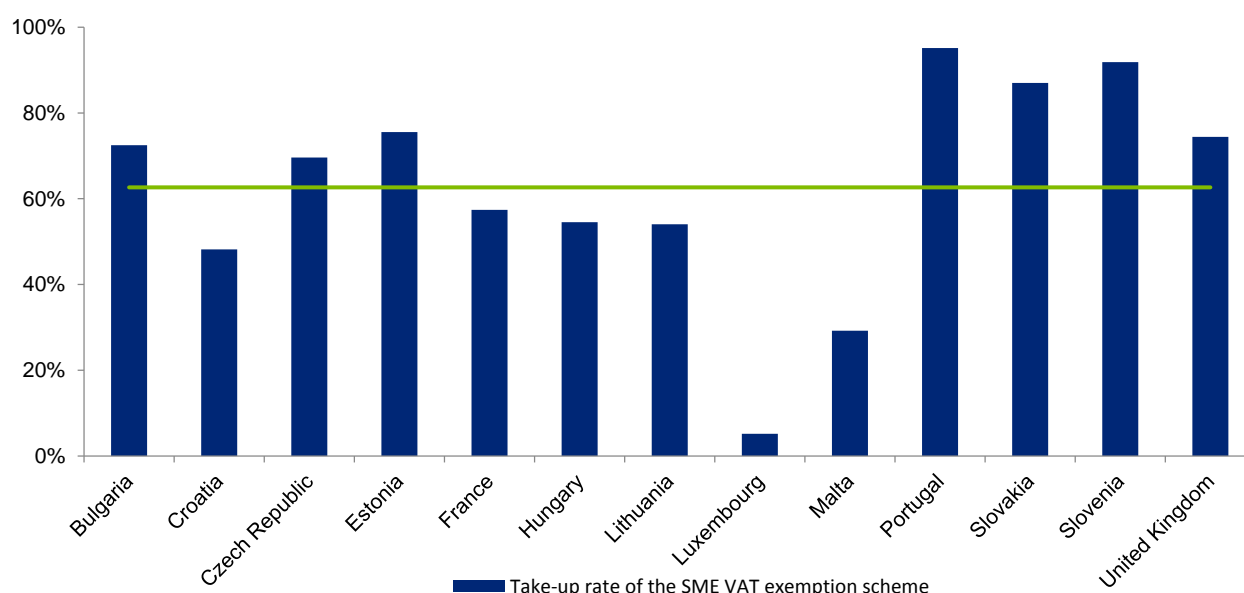
Source: Deloitte compilation of data from the Deloitte Tax Network Survey

Quantitative analysis on take-up of the scheme, including cross-border dimension

The SME exemption scheme is the **most prevalent scheme across the EU**, being in place in 26 of the 28 Member States (with the Netherlands and Spain being the exceptions). While the exact obligations vary across Member States, the scheme generally imposes few requirements on businesses other than monitoring their sales. This section analyses participation rates amongst businesses and across countries (the proportion of eligible businesses taking advantage of it), the turnover they generate and hence the forgone VAT revenues at stake. In addition, the cross-border implications of the SME exemption scheme are investigated.

The positive impact that the SME exemption scheme can have on SME compliance costs is generally reflected in the participation rate. While this varies by Member State, across the EU the majority of businesses eligible for the scheme take advantage of it. The **average take-up rate** across Member States, defined as the percentage of eligible businesses using the scheme, was calculated for the Member States whose tax authorities provided the required data – it is **around 63%** as shown in the figure below.

Figure 24 – Take-up rate of the SME exemption scheme by Member State¹³⁰



Source: Deloitte estimates based on data obtained from surveys to tax authorities.

While there is no firm evidence on the reasons for these differences, the variations in the participation rates observed across Member States may be due to a combination of factors such as:

- **The threshold in place.** The lower the threshold, the more incentive a business may have to opt out of the scheme and register for VAT, as it is more likely to exceed the threshold at some point during its economic activity. The level at which Member States set their exemption thresholds depends on economic, compliance risk and other factors linked to national contexts, which contribute to explain the variance of the threshold across countries (see Section 6.1.2)

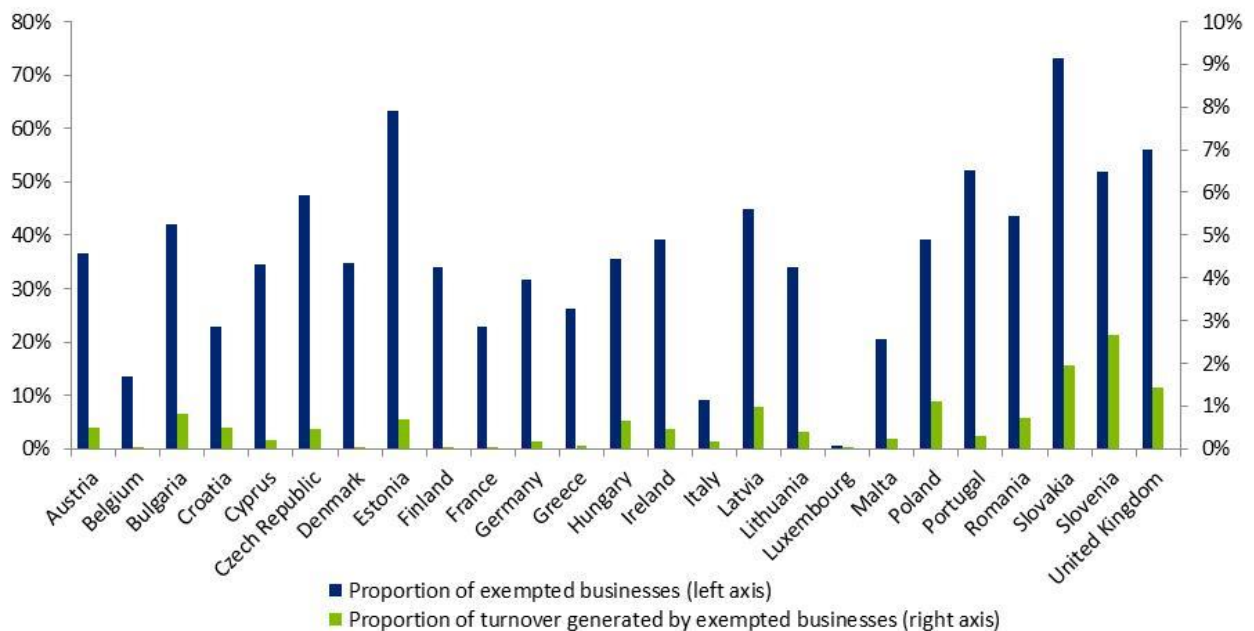
¹³⁰ The figure is based on data from the Member States that were able to provide the required data.

- **The simplification measures** tied to the SME exemption scheme. The more similar the obligations are in and out of the scheme, the easier it may be for a business to opt for the VAT standard regime, which could translate into a low participation rate for the scheme. For example, some Member States make VAT registration mandatory even for those businesses that use the scheme and ultimately pay no VAT. The additional administrative burden imposed by the common regime compared to the scheme is therefore reduced, which may in turn reduce the take-up rate of the scheme.
- **Labour market characteristics** in each Member State might also explain the differences observed. For example, fieldwork interviews in France and Estonia have revealed that it is common for individuals to conduct economic activity outside of their main employment. These individuals will be considered as taxable persons with low turnover and are more likely to take advantage of the scheme, as they are not planning to grow their activity above the threshold. This may differ for businesses that may have incentives to register for VAT anyway despite being eligible for exemption, in case their sales could potentially exceed the threshold at a given time.

While the thresholds vary across Member States, businesses with less than EUR 50 000 of turnover are the ones most likely to be eligible for the scheme across the EU. As described in Section 3, these businesses generate a negligible proportion of turnover in the EU, and the VAT revenue at stake should therefore also be negligible. This is corroborated by the estimates obtained: the proportion of businesses exempted from paying VAT in the EU is estimated to be around 27% of all businesses, but the proportion of turnover they represent is around 0.3% of all turnover generated in the EU.¹³¹ This is consistent for individual Member States: while exempted SMEs in a given country can represent up to 60% of all businesses, data received from tax authorities indicates that they generate at most 3% of the country's turnover, as shown in the figure below.

¹³¹ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

Figure 25 – Proportion of businesses exempted from paying VAT under the SME exemption scheme, and share of turnover generated by Member State¹³²



Source: Deloitte estimates based on data obtained from tax authorities and public sources. See Volume II, Annexes B and C for details on the calculations and Annex D for the country specific final estimates.

However, the turnover generated by exempted businesses is only an upper bound of the actual turnover exempted from VAT under the scheme. For most Member States, the threshold for eligibility to the scheme refers only to the domestically taxable supplies. For example, a business generating EUR 50 000 of sales with EUR 20 000 generated through supplies subject to VAT in another country, would only have EUR 30 000 of its turnover exempted from VAT under the scheme. Hence, it is only these domestic taxable supplies that should be considered when analysing the VAT revenue at stake.

Results from the Ipsos MORI surveys have revealed that across businesses interviewed in Austria, Italy, Poland and the UK, the average value of exempted transactions is from 70% to 100% of a business' turnover. Hence, while the turnover generated by exempted businesses remains an upper bound for the actual value of exempted transactions, the difference is not estimated to be substantial.

Cross-border implications of the SME exemption scheme

Overall, the SME exemption scheme is used by a majority of businesses that are eligible for it, and the foregone VAT revenue for governments is estimated to be small compared to the total revenues generated. However, the **scheme is only applicable to domestically established businesses**. This **may create distortions** in the market due to the unequal treatment of suppliers from other Member States that do not have access to the SME exemption scheme compared to domestic suppliers that can benefit from it.

Little evidence is available however on the cross-border trading behaviours of SMEs within and outside of the exemption scheme. Some insights have been obtained from three sources:

- A Flash Eurobarometer study conducted in 2014/2015 on the internationalisation of SMEs;

¹³² Data for Sweden is missing as the scheme was introduced only in January 2017.

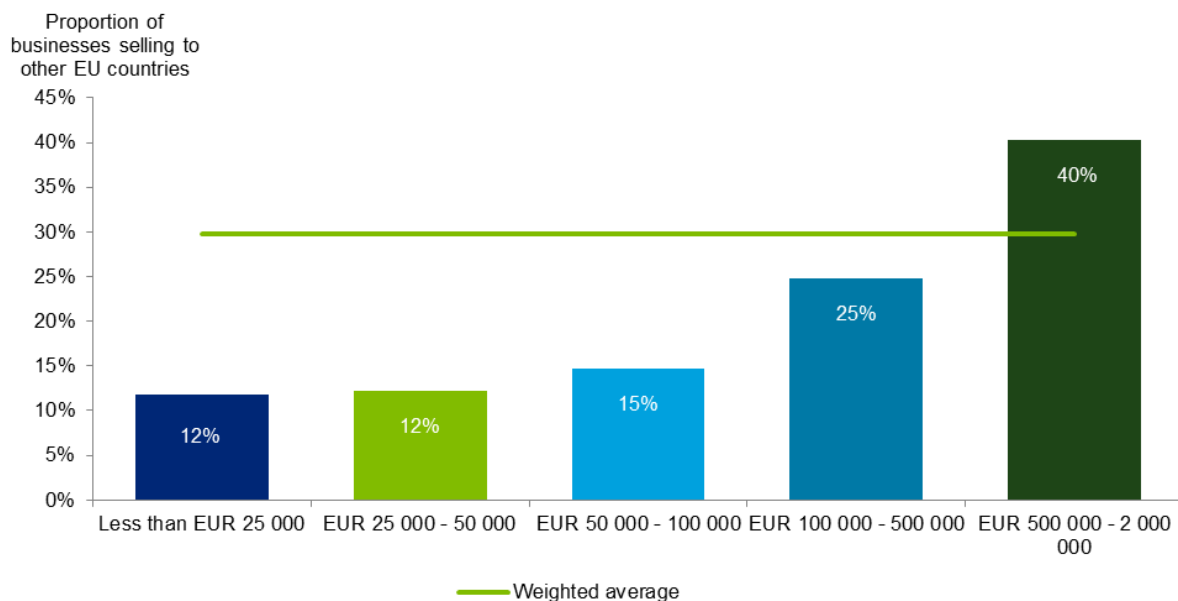
- Ipsos MORI surveys conducted in Austria, Italy, Poland and the UK; and
- Data obtained from tax authorities on the trading behaviours of VAT-registered businesses eligible for the scheme.

The Flash Eurobarometer study was carried out by TNS Political & Social at a request of the Commission on the internationalisation of SMEs.¹³³ As part of this study, about 500 SMEs were interviewed in each of the 28 Member States¹³⁴ and information on the following variables was collected:

- Turnover;
- The type of supplies provided;
- Whether the businesses carry out cross-border transactions and where to/where from;
- The percentage of the business' sales related to cross-border sales from different places; and
- Their experiences with carrying out cross-border transactions, including potential barriers.

The resulting dataset was used to calculate the proportion of SMEs of different size carrying-out cross-border transactions in the EU. As shown in the figure below, on average 30% of businesses in the EU sell to other EU countries. Amongst the smallest size classes however (turnover less than EUR 50 000), for those businesses most likely to be eligible for the exemption scheme domestically, **around 12% of businesses sell to other EU countries.**¹³⁵

Figure 26 – Proportion of EU businesses selling to other EU countries by turnover bracket



Source: Deloitte estimates based on data collected as part of a Flash Eurobarometer study

Tax authorities were also asked about the proportion of their VAT-registered businesses eligible for the SME exemption scheme which trade cross-border. On average, between 5% and 18% of these businesses were reported to trade cross-border. However, the metrics and information reported vary

¹³³ Flash Eurobarometer 421, Internationalisation of Small and Medium-sized Enterprises (2015)).

¹³⁴ Except in Malta, Cyprus and Luxembourg where only 200 enterprises were interviewed.

¹³⁵ The estimates were calculated for the EU as a whole. Even though the survey results separate the answers per Member State, the sample sizes of the number of businesses obtained in each size classes were judged too small to obtain robust and representative estimates.

across countries and do not permit definitive conclusions on the cross-border behaviours of such businesses to be drawn. For more details on the estimates provided, see Volume II, Annex B.

Surveys were also conducted by **Ipsos MORI** in four markets (Austria, Italy, Poland and the UK) which enables analysis of the cross-border behaviours of SMEs. 500 SMEs were interviewed in each market, focusing on businesses with low turnover that may be eligible for the SME exemption scheme domestically.¹³⁶ Businesses were asked about their VAT obligations and cross-border activities.

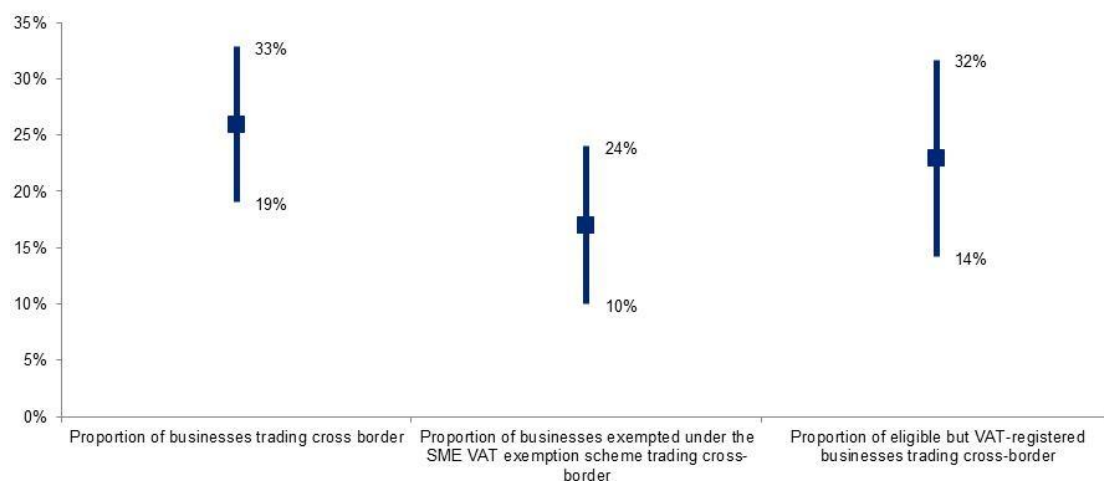
While this provided evidence on the proportion of businesses carrying out cross-border trade, closer analysis of the data revealed apparent confusion amongst businesses on their exact situation and their international VAT obligations. Given some of the inconsistencies in firms' responses, a range rather than single point estimates is reported: when it was not clear whether a business did carry out cross-border trade or not, this business was assumed to not sell outside of its country to obtain the lower bound estimate, and was assumed to do so to obtain the upper bound estimate.¹³⁷

The results obtained (see Figure 27 below) show that on average across the four markets, **between 19% and 34% of the businesses interviewed carried out cross-border trade** with other EU Member States.

In addition, the surveys allowed analysis of the trading behaviours of businesses in and out of the scheme separately. Because of the limited sample size for businesses benefitting from the SME exemption scheme at the level of a Single Market, the results were combined across markets to obtain more robust estimates.¹³⁸

The answers obtained suggest that the eligible businesses choosing to opt out of the scheme¹³⁹ are slightly more likely to carry out cross-border transactions than the businesses taking advantage of the scheme, as shown in the figure below.

Figure 27 – Proportion of SMEs trading cross-border



Source: Deloitte estimates based on Ipsos MORI survey results

¹³⁶ More details on the businesses interviewed can be found in Volume II, Annex E, Section E.1.

¹³⁷ The situation was unclear for less than 20% of all businesses interviewed.

¹³⁸ Italy was however excluded as only few businesses were exempted under the scheme and eligible businesses could not be identified due to the multiple thresholds and additional conditions applicable in Italy for eligibility to the scheme.

¹³⁹ These were identified as businesses charging VAT on some of their sales while having turnover below the national threshold. As explained in Annex C, this is not a perfect measure and may lead to an over- or under-estimation of the number of eligible businesses.

However, it is not clear whether the difference in trading behaviours between domestically exempted SMEs and eligible SMEs opting for the common regime is due to:

- The fact that SMEs taking advantage of the scheme domestically mainly trade locally by nature, and have less interest in expanding into cross-border trade regardless of whether they could benefit from the scheme in other Member States or not.
- The fact that the domestic nature of the schemes creates distortions in the market, either (i) disincentivising firms from trading cross-border or (ii) leading some eligible firms to register unnecessarily – potentially due to the apparent uncertainty about international VAT treatment – thereby creating additional administrative costs.¹⁴⁰

While no data obtained from tax authorities, Ipsos MORI surveys, or the literature allow definitive conclusions to be drawn, some insights can be developed from the Flash Eurobarometer survey and the fieldwork interviews.

The Flash Eurobarometer surveys investigated the **barriers to trade** faced by businesses. Businesses that were not exporting were asked about the difficulties they would encounter if they were to export. About 15% of the SMEs interviewed answered that dealing with foreign taxation is too complicated or too costly, and this would represent a major problem for them.¹⁴¹ In addition, 9% of these businesses reported that the fact that their company does not know the rules which have to be followed when exporting would represent a major problem for them.¹⁴²

While these answers are not specific to VAT, they suggest that the tax obligations in other Member States are not the **main drivers** discouraging SMEs from trading cross-border. In addition, a majority of the SMEs interviewed as part of the fieldwork only traded domestically, and had no incentive to trade cross-border regardless of the rules in place in other Member States as their activity was mainly local by nature.

Overall, the different sources suggest that **between 10% and 30% of SMEs carry out cross-border trade**. While there is some variation across Member States, this proportion does not vary significantly across countries. In addition, no evidence demonstrated that SMEs not trading cross-border choose not to do so because the VAT obligations in other Member States are too burdensome. However, given the limited evidence found on the topic no definitive conclusions can be drawn.

Compliance costs of the scheme

The SME exemption scheme **reduces the VAT-related obligations** for businesses benefiting from the scheme, even if to a different extent depending on whether the Member States have coupled it with additional simplification measures (for instance regarding the obligation to register for VAT or some bookkeeping requirements).

Overall, it was found that **the SME exemption scheme reduces the VAT-related obligations for businesses by approximately 60%** compared to businesses using the normal VAT regime.

¹⁴⁰ Results from the Flash Eurobarometer suggest that larger businesses are more likely to trade, and it is hypothesised that larger SMEs may also be more likely to register for VAT although eligible for the exemption scheme. However, the Ipsos data obtained does not suggest that eligible businesses choosing to opt for the common regime are consistently larger than exempted businesses. The differences in trading behaviours can therefore not directly be attributed to businesses' size.

¹⁴¹ Deloitte estimates based on Flash Eurobarometer 421, Internationalisation of Small and Medium-sized Enterprises (2015)).

¹⁴² Deloitte estimates based on Flash Eurobarometer 421, Internationalisation of Small and Medium-sized Enterprises (2015)).

The assessment of the businesses' compliance costs of adhering to the SME exemption scheme was carried out for five out of the eight Member States selected for fieldwork (Estonia, France, Italy, Romania¹⁴³ and UK). The following table lists the **Information Obligations (IOs)** that apply in the different countries both within and outside of the special scheme, and summarises the compliance costs sustained by businesses within and outside of the SME exemption scheme. Based on this assessment, the average costs at EU level were estimated.

The detailed analysis of the compliance costs and of the methodology and approach applied can be found in Volume II, Annex G.

¹⁴³ Only accountants were interviewed in Romania therefore it was not possible to quantify the costs for businesses, only advisory fees are presented.

Table 3 – Annual compliance costs for businesses within and outside of the SME exemption scheme in selected Member States

Member State	Within the SME exemption scheme		Outside of the SME exemption scheme	
	Relevant IOs	Overall costs (annual basis)	Relevant IOs	Overall costs (annual basis)
Estonia	No VAT-related obligations	No VAT-related compliance costs	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	EUR 872 (of which advisory fees: EUR 183)
France	<ul style="list-style-type: none"> ✔ Applying for exemption scheme ✔ Bookkeeping 	EUR 960	<ul style="list-style-type: none"> ✔ VAT registration ✔ VAT input ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	EUR 1 981 (of which advisory fees: EUR 265)
Italy	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT return ('Unico', annual statement) 	EUR 1 371 (of which advisory fees: EUR 500)	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	EUR 2 907 (of which advisory fees: EUR 1 015)
Romania	<ul style="list-style-type: none"> ✔ No VAT-related obligations 	No VAT-related compliance costs	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	EUR 2 500 (of which are advisory fees: EUR 2 215) ¹⁴⁴
UK	No VAT-related obligations	No VAT-related compliance costs	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	EUR 2 492 (of which are advisory fees: EUR 1 100)

Source: Deloitte compilation of data from fieldwork

As shown by the table above, the application of the SME exemption schemes varies greatly across Member States, e.g. in the number of VAT-related obligations businesses are exempted from, and in the integration of the SME exemption scheme with additional simplification measures. Consequently, the overall compliance costs vary, both within and outside of the scheme. **Overall, the schemes**

¹⁴⁴ Only accountants were interviewed in Romania therefore the costs for businesses in-house may be underestimated.

result in savings of around EUR 1 500 per year on average in the Member States included in the analysis.

While applying the available schemes, businesses may be exempted from all VAT-related obligations (as in the case of Estonia and Romania), or may still be required to register for VAT (as in the case of Italy). In addition, Italy requires businesses to still issue invoices and/or fiscal receipts (while not applying VAT), and to submit an annual statement, which covers income, social security and VAT-related obligations ('Unico').

According to the results of the analysis (summarised above), and to the interviews carried out in Member States, the application of the SME exemption scheme (with additional simplification measures) is **effective in reducing the administrative burden** for businesses. The reduction of the administrative burden for businesses applying the SME exemption scheme varies also depending on obligations from which each of them releases businesses. Clearly, the more obligations still relevant, the lower the reduction.

In some cases, the SME exemption scheme is linked with **additional simplification measures** in fields other than VAT, which may represent an important reason for applying the scheme. In Italy, for instance, the SME exemption scheme is linked to a series of additional simplifications, the most important being the application of a substitute tax of 15% or 5% for both income and regional taxation. This would tend to reinforce the rationale for the scheme.

An important **'hidden' cost** of complying with the exemption scheme is the monitoring of the threshold. Although not an information obligation of the scheme, businesses have to monitor their transactions in order to not unintentionally breach the threshold. This monitoring is understood as occurring during general accounting/bookkeeping activities and is thus difficult to separate from 'normal business practice'. Further, costs for monitoring the threshold are not captured by the standard cost model as they do not constitute an information obligation on the business. However, based on expert estimations, the cost for monitoring the threshold can be estimated at approximately EUR 193 per business per year. This cost is taken into account in the estimated costs for a business in the EU operating under the SME exemption scheme (see Table 4 below).

Table 4 – EU average annual compliance costs for businesses within and outside of the SME exemption scheme

Member State	Within the SME exemption scheme		Outside of the SME exemption scheme	
	Relevant IOs/costs	Overall costs (annual basis)	Relevant los/costs	Overall costs (annual basis)
EU Average	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ Bookkeeping <p>Hidden costs: monitoring threshold</p>	<p>Average across all Member States: EUR 550 of which hidden costs are EUR 193 (this average reflects the fact that some Member States impose no or few of the listed IOs to businesses within the scheme; the average cost in Member States where the listed obligations are applied is EUR 1 083, of which advisory fees: EUR 500</p>	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ VAT payment (domestic) ➤ Bookkeeping 	<p>EUR 2 964</p> <p>(of which advisory fees: EUR 1 023)</p>

Source: Deloitte elaboration of data from fieldwork

Fixed vs. variable costs

Frequency of the obligations is an important driver of compliance costs. Even outside of the SME exemption scheme, businesses below a certain turnover threshold benefit from simplification measures that reduce the frequency of obligations (such as quarterly VAT returns instead of monthly), and thus the related costs.

The **cost of invoicing** is strictly related to the number of invoices/fiscal receipts that businesses issue in a certain period of time. For instance, professionals may issue less than a dozen invoices per year (even only one per year to each of their clients), while other businesses have much larger volumes (for instance, cafés and restaurants). Based on the data collected during fieldwork, issuing an invoice/fiscal receipt does not require a long time, even when done manually (businesses never indicated more than 5 minutes per document). While using the same average number of 20 invoices/fiscal receipts per month during the analysis of the compliance costs, the sensitivity analysis carried out did not point to relevant effects. For instance, a 50% increase in the number of invoices

per year, led to an overall increase of compliance costs of only about 12-15%¹⁴⁵. It is likely that automation of administrative tasks will further lower variable costs for businesses, while not necessarily reducing fixed costs (for instance, for purchasing and/or updating specific software, etc.).

In-house vs. outsourcing costs

The **large majority** of businesses interviewed (with the exception of accountancy practices qualifying as SMEs) have **external advisors/accountants** to support them with tax-related issues (VAT, but also for income taxes and social security).

The dependence on external accountants/fiscal advisors by SMEs rests on several factors.

One important element is the SMEs' **lack of resources** to devote to tasks other than their core business. The interviews revealed how businesses (especially the very small ones) do not have the resources (both economic and human) to understand and carry out administrative obligations, so that they have recourse to external advisors to obtain guidance and to carry out administrative tasks (in relation to VAT, but also to all other obligations). Usually these are very small businesses, run by the owner with one or two additional people (often family members) who focus on the core activities. In addition, the frequency of changes to the legislative framework also influences the dependence on accountants and external advisors, as businesses do not have the time to remain up-to-date with the framework, and feel inadequate to take such responsibilities.

Technological developments represent another important element in the tendency to outsource. In the last decade or so, tax authorities have been progressively simplifying and moving online administrative obligations (for VAT, but not only). This has led to automation of processes for businesses and for advisors and accountants, which in turn has made investments in specific accounting software necessary (and a related learning curve to become familiar with the new procedures). Smaller businesses can rarely afford such investments, so rely on their accountants (who have access to those programmes).

The costs of accountants/advisory services vary across countries, based on differences in income, but also on the number and complexity of the administrative tasks to be performed under each system. Among the businesses interviewed for the analysis of the SME exemption scheme, **the yearly costs for advisory fees range from none¹⁴⁶ to EUR 500 for businesses within the scheme, and from EUR 250 to EUR 1 000 outside of the scheme.**

In both cases (within and outside of the SME exemption scheme), advisory fees are generally charged as a lump-sum, based on a bundle of services provided. The advisory fees usually include support with income taxes and social security tasks, in addition to VAT-specific obligations.

Based on the estimations of costs for businesses at EU level, the difference in yearly compliance costs between businesses within the SME exemption scheme and those outside of the scheme is approximately EUR 500.

Advisory fees include also the costs of specific accountancy software that accountants and advisors purchase. Based on the data collected during fieldwork, such costs vary from EUR 700 per year to up to EUR 10 000 per year, depending on the complexity and functionalities provided. It is quite rare that

¹⁴⁵ See Volume II, Annex G, Section G.1: 'SME exemption Scheme' for more details.

¹⁴⁶ Advisory fees for VAT purposes are zero when there are no VAT-related obligations whatsoever in the Member State under the exemption scheme (for example in Estonia)).

businesses themselves purchase such software, especially the smaller ones. However, the accountants interviewed noticed an increasing trend toward digitalisation also among businesses, with more tending to register their operations (including sales, purchases, etc.) on IT tools, even very simple ones as excel files. This trend reduces the time needed for accountants and advisors to perform some tasks (such as the registering of invoices/fiscal receipts), which translates (at least in time) into a reduction of the advisory fees for businesses.

The table below provides estimations of advisory fees for businesses in each analysed Member State within and outside the SME exemption scheme.

Table 5 – Average advisory fees within and outside the SME exemption scheme

Member State	Average advisory fees (annual)	
	Within the Scheme	Outside the Scheme
Estonia	No VAT-related advisory fees	EUR 183
France	No VAT-related advisory fees	EUR 265
Italy	EUR 500	EUR 1 015
Romania	No VAT-related advisory fees	EUR 2 215 ¹⁴⁷
UK	No VAT-related advisory fees	EUR 1 100

Source: Deloitte elaboration of data from fieldwork

Evidence of the effectiveness of the schemes

The **SME exemption scheme** can be considered as the most successful measure specifically designed for smaller businesses: it has the highest implementation rate of all schemes explicitly provided for in the VAT Directive (see Figure 24 above) and is also the most used scheme among eligible businesses, according to available data and expert assessment.

Advantages

Firstly, the SME exemption scheme **provides an exemption from VAT** for supplies made by eligible businesses, which results in the non-taxation of the added value created by those businesses. This provides a significant tax benefit and can constitute a price advantage for those SMEs using the scheme. There is however a cost-benefit analysis to be made by such an SME, since the inherent nature of the SME exemption means that there is no input VAT recovery. The SME exemption scheme will be more beneficial if the cost of the input VAT is lower than the VAT which would be due for a business not using the scheme and the administrative cost of such a business not using the SME scheme. The benefit of the scheme would depend also on the client base, being more appropriate and beneficial for SMEs in B2C trade, whilst SMEs in B2B trade may prefer the common VAT regime to enable their clients to deduct input VAT.

¹⁴⁷ Interviewed accountants stressed the high compliance burden for SMEs not availing themselves of the SME exemption scheme. In particular, accountants reported a refusal rate for the first two to three VAT registration applications of approximately 70-75%, meaning that businesses have to conduct the lengthy application process several times. Once registered, it was also pointed out that administrative requirements for businesses are quite burdensome. Nevertheless, given the small sample of accountants interviewed in Romania and the lack of comparable data from SMEs, these figures are indicative only.

Another major benefit is that, considering the way the scheme is usually implemented by the Member States, it **substantially lowers the administrative burden for the businesses** applying the scheme. This is due to the fact that the exemption is often accompanied with additional simplification measures. Based on the analysis of the compliance costs for the SME exemption scheme, compliance costs for businesses within the scheme range from zero (when the scheme is implemented together with additional simplifications, as in the case of Estonia) to EUR 1 381 per year per business (as in the case of Italy). Compliance costs for businesses outside of the scheme range from EUR 690 (in the case of Estonia) to EUR 1 671 (in the case of Italy). Overall, compliance costs for businesses within the scheme are lower.

Additionally, it **could lower the administrative cost for tax authorities**, as it may save them some time and resources to not have to control the VAT compliance of these small businesses¹⁴⁸. The performed checks would mainly focus on the applicable thresholds. This consideration obviously has to be held up against the loss of VAT revenue for tax authorities.

The implementation of the SME exemption with additional non-VAT related simplification measures can represent a crucial element in a business' decision to opt for the scheme. In the case of Italy, the ability to benefit from a substitute tax on income and regional taxation (which is an integral part of the SME exemption scheme as implemented in the Member State) represents a key driver for businesses, based on data collected during the fieldwork.

Disadvantages

The **loss of the right to deduct input VAT** is often indicated as a major drawback. However, it should be noted that this loss is the inherent consequence of the exemption, and, as such, part of the scheme. Indeed, VAT law provides that when exemption applies, a business loses its right to recover input VAT.¹⁴⁹

This drawback should, however, be balanced against the benefits that make it economically beneficial for the SME to apply the scheme, such as tax benefits provided by the exemption and linked simplification measures.

In cases where the onward supplies are to final consumers (**B2C supply**), the blocked input VAT deduction would not usually be a problem for the exempted business. Business would usually gain from the exemption, as their input VAT cost is lower than output VAT calculated on the price of their supplies, which enables them to offer lower prices to final consumers. However, an exemption may cause problems in cases where the onward supply is to other VAT registered businesses (**B2B supply**), as VAT registered business customers expect to be able to deduct their input VAT, in order to reduce their VAT payable (calculated as output VAT minus input VAT). As a result of the exemption, the VAT registered business customer ends up with a VAT cost (carried forward irrecoverable 'hidden' input VAT cost). This may deter VAT registered businesses from buying from exempt businesses, even where the price may be slightly lower. In the above cited practical example (see Figures 21 and 22), this loss was apparent, as the VAT invoiced to the manufacturer was not deductible and thus increased the costs on the SME by EUR 20. Therefore, **the SME exemption scheme is less beneficial to SMEs in B2B trade.**

¹⁴⁸ However, tax authorities interviewed could not provide any quantification of such costs.

¹⁴⁹ Article 289 of the VAT Directive.

Consultation with businesses confirmed such an impact of the SME exemption. A large majority of interviewed SMEs selling to other businesses have **opted out** of the exemption scheme and preferred to charge VAT on their supplies, although they have had to give up the simplification measures attached to the SME exemption scheme. However, the decision to opt out or not may depend on the extent of B2B supplies and overall financial and administrative benefit (and its importance) for the particular business.

Similarly, **start-ups** (or local subsidiaries of existing (foreign) businesses) may be more inclined to opt-out of the exemption scheme and immediately register for VAT, to be able to deduct input VAT on their capital investments made before they commence their sales activities. The study proved that the category of VAT registered businesses with the smallest sales turnover has negative VAT revenue (i.e. tax authorities refund more VAT than they collect from these businesses) in 9 out of 28 Member States¹⁵⁰. It is likely that such starting businesses (and input VAT refunds on their initial investments) are the main (legitimate) reason for the negative VAT revenue.

As the general policy objective of the SME scheme is to **support entrepreneurship** and the **growth of SMEs** and more generally to encourage **economic growth**, and because input VAT deductions on investments before the start of sales are a normal part of business activities, the Member States seem to generally accept such effect on VAT revenues (as the VAT revenue collected from businesses later on in their business cycle more than compensates for the initial loss), and do not consider this a problem. From the business angle, the ability to claim back input VAT on initial investment costs also provides significant financial support to start-ups with limited start-up capital.¹⁵¹ Therefore, the SME exemption scheme is less beneficial to starting businesses with significant initial investment costs, and the right to opt out forms an important part of the SME support measures.

Another drawback of the way wherein the SME exemption scheme is generally implemented, is the fact that **businesses opting out of the scheme (e.g. due to the need for input VAT deduction) also usually lose the benefit of the additional simplifications which are often tied to the SME exemption scheme**. This makes the difference in the tax and administrative burden between those within and outside of SME exemption scheme more significant, as these SMEs may be of similar size, having thus similarly limited resources. This illustrates the need for simplification measures outside the scheme as well.

This also leads to the negative **effect of breaching VAT thresholds (the so called ‘threshold effect’)**, which means that SMEs might fear growth and reaching sales that exceed the threshold, as in most Member States this means that a business with minimal or no VAT obligations must start complying immediately with all VAT obligations. On top of that, in most countries, once a business exceeds the threshold, it cannot opt in to the scheme again, even if its sales decrease. In this respect, studies have found evidence of ‘bunching’ behaviour of businesses immediately below the threshold (i.e. there is a very high concentration – or grouping – of businesses immediately below the threshold), implying that businesses actively avoid breaching the threshold.¹⁵²

¹⁵⁰ See above Section 3.4 on VAT revenues generated by SMEs.

¹⁵¹ The Commission's recent Communication: Europe's next leaders: the start-up and scale-up initiative, (COM(2016) 733), published on 22 November 2016, emphasises the importance of start-ups and the need to support their access to finance, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0733&from=EN>, consulted on 1 February 2017.

¹⁵² Harju, J. Matikka T. and Rauhanen T. (2015), The Effect of VAT Threshold on the Behaviour of Small Businesses: Evidence and Implications, CESifo Area Conference on Public Sector Economics.

Although the threshold effect is inherent in all measures using a threshold and as such not specific to the SME exemption scheme, this is considered by businesses to be a drawback of the scheme and places pressure on SMEs to remain below the threshold (see Section 5.1 on problem assessment).

A flexible threshold, as applicable in the United Kingdom and Belgium, could (to a certain extent) mitigate this threshold effect. As explained above¹⁵³, such a threshold allows the exemption threshold to be exceeded temporarily. As a downside, this adds some complexity and another threshold to monitor.

Regarding cross-border trade, the scheme usually results, to a certain extent, in an **unequal treatment between businesses** performing only local supplies and businesses also operating cross-border, since the cross-border supplies are not covered by the exemption when they are subject to VAT outside of the Member State of establishment of the SME (cross-border supplies of goods in B2C being taxed at destination only when businesses exceed national distance selling thresholds, for services only for specific categories of services like so-called TBE services (telecommunications, broadcasting and electronically supplied services). However, many smaller businesses applying the scheme tend to only operate on the domestic market, for example hairdressers and cafés, thus it seems unlikely that the distortion between domestic and cross-border businesses results from the exemption scheme itself (i.e. a local café would not be supplying cross-border due to the nature of its business).

Businesses, trading both domestically and cross-border may find the **combined application of the SME exemption scheme and regular VAT rules for supplies not covered by the scheme very complex as well as administratively burdensome**. They would need to keep separate accounts for such supplies and apply different VAT rules. Also, the EU legislation has intended to provide additional simplifications for SMEs (either specifically for SMEs exempted under the scheme or more widely), such as the relief from reporting intra-EU acquisitions of goods below EUR 10 000 on a yearly basis (and hence the submission of the related purchases with VAT in the Member State of departure). Although these measures are intended to simplify and reduce tax and administrative burden of SMEs, such not well aligned combination of several thresholds, sets of eligibility criteria and accompanying obligations may significantly reduce the overall benefit of the measures. Taking into account the limited resources of SMEs, it is therefore raising a question whether such approach delivers the intended objectives.

Other drawbacks identified, were the following:

- Often, the national **SME exemption schemes are perceived as unclear** regarding their applicability. This is especially true for businesses performing domestic transactions as well as cross-border transactions, where businesses are unsure and sometimes unduly apply the scheme to cross-border transactions. Businesses not established in a Member State also mistakenly think they can apply the SME exemption, whereas they are excluded from the scheme.
- In some cases, **businesses prefer to engage in trade with VAT registered companies**, which could constitute an issue in countries which relieve SMEs in the scheme from the VAT registration obligation. Such SMEs could be prevented from growing since other businesses do not wish to sell to them (as they might experience issues evidencing sales if the business

¹⁵³ Cf. above under “The SME exemption scheme” – “Application in the EU” – “Functioning”.

customer has no VAT number, especially in cross-border situations) or buy from them (since they cannot deduct input VAT on purchases from an exempted SME).

- The **SME exemption causes VAT to be no longer neutral**, as there is so-called hidden VAT in the supplies of the SME applying the scheme. It purchases goods and services for which it cannot recover input VAT. As a consequence, this non-recoverable VAT is part of the costs taken into account to set the price for customers (although the overall price could be lower as no VAT is charged on added value). This could be particularly harmful for businesses operating in a B2B environment.
- Businesses and tax authorities have to **monitor the threshold**.
- The scheme leads to a **loss of revenue for Member States**. However, it should be noted that this is to a certain extent intentional and the result of a cost-benefit analysis of having such a scheme. Indeed, although the Member States' revenue is reduced to a certain extent, their administrative burden (from processing VAT returns and auditing taxpayers) is also reduced significantly, also as an effect of undergoing simplification and automation of administrative procedures.

Overall effectiveness

The analysis of data gathered indicates that despite the drawbacks, **the SME exemption scheme (when tied with simplification measures) is an effective scheme**.

Indeed, **small businesses receive financial benefit from the exemption and face a substantially lower compliance burden**. As a result, the barriers for entering the market to grow are removed to a large extent (at least until the threshold is reached). This remains, however, limited to the national market. It is unclear how much of this is attributable to the fact that SMEs benefiting from this scheme are tax exempt, are not required to VAT register, or have potential reduced obligations.

The key to the success of the SME exemption scheme is the fact that businesses operating under this scheme, besides benefiting from the exemption, are also widely discharged from additional VAT obligations: they do not have to file VAT returns, do not have to account for VAT and, in the majority of the cases, are not obliged to issue VAT invoices. Thus the SME exemption scheme seems **most effective where it is accompanied by extensive simplification measures**.¹⁵⁴

The effectiveness of the scheme may be substantially reduced where the simplifications are more limited. For example, as shown in Table 2, some Member States require businesses under the scheme to issue invoices that are compliant with the VAT legislation, although the invoice serves no purpose for the deduction of input VAT. In some Member States, the SME exemption scheme is applied just as foreseen in the VAT Directive and businesses are only released from VAT calculation and payment, but are still faced with the same administrative obligations as a normal VAT-registered taxable person (such as filing VAT returns, VAT bookkeeping etc.).

However, the decision of Member States to bundle the SME exemption scheme with a set of additional simplifications (more or less extended) is also linked to considerations other than reduction of compliance costs for businesses, such as the monitoring of compliance and the fight against tax fraud. Indeed, the level of thresholds in Member States is often set to find a balance between different and sometimes contrasting needs, such as reducing the tax burden and compliance cost for businesses who need it most and administrative costs for tax authorities on the one hand, and the

¹⁵⁴ For an overview of the Member States' including simplification measures in the SME exemption scheme, see Table 2 above.

negative revenue impact, risk assessment regarding the need for compliance monitoring and the fight against tax fraud on the other.

Additionally, **the flexibility to opt out of the scheme maximises its overall effectiveness for SMEs** (although it may increase complexity and burden for tax authorities), as its application becomes targeted to those businesses that benefit from it. Businesses are allowed, for example, to register voluntarily for VAT to by-pass the disadvantages of the scheme, in cases where the disadvantages are for them more important than the advantages (for instance, if they are active in the B2B segment of the market or if they have to make significant investments in the start-up phase of their business).

4.2.2 VAT graduated relief

Description of the scheme

Graduated relief can be described as a variation of the SME exemption scheme in the sense that it also **reduces the burden of collecting tax for SMEs**, albeit not completely. A small business benefiting from this scheme receives a VAT relief on part of their turnover or VAT payable, which gradually decreases with the increase of turnover or VAT payable. Thus the tax burden for such a business is partly reduced and a business benefiting from the scheme is gradually introduced to a full set of tax obligations.

A Member State could decide only to tax none or part of the turnover up until a certain threshold, and tax more of the turnover (still not fully) until a second threshold, and to then tax fully when a third threshold is reached.

An example could be:

- Up to a first threshold (e.g. EUR 10 000): the Member State taxes 33% of the turnover
At a VAT rate of 20% and a turnover of EUR 10 000, this would mean that VAT is calculated on EUR 3 300. In other words, the business is liable for the payment of EUR 660 (instead of the EUR 2 000 which would be normally applicable).
Between the first and a second threshold (e.g. EUR 30 000): the Member State taxes 66% of the turnover. At a VAT rate of 20% and a turnover of EUR 30 000, this means that the business is liable for EUR 660 for the turnover up until EUR 10 000 (as above). On the turnover between EUR 10 000 and EUR 30 000, 66% of EUR 20 000 would be taxed. In other words, the additional taxable base is EUR 13 200 and the additional VAT is then EUR 2 640.
In total the business with a turnover of EUR 30 000 is liable for the payment of EUR 3 300 (instead of having to pay EUR 6 000 at the normal rate).
- Exceeding the second threshold: the Member State taxes 100% of the turnover.

The legal basis for graduated relief is Articles 282 to 292 of the VAT Directive. Article 282 states that 'the exemptions and graduated tax relief provided for in this section apply to the supply of goods and services by small enterprises'. In principle, businesses benefiting from graduated relief are considered as falling inside of the scope of the normal VAT rules.¹⁵⁵ The relief is mainly intended to reduce the tax burden for SMEs (rather than the administrative burden). The **scheme is optional** in its application for both Member States and businesses.

¹⁵⁵ Article 291 of the VAT Directive.

Member States can additionally provide simplifications for businesses applying the graduated relief scheme or discharge them from certain obligations, in order to provide also a reduction of the administrative burden. These may concern VAT registration (simplified procedure, rather than no registration), invoicing, accounting and filing of returns. These simplifications could consist of annual accounting, simplified records and invoicing etc.

The figure below provides an example of the SME graduated relief, describing the scheme currently applicable in the Netherlands, whereby graduated relief is granted in relation to the level of net annual VAT due rather than turnover. The figure below are therefore shown as net annual VAT due. The Netherlands use a threshold of net annual VAT due of EUR 1 883 (as the highest threshold of the scheme).

As a consequence, depending on the turnover and input VAT, the threshold of EUR 1 883 could thus be exceeded by a business realising a turnover of EUR 20 000 with EUR 4 000 VAT due (at a rate of 20%) and deductible input VAT of EUR 2 000. At the same time, other things being equal, if the deductible input VAT is EUR 3 000, the threshold of EUR 1 883 is not exceeded, since the net annual VAT due would be EUR 1 000.

Figure 28 – Example of the functioning of graduated relief scheme in the Netherlands

≥ EUR 1 883	<i>no relief</i>
above EUR 1 345 – up to EUR 1 883	relief equals 2,5 x [EUR 1 883 – (output VAT – input VAT)]
≤ EUR 1 345	relief equals VAT amount
EUR 0	<i>no relief</i>

**Note: amounts are expressed as net annual VAT due
Source: Deloitte*

Under the **Dutch graduated relief scheme** the following scenarios are possible for a Dutch florist:

- The florist has a turnover (excl. VAT) of EUR 108 400. She has to pay 6% VAT on her turnover, i.e. EUR 6 604. She paid EUR 2 865 input VAT on the costs of the business.
 - The VAT due is EUR 3 739;
 - Since the VAT due exceeds EUR 1 883, no relief is provided.
- The florist has a turnover (excl. VAT) of EUR 75 000. She has to pay 6% VAT on her turnover, i.e. EUR 4 500. She paid EUR 2 865 input VAT on the costs of the business.
 - The VAT due is EUR 1 635;
 - The relief amounts to 2.5 times the difference between the threshold and the VAT due (1 883 minus 1 635), or EUR 620;
 - The final VAT payable is EUR 1 015.
- The florist has a turnover (excl. VAT) of EUR 67 750. She has to pay 6% VAT on her turnover, i.e. EUR 4 065. She paid EUR 2 865 input VAT on the costs of the business.
 - The VAT due is EUR 1 200;

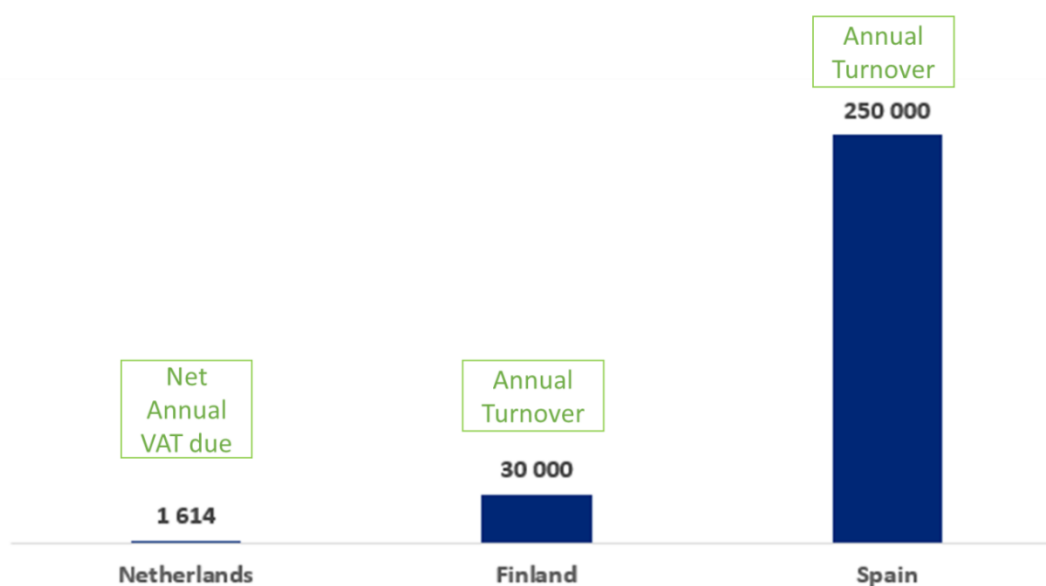
- The florist benefits from relief of the entire sum.

Application in the EU

Graduated relief is **currently only implemented in Spain¹⁵⁶, Finland and the Netherlands**. The relevant thresholds for graduated relief are set out in Figure 29 below.

The threshold for Spain and Finland is calculated by reference to annual turnover, whereas in the Netherlands the threshold relates to the net annual VAT due (output VAT minus input VAT).

Figure 29 – Thresholds for VAT graduated relief schemes (EUR)



Source: Deloitte tax network survey

Further, Spain intends to decrease the threshold to EUR 150 000 from 2018.

Functioning of the national schemes

In **Spain**, there is no SME exemption scheme with a VAT threshold and all traders need to register and account for VAT. However, the Spanish tax authorities have introduced a type of graduated relief scheme for individual entrepreneurs and pass-through entities formed exclusively by individuals with turnover up to EUR 250 000.

Businesses that are within the scope of the graduated relief scheme still file a **quarterly return**, but have **simplified VAT accounting obligations** (no obligation to keep a sales book) and are not required to issue invoices (save some exceptions in a B2B environment). The scheme is automatically applicable for a period of three years unless a trader chooses to opt-out.

The calculation of the output VAT within the scheme is rather complex and is based on certain indexes (called 'módulos'). However, some additional rules apply in relation to recovery of input tax. The result of the calculation can be VAT due that is higher or lower than under the normal regime.

¹⁵⁶ The 'Regimen Simplificado' in Spain is not a pure graduated relief scheme. However its attributes are similar and can be used for comparison.

In **Finland**, graduated relief is available only to domestic businesses or businesses with an establishment in Finland. In order to apply the relief, the turnover of the business must exceed EUR 10 000 and remain below EUR 30 000. It must register for VAT. The SME is obliged to report and account for VAT but can recover part of the VAT that has been accounted for in the last periodic tax return for a period (that is a simplified input VAT calculation is applied). In addition, it is entitled to additional VAT simplifications such as simplified reporting in relation to financial statements and the production of an annual report. Before a business uses the graduated relief, it must inform the Finnish tax authorities of its intention to do so.

It is important to note that Finland has also implemented the SME exemption scheme, applying a threshold of EUR 10 000.¹⁵⁷ In other words, the turnover of a qualifying SME in Finland is VAT exempt until EUR 10 000, and the same business enjoys a graduated relief up to EUR 30 000. Once it has exceeded that amount, it is subject to the normal VAT obligations.

In the **Netherlands**, where no SME exemption scheme applies, a graduated relief scheme is only available to established private taxable persons (i.e. sole traders), as opposed to legal entities, and only for domestic supplies.

The two graduated relief thresholds of EUR 1 345 and EUR 1 883 indicated above (Figure 29) are calculated for the Netherlands with reference to the value of the balance between VAT payable and VAT deductible (i.e. the net VAT due) on an annual basis. A taxable person making use of the relief can thus also in principle recover input VAT, as it is deducted when calculating net VAT due. However, the deductions are limited as the taxable person cannot be in a refund position under this scheme and full relief is already provided for an annual net VAT amount up to EUR 1 345. Where the trader applies the relief, it may be also entitled to simplified administrative obligations. For example, if its net VAT payable does not exceed the first threshold of EUR 1 345, it can opt for relief from all administrative obligations (including the obligation to submit VAT return or invoices).

The optional graduated relief scheme in the Netherlands has been recently widely used by sole traders whose taxable activity is only incidental (i.e. a 'side-product' of a non-taxable activity), such as individuals who install for the needs of their household solar panels and supply the surplus electricity to the network. Discussions with the tax authorities indicate that the main reason seems to be a recent relevant CJEU ruling which confirmed that such activity is considered as economic activity for the purposes of the VAT Directive.¹⁵⁸ A combination of such incidental business activities of private individuals with the local graduated relief scheme created an especially undesirable outcome for the tax authorities:

- A large number of individuals have registered for VAT, increasing the amount of VAT registered taxpayers in the system;
- when registered, the individuals deduct the input VAT paid on solar panels, creating a VAT loss for the tax authorities;
- Having only minimal taxable supplies from the sale of surplus electricity (below the annual threshold of EUR 1 345), enables these VAT registered individuals to continuously benefit from the graduated relief scheme by not paying any VAT and being relieved from all VAT obligations.

¹⁵⁷ Until recently, the threshold was set at EUR 8 500.

¹⁵⁸ See CJEU judgment of 20 June 2013 in Case C-219/12 *Finanzamt Freistadt Rohrbach Urfahr*.

As a result, the tax authorities have a significant number of 'dormant' taxpayers in the system and have suffered a considerable VAT loss from the initial deduction of input VAT, without any paid or expected output VAT. Based on information from the Netherlands, in 2014 there were 46 000 such new taxable persons registered with a VAT loss of EUR 38 million and in 2015, 56 000 new taxable persons and a VAT loss of EUR 49 million.

Table 6 below shows an overview of how the graduated relief scheme functions in all the Member States which have implemented it. It is based on a survey conducted with the Deloitte tax expert network.

Table 6 – Applicable features of the VAT graduated relief scheme per Member State

Member State	Requirement to register for VAT purposes	Requirement to register for other purposes such as commercial or tax purposes.	Released from obligation to submit periodical VAT returns	Simplified accounting obligations	Obligation to issue VAT invoices	Obligation to charge output VAT	Right to deduct input VAT
Finland	✓	✗	✗	✓	✗	✓	✓
Spain	✓*	✓	✓	✓	✓	✓	✓
The Netherlands	✓	✓	✗	✗	✓	✓	✗/✓**

* Note: Spain: Requirement to register for VAT purposes if VAT registration threshold is exceeded.

** In principle the input VAT is deducted when the business calculates the net VAT due. However, the deduction of input VAT is limited as the relief can never exceed the net VAT due (so business cannot be in a refund position). If this is the case, the SME is also not allowed to deduct as input VAT the 'reverse charge VAT', acquisition VAT and import VAT.

It is difficult to assess the consequences on **prices for customers** due to the complexity of the schemes and their national differences. It is likely that prices will be affected, but this will depend on the administrative burden for the SMEs applying the scheme. Due to the fact that businesses can in principle deduct VAT (with limitations noted above), there should be less or no 'hidden VAT' cost, in comparison to the SME exemption.

Quantitative analysis on take-up of the scheme, including cross-border dimension

The VAT graduated relief is **not a commonly applied scheme**, as it is implemented in only 3 out of 28 Member States. With regard to businesses, information received by Member States suggest that the businesses using such schemes represent a small proportion of overall businesses, especially when compared to the proportion of businesses using the SME exemption scheme.

Tax authorities in **Spain** indicated that overall in 2014, 8.4% of all taxpayers took advantage of the scheme¹⁵⁹, and they contributed 0.6% of overall VAT collection.

In **Finland** the take-up rate of the graduated relief scheme can be estimated at about 14% of VAT-registered businesses with turnover between EUR 5 000 – EUR 50 000 in 2014 applying the scheme¹⁶⁰. Data on the number of businesses eligible for the scheme and applying is not currently available.

In the **Netherlands** take-up rates are likely to be generally much lower since the graduated relief scheme only applies to individual traders. However, as mentioned above, tax authorities are concerned about increasing use of the scheme by individuals purchasing and installing solar panels in their homes, which has created a number of 'dormant' VAT registered taxable persons continuously relieved from all VAT obligations. Based on data from the tax authorities, in 2014 there were 46 000 such new taxable persons registered and in 2015 56 000 new taxable persons.¹⁶¹

As in case of the SME exemption scheme, graduated relief can currently provide benefit also on these cross-border supplies, which are taxed in the Member State where the SME is established (e.g. under distance sales rules). No quantitative information has been found on the cross-border dimension of the graduated relief scheme

Compliance costs of the scheme

The graduated relief scheme **can reduce the compliance costs for business** (as well as the tax burden). Based on the interviews with businesses applying the scheme in Spain, a **decrease of approximately 48% was recorded in comparison to the normal VAT regime**.

An assessment of businesses' costs to comply with the scheme was carried out for Spain. The following table lists the Information Obligations (IOs) that apply both within and outside of the special scheme, and summarises the compliance costs sustained by businesses.

The detailed analysis of the compliance costs can be found in Volume II, Annex G.

¹⁵⁹ Approximately 70% of all taxpayers are eligible for the scheme.

¹⁶⁰ The threshold for application of the scheme is between EUR 8 500 – EUR 22 500 thus the most relevant indicator for take up rates is the number of businesses within the turnover category EUR 5 000 – EUR 50 000.

¹⁶¹ This issue has been further described in the rationale of policy option 3 in Section 6.2.3.

Table 7 – Annual compliance costs for businesses within and outside of the graduated relief scheme in Spain

Member State	Within the graduated relief scheme		Outside of the graduated relief scheme	
	Relevant IOs	Overall costs (annual basis)	Relevant IOs	Overall costs (annual basis)
Spain	<ul style="list-style-type: none"> ✔ VAT registration ✔ VAT declarations/return ✔ VAT payment ✔ Bookkeeping <p>Hidden costs: monitoring threshold</p>	<p>EUR 1 098</p> <p>(of which advisory fees: EUR 606; of which are hidden costs: EUR 193)</p>	<ul style="list-style-type: none"> ✔ VAT registration ✔ Invoicing (re domestic) ✔ VAT declarations/returns ✔ VAT payment (domestic) ✔ Bookkeeping 	<p>EUR 1 952</p> <p>(of which advisory fees: EUR 806)</p>

Source: Deloitte compilation of data from fieldwork

As shown by the table above, the **obligations** under the graduated relief scheme **do not differ greatly** from obligations in the normal regime. In general, businesses opting for the scheme are exempt only from issuing invoices. However, other obligations are slightly less burdensome in the time that is taken to complete them. For example, the form used for the VAT return under the simplified regime is different from the one used in the standard regime. However, the return and payment period is also quarterly and the submission of an annual summary return is likewise required. The calculation of VAT is carried out by applying indexes that depend on the activity(ies) of the business.

Of these obligations, the most burdensome for businesses under the graduated relief scheme is the **VAT declaration**, accounting for approximately 18% of the overall costs. As with the other schemes, advisory costs are also significant for businesses under the scheme as most obligations would be carried out partially by accountants.

Like the VAT exemption, some costs are borne by businesses in **monitoring** their activities with respect to the threshold. As explained before, these costs are likely to be incurred within regular business activities such as bookkeeping. However, based on expert assessment, it is estimated that monitoring the threshold costs businesses approximately EUR 193 per year.

Fixed vs variable costs

As mentioned before, **frequency of obligations is an important driver of costs**. With regard to the Spanish graduated relief scheme, there are no striking differences in variable costs between businesses within and outside of the scheme with regard to the frequency of obligations. In Spain, although the forms to be completed for filing the VAT return are different inside and outside the scheme, returns are still filed quarterly and an annual summary form is also completed.

The cost of invoicing (another relevant driver for variable costs) is not taken into account since the graduated relief scheme in Spain does not apply to businesses that have an obligation to invoice.

In-house vs. outsourcing costs

Similar to the other special schemes, **businesses using the graduated relief scheme (in Spain) have external advisors/accountants to support them** with tax-related issues (VAT, but also for income taxes and social security).

The reasons for employing external advisors are the lack of resources to deal with administrative and fiscal obligations (in relation to VAT, income and social security), frequent changes in the legislative framework, the necessary investments in specific accounting software (and a related learning curve to become familiar with the new procedures).

In Spain, the **costs** of accountants/advisory services do not vary greatly among similar sized businesses. Businesses indicated that accountancy services cost on average approximately EUR 800 per year). This fee usually includes support with income taxes and social security tasks, in addition to VAT-specific obligations.

Advisory fees include also the costs of specific accountancy software that accountants and advisors purchase.

Evidence of the effectiveness of the schemes

The **SME graduated relief scheme** is not widely implemented across the EU and indeed only three Member States currently apply this. There is no consistency in how graduated relief is applied across Member States. Member States have mainly implemented the graduated relief on its own. **Finland** implemented both the SME exemption scheme and graduated relief, however there are concerns regarding the overall effectiveness, as applying two schemes (SME exemption and graduated relief) implies two thresholds, which increases complexity and may reduce the overall effectiveness.¹⁶²

Advantages

The main advantage of the scheme, similarly to the practical implementation of the SME exemption scheme (i.e. with simplification measures), is that businesses operating below the thresholds:

- **Can benefit from a reduced tax burden on their output transactions** (albeit not completely), while still enjoying (full or limited) right to deduct input VAT; and
- **Can benefit from exemption from certain obligations** (where applicable), such as VAT registration (e.g. simplified procedure), invoicing, accounting and filing of returns.

As a concept, graduated relief constitutes a step between very limited or no VAT obligations and having to fulfil all VAT obligations as a normal taxpayer. Taking into account the relatively small size of the businesses and their limited resources, reducing the tax and administrative burden will be beneficial for them. When their turnover and thus also their resources increase, they will be better equipped to deal with full VAT obligations. It is therefore beneficial for the business to be gradually introduced into the VAT system to get acquainted with the different obligations it imposes.

In the few countries where it is effectively implemented, the relief from VAT obligations is however limited, in contrast to the situation of the SME exemption scheme, where the majority of Member States accompanied the SME exemption with simplification measures relieving SMEs from most or all of the VAT administrative obligations.

¹⁶² See below in section on 'Overall Effectiveness': a recent study demonstrates that excess bunching is significant and very similar both for the SME exemption scheme and the graduated relief scheme.

Without such simplification measures, administrative burden for SMEs is more or less the same as those incurred in the normal VAT regime.

Disadvantages

An important drawback, similar to the VAT exemption, is the **effect of breaching VAT thresholds**,¹⁶³ which means that SMEs may be reluctant to grow and realise sales that exceed the threshold¹⁶⁴ as the business must start complying with full VAT obligations and does not benefit from a partial exemption. This is a general effect of all threshold related schemes and places pressure on SMEs to remain below the threshold (see Section 5 on problem assessment). Although the aim of the graduated relief scheme is to reduce this threshold effect, the low take-up figures suggest a low popularity amongst businesses.

Applying **two thresholds** and introducing the business gradually to the full VAT system, as applicable in the Netherlands, could (to a certain extent at least) mitigate this breaching effect. The downside of this, is that it **adds some complexity** and another threshold to monitor.

Other drawbacks identified were the following:

- The scheme might result in a **distortion of competition** between businesses performing only local supplies and businesses also operating cross-border, since the latter are in principle not covered by the scheme.
- Businesses and tax authorities **still have to monitor the threshold**. Especially where the net annual VAT is used as threshold, meaning that businesses have to monitor their tax due according to the precise conditions of the graduated relief scheme and combine it with a calculation of their tax due under the normal scheme. Complex calculations are therefore not uncommon under this regime.
- The scheme leads to a **potential loss of revenues for Member States** (possibly offset by the fact that these businesses need to be audited less).
- The scheme can be **complicated in its application**, since the business needs to calculate how much relief it will receive, as opposed to the SME exemption scheme where there is no need for such a calculation.

Overall effectiveness

The fact that such a scheme has been implemented only in three Member States suggests that **it is not seen as particularly effective**, notably given that two of the Member States providing graduated relief have not implemented an SME exemption, so that graduated relief is in a sense a replacement or substitute for a full exemption scheme.

As mentioned above, the **Spanish tax authorities consider it an effective measure**. However VAT advisors commented that the scheme does not necessarily reduce the burden to a significant level given that businesses are obliged to carry out all of the same IOs as the normal regime except for invoicing. Due to its complexity, the **Finnish tax authorities do not consider it an effective measure**, as it also involves significant manual administrative work for the tax authorities. The **Dutch**

¹⁶³ As explained, in this respect, studies have found evidence of 'bunching' behaviour of businesses immediately below the threshold (i.e. there is a very high concentration – or grouping – of businesses immediately the threshold), implying that businesses actively avoid breaching the threshold. See Harju, J. Matikka T. and Rauhanen T. (2015), The Effect of VAT Threshold on the Behaviour of Small Businesses: Evidence and Implications, CESifo Area Conference on Public Sector Economics.

¹⁶⁴ Which might even lead to turnover manipulation.

tax authorities consider that it does not fully deliver its objectives since it constitutes an exception to the general system and in general they favour a simple system.

Both the Finnish (higher threshold and simplification) and Dutch tax authorities (extension to legal persons) favour a broadening of its scope, possibly in order to make it more fit for purpose. For the tax authorities in Finland, though, the scheme would first have to be simplified, since it is not widely used, before it could be broadened (to other taxable persons) and would otherwise suggest terminating the regime. It should be noted that a broadening will not remove the so-called excess bunching effect of businesses remaining below the threshold. It will only reinforce the effect.

4.2.3 VAT flat rate scheme

Description of the scheme

The **flat rate scheme** provided in Article 281 of the VAT Directive allows Member States, who may encounter difficulties in applying the normal VAT arrangements to SMEs, to apply simplified procedures to VAT calculation, subject to specific conditions and after consulting with the VAT Committee¹⁶⁵. Any flat rate scheme implemented **must aim to reduce only the administrative burden** as opposed to the tax burden. It is often applied in fraud-sensitive sectors.

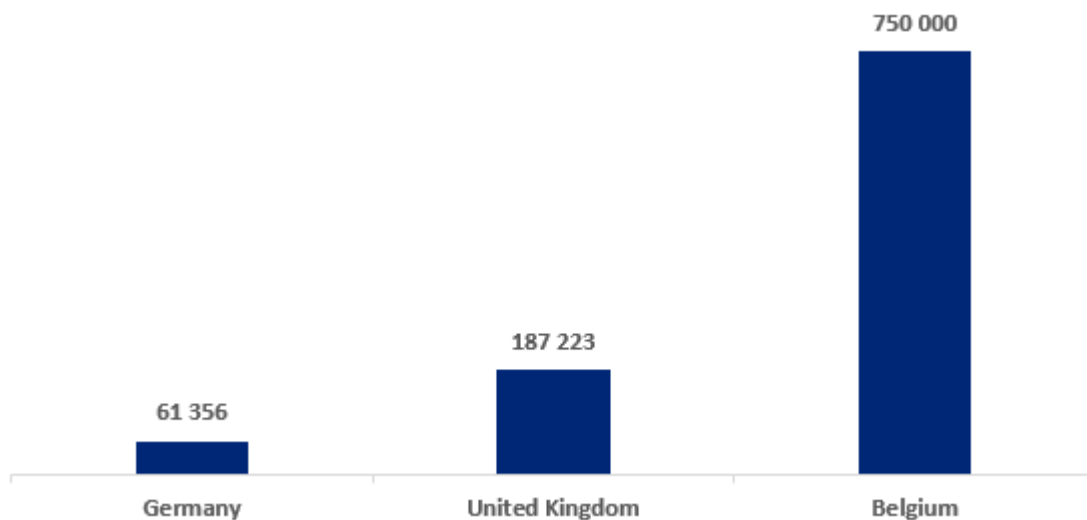
Application in the EU

Member States apply different types of flat rate schemes and their variation in nature and scope is significant. According to Article 281 of the VAT Directive, Member States are required to consult the VAT Committee before applying a special VAT scheme for SMEs. Information on the Member States' VAT Committee consultations on the application of SME special schemes has been provided in Volume II, Annex A.

Figure 30 below provides an overview of the **three Member States** that apply a general flat rate scheme and the applicable thresholds. For the other Member States using the flat rate scheme, eligibility is based on sectorial activity rather than on thresholds.

¹⁶⁵ The list of Member States that consulted the VAT Committee and for which topics can be found on: http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/vat_committee/consultations_vat_committee_en.pdf, consulted on 15 June 2016. The Member States that consulted the VAT Committee have not necessarily implemented the scheme at present.

Figure 30 – Flat rate thresholds applied in relevant Member States (EUR)



**Note: Thresholds based on annual turnover*

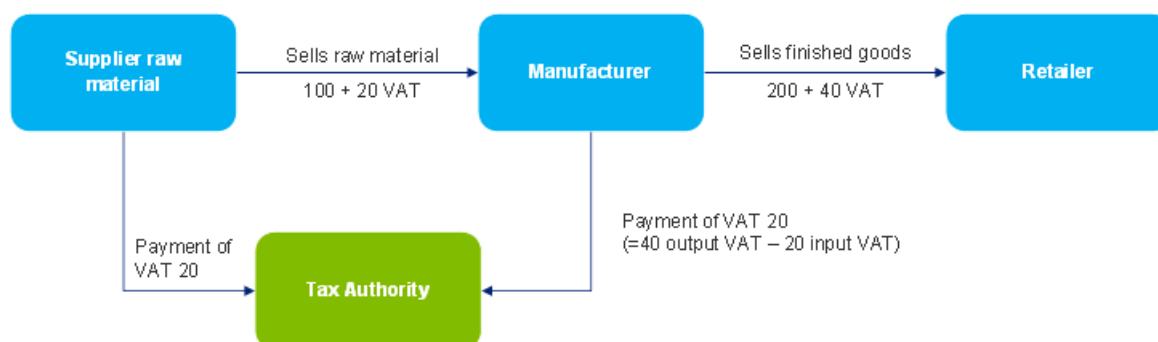
Source: Deloitte compilation of data from the Deloitte Tax Network Survey

SME flat rate schemes are **relatively popular among Member States** (as 8 out of 28 countries apply them). Information received from tax authorities (via survey and interviews) points out that such schemes are **however not widely used by eligible businesses**, as in many cases they are more complex to apply than the standard VAT regime, or because other schemes and/or simplifications are preferred (for instance, in Poland, where such a scheme is available only for taxi drivers, most taxi services instead make use of the SME exemption scheme if they are below the threshold.). It is therefore likely that businesses benefiting from flat rate schemes only represent a small share of the turnover generated by businesses of the same class size (and in the overall economy), and a corresponding minor share of VAT revenues for Member States.

Functioning and country specific features

Under the normal VAT rules, a taxable person must pay the national tax authorities the difference between VAT charged on their supplies (output VAT) and input VAT being reclaimed, resulting in either a net payment or repayment position (as described in Figure 31 below where the result is a net payment position).

Figure 31 – Example of VAT balance under normal VAT rules



Source: Deloitte elaboration

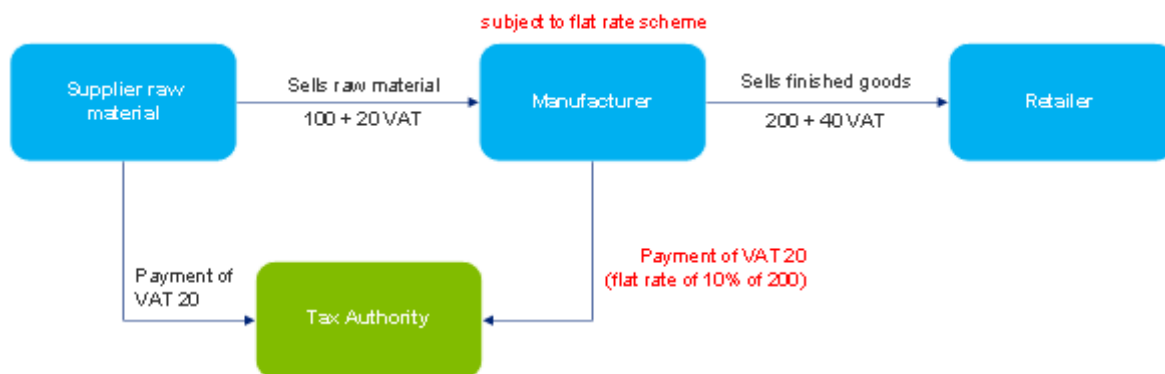
However, under a flat rate scheme a trader whose turnover is below the limits specified in national law may opt to join the scheme in order to **simplify the calculation of the VAT due**¹⁶⁶.

The designs of the flat rate schemes vary. In **the UK flat rate scheme**, if an SME chooses to apply the scheme, it will charge the normal VAT rate on outputs, but pay VAT to the tax authorities at a lower single rate (which may be calculated as a percentage of the turnover, including VAT charged) as determined by the tax authorities. A business qualifying for the scheme in the UK will pay a flat rate depending on the specific business sector. If it is active in the sector of accountancy or bookkeeping, the VAT flat rate is 14.5%. In advertising and agricultural services, it is 11%, and so on. The variable flat rates aim to reflect the average effective VAT rate in any specific sector taking into account reduced rates and recovery of VAT on inputs (i.e. estimated proportion of inputs). As the aim of the scheme is to provide simplification, not a tax advantage, the UK has decided to introduce from April 2017 a new general (not industry specific) flat rate of 16.5% which is mandatory for all businesses applying the scheme that qualify as 'limited cost traders' (less than 2% of turnover spent on purchasing goods), in order to address the identified aggressive abuse of the flat rate scheme by businesses whose input VAT costs are minimal (by additional use of artificial splitting of larger companies to become eligible).¹⁶⁷

¹⁶⁶ One Member State made the application of the flat-rate compulsory: Spain.

¹⁶⁷ HMRC guidance Tackling aggressive abuse of the VAT Flat Rate Scheme - technical note, <https://www.gov.uk/government/publications/tackling-aggressive-abuse-of-the-vat-flat-rate-scheme-technical-note/tackling-aggressive-abuse-of-the-vat-flat-rate-scheme-technical-note>.

Figure 32 – Example of VAT balance under flat rate scheme



Source: Deloitte elaboration

The example above (Figure 32) shows that in principle under a **general flat rate scheme** the tax burden ought to be equal to the tax burden in a normal situation, i.e. EUR 20¹⁶⁸. The difference is that the manufacturer did not have to calculate output VAT minus input VAT, but could limit itself to merely applying a flat rate on the output VAT. The simplification consists of the fact that the manufacturer does not need to perform an additional calculation.

In the example given above, the difference is straightforward. In the flat rate scheme, the only calculation which needs to be made by the business benefiting from it is a simplified calculation on its output VAT. When the calculation of the flat rate is rather complicated, it is possible however that the administrative burden of calculating the tax is not reduced and as seen from the UK scheme the tax burden is not always neutral either.

In most jurisdictions which have adopted the above style flat rate scheme, SMEs cannot recover input VAT, as shown in the example above. What the example above also shows, is that this is supposed to be compensated by the lower flat rate which should be equal to the situation where no such scheme applies. The manufacturer pays EUR 20 in both situations. As such, there should be no influence on the price for the customer, either in a B2B or B2C situation. Depending on the set-up of the flat rate scheme, opting to apply it can however sometimes be more financially beneficial, if the input VAT cost of the business is below the average of the industry¹⁶⁹.

Some Member States choose to adopt what is known as a **simplified input tax credit flat rate scheme**. In this case, the SME charges VAT on outputs in accordance with the regular VAT provisions but deducts a fixed input tax sum from the amount due. **Such a scheme applies in Germany**, for example, where SME traders, subject to certain conditions, can calculate the input tax which may be recovered on the basis of a fixed amount (i.e. a flat rate) applicable to the overall turnover, thereby relieving the business of some administrative burden.

The purpose of such a simplified flat rate schemes is to reduce the administrative burden for SMEs, as it is not necessary to determine the recoverability of VAT on a line by line basis with respect to items of expenditure.

¹⁶⁸ However, as noted in the UK the flat rate is calculated on gross amount (i.e. 10% of EUR 240) resulting in slightly higher tax burden than in regular VAT regime (EUR 24 instead of EUR 20)

¹⁶⁹ As above, wide-ranging abuse of such tax benefit has been now tackled in the UK by a specific measure.

Foregoing the right to recover input VAT as part of a flat rate scheme is not consistent practice across the EU. For example **in Belgium**, SMEs that meet certain criteria have their annual turnover (basis for the output VAT) set under special regulations (on the basis of variables such as hours worked, purchases made, etc.) with the deduction of inputs based on the normal rules for VAT recovery.

In Spain the scheme works again slightly differently. A Spanish taxable person benefiting from the flat rate scheme will pay both VAT and the recargo de equivalencia to its supplier. It is as if the taxable person pays a higher VAT. In return though, the taxable person is released from a number of obligations (such as obligation to submit VAT returns), which is the main benefit for businesses applying the scheme, compensating for the slightly higher tax burden. For example, a Spanish taxable person benefiting from the regime will pay on the purchase invoice for an amount of EUR 3 000 the 21% VAT (EUR 630) but also the recargo de equivalencia of 5.2% (EUR 156). In total the taxable person will pay the supplier EUR 3 786. The supplier will pay 786 to the treasury (instead of the normal EUR 630).

As demonstrated in Table 8 below, in almost all of the Member States having implemented it, the SMEs under the flat rate scheme can benefit from simplified tax and accounting obligations¹⁷⁰. Under the flat rate scheme, businesses are allowed to account for VAT in a simplified way¹⁷¹. Generally, half of the Member States applying the flat rate scheme allow non-established businesses to apply it. This means that the flat rate scheme is open to both locally established businesses and non-established businesses (e.g. established in another Member State).

In terms of the supplies covered by the flat rate scheme, in most of the Member States the scheme solely covers domestic supplies (generally locally supplied goods and services, other than, e.g., intra-EU supplies or export/import, even when supplied by a non-established business). Any intra-EU supplies are then not covered by the scheme and the general rules apply. The flat rate scheme is also generally reserved for specific sectors. Amongst others the following sectors and/or activities can be given as an example:

- ❑ Handcraft sector;
- ❑ Gastronomy sector;
- ❑ (Coastal) fishery;
- ❑ Exploitation of horse drawn vehicles;
- ❑ Door-to-door sales of gas, milk or bread;
- ❑ Supply of bread by bakeries;
- ❑ Taxi services;
- ❑ Hairdressers;
- ❑ Retailers that sell to the general public;
- ❑ Hotel and leisure industry (including cinemas, theatres and public shows);
- ❑ Restaurants, bars, kiosks, etc.;
- ❑ Dry cleaners, repair services;
- ❑ Car parking, taxi services and public transport;
- ❑ Butchers; and

¹⁷⁰ E.g. an exemption to keep accounting books.

¹⁷¹ Several options are possible:

- The SME covered by the scheme accounts for VAT due based on a specific basis or a different taxable base than outgoing supplies (e.g. number of bags of flour purchased by a baker or weight of purchased coffee); or
- The SME covered by the scheme accounts for VAT applying the special lower flat rate; or
- A combination of both.

➤ Retailers in books.

The mentioned sectors are mostly labour-intensive sectors.

Table 8 below shows an overview of how the flat rate scheme functions in all Member States which have implemented it. It is based on a survey conducted with the Deloitte tax expert network.

Table 8 – Applicable features of the VAT flat rate scheme per Member State

Member State	Accounting for VAT based on a specific basis or a different taxable base than regular turnover*	Accounting for VAT applying the special lower flat rate(i.e. not regular/standard VAT rate)	Right to deduct input VAT	Simplified accounting obligations	Exempt from other tax obligations
Belgium	✓	✗	✓	✓	✓
Cyprus	✓	✗	✗	✗	✗
Germany	✗	✓	✓	✓	✗
Greece	✓	✓	✗	✓	✓
Malta	✓	✗	✓	✓	✗
Poland	✗	✓	✗	✓	✓
Spain	✓	✗	✗	✓	✗
The United Kingdom	✗	✓	✗**	✓	✗

* Note: for example number of bags of flour purchased by a baker or weight of the purchased coffee.

** Note: some exceptions are in place

What can be concluded from the above overview, is that generally Member States either apply a special lower flat rate (on the regular turnover), or allow taxable persons to account for VAT based on a specific (e.g. limited) basis or a different basis than general turnover (but applying the standard VAT rate). The only Member State which has both (i.e. specified basis and a special lower flat rate) is Greece.

Quantitative analysis on take-up of the scheme, including cross-border dimension

The **take-up rate of the flat rate scheme** was not available from all Member States. However, from the available data we can see that it **varies substantially across the Member States**.

In **Belgium**, it is estimated that approximately 3% of businesses in the eligible turnover bracket apply the flat rate scheme. This cannot be representative of all the eligible businesses however, since the flat rate scheme can only apply to certain activities. Data was not available on the number of businesses conducting these activities. From discussions with accountants and business associations, it was found that not many businesses opt for application of the flat rate scheme. For one of the accountants interviewed, approximately 10% of their client base (the majority of which were SMEs) were applying the scheme. Another accountant indicated that they had no clients using the scheme.

In the **UK**, the take-up of the scheme among eligible businesses is estimated at around 20%.

For the flat rate scheme, the **cross-border element** is not relevant. By their nature, the businesses that are eligible for the scheme are domestic and mainly based in service-oriented industries. Therefore no analysis of taxable cross-border transactions is required.

Compliance costs of the scheme

Analysis of the flat rate scheme indicates that the **businesses benefitting from the scheme do not necessarily enjoy reduced VAT-related obligations**.

The assessment of businesses' costs to comply with the flat rate scheme was carried out for four of the eight Member States selected for fieldwork (Belgium, UK, Poland and Spain). The following table lists the Information Obligations (IOs) that apply both within and outside of the special scheme, and summarises the compliance costs sustained by businesses.

The detailed analysis of the compliance costs can be found in Volume II, Annex G.

Table 9 – Annual compliance costs for businesses within and outside of the VAT flat rate scheme in Belgium

Member State	Within the flat rate Scheme		Outside of the flat rate scheme	
	Relevant IOs	Overall costs (yearly basis)	Relevant IOs	Overall costs (yearly basis)
Belgium	<ul style="list-style-type: none"> ☒ VAT registration ☒ Applying for special scheme ☒ Invoicing (re domestic) ☒ VAT declarations/returns 	<p>EUR 9 406</p> <p>(of which advisory fees: EUR 3 375)</p>	<ul style="list-style-type: none"> ☒ VAT registration ☒ Invoicing (re domestic) ☒ VAT declarations/returns ☒ VAT payment (domestic) 	<p>EUR 9 217</p> <p>(of which advisory fees: EUR 3 375)</p>

Member State	Within the flat rate Scheme		Outside of the flat rate scheme	
	Relevant IOs	Overall costs (yearly basis)	Relevant IOs	Overall costs (yearly basis)
	<ul style="list-style-type: none"> ☑ VAT payment (domestic) ☑ Bookkeeping 		<ul style="list-style-type: none"> ☑ Bookkeeping 	
Spain	<ul style="list-style-type: none"> ☑ VAT registration 	One-off costs: EUR 50 for VAT registration	<ul style="list-style-type: none"> ☑ VAT registration ☑ Invoicing (re domestic) ☑ VAT declarations/ returns ☑ VAT payment (domestic) ☑ Bookkeeping 	EUR 1 952 (of which advisory fees: EUR 806)
UK	<ul style="list-style-type: none"> ☑ VAT registration ☑ Applying for special scheme ☑ Invoicing (re domestic) ☑ VAT declarations/returns ☑ VAT payment (domestic) ☑ Bookkeeping 	EUR 2 686 (of which are advisory fees: EUR 1 100)	<ul style="list-style-type: none"> ☑ VAT registration ☑ Invoicing (re domestic) ☑ VAT declarations/ returns ☑ VAT payment (domestic) ☑ Bookkeeping 	EUR 2 492 (of which are advisory fees: EUR 1 100)
Poland	<ul style="list-style-type: none"> ☑ VAT registration ☑ Applying for special scheme ☑ Invoicing (re domestic) ☑ VAT declarations/returns ☑ VAT payment (domestic) ☑ Bookkeeping 	No cost data could be collected in Poland	<ul style="list-style-type: none"> ☑ VAT registration ☑ Invoicing (re domestic) ☑ VAT declarations/ returns ☑ VAT payment (domestic) ☑ Bookkeeping 	EUR 4 245 (of which advisory fees: EUR 3 375)

Source: Deloitte compilation of data from fieldwork

As shown above, the **IOs** do not differ greatly between businesses inside the scheme and those outside of the scheme, except in Spain where there are almost no obligations aside from VAT registration. In Belgium and the UK however, businesses inside the scheme have to satisfy an additional IO, i.e. **applying for the special scheme**. However, this obligation was not indicated as being particularly burdensome and consists mainly of a simple submission to the tax authorities indicating the intention to apply the scheme.

It should be noted that slight variations may occur with regard to the **VAT return** within and outside of the scheme. Accountants in Belgium indicated that the return under the flat rate scheme can actually be more burdensome than the normal VAT return. This is because the flat rate scheme requires an additional calculation (i.e. **calculation of the taxable turnover**)¹⁷². Although only a minor calculation, it still requires an additional effort on the part of the accountant dealing with the VAT return. In addition, a document explaining the calculation must also accompany the VAT return. Despite the addition of an administrative task which should in theory make the flat rate scheme more costly to comply with, accountants for businesses within the scheme indicated that there were no extra costs incurred for this. This is due to software which can easily carry out the calculations automatically.

¹⁷² Based on three options as explained in Annex A – Section A3 Flat-rate scheme.

As with other schemes determined by thresholds, **'hidden' costs** are incurred for monitoring the threshold. Although thresholds are only applied in 4 out of the 8 Member States applying the flat rate scheme, similar monitoring would normally take place with regard to the activities conducted by the business. In Malta for example, the scheme only applies to door to door sales of gas, milk or bread; supplies of bread by bakers; supplies of fuel from pumps; supplies of food and beverages by a canteen situated in a work or study area; and supplies of goods by vending machines, thus the business would have to monitor its activities to ensure conformity with these requirements. As above, the cost for monitoring thresholds and activities can be estimated at approximately EUR 193 per business per year. This cost is taken into account in the estimated costs for a business in the EU operating under the flat rate scheme (see Table 10 below).

Table 10 – EU average annual compliance costs for businesses within and outside of the flat rate scheme

Member State	Within the flat rate scheme		Outside of the flat rate scheme	
	Relevant IOs/costs	Overall costs (annual basis)	Relevant IOs/costs	Overall costs (annual basis)
EU Average	<ul style="list-style-type: none"> ➤ VAT registration ➤ Applying for the special scheme ➤ Invoicing (re domestic) ➤ VAT declarations/-returns ➤ VAT payment (domestic) ➤ Bookkeeping <p>Hidden costs: monitoring threshold/-activities</p>	<p>EUR 3 022</p> <p>(of which advisory fees: EUR 1 270; of which are hidden costs: EUR 193)</p>	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/-returns ➤ VAT payment (domestic) ➤ Bookkeeping 	<p>EUR 2 964</p> <p>(of which advisory fees: EUR 1 023)</p>

Source: Deloitte compilation of data from fieldwork

Overall, the average costs for the flat rate scheme at EU level are **higher** than the costs for businesses not using the scheme. Although the costs for business in the UK and Spain within the scheme are actually lower than the normal regime, the high administrative burden in Belgium has an adverse effect on the overall average. As mentioned above, in Belgium, the flat rate scheme does not necessarily reduce the administrative burden but is applied by businesses for the potential tax burden reduction, which is not the intended purpose of the scheme.

Fixed vs. variable costs

As mentioned before, **frequency of obligations** is an important driver of costs. With regard to the flat rate scheme in Belgium and the UK, there are no striking differences in variable costs between businesses within and outside of the scheme with regard to the frequency of obligations. In **Belgium**,

since businesses fall below the annual turnover of EUR 2.5 million¹⁷³ and can benefit from quarterly VAT reporting, there is no difference between those inside and outside the scheme. Similarly in the **UK**, reporting under the flat rate scheme is quarterly as in the standard VAT regime. In the Member States analysed, **Spain** is the only exception, as there are no VAT obligations whatsoever apart from registration.

As with the other schemes where invoicing is required, the **cost of invoicing** is strictly related to the number of invoices/fiscal receipts that businesses issue in a certain period of time. As explained before, the calculation of invoicing costs assumes an average number of 20 invoices/fiscal receipts per month and likewise the sensitivity analysis carried out for the flat rate scheme did not point to relevant effects. For instance, a 50% increase in the number of invoices per year, led to an overall increase in compliance costs of only about 12-15%¹⁷⁴. It is likely that automation of administrative tasks will further lower variable costs for businesses, while not necessarily reducing fixed costs (for instance, for purchasing and/or updating specific software, etc.).

In-house vs. outsourcing costs

Similar to the other special schemes analysed, businesses using the flat rate special scheme have external **advisors/accountants** to support them with tax-related issues (VAT, but also for income taxes and social security).

The reasons for employing external advisors are the lack of resources to deal with administrative and fiscal obligations (in relation to VAT, income and social security), frequent changes in the legislative framework, the necessary investments in specific accounting software (and a related learning curve to become familiar with the new procedures).

At an EU level, the average costs of accountants/advisory services for businesses within the flat rate scheme amount to approximately EUR 1 270, which is slightly higher than the fees for those outside the scheme.

Advisory fees include also the costs of specific accountancy software that accountants and advisors purchase.

The table below provides estimated advisory fees for businesses in each analysed Member State within and outside of the scheme.

Table 11 – Average advisory fees within and outside the VAT flat rate scheme

	Average advisory fees (annual)	
	Within the scheme	Outside the scheme
Belgium	EUR 3 375	EUR 3 375
Spain	No advisory related costs	EUR 806
UK	EUR 1 100	EUR 1 100
Poland	No cost data could be collected in Poland	EUR 3 375

Source: Deloitte compilation of data from fieldwork

¹⁷³ Note that this threshold is EUR 250 000 when the taxable person is active in one of the following sectors: energy generating products, cell phones and computers, land motorised vehicles which need to be registered.

¹⁷⁴ See Volume II, Annex G, Section G.1: 'Flat-rate scheme' for more details.

Evidence of the effectiveness of the schemes

Based on the data gathered during fieldwork, the flat rate scheme does not appear to have significant beneficial impacts on the administrative burden of businesses applying it.

Advantages

The main advantage of the flat rate scheme is the **potential for simpler VAT calculations** for businesses, taking into account that Article 281 of the VAT Directive foresees that the overall tax amount cannot be smaller.

Nevertheless, **although not anticipated, the scheme may provide financial benefit** in circumstances where input VAT is below the level ordinarily faced by businesses. In other words, if the input VAT deduction taken into account for the calculation in reality is lower, then businesses are better off.

In **Belgium**, in terms of administrative burden, the advantages of the scheme are:

- ✔ No obligation on the business to keep a journal of daily receipts;
- ✔ No obligation to keep documents for goods given away or used for personal purposes.

Similarly, in the **UK**, the benefit of the scheme is that by applying a fixed percentage, the output VAT due is calculated as a single figure and the business therefore has simple VAT records.

In **Spain**, businesses do not have to comply with any VAT obligations apart from registering, as under the scheme, VAT is assessed by the suppliers of goods charging a surcharge (in addition to the VAT chargeable) to the retailers. By requiring suppliers to apply this surcharge, retailers are exempted from the obligations to report and remit VAT.

In general, the **tax authorities** in the Member States regard the flat rate scheme as effective mainly because the **administrative costs on tax authorities are minimal**. In the UK, it was noted that flat rate applications are processed automatically and only require manual intervention, where there is an error on the form. Similarly in Spain, the tax authorities communicated that they did not incur any additional administrative costs for the scheme.

Disadvantages

The main disadvantage of the flat rate scheme is that **it does not work in the same way for all types of business**. An important factor with regard to the businesses applying the scheme is that there may be businesses applying the scheme merely because it is advantageous for them in terms of the VAT they remit to the tax authorities.

It was further noted that **understanding the scheme is difficult for some businesses**. In the UK and Belgium, it is important to first understand the functioning of the scheme (which is deemed complicated by many businesses) and then to understand whether the scheme would be beneficial or not.

Businesses benefiting from the flat rate scheme also often cannot recover any input VAT. This is often quoted as a disadvantage but is an inherent characteristic of the scheme.

Specific to Belgium is the additional accounting calculation of the taxable turnover. This is not only an additional administrative burden, but the taxable base may not be reflective of the real situation (i.e. if the business turnover is significantly below the average).

Further, the scheme does not apply to cross-border transactions.

From the perspective of the tax authorities in the UK, the fact that businesses can **manipulate the scheme to arrive at the most beneficial value** for them is a drawback of the scheme, evidenced by the recently perceived aggressive abuse which will be tackled by legislative changes to the scheme (see above). Therefore another drawback is that in certain countries the scheme may be prone to fraud.

Effectiveness

Overall, the effectiveness of flat rate scheme is mixed among the Member States, whilst the **general flat rate schemes seem more effective (UK, Spain) than the specific ones (Belgium)**.

On the one hand, in Belgium, there does not seem to be much incentive to apply the flat rate scheme and take up of the scheme is very low. On the other hand, in Spain and the UK, the flat rate scheme is more widely applied and is deemed to have less burdensome obligations than those under the normal regime.

One of the main reasons for applying the scheme was attributed to **financial benefits** rather than administrative burden reduction, which ought to be the main objective. In some cases, depending on the sector of business and the volume of sales, a business may benefit from paying less VAT when applying the flat rate scheme. This is mainly because the VAT margin applied to the business' stock is based on an average. Where a business is earning more than the average it ultimately benefits from paying less VAT than it should. In Belgium, it was indicated that this is particularly the case within the textile industry, where the average margin to be applied to the stock is not reflective of the current situation. In the UK, service sectors (i.e. 'labour-only' businesses) were identified as unduly benefitting from the scheme.

Another reason indicated for applying the scheme is **habit**. Accountants indicated that businesses that are familiar with the scheme (over a long period of time) are reluctant to change. Also, since in some countries the flat rate scheme applies to sectors which are typically 'family-run' businesses, the familiar system of accounting for VAT continues through generations.

The main reason for the low uptake of the flat rate scheme can be attributed to **digitalisation** and the improved system of VAT compliance. Accountants indicated that because of modern bookkeeping and accounting software, businesses can easily identify the most beneficial taxation scheme for them and that the flat rate scheme is no longer perceived as beneficial.

With regard to **administrative burden**, despite its potential to lessen the burden upon businesses, the take-up of the scheme is not normally attributed to this feature. As expressed above, the main reason for businesses applying the scheme is to benefit from paying a reduced amount of VAT to the authorities and reluctance to change.

4.2.4 Cash accounting scheme

Description of the scheme

The **cash accounting** scheme is an SME special measure which allows a business to account for and pay VAT on the basis of cash (or other consideration¹⁷⁵) paid and received, rather than on an accrual (invoice) basis. Under the normal VAT rules, a business must account for the tax due on an accruals basis so that VAT is accounted for on sales, or reclaimed on purchases, regardless of the amounts being paid or not.

In contrast, under cash accounting, VAT becomes **chargeable** on sales only once cash has been received by the trader. Similarly, in most countries input tax can be claimed only when the cash has been paid on a purchase. However, some Member States apply cash accounting only to outputs.

The **legal basis** for cash accounting on outputs is Article 66(b) of the VAT Directive. The VAT Directive foresees no threshold for the cash accounting scheme applied to outputs.

With respect to **input VAT deduction**, the legal basis is a combination of Articles 66(b) and 167a of the VAT Directive. The legislation sets out that the full cash accounting scheme (that is, applying to both output and input) is available to SMEs whose turnover is below EUR 500 000. Alternatively, following consultation¹⁷⁶ with the VAT Committee, a country may apply to use a higher threshold up to a maximum of EUR 2 000 000 (or the equivalent in national currency).

The **rationale** for the cash accounting scheme is to assist SMEs with their **cash flow management** by deferring tax payments until the customer has effectively paid for the items and providing immediate relief in the instance of bad debts, i.e. where the customer is unable to settle the debt. Importantly, the scheme is not designed to reduce the tax or administrative burden to a business. The intention of the scheme is to move the tax point to the stage where cash has been exchanged. As such, there is no direct impact on the customer, neither in a B2B nor B2C relationship.

With respect to the application of the cash accounting scheme on **inputs**, this is normally tied with the application of the cash accounting scheme on outputs. To a certain extent, it reduces the business benefits of applying the cash accounting scheme on outputs, since the business will only be able to deduct input VAT when having settled the invoice received. This is different from the situation of a business not applying cash accounting on its invoices received, since it can deduct VAT upon receipt of the invoice, without necessarily having paid it to their supplier. In other words, in order to help SMEs manage their cash flow, the best result is achieved when it is only applied on **outputs**. This can however have a drawback, since accrual accounting in terms of inputs may be fraud sensitive (in the sense that VAT is already deducted but not yet paid to the supplier). Cash accounting specifically targeted for SMEs is therefore mandatorily applied on both inputs and outputs.

¹⁷⁵ A consideration is any form of payment in money or in kind, including anything which in itself is a supply.

¹⁷⁶ Italy, Austria, Spain, Greece and Latvia have done so. For an overview of the consultations of the VAT Committee, see http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/vat_committee/consultations_vat_committee_en.pdf, consulted on 15 June 2016.

Application in the EU

SME specific cash accounting schemes are applied in the **large majority** of Member States (24 Member States), with the exception of Belgium, the Czech Republic, Denmark and France. This does not necessarily mean that there is no cash accounting available for businesses in those countries, just that there is no cash accounting scheme specifically targeted towards SMEs (i.e. with a turnover-related threshold or industry specific application).

Belgium and **France**, for example, have cash accounting schemes which are not SME specific. Belgium allows the application of the cash accounting scheme for supplies of movable goods and services to private persons for which the business is not required to issue an invoice. France applies cash accounting for most services, with the possibility for the supplying business to opt out.

In practice, there is a significant variation between the Member States in terms of the way that the scheme is operated.

Threshold

As previously mentioned, for a business to use cash accounting it must stay below a pre-defined threshold. The level of the threshold **varies across the EU**. **Cyprus** applies the lowest threshold of all Member States; the value of transactions carried out in a period of twelve months cannot exceed EUR 25 000. In contrast, **Spain, Ireland, Italy and Malta** all apply the maximum threshold of EUR 2 000 000. More recently, in **Finland**, cash accounting for businesses with a threshold of EUR 500 000 turnover per accounting period was adopted (January 2017).

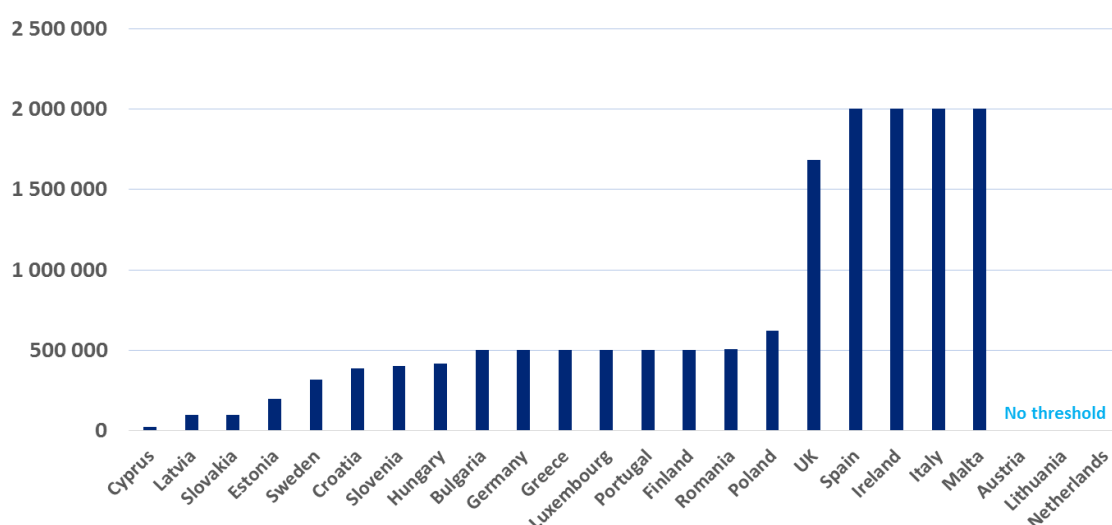
In the **UK**, to reduce incentives for SMEs to remain below the threshold, a flexible threshold is implemented which permits businesses to exceed the threshold to certain extent without losing the ability to use the scheme. This means that the trader must initially have met the fixed threshold (i.e. taxable supplies must not exceed approximately EUR 1 710 000¹⁷⁷, but whilst using the scheme there is no requirement for the business to leave, provided turnover does not exceed EUR 2 028 000¹⁷⁸).

The following figure provides an overview of all the Member States that apply the cash accounting scheme to SMEs. In **Austria** for unregulated, self-employed businesses there is no threshold, in **Lithuania** cash accounting applies only for agricultural businesses and in the **Netherlands** only to listed categories of locally trading taxable persons (hairdressers, shopkeepers, shoe repair etc.). Although strictly speaking there is no threshold for these two countries, by definition we would expect them to fall within the SME category.

¹⁷⁷ GBP 1 350 000.

¹⁷⁸ GBP 1 600 000.

Figure 33 – Cash accounting thresholds applied in relevant Member States (EUR)



Source: Deloitte compilation of data from the Deloitte Tax Network Survey¹⁷⁹

Functioning of the cash accounting scheme

The following elements are usually features of the cash accounting scheme.

- Optional application (or notification) to use the cash accounting scheme¹⁸⁰, provided businesses are below the cash accounting threshold (if any);
- Businesses may need an approval for the application of the scheme;
- Business are sometimes required to stay in the scheme for a specified period (provided they do not exceed the threshold);
- Businesses charge the normal rate of VAT on all supplies;
- Businesses account for (and pay) VAT only on supplies where the customer has paid; and
- Businesses can deduct input VAT only on purchases they have paid for (where the scheme applies to both output and input).

It is important to note that the scheme involves **additional accounting obligations** that may make it less appealing to businesses. As accounting legislation requires businesses usually to apply accrual accounting, businesses would need to implement separate cash based accounting for VAT calculation purposes in order to apply the cash accounting scheme.

Other VAT obligations apply as usual such as invoicing and record keeping, but there may be specific additional requirements (e.g. a reference on the invoice).

There are some **variations** to how the above general elements apply across the Member States. Examples of the differences include varying requirements in relation to the need to notify or apply to the tax authorities to use the scheme, and the need for a registration. In some Member States, businesses can only apply the cash accounting scheme with respect to their outputs, and not their inputs (as is the case for Germany, Ireland, the Netherlands and Lithuania). In some cases, there are

¹⁷⁹ With updates to include the introduction of cash accounting in Finland on 1 January 2017. This is not included in the impact assessment calculations.

¹⁸⁰ In the Netherlands however, cash accounting is applied by default and business needs to notify tax authorities if wishes to opt out.

additional requirements with respect to record keeping in order to determine whether payment has actually occurred or to distinguish between supplies subject to the cash accounting regime and supplies that are not covered. We have set out the differences more comprehensively in Volume II, Annex A to this report.

Table 12 shows an overview of how the cash accounting scheme functions in all Member States which implemented it. It is based on a survey conducted with the Deloitte tax expert network.

Table 12 – Applicable features of VAT cash accounting schemes per Member State

Member State	Requirement to apply for the scheme or notify the tax authorities	Requirement to stay in the scheme for a certain amount of time	Business accounts for and pays VAT only when customer has paid	Business can deduct input VAT only on purchases it has paid for	Other VAT obligations still applicable
Austria	✗	✗	✓	✓	✓
Bulgaria	✓	✓	✓	✓	✗
Cyprus	✓	✓	✓	✓	✓
Croatia	✓	✓	✓	✓	✓
Estonia	✓	✗	✓	✓	✓
Finland	✗	✗	✓	✓	✓
Germany	✓	✗	✓	✗	✓
Greece	✓	✓	✓	✓	✓
Hungary	✓	✓	✓	✓	✓
Ireland	✓	✗	✓	✗	✓
Italy	✗	✓	✓	✓	✓
Latvia	✓	✓	✓	✓	✓
Lithuania	✓	✓	✓	✗	✓
Luxembourg	✓	✓	✓	✓	✓
Malta	✓	✗	✓	✓	✓
Netherlands	✗ ¹⁸¹	✗	✓	✗	✓

¹⁸¹ In the Netherlands, the cash accounting scheme is applied by default and business needs to notify when opting out.

Member State	Requirement to apply for the scheme or notify the tax authorities	Requirement to stay in the scheme for a certain amount of time	Business accounts for and pays VAT only when customer has paid	Business can deduct input VAT only on purchases it has paid for	Other VAT obligations still applicable
Poland	✓	✓	✗	✓	✓
Portugal	✓	✓	✓	✓	✓
Romania	✓	✓	✓	✓	✓
Spain	✓	✗	✓	✓	✓
Sweden	✓	✗	✓	✓	✓
Slovenia	✓	✗	✓	✓	✓
Slovakia	✓	✓	✓	✓	✓
UK	✗	✗	✓	✓	✓

Source: Deloitte compilation of data from the Deloitte Tax Network Survey

Quantitative analysis on take-up of the scheme, including cross-border dimension

Information from Member States (from interviews and surveys of tax authorities) point out that the **share of eligible businesses actually adopting the scheme is quite low.**

Data from tax authorities in Italy show no more than 2-3% of eligible businesses decided to adopt the cash accounting scheme. Data from Bulgaria also shows that businesses do not opt for the scheme very often; from the data provided by the tax authorities it was calculated that only around 0.05% of eligible businesses apply the cash accounting scheme. Data from Luxembourg, although it was not possible to calculate an approximate take-up rate, points to a higher take-up of the cash accounting scheme.

This low participation rate in some Member States is **usually attributed to the additional accounting obligations** related to this scheme, that in many cases make it less appealing to businesses. However, another reason may be that very general eligibility criteria result (statistically) in a large group of eligible businesses, only a small portion of which may actually need cash flow support (not necessarily related to their level of turnover, but perhaps trade specific). Therefore, a number of tax authorities reported that the scheme is still effective, probably as businesses who do need cash flow support can apply it, thus it delivers its objective.

Based on the low take up, it is likely that businesses benefiting from cash accounting schemes only represent a small share of the turnover generated by businesses of the same class size (and in the all economy), and a corresponding minor share of VAT revenues for Member States. In addition, as this scheme does not involve any exemption from VAT, but merely a different timing for the payment, the implications for VAT revenues of Member States are extremely limited when the scheme is only limited to SMEs. This was confirmed by the tax authorities of the Member States interviewed during fieldwork¹⁸².

Compliance costs of the scheme

The assessment of businesses' costs to comply with the obligations of the cash accounting scheme was carried out for three out of the eight Member States selected for fieldwork (Estonia, Italy and Romania).

The full analysis is provided for Italy only. Data collected in Romania was from accountants only, thus the costs for businesses could not be accurately quantified. In Estonia, it was not possible to identify and interview any business using the cash accounting scheme (the take up in Estonia is extremely low, mostly just sole traders).

The detailed analysis of the compliance costs can be found in Volume II, Annex G.

¹⁸² Although potential VAT revenue/budgetary impact was mentioned as one of the reasons by a Member State that has decided not to apply the scheme. Another reason mentioned was increased complexity from a dual VAT system.

Table 13 – Annual compliance costs for businesses within and outside of the cash accounting scheme in selected Member States

Member State	Within the cash accounting scheme		Outside of the cash accounting scheme	
	Relevant IOs	Overall costs (yearly)	Relevant IOs	Overall costs (yearly basis)
Italy	<ul style="list-style-type: none"> ☒ VAT registration ☒ Applying for the scheme ☒ Invoicing (re domestic) ☒ VAT declarations/returns ☒ VAT payment (domestic) ☒ Bookkeeping 	EUR 3 521 (of which advisory fees: EUR 1 815)	<ul style="list-style-type: none"> ☒ VAT registration ☒ Invoicing (re domestic) ☒ VAT declarations/returns ☒ VAT payment (domestic) ☒ Bookkeeping 	EUR 2 907 (of which advisory fees: EUR 1 015))
Romania	<ul style="list-style-type: none"> ☒ VAT registration ☒ Invoicing (re domestic) ☒ VAT declarations/returns ☒ VAT payment (domestic) ☒ Bookkeeping 	EUR 2 500 (of which are advisory fees: EUR 2 215) ¹⁸³	<ul style="list-style-type: none"> ☒ VAT registration ☒ Invoicing (re domestic) ☒ VAT declarations/returns ☒ VAT payment (domestic) ☒ Bookkeeping 	EUR 2 500 (of which are advisory fees: EUR 2 215) ¹⁸⁴

Source: Deloitte compilation of data from fieldwork

The cash accounting scheme is designed with the main objective of **providing assistance in cash-flow** management to businesses, rather than reducing the administrative burden. Such support is particularly relevant for businesses supplying goods or services to a very limited number of (larger) companies, which may be paying for such supplies with a delay of a few months.

Compared to the standard VAT scheme applicable to similar businesses, the cash accounting schemes **does not present with different relevant IOs**. In Italy, the only additional IO business have to comply with is the application to tax authorities for benefiting from the scheme, which however does not represent a relevant cost (less than 1% of the total compliance costs for such a measure).

Overall, based on analysis of data from Italy and our expert assessment, the compliance costs for businesses benefiting from the cash accounting measure are slightly higher than the compliance costs for businesses in the standard VAT system (about **17% higher** in the case of Italy).

The **main drivers of higher compliance costs** for the cash accounting scheme are the **bookkeeping obligations and the advisory fees**. The use of the cash payment or receipt as a basis for the obligation to account for VAT (especially when applied both for input and output VAT) obliges businesses to keep records of invoices as well as of the related cash flows, which they would not do otherwise. This translates into increased bookkeeping obligations, which tend to increase the in-house compliance costs (if carried out internally) or the advisory fees (if outsourced to accountants).

¹⁸³ Only accountants were interviewed in Romania therefore the costs for businesses in-house may be underestimated.

¹⁸⁴ *ibid*

Bookkeeping costs for businesses adopting the cash accounting scheme tend to be higher than those of businesses in the standard VAT system (about **14% higher** than the bookkeeping costs for similar businesses not adopting this measure).

Overall, the **advisory fees** tend to be higher for businesses using the cash accounting system, to account for the increased record keeping (about **40% higher** in the case of Italy).

As with other schemes determined by thresholds, ‘hidden costs’ are incurred for monitoring the threshold. As above, the cost for monitoring thresholds and activities can be estimated at approximately EUR 193 per business per year. This cost is taken into account in the estimated costs for a business in the EU operating under the cash accounting scheme (see Table 14 below).

Table 14 – EU average annual compliance costs for businesses within and outside of the cash accounting scheme

Member State	Within the cash accounting scheme		Outside of the cash accounting scheme	
	Relevant IOs/costs	Overall costs (annual basis)	Relevant IOs/costs	Overall costs (annual basis)
EU Average	<ul style="list-style-type: none"> ➤ VAT registration ➤ Applying for the special scheme ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ VAT payment (domestic) ➤ Bookkeeping <p>Hidden costs: monitoring threshold/-activities</p>	<p>EUR 3 865</p> <p>(of which advisory fees: EUR 2 000; of which are hidden costs: EUR 193)</p>	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ VAT payment (domestic) ➤ Bookkeeping 	<p>EUR 2 964</p> <p>(of which advisory fees: EUR 1 023)</p>

Source: Deloitte compilation of data from fieldwork

Fixed vs. variable costs

Frequency of the obligations is an important driver of compliance costs. Also, businesses applying cash accounting scheme can in some countries benefit from additional simplification measures, such as reduced frequency of reporting obligations (which are not linked to the scheme, but can be applied by businesses meeting the same or similar eligibility criteria (usually just turnover threshold)). As mentioned above, in Italy, even outside of the SME exemption scheme, businesses (such as the ones applying the cash accounting scheme) can benefit from simplification measures that reduce the frequency of obligations (such as quarterly VAT returns instead of monthly, up to a threshold of EUR 400 000 for services/ EUR 700 000 for other supplies), and thus the related costs.

The **cost of invoicing** is strictly related to the number of invoices/fiscal receipts that businesses issue in a certain period of time. As in the case of the other schemes, the volume of invoices has a limited impact on the compliance costs for businesses (both within and outside of the cash accounting scheme). The standard sensitivity test performed for the analysis did not point to relevant effects. For

instance, a 50% increase in the number of invoices per year led to an overall increase of compliance costs of 12-22%.

Overall, within the sample selected for this analysis, businesses opting for the cash accounting scheme tend to be larger than those in the SME exemption scheme or in the graduated relief scheme, and tend to have more resources to invest in IT systems for managing the business and carrying out part of the accounting obligations.

In-house vs. outsourcing costs

Similar to the VAT special schemes analysed in the previous sub-sections, businesses using the cash accounting scheme have external advisors/accountants to support them with tax-related issues (VAT, but also for income taxes and social security).

The reasons for employing external advisors are the lack of resources to deal with administrative and fiscal obligations (in relation to VAT, income and social security), frequent changes in the legislative framework, the necessary investments in specific accounting software (and a related learning curve to become familiar with the new procedures).

As mentioned before, the advisory fees tend to be higher for businesses using the cash accounting systems, to account for the increased record keeping (about 40% higher in the case of Italy). However, accountants in Romania noted that there was no difference in their fees with regard to the application of schemes.

The table below provides estimated advisory fees for businesses in each analysed Member State within and outside of the scheme.

Table 15 – Average advisory fees within and outside the cash accounting scheme

	Average advisory fees (annual)	
	Within the scheme	Outside the scheme
Italy	EUR 1 815	EUR 1 015
Romania	EUR 2 215	EUR 2 215 ¹⁸⁵

Source: Deloitte compilation of data from fieldwork

Evidence of the effectiveness of the schemes

In general, the cash accounting scheme is implemented by a number of Member States as a measure to support the cash flow management of SMEs. Despite the generally low take up, the scheme is important for specific small businesses that face potential cash flow issues. This could be for example where the main customer of the SME is a large business that regularly pays its invoices late.

Advantages

The primary benefits of the scheme are (i) **reduction of the cash flow burden**; and (ii) **immediate bad debt relief** (where it is included).

¹⁸⁵ See footnote to Table 5 above in relation to some reasons for high advisory fees in Romania.

The scheme does not reduce the tax burden of the business as the aim is simply to defer the timing of the tax accounting to the point where consideration has been exchanged.

Disadvantages

The first main drawback of the scheme is that, where input tax may only be recovered on a cash basis **recovering input tax is delayed** and can create cash flow issues for the SME business. Furthermore, the need to take into account cash movements for the VAT reporting can create an additional administrative burden on SMEs as a result of **increased administrative obligations**, for example in terms of record keeping (which supplies are subject to the cash accounting scheme and which are not) and **carrying out cash based accounting for tax calculations** in addition to accrual accounting if required for general accounting purposes.

Indeed, businesses need to follow up on whether an invoice has been paid in order to settle VAT on time, whereas in a normal situation they merely monitor the chargeable event. De facto, cash accounting adds another obligation to the regular administrative obligations, i.e. the keeping of a list to compare invoices issued with payments. The additional obligations exist so that tax authorities can better monitor the financial movements of the businesses on inspection. However, this can have the effect of discouraging businesses that meet the eligibility requirements from adopting cash accounting, as it complicates VAT accounting.

Other disadvantages identified included the following:

- Where it is necessary to first apply to the tax authorities to use the scheme, there will be an additional administrative burden for business from submitting the application and increased administrative costs for the tax authorities in relation to the processing of applications;
- There is a risk of potential fraud in circumstances where output tax is due in accordance with cash accounting rules but input tax may still be deducted by the recipient under the normal VAT system, for example a business may deduct input tax (which may possibly not be due yet or not be due at all), charge output tax to the final customer, but disappear before accounting for this to the tax authorities.

Effectiveness

Interviews with businesses, accountants and tax authorities highlighted that the implementation of the **cash accounting scheme is relevant in supporting businesses** in their cash flow management.

However, such schemes usually **require records to be kept of each transaction twice**, once on accrual, based on the issuing or receiving of invoices, the other based on the actual cash transfer (the amount of input and output VAT to declare in each periodic VAT return). Such additional record keeping (monitoring of cash flows is not required as part of the standard VAT obligations) increases compliance costs for businesses, however it could be considered as an inherent part of the scheme.

The **trade-off between better cash flow management and increased compliance costs** is such that businesses opt for this scheme only when the (expected) cash flow benefits compensate for the additional compliance costs.

The trade-off also explains the low take-up rate of the cash accounting schemes in Member States (assessed to be not above 2-3% of eligible businesses in the Member States implementing it and having provided information on take-up).

There is **no agreement on the effectiveness of the cash accounting scheme** among Member States that apply it, due to the trade-off between the improvement in cash flow management and the additional obligations set out by the scheme (which may vary in the relevant Member States).

Based on interviews carried out both with businesses and tax authorities, where the scheme is considered effective the cash flow advantage is cited as essential in supporting SME businesses to operate within the VAT system. However, in countries where the additional administrative tasks are considered onerous, there is a low uptake of the scheme as cash accounting does not include simplification measures and can therefore have the result of complicating VAT accounting.

4.2.5 Other simplifications

Many Member States have implemented additional simplifications to lower the administrative burden for taxable persons. These simplifications are not linked to the above described schemes, although may often be applied by the same businesses, as they are to a smaller or larger extent targeted towards SMEs. This entails also that SMEs that cannot benefit from the abovementioned schemes can usually still benefit from other simplifications.

In terms of reporting, there are simplifications reducing the periodicity (annual recapitulative statements and annual accounting) or simplified reporting. Other simplifications allow for a standard deduction, a domestic reverse charge or the issuance of simplified invoices.

They are discussed more in detail below.

Functioning and application in the EU

Longer period for the filing of annual recapitulative statements

Articles 269 and 270 of the VAT Directive allow Member States to apply for authorisation to implement the option for businesses to submit annual recapitulative statements, also known as annual EU Sales Lists (or ESL¹⁸⁶) where goods or services are supplied to a VAT-registered customer in another Member State (i.e. on intra-EU B2B cross-border supplies)¹⁸⁷.

The EU Sales List requires a business to provide details on the customers, the country the supply is made to and the value of the goods or services. A business may be required to submit an EU Sales List monthly, quarterly or annually depending on the value of the supply of goods¹⁸⁸.

If a business has a low level of supplies to VAT registered customers in other EU countries then it may apply to submit the annual simplified ESL, in Member States that apply this measure¹⁸⁹. In the UK

¹⁸⁶ Or sometimes as VIES statements.

¹⁸⁷ The rationale for ESLs is to allow the tax authorities in the EU to check that businesses properly account for VAT on intra-EU trade.

¹⁸⁸ The obligation to submit monthly statements arises where a supply of goods exceeds EUR 50,000 in one of the previous four quarters. If the supply is below this or of services, normal rules allow for quarterly submission.

¹⁸⁹ Article 269 of the VAT Directive provides, however, specifically that where simplified statements are used '*such measures may not jeopardise the proper monitoring of intra-Community transactions.*' To be eligible all of the following conditions must be met:

- The total taxable turnover in a year does not exceed the relevant VAT registration threshold plus EUR 35 000;
- Supplies to customers in other EU countries do not exceed EUR 15 000 a year; and
- Sales do not include New Means of Transport.

for example, approval is required from the national tax authorities for permission to use the simplified ESL.

Member States can also apply for authorisation to align the periodicity of the filing of the recapitulative statements with a longer periodicity for the filing of the VAT return (on the basis of Article 271 of the VAT Directive).

The lower the frequency of the obligations, the lower the administrative burden is on these companies¹⁹⁰.

Other national simplification measures

Annual accounting – allows Member States flexibility with respect to VAT return submission deadlines and frequency within set guidelines (such as monthly, bi-monthly or quarterly), provided that the tax period does not exceed one year¹⁹¹.

Member States have usually set a turnover **threshold** to regulate the eligibility of businesses to apply less regular reporting. Such thresholds differ significantly and depend also on the regular reporting period applied in the country (i.e. if the regular period is monthly, then the Member State is less likely to allow a wide use of annual accounting). For example, regarding annual accounting, such thresholds range from EUR 25 000 in Finland to EUR 1.7 million in the UK.

By way of example, the **UK** has an annual accounting scheme which may be used by businesses who apply to do so when the annual value of their taxable supplies is expected to be less than approximately EUR 1.7 million¹⁹² and does not exceed approximately EUR 2 million¹⁹³ at any time. Businesses that apply this scheme make advance payments based on their previous VAT return and apply for a refund on the next return if they have overpaid tax. The purpose of the scheme is to reduce the administrative burden and compliance costs for SMEs and also to assist with financial forecasting.

Simplified reporting – In Portugal, special accounting standards apply to SMEs based on turnover and number of employees to provide administrative simplification with filing for such businesses. They are also not required to have certified billing software, contrary to bigger businesses.

Standard deduction of input VAT – In Austria, there is a set percentage (1.8%) for the deduction of input VAT applicable to turnover for small businesses that have opted out of the SME exemption scheme. The scheme applies only to certain businesses and types of sales. Additionally, there is an annual maximum amount for the deduction of input VAT.

Domestic reverse charge – These measures are usually not specifically targeted at SMEs, but are used as anti-fraud measures for certain type of supplies, considered to have a higher fraud risk (e.g. computer chips, mobiles). The scope of such measures may differ significantly, as Member States may apply for a derogation if they have a specific fraud concern (e.g. reverse charge on wood in Latvia). In practice the scheme may provide also a simplification to the supplier (although having mixed impact on their cash flow), as the supplier does not charge or declare VAT on domestic B2B supplies (on specific goods or services), but has a full right to input VAT. Some research however indicates that if applied more widely, a general reverse charge mechanism could result in a significant

¹⁹⁰ Concrete numbers were not gathered as part of the survey to perform an analysis of the impact on compliance.

¹⁹¹ See Table 1 in Volume II Annex A.

¹⁹² GBP 1.35 million.

¹⁹³ GBP 1.6 million.

increase in compliance costs.¹⁹⁴ Customers are required to account for VAT on their purchases and deduct it as input VAT on same VAT return, resulting in zero net VAT to be paid.

Right to issue simplified invoices – Although not specifically targeted towards SMEs, Articles 238 and 226b of the VAT Directive provide for Member States to allow simplified invoicing under certain circumstances. The VAT Committee needs to be consulted to this end.¹⁹⁵ The aim is to limit the amount of information required to be mentioned on the invoice for cases where the invoiced amounts are relatively low or where the market practice in the relevant sector prevents the businesses from issuing invoices in conformity with the VAT laws. For example, in Spain businesses can, in certain circumstances, issue simplified VAT invoices, provided the value of a transaction is below EUR 400.

Regarding the **take up of the simplification measures**, qualitative information provided by tax authorities so far points out that such measures only interest a residual number of businesses in the different Member States, representing a very limited share of turnover (as part of the turnover generated by businesses of the same class and of the total economy), and a very limited share of the VAT revenue for Member States. This may be due to the fact that they are not directly linked with the simplifications provided under the main schemes.

Assessment of the measures

These simplifications are very diverse in their nature and application. It is thus **difficult to draw an overarching assessment of their application and effectiveness**. However, the tax authorities are fairly satisfied with these simplifications in terms of their effectiveness, since generally they also reduces also their audit costs. Businesses are also generally positive about these measures, as they reduce their administrative burden (e.g. longer periodicity allows for costs to be reduced).

The effects of these simplifications on cross-border transactions seem very limited. The main reason for this may come from the legislative constraints of the VAT Directive (Article 272 in particular) for introducing any simplifications for international trade. Article 272 lists the categories of taxable persons who may be released from certain or all obligations; the list includes, for example, specifically the businesses covered by the SME exemption scheme (which is widely used by countries as explained above), but excludes businesses engaged in regular taxable cross-border trade. More relaxed EU legislation may therefore increase the application of general simplification measures across the Member States and their effectiveness.

In terms of the drawbacks, insofar as they constitute deviations from the normal rules, these need to be monitored by both the tax authorities and businesses.

¹⁹⁴ Ernst & Young (2014) Assessment of the application and impact of the optional 'Reverse Charge Mechanism' within the EU VAT system, Section 3 'Findings' pp. 49-69, available: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/kp_07_14_060_en.pdf, consulted on 15 June 2016.

¹⁹⁵ See for the consultations of the VAT Committee: http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/vat_committee/consultations_vat_committee_en.pdf, consulted on 15 June 2016.

4.3 Summary of functioning of the SME schemes

The VAT Directive leaves considerable **flexibility** for Member States regarding the implementation of the SME schemes. Member States have made use of that freedom, by implementing different schemes and measures in a number of different ways. This results in a **heterogeneous patchwork** of different national VAT rules.

Key conclusions regarding VAT schemes and measures for SMEs

General issues common to all schemes

The analysis of the current SME schemes makes it clear that they were predominantly designed for businesses trading domestically¹⁹⁶. This is unsurprising, since the provisions for SMEs were already in the 6th Directive¹⁹⁷ (which later became the VAT Directive) dating back to 1977, before the introduction of the internal market in 1993, and these have evolved little. Therefore, as Member States generally apply the schemes to domestically taxed supplies of domestic businesses, which can inadvertently act a **barrier to operate cross-border** for small business. Thus, SMEs that can benefit from simplifications and that are also operating cross-border are faced with a higher compliance burden.¹⁹⁸

When operating **cross-border**, these small businesses are usually confronted with the VAT obligations to which a normal taxable person is subject. For example, an SME benefiting from the exemption domestically is often still liable for the payment of output VAT (and fulfilment of other related obligations) in other Member States when it is selling goods or services taxable in other Member States (e.g. when providing e-services to final consumers in other Member States). The recent e-Commerce proposal¹⁹⁹ aims to address this problem and reduce such barriers to international trading by introducing a common EU threshold²⁰⁰ of EUR 10 000 under which the cross-border transactions of an SME would still fall under the domestic regime, including the SME exemption scheme.²⁰¹

In terms of **purchases from other Member States** by a business benefiting from an SME exemption, graduated relief or flat rate scheme, the business may also be required to file a special return in order to pay the VAT for which it is liable (unless falling under an exempt intra-EU acquisition). Depending on the scheme, this VAT will be deductible or not, but in any case it constitutes an additional administrative burden for SMEs. As mentioned above, despite the intention to support SMEs, the combined application of different (often not well aligned) simplification measures can become very complex as well as administratively burdensome for the SMEs.

¹⁹⁶ The VAT Directive provides in Article 283 that non-established businesses are excluded from the special arrangements in Articles 282 – 292, so only the flat-rate scheme (based on Article 281) can in principle be applied also to non-established businesses.

¹⁹⁷ Council Directive 77/388/EC 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.

¹⁹⁸ For more information on this aspect see Section 5 Problem Assessment.

¹⁹⁹ *Ibid.*, see:

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_757_en.pdf, consulted on 6 January 2017.

²⁰⁰ For the purposes of this study the term 'common EU threshold' is used to refer to the threshold of EUR 10 000 of cross-border supplies of goods and services applicable in all Member States as proposed in the e-Commerce proposal.

²⁰¹ However, in the current proposal under the Commission's VAT Digital Single Market Package, it is foreseen that EU businesses selling cross-border electronic services without exceeding a yearly turnover threshold of EUR 10 000 can opt to apply the rules of their home country, possibly including the SME exemption scheme (if available).

Additionally, nearly all of the schemes are associated with a **threshold**. This means that necessarily, businesses and tax authorities need to **monitor** such thresholds and businesses are faced with a **threshold effect**.

Finally, it is noteworthy that the current landscape for SME schemes is not harmonised, and that the obligations within each of the schemes differs from Member State to Member State. This entails the risk that SMEs will go '**scheme shopping**', i.e. that they will establish themselves in a Member State with the most beneficial rules. However, although alignment should be considered generally desirable, this is not considered a high risk, as SMEs do not really have the possibility nor incentive to go and establish themselves in other Member States.

Specific SME schemes

The **SME exemption scheme** has the highest implementation rate among Member States and also a very high participation rate among eligible businesses (based on our estimation, average EU take-up rate is of 63%²⁰²). The main advantage of the scheme is the significant tax benefit from the exemption. Due to the widely applied combination of an exemption with simplification measures, also the administrative burden for businesses falling under the scheme is substantially lowered, because in most countries these businesses do not have to register for VAT, file VAT returns, or incur any VAT management costs, and often do not have to issue any VAT invoices.

A perceived drawback for businesses is that when falling under the scheme, they are not allowed to deduct input VAT, however it is an inherent consequence of the exemption. Another drawback is the threshold effect, which means that SMEs might fear going above the threshold, as in most Member States this means that the business has to comply with full VAT obligations. This is a common issue with all thresholds and seen as significant drawback of special schemes, placing pressure on SMEs to remain below the threshold (see Section 5 on problem assessment).

The **SME graduated relief scheme** is not widely implemented across the EU and indeed only three Member States currently apply this. Also, it does not seem to be largely used by eligible businesses in the Member States where it is available. The main advantage of the scheme, similarly to the SME exemption scheme, is that businesses operating below the thresholds can receive a tax benefit, which is to some extent accompanied with relief from certain obligations. It potentially constitutes a step between very limited VAT obligations and having to fulfil all VAT obligations as a normal taxpayer. In Spain for example, the scheme is generally considered to be an effective measure, although it may not provide the same full effect as the SME exemption scheme. In contrast, in Finland the scheme has complicated rules and therefore is not widely used.

The **SME flat rate scheme** is not implemented broadly: only eight Member States currently make use of this scheme. The main advantage of this scheme is that businesses under the scheme can benefit from simplified accounting obligations. The loss of the right to deduct input VAT (where applicable) is considered to be a drawback of this scheme, as was the case for the SME exemption scheme (but similarly also inherent to the scheme). The flat rate scheme is prone to fraud in some Member States and the tendency with tax authorities is more to move away from this kind of scheme.

²⁰² More details are provided in Section 4.2.1 and in Annex D, Section D.2.

In general, the **cash accounting scheme** is implemented widely as a measure to support SMEs²⁰³. The scheme is important for the specific group of businesses encountering cash-flow management issues, for instance in those cases where the SME depends to a great extent on a large contract and/or a large business that does not make payment on time (or pays after several months), or is confronted with a high level of bad debtors.

This special scheme does not include specific simplification measures (e.g. reduction of VAT-related obligations); on the contrary, it often requires additional reporting and/or record keeping obligations, to account for the financial movements of the traders. This has often the effect of discouraging businesses meeting the eligibility requirements from adopting it, on the basis that it increases or complicates the accounting obligations for businesses. This is reflected in the relatively low adoption rates of such schemes by eligible businesses, as reported by tax authorities.

Other simplifications are implemented by Member States, such as reducing the periodicity of reporting obligations (annual recapitulative statements and annual accounting) or simplified reporting, as well as a standard deduction, a domestic reverse charge or the issuance of simplified invoices. Such simplification measures are very diverse in their nature and application, and represent very residual cases.

The table below provides an overview of the main characteristics of the main SME schemes as implemented in Member States.

²⁰³ And also businesses in general since several Member States implemented cash accounting not exclusively reserved for SMEs.

Table 16 – Main characteristics of the SME schemes as implemented in Member States

VAT special scheme for SMEs	Advantages	Disadvantages	Take-up
SME exemption scheme	<ul style="list-style-type: none"> ➤ Reduces tax burden of SMEs by providing exemption ➤ Often combined with additional simplification measures, in which case it substantially lowers the administrative burden for the businesses falling under the scheme ➤ Optional application enables businesses to apply scheme only when suitable for their purposes (more beneficial in B2C environment) ➤ Lowers administrative cost for tax authorities 	<ul style="list-style-type: none"> ➤ No input VAT deduction or VAT charged (inherent elements of scheme) makes scheme less suitable in B2B trade ➤ Threshold effect, i.e. SMEs might fear going above the threshold as this in most Member States means that the business has to comply with full VAT obligations ➤ Potential distortions due to limitation to domestically taxed supplies and domestic businesses ➤ Administrative simplifications often not applied to businesses opting out of scheme ➤ Loss of revenue for tax authorities ➤ Optional scheme increases risk of abuse by businesses and increases administrative cost for tax authorities 	<ul style="list-style-type: none"> ➤ Overall, high take-up by businesses ➤ Relevant reduction of tax burden and compliance costs
VAT graduated relief	<ul style="list-style-type: none"> ➤ Businesses operating below the thresholds can receive tax benefit and benefit from exemption from certain obligations. ➤ Potentially constitutes a step between very limited VAT obligations and having to fulfil all 	<ul style="list-style-type: none"> ➤ Complexity of scheme can reduce benefits, e.g. monitoring several thresholds ➤ Threshold effect, i.e. SMEs might fear going above the threshold as this in most Member States means that the business has to comply with full VAT 	<ul style="list-style-type: none"> ➤ Overall, low take-up by businesses ➤ Rules for practical implementation can be complex, removing for businesses the reasons for adopting it

VAT special scheme for SMEs	Advantages	Disadvantages	Take-up
	<p>VAT obligations</p> <ul style="list-style-type: none"> ➤ Optionality enables scheme to be applied when considered sufficiently beneficial 	<p>obligations</p> <ul style="list-style-type: none"> ➤ Potential distortions due to fully domestic application ➤ Loss of revenue for tax authorities 	
VAT flat rate scheme	<ul style="list-style-type: none"> ➤ Potential for simpler VAT calculations for businesses, especially regarding general flat rate schemes ➤ Relief from some administrative obligations ➤ Unintended limited tax benefit for businesses with less than average input VAT cost ➤ Optionality enables scheme to be applied when considered beneficial 	<ul style="list-style-type: none"> ➤ Can be prone to fraud and abuse due to unintended financial benefit ➤ Additional accounting calculation of the taxable turnover increases compliance costs in specific flat rate schemes ➤ Potential distortions of scheme, especially if applied just to specific activities ➤ Complexity for tax authorities to set appropriate flat rates to match the average input VAT cost 	<ul style="list-style-type: none"> ➤ Overall, low take-up by businesses, but higher in countries with general flat rate scheme ➤ Can lead to tax benefits (business may benefit from paying less VAT when applying the flat rate scheme) and according loss of revenue for tax authorities ➤ Can be more complex to apply than standard VAT regime
Cash accounting scheme	<ul style="list-style-type: none"> ➤ Supports cash-flow management for businesses ➤ Immediate bad debt relief (where it is included). ➤ Optionality enables scheme to be applied when considered beneficial 	<ul style="list-style-type: none"> ➤ Additional record keeping (the monitoring of cash flows is not required as part of the standard VAT obligations) increasing compliance costs for businesses. ➤ Can be prone to fraud if applied only to outputs 	<ul style="list-style-type: none"> ➤ Overall, low take-up by businesses ➤ Trade-off between better cash flow management and increased compliance costs

Source: Deloitte

Key issues regarding compliance costs for businesses in SME schemes

With regard to **businesses**, the fieldwork revealed that **SMEs** (whether they benefit or not from VAT special schemes) **depend to a very large extent on the support of accountants and business organisations** providing fiscal services to comply with fiscal obligations on VAT, but also on income tax and social security. This finding is not entirely surprising, as in general these businesses are small in size, and often consist of the entrepreneur and one or two additional family members or employees. Entrepreneurs have skills and expertise in the specific fields relevant to their core business, but have no time or interest to develop the competences and the knowledge to carry out VAT-related obligations themselves (the same also holds for income tax and social security obligations). On the contrary, they prefer relying on professionals for all fiscal obligations, as they have little or no awareness of the legislation, and of the implications of adopting the different schemes (or even of the existence of options).

In general, **accountants** define 'packages' for VAT-related services based on the size and need of the businesses (e.g. whether they benefit from VAT special schemes and/or administrative simplifications, whether the services also include income tax and social security support, etc.). The prices of such packages vary across countries, based on the complexity of the legislation, the frequency and complexity of the obligations, the differences in wages and cost of living among Member States, the type of providers (e.g. private-sector accountants may charge higher prices than business organisations, which might be more interested in increasing their membership). See Volume II, Annex G for more details.²⁰⁴

Another trend emerged from fieldwork is a **progressive move by tax authorities towards automating administrative tasks (including VAT-related obligations), as a way to streamline and simplify compliance**. While such simplification does not benefit businesses directly (as they generally outsource such tasks to accountants, and might not have the resources or the interest in investing in more sophisticated accountancy systems), it has an impact on the time needed by accountants to carry out the relevant administrative obligations for their clients. Overall, accountants invest in specific software packages (and in related maintenance and support services) to use such channels, but the ones interviewed confirmed that the overall process has benefited from a simplification (in the form of a reduction in the time needed to perform the administrative tasks and submit the different documents). On the other hand, frequent changes in the legislative framework and possible increases in complexity have the opposite effect of increasing costs for accountants, in the form of increases in the time needed to perform administrative tasks and to assess the impact of legislative changes.

Such **tendencies to simplification** or complication of requirements (and related costs) may not be reflected in the short term on the prices for VAT packages applied to businesses, but they **are likely to be passed through in the medium to long term, impacting directly the costs for businesses**, due to the competitive nature of the accounting service sector for micro-businesses.

Key issues regarding tax authorities and SME schemes

Interviews with tax authorities revealed a **move towards streamlining and automating many administrative tasks** for both businesses and citizens, and the provision of an increasing number of

²⁰⁴ Annex G, Section G.1, 'Main assumptions used for the analysis'.

services via automatic/digital channels (e.g. pre-filled tax and VAT return forms to be submitted online). This trend includes also the simplification of administrative tasks related to VAT obligations for micro-businesses, both within and outside special schemes. The simplification and automation of VAT-related obligations is intended to reduce the effort needed to comply (either directly by businesses or by accountants) and thus reduce the compliance costs for businesses. In addition, simplification of requirements and of the procedure to carry out administrative tasks is expected to reduce errors, and thus increase compliance. Furthermore, the implementation of digital services allows tax authorities to collect and process increasingly accurate data on businesses (including micro-businesses), and thus to improve the accuracy of compliance activities.

Automation and digitalisation is a strong trend also on the tax authorities' side, where, as a result, the administrative costs of tax authorities have been significantly reduced by the use of automated processing.

Implementing electronic services has also allowed tax authorities to re-design to some extent their organisational structures. During the interviews, a trend emerged of moving away from specialisation in the tax authorities and instead using general compliance teams to work on any tasks not done automatically or needing manual review.

Given such trends towards automation of processes and reduced specialisation of tasks, tax authorities could not provide us with specific information or quantification of the time and costs for administering the different VAT special schemes and the normal VAT obligations. In fact, tax authorities' workflows tends not to differentiate among the different schemes in the treatment of data (which is automated for the large part).

Despite a lack of specific data, as a general remark, **the SME schemes do generally reduce also the administrative costs of tax authorities**. This is especially the case regarding the SME exemption scheme, which in most countries significantly reduces the number of VAT registered taxable persons and related processing tasks and auditing costs for tax authorities. However, nearly all of the SME schemes are optional for businesses, which is a strong positive element for businesses, but consequentially increases the administrative cost for tax authorities, as well as potentially increasing the risk of abuse of schemes. Specifically in the case of flat rate schemes, the optionality creates also (unintended) loss of VAT revenue, as the scheme is usually applied only by businesses that would receive some tax benefit, whilst businesses that would end up paying more VAT in the flat rate scheme tend to apply the standard VAT regime instead, despite simplifications provided by the scheme (unless the tax difference is considered small, and thus the overall balance still provides them with a clearly positive outcome).

5 Problem assessment

This section presents the relevant problems related to the special VAT schemes and measures for SMEs and their drivers.

5.1 Problem tree

This section presents the relevant problems related to the special VAT schemes and measures for SMEs and their drivers. These have been identified on the basis of the following information sources:

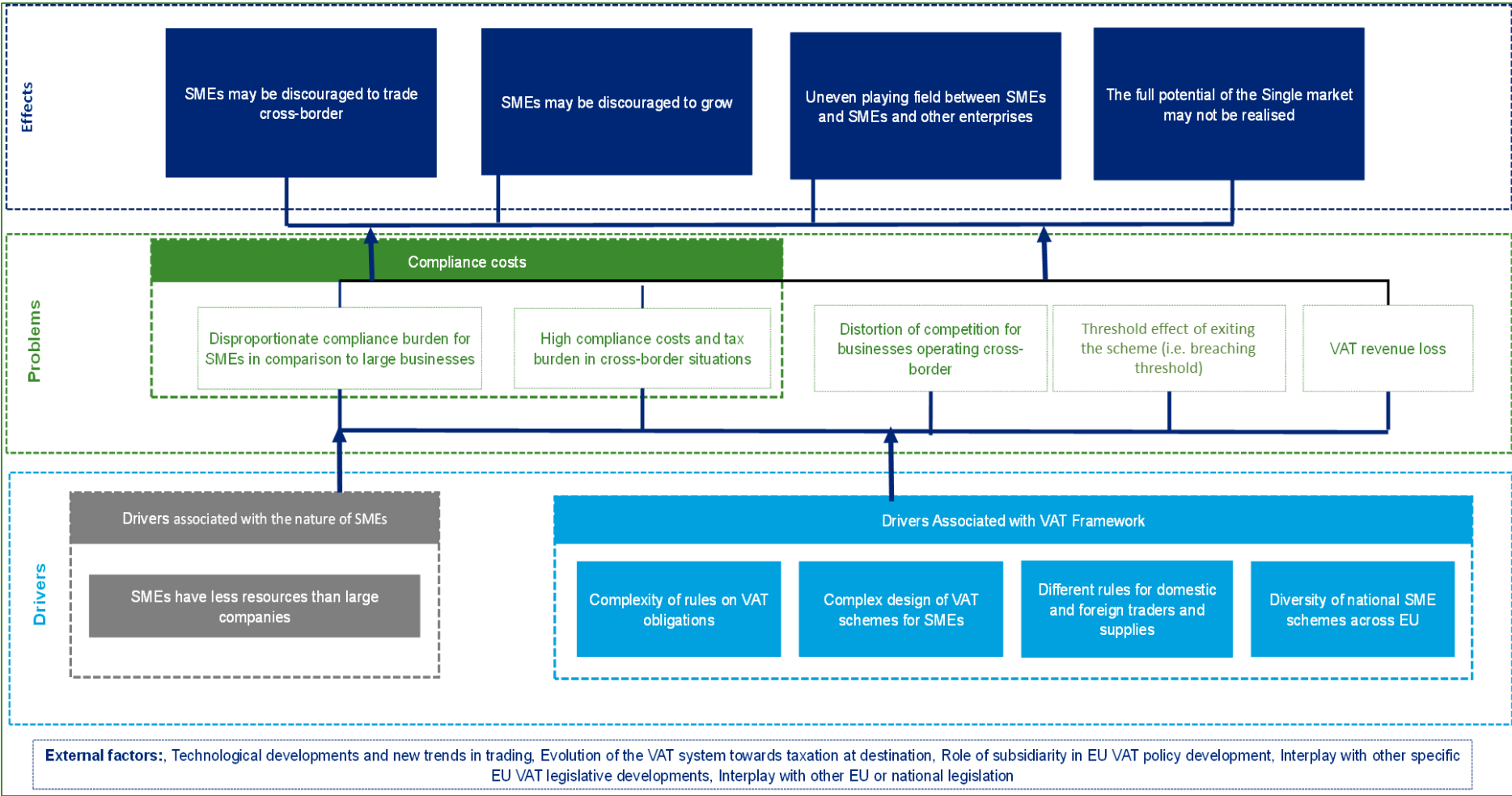
- ❑ Desk research;
- ❑ Surveys to Member State tax authorities and businesses;
- ❑ Input from the stakeholder workshop; and
- ❑ Interviews conducted with business associations, the European Commission and businesses and tax authorities during fieldwork in eight Member States²⁰⁵.

The problems identified are presented using a problem tree (Figure 34), which illustrates the link between the problems identified, their drivers and their high-level effects. A **problem tree** helps establishing a de facto hierarchy between the causal elements (root of the tree) and their consequences (branches of the tree). It also helps representing visually the different elements identified and their casual relationships.

Figure 34 provides a visual representation of these issues and their causal relationships.

²⁰⁵ The eight Member States were: Belgium, Estonia, France, Italy, Poland, Romania, Spain and UK.

Figure 34 – Problem tree



Source: Deloitte analysis

The **external factors** are represented at the bottom of the figure. These are events and developments that deemed to happen at any rate, and cannot be influenced by the policy intervention under consideration. It is important to understand the external factors when assessing the effect of the policy options on the problems identified as external factors could limit or increase positive effects of one or several options.

Drivers represent the main underlying causes of the problems that the policy intervention aims to address. They are represented at the basis of the figure (i.e. the 'root of the tree'), distinguishing between those more related to the nature of SMEs and those more related to the VAT framework and legislation in general.

Problems are the 'trunk of the tree' and constitute the main issues concerning the current context. Problems derive from the drivers identified. The key problems for SMEs are the high compliance cost, especially in cross-border trade, causing cross-border distortions of competition, and when breaching the eligibility threshold for the SME scheme, causing the threshold effect. The key problem for tax authorities is the loss of VAT revenue from provided tax benefits and non-compliance.

Finally, **effects** are the current and future consequences of the problems acknowledged. The effects identified include not realising the full potential of the **Single Market, SMEs being discouraged to grow, SMEs being discouraged to trade cross-border** and an **uneven playing field for EU businesses**.

The following sub-sections present a detailed description of the external factors, drivers, problems and effects presented in the problem tree.

5.2 External factors

External factors are independent events and trends that influence the environment in which SMEs operate. They are not affected by the policy intervention, but they can limit or increase the positive effects of one or several options. Therefore, when discussing the special VAT schemes and measures for SMEs, a number of external factors must also be taken into account, namely: technological developments and new trends in trading, the interplay between VAT rules and other legislation at EU or Member State level, and the broader evolution of the EU VAT system in a global context.

5.2.1 Technological developments and new trends in trading

Technological developments play an important role in the examination of this policy area. **Digitalisation** in both the business context and taxation context is becoming increasingly more prominent and is expected to continue to grow with the Digital Single Market Strategy. This is particularly relevant from an SME perspective since the increase of digitalisation (which is intended to be positive) can have a negative effect on very small businesses. Digitalisation, by its nature, is disruptive. SMEs without technological knowledge or expertise or the willingness to learn can be left behind if unable to adapt to new developments²⁰⁶. For example, a business may be unwilling to adopt

²⁰⁶ Literature shows that that the main barrier to better utilisation of ICT and e-Business, and thus the main reason why SMEs face a digital divide, is not so much the lack of access to information technology as the lack of proper knowledge, education and skilled owner-managers and employees within the enterprise ("skills access" barrier). See Arendt L., (2008), "Barriers to ICT adoption in SMEs: how to bridge the digital divide?", Journal of Systems and Information Technology, Vol. 10 Issue: 2, pp. 93-108

a beneficial scheme if it means having to adapt to a new system or technology. At the same time, new technological solutions may provide more level playing field and new opportunities for tech-savvy SMEs and start-ups²⁰⁷.

Technological developments have changed how businesses and individuals trade: e-commerce is drastically changing the whole concept of 'business' or 'trading'.

Firstly, the rise of the Internet and **e-Commerce** has made accessible a wider geographical reach for businesses, particularly small and micro-businesses. This has led to an important increase of SMEs trading across borders within the EU. Eurostat data show that in the period 2008-2015 the number of businesses selling online increased from 13% to 20% (18% among SMEs) and the corresponding turnover went from 12% to 16% (but only 6% among SMEs) of total turnover for EU businesses²⁰⁸, with 8% of online sales made to other EU countries in 2014. Data on activities of micro-businesses is only available to a limited extent, but it demonstrated that on average 6% of micro-businesses engage in cross-border e-commerce, compared to on average 15% of all firms²⁰⁹. Nonetheless, given the large number of micro-businesses, the application of standard VAT obligations on such businesses would result in an important increase of the overall administrative burden. The special schemes for SMEs were designed in an era where the business activities of such businesses were predominantly if not fully domestic within their own Member State.

Another consequence of technological development is that the widespread availability of information technology has led to increasing number of **individuals, selling often through online platforms** which provide them access to a wide network of potential customers both in the domestic market and cross-border. The increasing popularity of **the sharing (collaborative) economy** is also a trend that may intensify the challenge of defining what constitutes an economic activity for VAT purposes, and thus the complexity of or confusion in the application of VAT rules. The sharing economy is 'a socio-economic phenomenon based on sharing of human and physical resources and included shared production, distribution and consumption of goods and services by people and organisations'²¹⁰.

These trends have amplified the challenge for tax authorities in **defining economic activity for VAT purposes and identifying taxable persons**, and as a result deciding whether the supplier is a business potentially eligible for an SME scheme or an individual whose limited activities do not yet constitute an economic activity (occasional trader).

Being treated as a taxable person making taxable supplies, would, for example, enable the person to 'opt out' from the SME exemption scheme as they are currently designed and register for VAT. In such case, input VAT can be claimed back (which may sometimes be abused by claiming VAT also on personal expenses such as car related costs, affecting the VAT revenues of tax authorities). The case of individuals installing solar panels and selling to the network the surplus of energy produced in the **Netherlands** is one of the examples. The combination of the CJEU ruling (case C-219/12²¹¹) with the design of the graduated relief in that Member State scheme lead to a notable increase of 'dormant'

²⁰⁷ OECD (2016), Rethinking Tax services for SMEs, available at: http://www.oecd-ilibrary.org/taxation/rethinking-tax-services_9789264256200-en;jsessionid=3hcquk7n4gpr8.x-oecd-live-03

²⁰⁸ See: http://ec.europa.eu/eurostat/statistics-explained/index.php/E-commerce_statistics

²⁰⁹ SWD(2016) 382 final and European Commission (2016), and VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 1, prepared by Deloitte, p. 23. available: https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot1.pdf

²¹⁰ European Commission, Value Added Tax Committee working paper no 878, 22 September 2015, p. 2, available: <https://circabc.europa.eu/sd/a/878e0591-80c9-4c58-baf3-b9fda1094338/878>

²¹¹ See CJEU judgement of 20 June 2013 in Case C-219/12 *Finanzamt Freidstadt Rorhbach Urfahr*

taxpayers in the VAT system (46 000 new VAT registrations in 2014 and 56 000 in 2015) with a corresponding VAT loss quantified in EUR 38 million in 2014 and EUR 49 million in 2015²¹².

At the same time, a person making some **occasional or incidental transactions** not covered by the SME scheme may become subject to the full set of VAT obligations, creating a disproportionate administrative burden. The Commission concluded in their working paper for the VAT Committee that the VAT treatment of transactions in the sharing economy may differ depending on whether monetary consideration or remuneration in kind is provided or not, and if it is, then whether there is a direct link between the supplies and remuneration.²¹³ If the case-by-case analysis proves that the person in question qualifies as a taxable person and the transaction is a taxable supply, then this person may also qualify for a SME scheme. However, knowledge and understanding of the tax consequences of a transaction made through use of the sharing economy is still fairly limited, including amongst the individuals (occasionally) involved in it, and a systematic approach still to be identified.

Technological developments are relevant also for the special schemes themselves and can be **disruptive** or threatening. For example, fieldwork has found that the flat rate scheme in Belgium is becoming less widespread due to increased digitalisation of accounting systems. The previous benefit of the scheme (i.e. application of a fixed rate or alternative taxable basis providing relief from a need for extensive VAT calculations) is almost redundant due to automatic accounting systems.

5.2.2 Evolution of the VAT system towards taxation at destination

There are significant external factors outside the tax system that influence the impact or effectiveness of the SME schemes. However, a more direct impact on the application and effect of these schemes comes from the active evolution of the EU VAT system itself. It is important to recognise the wider VAT context for the analysis of current SME schemes and, more importantly, to take it into account when considering any future design changes.

The main development triggering change to the VAT system both in the past and coming decade is the systematic **move from an origin principle to a VAT system fully based on the principle of taxation at destination**.

The original EU VAT system (and the VAT Directive) was drafted with a commitment to a future definitive VAT regime based on the origin principle, i.e. a VAT system tailored to the Single Market and operated across Member States in the same way as within a single country. The means to achieve such result were intended to be the harmonisation of VAT rates and a clearing house for redistribution of VAT revenue collected in the country of origin to the country of consumption. The current VAT Directive still contains a so called 'transitional regime' for taxation of trade between Member States, though in its 2011 Communication, the Commission, endorsed by the Member States, committed to abandon the origin principle as the ultimate objective and instead focus all efforts on a properly functioning definitive regime based on the destination principle. The main reason for this move was a conclusion that a system based on the origin principle remains politically unachievable.²¹⁴

²¹² See Section 4.2.2 for more details.

²¹³ European Commission, Value Added Tax Committee working paper no 878, 22 September 2015, available: <https://circabc.europa.eu/sd/a/878e0591-80c9-4c58-baf3-b9fda1094338/878>.

²¹⁴ Communication on the Future of VAT, towards a simpler, more robust and efficient VAT system tailored to the single market, COM(2011)851 final.

This is a significant decision with far reaching consequences for the whole EU VAT system, including on the special regimes applying to SMEs.

The evolution towards the destination principle resulted in specific changes to the VAT Directive, starting already in 2003, when B2C e-services from non-EU suppliers became taxable in the Member State of the recipient of the service and a VAT on eServices (VoES) system was introduced²¹⁵. The VAT package introduced further place of supply changes expanding the application of the destination principle to all B2B services (2010)²¹⁶ and to B2C Telecommunication, Broadcasting and e-Services (TBE-services) and the introduction of the MOSS (2015)²¹⁷.

The recent VAT Action Plan²¹⁸ provides insights on the next planned changes towards the VAT regime based on the destination principle. Most importantly, the whole 'temporary regime' on cross-border supplies of goods will need to be changed, and the provisions, which are currently based on the origin principle (i.e. whether the business is established in the Member State or not), will need to be reviewed and adjusted to make them compatible with the destination principle.

This includes the SME special schemes and measures, which are still widely based on territorial application. The overall direction of the EU VAT system therefore triggers at least a review and more likely an adjustment of the special regimes applying to SMEs. This means in essence that **change is inevitable, as the SME schemes in their current form will become obsolete.**

One of the consequences of a full application of the destination principle to the taxation of SME supplies is a change in the understanding and application of VAT. The place of establishment of a business as supplier becomes irrelevant, while the identification of proxies for the place of consumption becomes crucial under the destination principle-based VAT system. Furthermore, the entire concept of 'cross-border' supply becomes irrelevant for VAT purposes, as all supplies become in a way 'local', in the sense that every supply takes place and is taxed at destination, and is subject to one set of VAT rules. Domestic and foreign traders are in principle trading in the same market (although as a consequence, a trader selling to many different countries may need to apply many sets of local rules).

From the perspective of the SMEs, an ideal VAT system for supplies to customers in their own Member State as well as in other countries would be based on the origin principle, applying their domestic VAT regime (including the SME exemption scheme) to all their supplies irrespective of the country of destination. As explained, this option is not viable due to the commitment made by the Commission and national governments²¹⁹ (as well as generally endorsed by global policymakers and businesses²²⁰) to move towards the destination principle.

The destination principle reflects significantly better taxation at the place of consumption, which, considering that VAT is a tax on consumption, is seen as more appropriate. Understandably this will limit the options available for any future policy changes on the SME schemes and measures.

It is inevitable that SMEs selling to other countries will become subject to the VAT rules of those Member States of destination and any initiatives aimed to support SMEs regarding their tax

²¹⁵ Directive 2002/38/EC adopted 7 May 2002.

²¹⁶ Directive 2008/8/EC adopted 12 February 2008.

²¹⁷ Ibid.

²¹⁸ Communication on an action plan on VAT, Towards a single EU VAT area – time to decide, COM(2016)148 final.

²¹⁹ ECOFIN Conclusions on the VAT action plan and on VAT fraud (paragraph 24), 25 May 2016, available: <http://www.consilium.europa.eu/en/press/press-releases/2016/05/25-conclusions-vat-action-plan/>

²²⁰ International VAT/GST guidelines, November 2015, available: <http://www.oecd.org/tax/consumption/international-vat-gst-guidelines.pdf>; p. 12.

and administrative burden need to take this into account. For example, when assessing the impact of a potential abolition of the distance selling thresholds in B2C cross-border supplies of goods, it was estimated that only about 5% of the micro-businesses currently active in cross-border e-Commerce would likely comply, as their turnover from such transactions would be lower than the estimated administrative burden to comply with VAT related obligations in the Member State of taxation. The rest of these micro-businesses would likely cease to trade cross-border or fail to register for VAT²²¹.

5.2.3 Role of subsidiarity in the EU VAT policy development

Despite the wide reform of the EU VAT system, not all SME schemes are likely to be impacted. Although the Member States and Commission are committed to support measures important for the smooth functioning of the Single Market, the competence of the Commission in developing EU level legislation is balanced against the sovereignty of the Member States regarding their own national matters, which have no impact on the Single Market or other Member States. Therefore, the tax measures that target activities that are by their nature local, such as, for example, most flat rate schemes, are more likely to be in the Member States' competence rather than subject to EU-level regulation.

In addition, even regarding the measures that clearly ought to be governed by common EU rules (e.g. due to cross-border impact), such as the SME exemption scheme, it **would be difficult to include in future policy changes any plans for full harmonisation of the VAT rules** (e.g. setting fixed VAT rates or uniform thresholds).

The Commission has attempted to align the SME VAT schemes before, by proposing an increase of the maximum threshold to EUR 100 000, which would have reflected better the optimal level of the threshold²²². The main reasons for this were to provide Member States more flexibility in determining their thresholds (providing them more autonomy in setting up the most appropriate regime in view of the structure of their national economy) and remove the need for the use of the derogation procedure for any changes in the threshold, which is time consuming.²²³ The discussions of this part of the proposal were stalled in the Council in 2007, and the proposal was eventually withdrawn by the Commission in May 2014.

Another important factor in the need for and impact of SME special schemes is the (often national) evolution of VAT compliance obligations and the related compliance cost for businesses. Apart from invoicing requirements which were largely harmonised on a European basis²²⁴, the format and requirements for VAT accounting and reporting are left to a large extent to the Member States to determine. Lessons can be drawn in this respect from the proposal for a standard VAT return, which was withdrawn by the Commission in 2016, as the changes made in the Council ran counter to the main objective of simplification²²⁵. As a consequence, the complexity of VAT returns is still very diverse across the Member States. Moreover, a number of Member States have implemented recently or are in the course of implementing new reporting or record keeping obligations at a national level,

²²¹ European Commission (2016), and VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 2, prepared by Deloitte, p. 57, available: https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot2.pdf.

²²² As described in Section 5.4.3.

²²³ COM(2004) 728, Proposal for Council Directive amending directive 77/388/EEC with a view to simplifying value added tax obligations.

²²⁴ Directive 2010/45/EU of 13 July 2010.

²²⁵ Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards a standard VAT return COM(2013) 721; Annex 4, Annex to Commission work program 2016 COM (2015) 610 final, List of withdrawals.

introducing standard audit file for tax (SAF-T) legislation²²⁶ or obliging companies to provide near real time VAT data²²⁷.

Therefore, a **pragmatic and balanced approach may be needed when designing future policy options**.

5.2.4 Interplay with specific EU VAT legislative developments

In addition to the general evolution of the VAT system, a number of specific VAT dossiers which are worked on by the Commission will also have an impact on the current SME schemes and measures and should be taken into account when analysing the potential changes to the design of these schemes and measures.

The lessons learnt from the implementation of the place of supply rules for telecom, broadcasting and electronically supplied (TBE) services in the B2C context provide key insights on the way that a shift to the destination regime can trigger additional complexity for SMEs and on the types of measures are called upon by the businesses concerned. These have been embedded to some extent in the e-Commerce proposal. The plans on the development of an EU VAT web-portal also influence the way how the needs for SMEs can be served in the overarching evolution of the VAT system.

Evaluation of the place of supply rules for TBE services (2015 changes)

A significant step in the progressive implementation of the taxation at destination principle is the change to the **place of supply rules for TBE services in a B2C context**. This measure is accompanied by the introduction of the **MOSS** as a reporting tool allowing businesses, including SMEs, to meet their VAT obligations outside of their country of origin, in a multitude of destination countries, through a single portal²²⁸.

An initial evaluation of the application of these rules highlighted several positive elements²²⁹. Data from the first year of implementation showed VAT revenues collected via the MOSS for about EUR 3 billion (about 70% of the total supplies for these services), projected to reach about EUR 3.2 billion in 2016, representing a net increase for most Member States. In addition, the MOSS has proved a crucial tool in reducing the administrative burden for businesses, and especially for SMEs. Estimates for the first year indicated that the sole implementation of the destination principle without MOSS and without the fiction under which platforms assume VAT liability under Article 9a of the VAT Implementing Regulation, would have brought a major burden on micro and small businesses (EUR 5 200 annually for each Member State to which they have sales)²³⁰.

However, despite the crucial support provided by the MOSS, the **implementation of the place of supply rules** represents a challenge for businesses (especially the smaller ones). Such businesses are faced with a set of different VAT national rules (potentially up to 28), requiring often changes in their business practices and systems (e.g. multitude of VAT rates applicable, need to identify the

²²⁶ Countries which have currently introduced such obligations include Portugal, France, Poland, Lithuania and Spain

²²⁷ Spain introduces per 1 July 2017 a new reporting obligation "Suministro Inmediato de Información" (SII) affecting in a first phase approximately 62 000 companies.

²²⁸ The MOSS allows businesses to register only once (and in their Member State of establishment) and to file (and pay) only one VAT return.

²²⁹ See Conclusions (Section 6) of SWD(2016) 382 final and European Commission (2016), VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 3, prepared by Deloitte, available: https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot3.pdf

²³⁰ European Commission (2016), VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 3, Ibid.

status of the customer and/or the Member State of destination). This could result in a competitive disadvantage and reduced market access for SMEs. In addition, such rules may result in an increased dependence of SMEs from online platforms for accessing market (especially in the absence of a turnover threshold for applying such rules). Online platforms enable businesses (especially the smaller ones) to access markets they would not be able to reach based on their own resources only. However, dependence from platforms entails two major issues, as the supplier will have to pay service fees to the platform (cost element) and the platform is not likely to give the supplier access to the customer details, resulting in the impossibility to promote their products to customers directly (reduced market access element).

The experience of the 2015 place of supply rules for TBE services (together with the MOSS) provides an example of a policy intervention that modifies the status quo based on specific policy principles, and introduces additional measures (i.e. the MOSS) to mitigate potential adverse impacts on businesses. Nevertheless, there are still major issues affecting SMEs, and their possibility to access cross-border markets without additional burdens and competitive disadvantages.

Legislative proposal on modernising VAT obligations for cross-border e-Commerce

Building on the experience of the TBE services changes in 2015, the main dossier impacting SMEs is the recently published **e-Commerce proposal**²³¹. This proposal will, amongst other elements, introduce a common EU-wide simplification measure (VAT threshold) (in this report referred to as 'common EU threshold') to help small start-up e-commerce businesses, which is directly relevant to this study.

More specifically, the proposal contains the following measures that have direct relevance for European-based SMEs:

As of 1 January 2018:

- Introduction of a common EU threshold (total value of supplies, exclusive of VAT, of EUR 10 000) for all B2C supplies of telecommunications, broadcasting and electronically supplied services (TBE services). Under this threshold, the place of supply of such services will remain the Member State of the supplier and the domestic rules of that Member State continue to apply (including the SME scheme). Once the threshold is exceeded, the supplier will be required to register (potentially via MOSS) and account for VAT due in all other Member States.
- Allowing EU sellers that are using MOSS to apply domestic rules in areas such as invoicing and record keeping.

As of 1 January 2021:

- Removal of the intra-EU distance selling threshold for supplies of goods (Article 34 of the VAT Directive). This measure allows businesses to treat cross-border B2C supplies of goods under domestic rules of the Member State of origin if sales in the Member State of destination do not exceed the threshold defined by that Member State (annual value of supplies to that Member State, exclusive of VAT, of EUR 35 000 or EUR 100 000). As also the exemption for importation of small consignments from suppliers in third countries (Title IV Directive 2009/132/EC) will be abolished, as a general rule, all cross-border B2C supplies of goods and services, independent of their country of origin, will be subject to VAT in the Member State of the consumer.

²³¹ COM(2016)757 final and SWD(2016) 382 final

- Extension of the common EU threshold (total value of supplies, exclusive of VAT, of EUR 10 000) for all B2C cross-border supplies of goods and services. Up to the threshold, an EU business making such supplies in other Member States will be able to treat these supplies as domestic transactions. Once the threshold is exceeded, the supplier will be required to register and account for VAT due in all other Member States.
- Extension of the existing MOSS (Chapter 6 of Title XII of the VAT Directive) to intra-EU distance sales of tangible goods and services other than electronic services as well as to distance sales of goods from third countries;

The e-Commerce proposal²³² has important implications for SMEs trading cross-border on B2C transactions, and interacts with the current special VAT schemes for SMEs, which have to be taken into consideration in any future change²³³. The shift towards taxation at destination that it entails triggers for many SMEs, particularly those trading outside of the special schemes, the confrontation with VAT regimes of a multitude of Member States where they currently do not exceed the national distance sales thresholds. At the same time, the introduction of the common EU threshold and extension of MOSS to all cross-border B2C supplies of goods and services provides significant simplification to SMEs trading cross-border²³⁴. According to the impact assessment, up to 430 000 businesses, representing 97% of all micro-businesses trading cross-border, may benefit from the common EU threshold and continue applying their domestic VAT regime (including the SME exemption) to cross-border supplies²³⁵.

This proposal will potentially provide a significant reduction of the administrative (and potentially also tax) burden to SMEs trading or planning to trade cross-border. However, further simplifications and changes are needed in order to level the playing field between domestic and foreign traders and reduce administrative burdens for SMEs which have opted out of the scheme.

EU VAT web-portal

Among the VAT dossiers in the pipeline within the Commission's VAT agenda, also non-legislative initiatives can have significant positive impact on SMEs. An example thereof is the development of an **EU VAT web portal**²³⁶, containing the national VAT rules of all 28 Member States and thus making the relevant national information more accessible to SMEs. The EU VAT web portal would build on the 'MOSS web portal,' which was developed by the Commission to support the 2015 place of supply changes and MOSS²³⁷.

It aims at providing an easy to use guide on the main VAT rules and obligations in EU Member States (and on additional sources and available support in Member States) to sustain businesses trading (or willing) to trade cross-border.

²³² Ibid.

²³³ Under the current legislative framework, in cross-border transactions between businesses (i.e. B2B transactions), the reverse charge mechanism applies.

²³⁴ See Section 5.4.2.

²³⁵ SWD(2016) 382 final and European Commission (2016), and VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 2, prepared by Deloitte, p. 266, available:

https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot2.pdf

²³⁶ Communication on the future of VAT, towards a simpler, more robust and efficient VAT system tailored to the single market, COM (2011) 851.

²³⁷ Telecommunications, broadcasting & electronic services, Rules applicable since 2015, see:

https://ec.europa.eu/taxation_customs/business/vat/telecommunications-broadcasting-electronic-services_en#new_rules consulted on 7 January 2017.

5.2.5 Interplay with other EU or national legislation

It is important to take into account the interplay between VAT rules and other legislation at EU or Member State level (especially those specific to SMEs). Changes introduced under the VAT regime may not have the desired effect due to requirements imposed by other legislation at EU or Member State level.

Importantly, general international or national accounting requirements may undermine any VAT accounting or recordkeeping simplification measures for SMEs, if they are obliged to keep detailed accounts anyway. As an example, international accounting standards require businesses to use the accrual basis for accounting²³⁸. Therefore, if a business (subject to a nationally set threshold for mandatory accruals accounting) wishes to apply cash accounting for VAT purposes, it needs to keep cash based VAT accounts separately or reconcile the accounts when submitting financial statements. This has direct implication of compliance costs for businesses. For instance, fieldwork has showed that on average in the EU costs for businesses applying the cash accounting scheme are higher (EUR 3 865 on an annual basis rather than EUR 2 964)²³⁹.

Furthermore, in most Member States, businesses applying the SME exemption scheme are exempt from the obligation to register for VAT purposes. Nevertheless, often, they still are obliged to register for other purposes, such as for income tax purposes or in the commercial register²⁴⁰.

5.3 Drivers

Drivers represent the main underlying causes of the problems that the policy intervention aims to address. Some drivers are inherent to the nature of SMEs, while others relate to the VAT framework, both at EU and national level. This sub-section describes both sets of drivers.

5.3.1 Drivers associated with the nature of SMEs

In general, SMEs experience certain **disadvantages** in comparison to larger companies. By their nature, SMEs have less (financial and human) resources than large companies. Traditional problems include lack of financing, difficulties in exploiting technologies, constrained managerial capabilities, low productivity, and difficulties in coping with regulatory burden²⁴¹.

This is not a problem of the legislative framework per se, but a reality that any policy intervention on SMEs cannot overlook.

The **lack of resources** of SMEs has specific implications when considering the application of the VAT framework. SMEs have less capacity to comply with all the administrative obligations. Fieldwork interviews have confirmed that SMEs feel at a disadvantage in comparison to larger companies when it comes to allocating resources to tax compliance.

A particular feature for SMEs that appeared during our fieldwork is the **lack of awareness and knowledge** of the applicable VAT regime on their business. This leads to additional confusion about

²³⁸ IASB, Paragraph 27 of the International Accounting Standard (IAS) 1.

²³⁹ See Section 4.2.4 'Cash Accounting Scheme'.

²⁴⁰ See Section 4.2.1, 'Cash Accounting Scheme', Table 2.

²⁴¹ Having fewer resources is often cited as a 'traditional problem facing SMEs', see OECD (2000), Small and Medium-Sized Enterprises: Local Strength, Global Reach, p. 1, available at: <http://www.oecd.org/cfe/leed/1918307.pdf>

specific obligations, particularly in relation to the application of special VAT schemes or when changes are applied to the VAT framework.

The complexity of the tax and VAT framework results in a situation where SMEs are often **dependent on their tax advisors** or accountants to handle all VAT-related obligations (about 90% of the businesses interviewed during the fieldwork rely on their accountants or tax advisors, with no differences across Member States). This is a less expensive (and safer in terms of non-compliance risk) alternative than making their own investment in resources to carry out the VAT-related tasks. The issue here is that by relying on an agent, the business is unaware of the tasks their agent should be carrying out on their behalf.

Therefore, the administrative burden (including all related costs, such as IT and/or outsourcing) faced by SMEs is felt to be higher than for larger businesses, when compared to their turnover. This is reflected in the compliance costs SMEs face (see Section 3.5).

5.3.2 Drivers associated with the VAT framework

The rules on VAT treatment of SMEs are very complex. Particular issues are linked to the design of VAT obligations as a whole and of the special schemes for SMEs, as well as to the implications of their territorial application. Below we describe each of them.

Complexity of national rules on VAT obligations

VAT obligations, particularly in the field of registration, invoicing and reporting requirements are experienced as burdensome and complex for businesses in general²⁴². VAT-related **costs** for EU businesses are estimated at about EUR 80 billion per year²⁴³.

Businesses appeal to a large extent to external advisors for achieving compliance with VAT obligations. Such external costs represent about 50% of the total administrative costs that businesses face to comply with VAT obligations, while equipment costs (such as IT systems and accounting software VAT-related) represent about 1.3%²⁴⁴.

The specific **format of VAT obligations** within a national context translates into the situation where different Member States apply different rules for tax points, invoicing rules, bookkeeping requirements, VAT return content, (e-)filing obligations and formats, etc. Specialised accounting software, either offered by local market providers or through localised versions of broader accounting or ERP systems, allows businesses to automate the VAT obligations in a significant way.

This diverse and complex rule set is particularly affecting SMEs, as they do not have the internal resource and knowledge capacity nor the access to technological tools that reduce the complexity and burden of the VAT obligations²⁴⁵.

²⁴² SWD(2016) 382 final and European Commission (2016), and VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 1, prepared by Deloitte, p. 37, available:

https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot1.pdf

²⁴³ European Commission (2010), EU Project on Measurement and Reduction of Administrative Costs, prepared by Ramboll, CapGemini and Deloitte, p. 33 available: http://ec.europa.eu/smart-regulation/refit/admin_burden/docs/enterprise/documents/files/abs_development_reduction_recommendations_en.pdf

²⁴⁴ European Commission (2010), Ibid

²⁴⁵ European Commission (2010), Ibid

Particularly confronted with **multiple VAT regimes** in case of a shift to the destination principle, an important factor defining the administrative burden for SMEs will be the access to information and tools with respect to the VAT obligations across borders.

Any possibility to pay VAT in the Member State of destination based upon the rule set in their Member State of establishment would significantly lower the threshold for achieving compliance with VAT rules.

Complex design of VAT special schemes for SMEs

A prominent issue with the current VAT framework is the **design of the SME exemption scheme**, more specifically the fact that **the simplification measures** that are nationally commonly applied together with the SME exemption, **are not part of the SME scheme in the VAT Directive**.

According to the VAT Directive SME exemption scheme (Articles 282-292), the Member States could, for example, still require businesses to register for VAT and perhaps issue invoices or declare exempted sales on a VAT return.

As the SMEs' compliance burden would be disproportionate compared to their turnover and the (potential or actual) VAT revenue they generate under normal VAT rules, all of the 26 Member States that apply an SME exemption scheme have introduced additional simplifications in respect of the compliance obligations for eligible SMEs, using a separate option provided by the VAT Directive (Article 272).

Such additional simplification measures differ across Member States. For instance, while 17 Member States have introduced simplified accounting obligations and exempted businesses from issuing VAT invoices, only two Member States (namely, Czech Republic and Latvia) have exempted eligible businesses to register for purposes other than VAT²⁴⁶.

The stakeholder consultation confirmed that these simplification measures are considered by both businesses and tax authorities to be a crucial part of the SME exemption scheme. The lack of alignment on the use of a range of simplification measures as well as the lack of certainty that these would be applied together with the exemption, is therefore a significant systematic problem in the current VAT framework, which ought to be addressed.

Regarding other SME schemes applied in Member States, such as flat rate schemes and graduated reliefs, these were also largely considered by both SMEs and tax authorities as too complex to be efficient²⁴⁷. These schemes are designed nationally, rather than in the VAT Directive, which provides only a basis. However, introducing an aligned simplified design in the VAT Directive for these mostly targeted and local schemes may not be appropriate considering the subsidiarity principle.

Different rules for domestic and foreign traders and suppliers

The territorial nature of the SME schemes leads to the **non-application of special schemes and measures to traders from other Member States that make cross-border supplies which are taxable for VAT in another Member State**. Therefore, SMEs are faced with standard VAT regimes (and obligations) for their cross-border sales in a Member State different than the one of establishment, while domestic businesses with the same characteristics (e.g. turnover) benefit from special schemes and related lower compliance costs.

²⁴⁶ See Section 4.2.1 'SME exemption scheme', Table 4.

²⁴⁷ See Sections 4.2.2. and 4.2.3.

This territorial limitation was logical in the policy and economic context when the relevant provisions of the VAT Directive were drafted, and as long as the origin principle for taxation was pursued. It has been embedded in the VAT Directive in the case of the SME exemption and graduated relief schemes, where it specifically prohibited to apply these schemes to the supplies of non-established businesses²⁴⁸.

The discriminatory nature of such application and the potential breach of an EC Treaty (principle of non-discrimination) and the general principle of equal treatment was also discussed in a CJEU case²⁴⁹, where the limited application was considered justified at this stage in the evolution of the VAT system.

However, the VAT framework is changing. Current international standards are based on the destination principle and recommend that according to the neutrality principle in a cross-border context, domestic and foreign businesses ought to have similar tax burdens: 'With respect to the level of taxation, foreign businesses should not be disadvantaged or advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid.'²⁵⁰

The territorial nature of the SMEs special schemes may not necessarily represent a problem for all schemes or all types of SMEs. For instance, some of the special schemes and measures apply to industries that do not typically trade across borders (e.g. in Belgium the flat rate scheme applies to café owners, chip shops, pharmacists etc.). In this case, the territorial nature of schemes does not directly affect SMEs in these industries²⁵¹.

In general, however, and given the expected increase in cross-border trade, the distortive effect of the territorial application of the SME schemes leads to distortion of competition for businesses operating cross-border (see Section 5.4.2), an uneven playing field in the EU Single Market (see Section 5.5) and is not consistent with a destination-based VAT system (see Section 5.2.2)²⁵².

Diversity of national SMEs schemes across the EU

The VAT Directive guarantees **flexibility** to Member States in the design of SME special schemes. This is reflected in the large variety of VAT-related obligations across Member States, with regard to VAT standard regimes²⁵³, SME schemes and additional simplification measures²⁵⁴.

The **territorial nature** of VAT legislation has direct implications for those businesses trading cross-border, as they need to be aware of, and comply with, different sets of obligations per each of the Member States where they have sales.

²⁴⁸ Article 283(1)(c) of the VAT Directive.

²⁴⁹ CJEU, judgment of 26 October 2010, *Schmelz*, C-97/09, EU:C:2010:632,

²⁵⁰ OECD, International VAT/GST Guidelines 2015, p. 16, available: <http://www.oecd.org/tax/consumption/international-vat-gst-guidelines.pdf>, consulted on 14 June 2016.

²⁵¹ Although some type of services have been taxed at destination since the Sixth Directive (Council Directive 77/388/EEC) came into force in 1977, such as services linked to immovable property. Therefore, foreign suppliers of these services (e.g. construction services) have been disadvantaged for a long time.

²⁵² One such example of the issues caused by the territorial nature of schemes is linked to the entry into force on 1 January 2015 of the new rules regarding the place of supply of telecommunications, broadcasting and electronically supplied services. According to the new rules, small businesses having had no VAT obligations in their own Member State have to charge VAT to their customers in other Member States whereby it is not possible to exempt the supplies of services supplied by businesses not established in that Member State. The e-Commerce proposal aims to alleviate the consequential burdens.

²⁵³ Annacondia F (eds, (2016), EU VAT Compass 2016, IBFD p 591-797, available: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/16_024_EU_VAT_Compass_2016-2017_final_web_0.pdf, consulted 1 May 2017.

²⁵⁴ Out of the 28 Member States, 26 apply the SME exemption scheme, 3 the graduated relief, 8 the flat-rate scheme, 24 a cash accounting scheme, and all of them foresee simplification measures for SMEs, besides the application of a special scheme (e.g. longer reporting periods, simplified bookkeeping, etc.). In addition, the national design of each SME special scheme and further simplification differ across Member States, with regard to e.g. eligibility requirements, VAT obligations businesses from which businesses are exempt. See Section 4.2.1.

While SMEs already have issues in complying with domestic VAT obligations (see Section 5.3.1), **compliance with cross-border obligations** represents an even higher obstacle. Linguistic and cultural barriers add up to the inherent complexities of the VAT framework, which increase SMEs' reliance on tax advisors and accountants for cross-border sales (when they can afford such costs) or limit their willing to trade cross-border.

This lack of alignment together with the domestic nature of SME schemes may create problems for businesses which start trading cross-border or have incidental cross-border supplies (taxable in another Member State). One simple example (referred by some of the businesses interviewed for this study) is where the SME supplier is benefitting from the SME exemption scheme and is also relieved from all VAT obligations on their domestic supplies. Such SMEs may not understand or be aware of the consequences of starting trading in another Member State (e.g. that it is required to register for VAT and cannot benefit from the SME exemption scheme in the other country or apply the domestic scheme to all its cross-border supplies).

Similar confusion was identified in cases where the SME exempt under the scheme may not be aware of its potential VAT obligations when purchasing goods or services from other Member States. The practical applications of the SME exemption scheme in Member States may also differ in these circumstances (e.g. whether an exempt SME is required to register for VAT purposes on receipt of taxable services from a non-established taxable person in another Member State).²⁵⁵

Businesses' interviews during fieldwork pointed out that, due to their limited resources, the differences between Member States' VAT legislation are too complex for SMEs and changes in legislation are difficult to monitor. Importantly, the SMEs reported that **the information on tax rules is hard to find**, and the level of information provided by the Member States and the quality of it is not consistent across all EU Member States. This can lead to an unfair playing field at an EU level, due to better informed and compliant (larger) traders versus (smaller) traders spending a disproportionate amount of resources on being VAT compliant or instead deciding to be non-compliant.

5.4 Problems

Problems derive from the drivers identified and constitute the main issues concerning the current context. The key problems for SMEs in this context are the **high compliance cost**, especially in cross-border trade, causing **cross-border distortions of competition**, and when **breaching the eligibility threshold** for the SME scheme, causing the threshold effect. The key problem for tax authorities is the loss of VAT revenue from provided tax benefits and non-compliance

5.4.1 Compliance costs for SMEs

Literature²⁵⁶ is consistent in assessing VAT-related **compliance costs as high and significant** for businesses. In addition, such compliance costs are **regressive**, in the sense that SMEs are more than proportionally affected by compliance requirements than larger businesses²⁵⁷.

²⁵⁵ As per HSBC's recent investigation of export activity among UK SMEs, 73% indicated a lack of international business experience and knowledge as a hindrance to accessing other markets. See p. 2 of *Exporting for growth: the SME perspective*, available at: <https://www.knowledge.hsbc.co.uk/trading-overseas/article/exporting-for-growth-the-sme-perspective>

²⁵⁶ Barbone L., Bird R. M., Vazquez-Caro J. (2012), *The cost of VAT: A Review of the Literature*, International Centre for Public Policy, available at: <http://icepp.gsu.edu/files/2015/03/ispwp1222.pdf>

The analysis of VAT-compliance costs for B2C businesses trading cross-border pointed out a similar disproportionate burden. The annual VAT-compliance costs were estimated to approximately EUR 8 000 per year per each Member State the business is VAT-registered, while the costs for SMEs was calculated of about EUR 5 000²⁵⁸. Furthermore, while it is estimated that the costs per return for submitting VAT returns for micro- and small businesses (from about EUR 300 to about EUR 450) is lower than for large companies in absolute terms (ranging approximately from EUR 600 to EUR 1 500), the share of such costs compared to the business turnover is much higher²⁵⁹.

When considering **micro-and small businesses** (i.e. business with a turnover up to EUR 100 000), our analysis reported similar conclusions²⁶⁰. In the status quo, the estimated overall costs that those businesses face to comply with VAT obligations is estimated at **approximately EUR 68 billion per year**. This figure includes businesses using the SME exemption schemes, businesses opting for the standard VAT regime (while being eligible for the SME exemption schemes) and businesses under the standard VAT regime (as not eligible for the SME exemption schemes)²⁶¹.

Based on our analysis, the overall compliance costs for the 11.2 million businesses in the EU that apply the SME exemption scheme amount to approximately **EUR 6.1 billion per year**, with large differences across Member States depending on national obligations (estimated costs per business range from EUR 190 to approximately EUR 1 800, with an average of EUR 1 100). For the 20.7 million businesses with turnover up to EUR 2 million which operate under the VAT standard regime (either opting out of or not eligible for the VAT exemption regime), compliance costs are estimated at approximately EUR 3 000 per year, with differences across Member States based on frequency and complexity of VAT obligations, advisory and additional costs. These figures underscore the relevance of the SME exemption scheme, as subjecting the businesses currently applying the SME exemption scheme would suffer an additional EUR 27 billion administrative burden if placed under the VAT standard regime, while the extra VAT revenue for the Member States is estimated at only EUR 3.8 billion.

In addition, most of the compliance costs are fixed, as they do not depend on variable reporting obligations, but are linked to acquiring and developing knowledge of the VAT system, registering for VAT (where required), establishing the necessary systems and procedures (for bookkeeping, invoicing, etc.). Furthermore, many of such costs are one-off initial costs, to be borne by businesses even before starting to trade in other Member States. Given the fixed, one-off nature of most of the compliance costs, they have a heavier impact on SMEs and can thus become a real market-entry barrier for SMEs (especially in cross-border contexts)²⁶².

²⁵⁷ European Commission (2011), A retrospective evaluation of elements of the EU VAT system, prepared by the Institute for Fiscal Studies in consortium with CBP, CAPP, CASE, CEPII, ETLA, IFO and HIS, p. 97, available: http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/studies/report_evaluation_vat.pdf

²⁵⁸ European Commission (2016), Modernising VAT for cross-border eCommerce, Lot 2, pp. 46-47, available at: https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot2.pdf.

²⁵⁹ European Commission (2013), Study on the feasibility and impact of a common EU standard VAT return, prepared by PwC, p. 136, available at: http://ec.europa.eu/taxation_customs/publications/studies-made-commission_en.

²⁶⁰ See Section 7.2.1 for more details.

²⁶¹ It has to be pointed out that SMEs (and especially small and micro-businesses, such as the ones which are the focus of our study) are often under-represented in available studies. For instance, the 2010 study (prepared by Ramboll et al.) does not include specific figures on SMEs and does not include micro-businesses in the analysis, while the 2011 study (prepared by PwC) provides figures on micro-businesses only on some of the costs items analysed.

²⁶² European Commission (2011), Ibid.

In addition, SMEs experience difficulties in **accessing relevant information** about legislative requirements (including on VAT), and in acquiring the knowledge necessary to comply with those. While many larger businesses rely on external advisors as well²⁶³, the dependence on external advisors is more evident in the case of SMEs (and micro-businesses). Among the businesses interviewed for this study, about 90% has external advisors helping them to comply with VAT (and other legislative) requirements. The average advisory fees vary across Member States depending on factors such as the VAT regime businesses apply, the complexity of national regulations, the frequency of some reporting obligations (such as VAT returns) and local labour costs. Nevertheless, it was found that the average advisory costs for very small businesses (such as the ones addressed by this study) represent from one third to half of the annual compliance costs²⁶⁴.

5.4.2 Distortion of competition for businesses operating cross-border

Already in 2003, the Commission reported in its Internal Market Scoreboard *“in November 2000 a Commission survey showed that 26% of businesses considered difficulties related to the VAT system and VAT procedures to be an obstacle to doing business in the Internal Market. In September 2001 a further survey showed that VAT payments and refunds were rated third among regulatory burdens that are the most costly for companies. The multiplicity and complexity of the VAT requirements in the 15 Member States, combined with difficulties in obtaining foreign refunds leads to substantial costs and represents a real barrier to cross-border activities”*²⁶⁵. Nowadays, commentators still point out how VAT can “distort competition between foreign and domestic business”²⁶⁶.

The current EU VAT system leaves considerable **operational and administrative freedom** to Member States (based on the subsidiarity principle). This means that, despite European coordination on the basic structure of VAT, the situation is still such that businesses operating in the Single Market have to deal with complex and heterogeneous patchwork of different national VAT rules.

This can **negatively affect the level of cross-border trade** in the Single Market. Dealing with different national VAT systems may create a fixed-cost market-entry barrier, because of the costs involved for the trading businesses in adapting to other Member States’ VAT regimes. Such fixed-cost trade barriers could have a negative impact on participation in trade, particularly for SMEs, as they need to sustain such costs even before starting to trade²⁶⁷.

Given the small revenue impact of the SME exemption scheme, particularly where applied cross-border, **compliance costs** faced by businesses in cross-border situations can be considered as a proxy of **distortion of competition** between businesses trading cross-border and domestically established businesses. There is a lack of evidence from literature on distortion of competition among SMEs trading cross-border, especially the very small ones which may benefit from SME schemes.

Overall, micro businesses (such as businesses eligible for the SME exemption scheme domestically) tend to have very **limited cross-border sales**; available evidence suggests that about 15% of SMEs trade cross-border, and that the vast majority of those (67%) make B2B supplies²⁶⁸. Cultural and language barriers, scarcity of knowledge and information about legal (including VAT) obligations in

²⁶³ European Commission (2010), Ibid.

²⁶⁴ See Section 7.2.1 on compliance costs for business

²⁶⁵ European Commission (2003), Internal Market Scoreboard, EC, Brussels

²⁶⁶ Global Trends in VAT/GST and Direct Taxation: Schriftenreihe IStR Band 93, edited by Sebastian Pfeiffer, Marlies Ursprung-Steindl 2015, para. 161.

²⁶⁷ European Commission (2011), Ibid.

²⁶⁸ See Section 7.2.1 and Volume II Annex I, Section I.2 ‘General Assumptions’, ‘Number of SMEs trading cross-border’.

other Member States are some of the factors that limit SMEs cross-border trade (see Section 5.3.1). In addition, compliance costs represent another important factor.

Available evidence suggests that SMEs that are able to apply the domestic treatment of B2C sales (especially if benefiting from the SME exemption scheme) on cross-border supplies are likely to do so, to minimise their compliance costs.

Therefore, the application of the destination principle represents a challenge for many SMEs, as they are faced with as many different VAT systems (and related compliance costs) as the Member States to which they have sales. The use of the MOSS provides notable economies of scale (more than 90% when used for submitting and paying VAT returns in more than one Member State)²⁶⁹ and reductions in compliance costs (costs estimated at about EUR 690 per year). Still, businesses willing to trade cross-border are faced with compliance similar (if not higher) than the one they face domestically, as the annual VAT compliance burden for businesses operating domestically under the SME exemption scheme is estimated at EUR 550 per year. Such situations result in a competitive disadvantage and reduced market access for SMEs. In addition, such rules may result in an increased dependence of SMEs on intermediaries for accessing market.

The territorial nature of the SME schemes leads to the **non-application of special schemes and measures to foreign traders that make cross-border supplies which are taxable for VAT in the Member State concerned**. Therefore, SMEs trading cross-border are faced with standard VAT regimes (and obligations) for their sales in a Member State different than the one of establishment, while domestic businesses with the same characteristics (e.g. turnover) benefit from special schemes and related lower compliance costs. Despite anecdotal evidence on this issue, available sources do not provide figures on the magnitude of this problem (e.g. number of businesses concerned or volume of transactions affected).²⁷⁰

5.4.3 'Threshold effect' of exiting the SME schemes

SME schemes are an inherent part of the design of VAT in the EU, and provide relief from paying VAT and related VAT obligations. While Member States differ in terms of type and characteristics of the schemes applied, all of them implemented one or more SME special schemes, the SME exemption scheme being the most popular²⁷¹.

Relieving SMEs from highly burdening compliance costs, and the tax administrations from the corresponding administrative costs, provide the **rationale for the SME exemption scheme** (and for the other SMEs special schemes)²⁷². The costs of ascertaining VAT liabilities, registering for VAT, bookkeeping, invoicing and so on are substantial, and particularly significant for SMEs, since many of these costs are fixed rather than proportional to turnover²⁷³. High compliance costs correspond to small VAT revenues, as evidence suggests that while SMEs represent about 98% of businesses in the EU,

²⁶⁹ SWD(2016) 382 final and European Commission (2016), VAT aspects of cross-border e-Commerce – Aspects for modernisation – Lot 3, prepared by Deloitte, Ibid, p. 15.

²⁷⁰ European Commission (2011), A retrospective evaluation of elements of the EU VAT system, prepared by the Institute for Fiscal Studies in consortium with CBP, CAPP, CASE, CEPII, ETLA, IFO and HIS, available at: http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/studies/report_evaluation_vat.pdf.

²⁷¹ See Section 4.2 for a detailed overview of the SME schemes implemented by EU Member States.

²⁷² A large part of available literature and evidence focus on the SME exemption scheme. Therefore, this subsections focuses on such SMEs special scheme, unless differently specified.

²⁷³ See Section 5.4.1

they only generate about 19% and 25% of gross and net VAT revenues respectively. More importantly, almost all of the net VAT revenues are generated by businesses with turnover above EUR 50 000 (therefore not likely to benefit from the SME exemption scheme or other SME special schemes²⁷⁴).

Optimal level of the SME exemption threshold

The identification of the **optimal level of the SME exemption threshold** is an important factor in the design of the SME special schemes, as it aims to reconcile the diverging needs of reducing compliance and administrative costs and of collecting VAT revenues²⁷⁵. The optimal turnover threshold for VAT registration (and collection) has been discussed by relatively little research literature. Keen and Mintz elaborated on a model that follows this approach and sets the optimal threshold at the level where the costs and benefits of a marginal change of threshold will be exactly balanced²⁷⁶. A marginal reduction in threshold would gain additional revenue, but would add an equivalent amount to the administrative costs of tax administrations and to the compliance costs for businesses.

In the Keen and Mintz model, the optimal SME exemption threshold is translated into a formula that takes into account both the costs for the tax authorities and for the businesses, as well as the VAT rate level and the share of value-added in turnover (which reflects the fact that exempt businesses cannot claim back input VAT)²⁷⁷.

The trade-off between the reduction of administration and compliance costs and the minimisation of distortions arising from the differential treatment of businesses above and below the thresholds leads to the threshold in the Keen and Mintz model being set at a considerably high level, about EUR 100 000²⁷⁸. A study calculating a potential optimal VAT rate for USA showed an optimal threshold of about USD 200 000 at a 10% VAT rate²⁷⁹.

An application of such model to the EU Member States on the basis of some representative assumptions about key parameters²⁸⁰, leads to an average EU VAT exemption threshold of EUR 67 000 (EU-27), ranging from EUR 56 000 to 93 000 across Member States²⁸¹. Sensitivity analysis on such exercise shows that higher administrative and compliance costs would increase the optimal level of the threshold, while a lower share of added-value in turnover (V), which reflects labour-intensive industries, leads to a notable lowering of the optimal threshold (estimate of EUR 15 000 at EU average

²⁷⁴ See in Section 4.2.1, Figure 23 on SME exemption thresholds in Member States.

²⁷⁵ OECD, International Tax Dialogue: Key issues and debates in VAT, SME taxation and the tax treatment of the financial sector, 2013, available at <http://oecd.org/tax/tax-global/ITD-publication-decade-sharing-experiences.pdf>, consulted on 7 January 2016.

²⁷⁶ Keen and Mintz (2004), The optimal threshold for a Value-added tax, Elsevier Journal of public economics 88(3-4), pp. 559-576

²⁷⁷ In a formula, the optimal level of VAT exemption threshold (Z^*) is defined as:

$Z^* = [DA + C] / [(D-1)tV]$, where:

D is the marginal costs of public funds, A represents the administrative costs borne by tax authorities, C is the compliance costs borne by businesses, t is the VAT rate, and V is the share of value-added in turnover share of value-added in turnover (which reflects the fact that exempt businesses cannot claim back input VAT).

Value-added by firms is the different between their gross turnover and the inputs purchased. The higher is the level of taxed input purchases relative to the firms' sales, the lower is V and the lower is the net revenue loss from exempting the firms' sales from VAT.

²⁷⁸ Keen and Mintz (2004), Ibid, p. 573.

²⁷⁹ Brashaers E, Knittel MJ et al, (2014) Calculating the Optimal Small Business Exemption Threshold for a US VAT, National Tax Journal 67(2), pp. 283-320 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443979&download=yes consulted on 6 January 2017.

²⁸⁰ The exercise updated estimates for administrative and compliance costs from 1994 and estimates them at EUR 135 per year for tax administrations and at EUR 675 per year for businesses. It also estimates the tax rate to be the standard VAT rate, the share of value-added in turnover (V) of 0.3 and the marginal cost of public funds (D) of 1.2.

²⁸¹ European Commission (2002), Ibid, p. 83

level)²⁸². Such high variance suggests that calculations should be taken cautiously, as they are very sensitive to uncertain parameters.

Keen and Mintz list four main additional considerations that arise while setting the optimal level of the threshold: design of optimal audit strategies, potential connection to administration of income taxes, adverse impact on B2B trade, and lastly the distributional effects from the regressive nature of the compliance costs weighted against the competitive advantage from exemption (at least in B2C trade).²⁸³

Distortions inherent to the SME exemption scheme

While the design of the SME exemption scheme varies among Member States, in all of them businesses' eligibility is based on a set turnover threshold. The **national threshold of the SME exemption scheme is one of the key features** of the VAT system and the level at which a Member State decides to set it depends on the combination of a number of economic, compliance risk and other factors. However, the thresholds applied by the Member States in practice are generally significantly lower than those identified as optimal by literature (even if there is a trend towards a limited increase of such thresholds)²⁸⁴. This indicates that the **efficiency, although a significant factor, is only one of the factors taken into account in setting the exemption threshold** for the SME exemption scheme and a range of wider policy factors may have been considered. In addition, while relieving businesses from compliance costs (and tax authorities from administrative costs), there is evidence (while limited) that such threshold hinder the growth of SMEs in the medium to long term.

The SME exemption threshold itself creates **distortions**, as it creates an incentive for businesses to remain below the turnover threshold (so called 'threshold effect, which can lead to different behaviours, such as limiting sales (and thus growth) and fraudulent methods such as underreporting of sales.

With regard to the **threshold effect**, Keen and Mintz found evidence that SMEs are likely to bunch just below the VAT threshold due to fixed elements in the compliance costs and the high marginal costs involved with breaching the threshold²⁸⁵. As a way to avoid breaching the threshold, businesses can be also artificially split, as detected in the case of Japan²⁸⁶. Recent data from UK provided further evidence of bunching behaviour of businesses (i.e. a very high concentration – or grouping – of businesses immediately below the threshold) right below the turnover VAT exemption threshold, and suggests that a part of bunching is driven by under-reporting of sales (i.e. fraud)²⁸⁷.

Such literature is consistent with the findings of the fieldwork, as some of the businesses interviewed identified one of the main negative implications of the SME exemption scheme the 'disincentive to grow'. While available analysis does not provide an exact quantification of such threshold effect, it

²⁸² European Commission (2002), *Ibid*, p. 85

²⁸³ Keen and Mintz (2004), *Ibid*, p.574.

²⁸⁴ See Section 4.2.1. regarding 2017 threshold increases in France, Luxembourg and planned 2018 increase in Estonia.

²⁸⁵ Keen and Mintz (2004), *Ibid*.

²⁸⁶ Onji, K (2009), The response of firms to eligibility thresholds: Evidence from Japanese value-added tax *Journal of Public Economics* 93, (3-4), pp. 766-775.

²⁸⁷ In particular, Lockwood and Liu argue that a bunching is more likely when the cost of inputs relative to sales is low, or when the proportion of business-to-consumer sales is high. Their evidence suggests that the salary-inclusive input-cost ratio moves in parallel between the registered and non-registered group outside the bunching region, but starts to increase substantially for the non-registered companies just below the threshold. They interpret the large and sharp increase in the salary-inclusive input-cost ratio to be partly driven by the fact that it is costly to under-report salary expenses due to third-party reporting.

Lockwood and Liu (2015) Efficiency and welfare costs of VAT: Evidence from VAT notches, See: <http://voxeu.org/article/efficiency-and-welfare-costs-vat>.

shows that it is more than anecdotic, but happens to a non-trivial number of companies. For instance, Lockwood and Liu say that *"These patterns suggest that as small firms grow and approach the threshold, a non-trivial proportion of them slow down their growth to avoid crossing the threshold for registration, for which the saving in tax and compliance costs exceeds the reduction in sales volume"*²⁸⁸.

While a large share of the available literature focuses on the VAT exemption threshold, some analyses consider other SMEs special schemes, and namely the VAT graduated relief as applied in Finland.

The Finnish system was reformed in 2004, with the introduction of a sliding scale of tax rates when the business' turnover exceeds EUR 8 500 (below which is exempt from VAT) but is below EUR 22 500²⁸⁹. A first analysis of the impact of the introduction of such scheme was carried out in 2011²⁹⁰. It found out that the bunching behaviour decreased after the reform, but a large share of non-registered businesses remained, as such businesses seemed to restrict their turnover just below the registration threshold of then EUR 8 500, showing thus sign of voluntarily limiting their growth to benefit from the exemption.

A more recent study on the Finnish VAT graduated relief system pointed out that both the exemption (pre-2004) and the graduated relief system (after the reform) show significant and very similar bunching patterns from businesses, implying that compliance costs are important in explaining why SMEs actively stay below the threshold²⁹¹. The study did not find evidence that businesses stay below the threshold due to fraudulent behaviour (e.g. active avoidance and evasion) or via splitting in multiple firms, suggesting that businesses responded to the design of the graduated relief scheme by voluntarily limiting their sales. The study found that such bunching behaviour appears to be relatively permanent, implying that the **threshold decreases the growth of small businesses and thus overall economic growth in the medium to long term**²⁹².

5.4.4 VAT revenue loss

The design of SME schemes (and especially of the SME exemption scheme) implies a trade-off between the wish to support economic activities and entrepreneurship (by relieving businesses from a set of obligations and related costs) and the need to guarantee a level playing field for all economic operators (having all of them subject to the same obligations). By relieving SMEs from a set of VAT-related obligations, tax authorities also prioritise the support to (small and very small) economic activities (which can be undermined by the full set of obligations) over the need to monitor such activities²⁹³. In addition, tax authorities decide to part with the corresponding share of VAT revenue.

The implementation of SME schemes affects VAT revenues in three ways:

- VAT foregone due to exemption and other SME schemes providing tax benefit;

²⁸⁸ Lockwood and Liu (2015), Ibid.

²⁸⁹ Currently, both thresholds have been raised to EUR 10 000 and EUR 30 000 respectively. See Section 4.2.2 for a more detailed description of such scheme.

²⁹⁰ Rauhanen and Venetoklis (2011), Graduated tax relief system of VAT in Finland, Mimeo.

²⁹¹ Harju, J. Matikka T. and Rauhanen T. (2015), The Effect of VAT Threshold on the Behaviour of Small Businesses: Evidence and Implications, CESifo Area Conference on Public Sector Economics.

²⁹² Harju J. Matikka T. and Rauhanen T. (2015), Ibid.

²⁹³ Tax authorities in Member States use different methods to overcome these compliance control challenges. In some cases businesses are registered with the tax authorities for other taxes or are generally required to register when they start business activities. Tax authorities use also data from other governmental bodies (e.g. the commercial register) to gather information about businesses and their turnover.

- Non-compliance and fraud, such as traders covered by the SME special schemes fraudulently under-reporting (or under-recording, if not reported) taxable turnover to remain within the beneficial regime;
- Possible abuse of the optional nature of the SME special schemes, such as voluntary registrations and excessive input VAT claim.

With regard to the first element, evidence suggests that while SMEs represent about 98% of businesses in the EU, they only generate about 19% and 25% of gross and net VAT revenues respectively. More importantly, almost all of the net VAT revenues are generated by businesses with turnover above EUR 50 000 (therefore not likely to benefit from the SME exemption scheme or other SME special schemes²⁹⁴). Therefore the **VAT foregone** due to exemptions and other SME schemes is likely to be negligible.

Indeed, based on our estimates, approximately 11 million businesses are exempt from VAT under the exemption scheme in the EU, which generate a turnover of approximately EUR 109 billion per year²⁹⁵. Using the effective VAT rate of 12.3% adopted throughout the entire study and on data on VAT revenue/final consumption in the EU, it is possible to estimate the gross VAT revenue that exempt businesses would generate, i.e. EUR 13.4 billion, or 1.3% of net VAT revenues. This represents the upper bound of VAT revenues at stake. However, accounting for the fact that businesses would then deduct their input VAT, the actual net VAT revenue at stake is estimated of EUR 3.8 billion, or 0.4% of net VAT revenues collected in the EU²⁹⁶.

The consultations with tax authorities identified some concerns regarding **non-compliance levels and fraud** that would be inherent to or facilitated by a VAT exemption scheme with in general no or limited reporting obligations, however no quantitative data on these issues was provided within the framework of our study nor is it available in the existing VAT Gap calculations. Several Member States did point out that they have confidence in their broader compliance control systems to track such non-compliance and fraud and that therefore the balance regarding risks and potential impacts and costs involved is about right. **Fraud concerns regard also other SME schemes, e.g. flat rate schemes** (such as recently identified abuse in the UK relating to the artificial splitting of mostly labour based businesses²⁹⁷). Most of these frauds depend on the design of each SMEs special scheme, which is a prerogative of each Member State, therefore harder to address by EU level tax policy measures.

Further **concerns on abuse of the SME exemption scheme relate mainly to voluntary registrations (which Member States are required to allow) and fraudulent input VAT deductions**, which are mitigated by more rigorous background checks on VAT registration. Some suggestions were made that a partly mandatory SME scheme and a limitation for opting out may help tax authorities to control the compliance and further reduce their administrative cost. Some of these concerns relate to the increasing complexity of defining economic activity for VAT purposes and identifying taxable person, and therefore could benefit from a policy intervention at EU level.

²⁹⁴ See in Section 4.2.1, Figure 23 on SME exemption thresholds in Member States.

²⁹⁵ Based on the assumption that those businesses have a turnover below EUR 50 000 and on the data on average turnover collected during the study (see Volume II, Annex I), and Figure 7.

²⁹⁶ Based on the average net/gross ratio of 0.28 used in the analysis of the Status Quo (see Section 7.2) and Figure 13.

²⁹⁷ See Section 4.2.3 on the description of the VAT flat-rate scheme.

5.5 Effects

Effects are the current and future consequences of the problems acknowledged. The effects identified include not realising the full potential of the **Single Market, SMEs being discouraged to grow, SMEs being discouraged to trade cross-border** and an **uneven playing field for EU businesses**. SMEs represent 98% of all businesses that provide two-thirds of the private sector employment in the EU²⁹⁸. The Commission considers them the backbone of the EU economy²⁹⁹.

Businesses face high and relevant costs to comply with VAT-related obligations, and SMEs face an even bigger challenge, given that such costs are to a large extent fixed and one-off. The high compliance burden imposed on businesses (and the administrative costs faced by tax authorities), combined with the low VAT revenue generated, provides the rationale for relieving SMEs from (many of) VAT-related obligations, and for creating SME special schemes. The reduced burden on businesses supports thus the objective of supporting economic activities in Europe and ultimately long-term growth.

The VAT Directive guarantees flexibility to Member States in the design of SME schemes (in line with the subsidiarity principle, as many SMEs are local by nature). This is reflected in the large variety of VAT-related obligations across Member States, with regard to VAT standard regimes³⁰⁰, SME schemes and additional simplification measures³⁰¹. SME schemes have thus a territorial application, which was consistent with the policy and economic context when the relevant provisions of the VAT Directive were drafted, and with the adoption of the origin principle for taxation.

However, the combination of technological developments, larger international economic trends (such as the increase in international trade), the development and implementation of international standards for international accounting and the move towards the principle of taxation at destination have affected deeply the functioning of the SME special schemes, leading to or worsening **(unintended) consequences**.

The very setting of eligibility thresholds for SME schemes based on turnover has directed SMEs to actively remain below the turnover threshold ('bunching behaviour'), in order to avoid VAT compliance costs. While such behaviour may not necessarily lead to fraudulent measures (such as systematic under-reporting of sales, with consequent tax evasion), there is evidence that it hinders **medium to long-term growth**, as businesses tend to remain below the threshold for many years³⁰².

The regressive nature of compliance costs (affecting SMEs disproportionately), the large differences of VAT regulations including of SME schemes and the territorial nature of their application combined together, lead to a situation where businesses (and especially SMEs) are discouraged to trade cross-border. SMEs trading cross-border would in fact be faced with increased (regressive) compliance costs (a different regulation for each Member States where they have sales), and most likely different rules. They would not be able to benefit from any of the SME schemes and simplifications available to

²⁹⁸ See Volume II, Annexes B, C and D for details.

²⁹⁹ See: <http://ec.europa.eu/growth/smes/>

³⁰⁰ Annacondia F (eds, (2016), EU VAT Compass 2016, IBFD p 591-797, available: https://www.ibfd.org/sites/ibfd.org/files/content/pdf/16_024_EU_VAT_Compass_2016-2017_final_web_0.pdf , consulted 1 May 2017.

³⁰¹ Out of the 28 Member States, 26 apply the SME exemption scheme, 3 the graduated relief, 8 the flat-rate scheme, 24 a cash accounting scheme, and all of them foresee simplification measures for SMEs, besides the application of a special scheme (e.g. longer reporting periods, simplified bookkeeping, etc.). In addition, the national design of each SME special scheme and further simplification differ across Member States, with regard to e.g. eligibility requirements, VAT obligations businesses from which businesses are exempt.

³⁰² See Section 5.4.3.

businesses established in the other Member State. This could reflect in their final prices, which are likely to be higher and thus to make cross-border suppliers less competitive than the domestic ones.

Removing such obstacles is likely to support the economic activities of SMEs, reduce distortions and ultimately helping to achieve the **full potential of the Single Market**. Available evidence suggests that a 10% reduction in the dissimilarity of the general VAT administrative procedures between Member States would lead to a 3.7% rise in cross-border trade, while real GDP and consumption would increase by 0.4% and 0.3% respectively³⁰³.

³⁰³ European Commission (2011), A retrospective evaluation of elements of the EU VAT system, *ibid*, p. 23.

6 Development of policy options

This section focuses on definition of the objectives for policy intervention and the design and rationale of the policy options for review of the SME special schemes, preparing the basis for the comprehensive assessment of the options in the next section of the report.

6.1 Policy objectives

The Commission's policy objectives in the area of SMEs are based on the Small Business Act³⁰⁴ which has been aligned with the objectives of the Europe 2020 Strategy³⁰⁵³⁰⁶. The Small Business Act emphasises the reduction of the administrative burden of small businesses and supporting their free access to markets. In fact, one of the main political priorities of the European Commission is a "deeper and fairer Single Market"³⁰⁷. In this regard, the Single Market Strategy³⁰⁸ places focus on improving practical measures to help SMEs to grow and expand business across EU borders.

Internal market access and the administrative burden are intricately linked to the tax treatment of SMEs, including the VAT treatment. The Single Market Strategy³⁰⁹ and EU VAT Action Plan³¹⁰ promise a "comprehensive simplification package for SMEs that will seek to create an environment that is conducive to their growth and favourable to cross-border trade"³¹¹. Further, the Commission committed to "make legislative proposals in 2016 to reduce the administrative burden on businesses arising from different VAT regimes"³¹² with respect to the extension of the current single electronic registration and payment mechanism for cross-border online sales, the introduction of a common EU-wide simplification measure to help small start-up e-commerce businesses, removal of the VAT exemption for importation of small consignments, and allowing for home country controls for some VAT purposes³¹³. This legislative proposal was published in December 2016 and when approved by the Council will support the cross-border trade of SMEs.³¹⁴ The proposal provides significant simplification for SMEs, but further changes are needed to support SMEs trading both domestically and cross-border.

The following figure presents the policy objectives for SME schemes derived from these policy documents.

³⁰⁴ Small Business Act COM(2008) 394 final, available: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52008DC0394>.

³⁰⁵ Full text of the strategy available: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF>

³⁰⁶ The SBA Review was launched in February 2011 to integrate the SBA with the Europe 2020 strategy.

³⁰⁷ Single Market Strategy, see: http://ec.europa.eu/growth/single-market/index_en.htm.

³⁰⁸ The Single Market Strategy is the European Commission's plan to unlock the full potential of the Single Market, see: http://ec.europa.eu/growth/single-market/index_en.htm.

³⁰⁹ Ibid.

³¹⁰ Available: http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/action_plan/com_2016_148_en.pdf

³¹¹ VAT Action Plan, *ibid* 2.2.

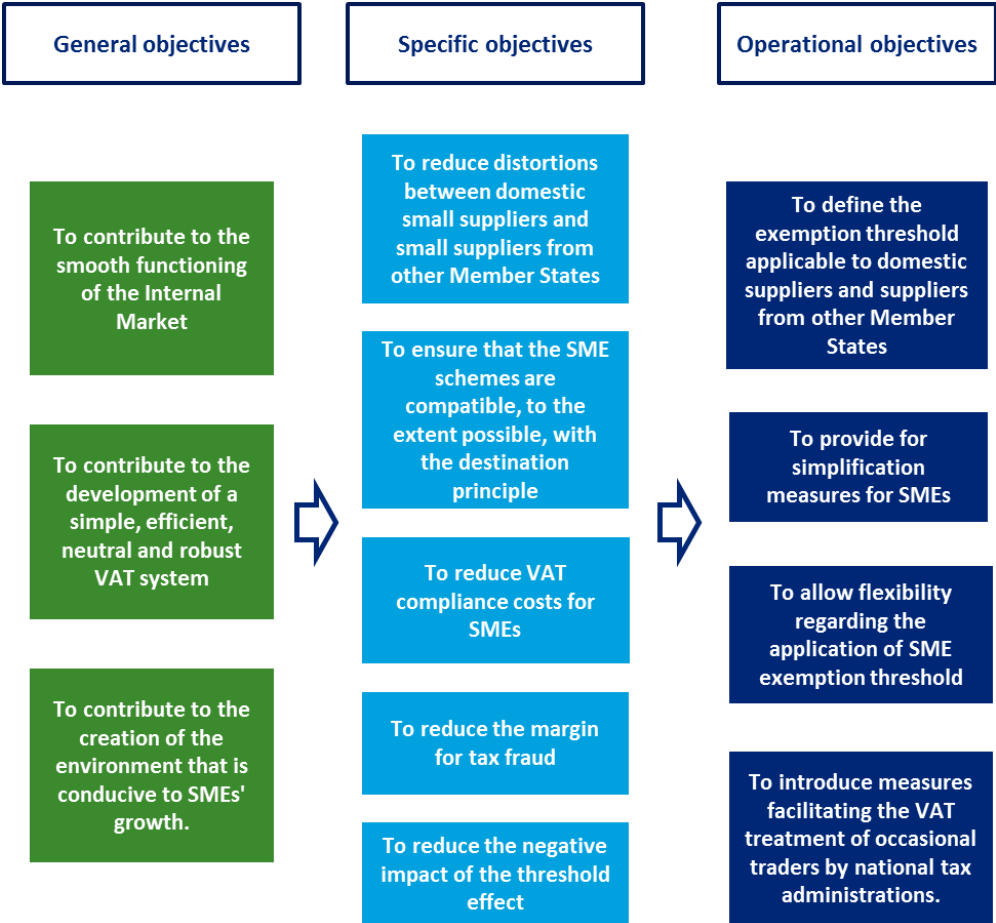
³¹² European Commission - Fact Sheet, Questions and answers - Digital Single Market Strategy, Brussels, 6 May 2015, see: http://europa.eu/rapid/press-release_MEMO-15-4920_en.htm.

³¹³ European Commission - Fact Sheet, Questions and answers - Digital Single Market Strategy, Brussels, 6 May 2015, see: http://europa.eu/rapid/press-release_MEMO-15-4920_en.htm.

³¹⁴ Commission Proposal COM (2016)757 Modernising VAT for cross-border B2C e-commerce.

The **general objectives** refer to the high level, broad objectives of the action in a broader policy context from an overarching strategy (in this case from the Europe 2020 Strategy). **Specific objectives** take into account the specific domain of the action (in this case SMEs) and aim to define crucial steps in the policy action to be taken and link the actions to the general context. The **operational objectives** are the lowest level objectives (i.e. 'nearest to the ground') and should relate most closely with result indicators of the chosen action.

Figure 35 – Policy objectives



Source: Deloitte elaboration

6.2 Policy options design

The policy options and their assessment build on:

- ❑ The above analysis on problems and policy objectives;
- ❑ Desk research on the current SME measures used in the EU and internationally and their effectiveness;
- ❑ Surveys, expert workshop and fieldwork to collect stakeholder input for future improvements;
- ❑ Other developments in the EU VAT system, such as the shift towards taxation at destination; and
- ❑ The e-Commerce proposal³¹⁵.

6.2.1 Background for the future policy changes to the VAT treatment of the SMEs

Current VAT framework – tackling existing problems

The assessment of the existing schemes applied in the Member States shows that a **majority of SMEs and micro-businesses still trade locally and benefit from the existing SME schemes** (e.g. on average 63% of eligible businesses apply the SME exemption scheme) although there is an acknowledgment, both from business interviews and in literature, that some schemes, such as the SME exemption scheme, may discourage growth. At the same time, the **current rules do not work well for the SMEs that trade cross-border** or would like to trade cross-border, as the schemes are mostly territorial.

The **current rules for the SME schemes and measures differ significantly between the Member States**, reflecting the flexibility currently provided by the VAT Directive. Although such diversity in rules complicates the EU VAT system, it has been caused by the attempt of the Member States to tailor their schemes to the national characteristics of the SME sectors and local needs (e.g. by setting different SME exemption thresholds). Therefore, an **alignment of the VAT rules ought to be balanced and take into account the diversity of the national context**³¹⁶, albeit taking the perspective of the destination country, which more and more defines the applicable VAT rules, into account.

It is also **important to keep in mind that the VAT measures are a part of the overall set of taxation and administrative framework** the SMEs need to comply with. Therefore the schemes can be linked to the non-VAT simplification measures, financial support measures outside the VAT system, the general administrative burden reduction agenda (not targeted to SMEs) and a mix of national social and economic policy objectives.

Therefore, instead of aiming for a full alignment of the VAT rules, **it may be more efficient to target the changes to the following points** : addressing distortions in cross-border trade, including the provision to SMEs of comprehensive, easily accessible and easily usable information on the VAT rules in other Member States, aligning simplification measures accompanying the SME special schemes

³¹⁵ Ibid.

³¹⁶ To note also the risk of 'upwards' harmonisation, which in the current case may limit the simplifying or supporting effect of the measures and schemes.

and introducing transitional measures to reduce the ‘threshold effect’ inherent to many SME special schemes.

Following the gradual shift towards the destination principle, the application of the SME exemption scheme (for example by relating it to supplies taxable in a Member State rather than a business establishment) should minimise distortions between local and foreign businesses, whilst the proposed common EU threshold limits the impact on the administrative burden of the smallest cross-border trading businesses. In addition, despite previous unsuccessful attempts, **some form of alignment on threshold levels may be useful** (i.e. by setting a higher maximum threshold in the VAT Directive) to remove the current reliance on derogation rules and allow flexibility in updating the threshold level by inflation.

Further encouragement of **the use of best practices within the existing legislative framework** ought to provide also better alignment between Member States and overall improvement of the VAT framework for SMEs. Such alignment may require some limited legislative support, such as adding the most widely used simplification measures into the SME exemption scheme.

As **an example of best practices, the ‘threshold effect’ is reduced by some flexibility in the application/eligibility of the SME exemption scheme** by providing the ability to opt-in and opt-out in a number of Member States (e.g. UK, Belgium). In addition to flexibility on temporarily exceeding the threshold, the ‘threshold effect’ could be further reduced by **a transitional measure, which gives businesses some extra time** to adjust to the full set of VAT obligations.

At the same time, the flexibility in opting in or out of the SME exemption scheme has caused some specific problems for tax authorities in case of occasional traders. **Clarifying the VAT treatment of incidental or occasional trading** would provide also more certainty to individuals, who don’t consider themselves as traders.

Wider context – evolution of the VAT system and other policies

Just addressing the problems with the current VAT rules for SMEs would not be sufficient, **the policy changes need to take into account the evolution of the VAT system**, which is moving towards taxation at destination, and other ongoing projects on VAT changes (especially the recent e-Commerce proposal³¹⁷), as well as other external factors such as digitalisation and the increase of e-commerce, and other relevant EU policies and strategies, such as Single Market and SME policy initiatives.

As a consequence of these developments, **the change is inevitable**. It is also inevitable that the SMEs selling to customers in other Member States will eventually become subject to the VAT rules of these Member States of destination. Therefore, in designing the future policy options, the main focus needs to be on simplification measures that SMEs would need in the new VAT environment based on the destination principle.

Due to such complexity of the impacting factors, a careful and thorough consideration is necessary in designing the policy changes, which are effective and provide appropriate support to the heterogenic, rapidly developing modern SMEs, desiring to trade freely across the EU. They should be balanced and considerate of the impacts on and interests of the tax authorities of the Member States.

³¹⁷ Ibid.

Next steps – main objectives for the policy options

Careful consideration and combination of all the aspects to be taken into account resulted in the concrete list of the main policy objectives:

- in order to contribute to the smooth functioning of the Single Market, the existing distortions would need to be addressed and the SME special schemes reviewed, with a focus on the **SME exemption** scheme, to ensure that it is compatible to the extent possible with the destination principle;
- as a contribution to development of a simple, efficient, neutral and robust VAT system, the compliance costs of SMEs should be reduced by providing for **simplification measures for SMEs** and the margin for tax fraud should be reduced by introducing measures facilitating the **VAT treatment of 'occasional traders'** by national tax authorities; and
- to contribute to the creation of an environment that is conducive to SME growth, the 'threshold effect' inherent to the SME special schemes should be reduced by introducing appropriate **transitional measures**.

6.2.2 Elements of the policy options

The above analysis forms the basis for the development of policy options. However, there are many alternative ways as to how the policy options could be designed in order to deliver the desired outcome. Therefore, as a first step the following full list of potential elements was compiled and assessed against the objectives³¹⁸:

1. SME exemption scheme (variations)

- a) General;
- b) Application – to domestic or all SMEs
 - a. Applied only nationally, to domestic SMEs;
 - b. Applied equally to all EU SMEs;
 - c. Applied also to non-EU SMEs;
- c) Level of threshold – national or standard EU
 - a. Set by Member States, based on standard criteria;
 - b. Set as standard level across the EU;
- d) Basis – total turnover, cross-border supplies or sales to a specific Member State of consumption
 - a. Domestic turnover;
 - b. Total turnover, i.e. extended to cross-border supplies;
 - c. Just on cross-border supplies;
 - d. Supplies to a specific Member State;
- e) Basis – other than turnover;
- f) Optionality
 - a. Optional for SMEs;
 - b. Obligatory, or;
 - c. Obligatory for certain type of SMEs;
- g) Number of thresholds;
- h) Graduated thresholds – extent of sales;

318 The descriptions and assessment of the elements can be found in Annex H

- i) Graduated relief – reduction of VAT burden;
- j) Graduated thresholds – alternatives;
- k) Flexible threshold;
- l) Transitional period.

2. VAT calculations, accounting simplifications and compensation measures

- a) Flat rate and presumptive tax measures³¹⁹;
- b) Reduced VAT rate for SMEs;
- c) Simplified/fixed input tax credit;
- d) Exemption for supplies to SMEs;
- e) Cash accounting;
- f) Payment flexibility measures;
- g) Less frequent filing of VAT returns;
- h) Special input VAT refund;

3. Simplified VAT administrative obligations

- a) Simplified or abolished administrative obligations
 - a. VAT registration;
 - b. VAT return;
 - c. VAT invoicing;
 - d. Evidence requirements;
 - e. Accounting standards;

4. Treatment as non-taxable person

- a) Harmonised and mandatory treatment as non-taxable person
 - 1) Applied to occasional traders;
 - 2) Applied to smallest nano-businesses;
 - 3) Applied to smaller 'micro' businesses.

6.2.3 Proposed policy options

The most suitable elements of the policy options for the delivery of the policy objectives were used in designing the policy options. Recently proposed legislative measures directly impacting the SMEs³²⁰ (especially the introduction of a common EU threshold) were also taken into account by adding the measures to the current legislative framework in order to create a new baseline scenario.

³¹⁹ Flat-rate and presumptive tax measures are a form of assessing tax liability using indirect methods such as income reconstruction or by applying base-line taxation across the entire tax base.

³²⁰ Commission Proposal COM(2016)757 Modernising VAT for cross-border B2C e-commerce.

The table below provides the full list of the policy options.

Table 17 – List of proposed policy options

Baseline scenario
Option 1: Baseline scenario (status quo with measures from the e-Commerce proposal) ³²¹
Policy changes
Option 2: SME exemption scheme extended to supplies from other Member States and including streamlined simplification measures
Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons
Option 4: Option 3 plus measures for transition period reducing the negative impact of the 'threshold effect'

In designing the policy options, a gradual change approach has been used, that is the policy options build on each other. Therefore the earlier options introduce more limited changes and the later ones contain larger changes from the current VAT system. The last option represents therefore a full package of measures. The gradual approach enables assessment of the cumulative cost and benefit effect of the policy measures, which will give a more accurate impact assessment of a policy package. The downside of this approach is, however, that it will be challenging to separate the impact of each element in the policy package.

Option 1: Baseline scenario

Description

This policy option reflects the current legislative framework of the VAT Directive, therefore the current SME exemption scheme, based on Articles 282-292 of the VAT Directive would continue, with the following characteristics:

- ❑ SME exemption scheme based on territorial VAT exemption threshold: limited to businesses established in the Member State, limited flexibility to set the level of threshold, generally based on total turnover (domestic supplies);
- ❑ Optional for Member States and businesses;
- ❑ Businesses using the scheme cannot indicate VAT on their invoices or deduct the input VAT;
- ❑ In legal terms, the scheme in its current shape is temporary and applies until the definitive VAT regime enters into force (article 294); and
- ❑ Simplification measures for businesses benefitting from the SME scheme, such as relief from VAT registration and declaration) are optional for Member States and outside of the SME exemption scheme in the VAT Directive (based on Article 272³²²).

In addition, this policy option contains the VAT changes proposed in the legislative proposal Modernising the VAT obligations on cross-border B2C e-Commerce³²³, more specifically:

³²¹ Ibid.

³²² However, Article 272 makes a reference to the SME exemption scheme, thus the possible joint application of these measures has been generally indicated also in the Directive.

- Removal of the intra-EU distance selling threshold for supplies of goods (Article 34 of the VAT Directive) and of the exemption for importation of small consignments from suppliers in third countries (Title IV Directive 2009/132/EC). Therefore, as a general rule, all cross-border B2C supplies of goods and services, as well as imports, will be charged in the Member State of the consumer, exposing a wider range of SMEs to foreign VAT regimes.
- Extension of the existing MOSS (Chapter 6 of Title XII of the VAT Directive) to intra-EU distance sales of tangible goods and services other than electronic services as well as to distance sales of goods from third countries.
- Allowing for EU sellers that apply MOSS to apply domestic rules in areas such as invoicing and record keeping.
- Introduction of a common EU threshold (total value of the supplies, exclusive of VAT, of EUR 10 000) for all B2C cross-border supplies of goods and services. Up to the threshold, an EU business making such supplies in other Member States will be able to treat these supplies as domestic transactions, including coverage by the SME exemption scheme. Once the threshold is exceeded, the supplier will be required to register and account for VAT due in all other Member States. The characteristics of the threshold are:
 - Mandatory for Member States;
 - Optional for businesses. They will be able to choose declaring VAT in the Member State of destination via the MOSS;
 - Businesses with supplies below the threshold will apply the rules of, and will be subject to control in, the Member State (including VAT rates and exemptions) where they are established.

Rationale

Problem to be addressed

Based on above characteristics, the current territorial SME exemption scheme is outdated and does not take into account the Single Market perspective and the evolution of the VAT system towards the destination principle. It does not suit SMEs trading cross-border and creates distortions, including distortions between locally established SMEs who trade either locally or cross-border.

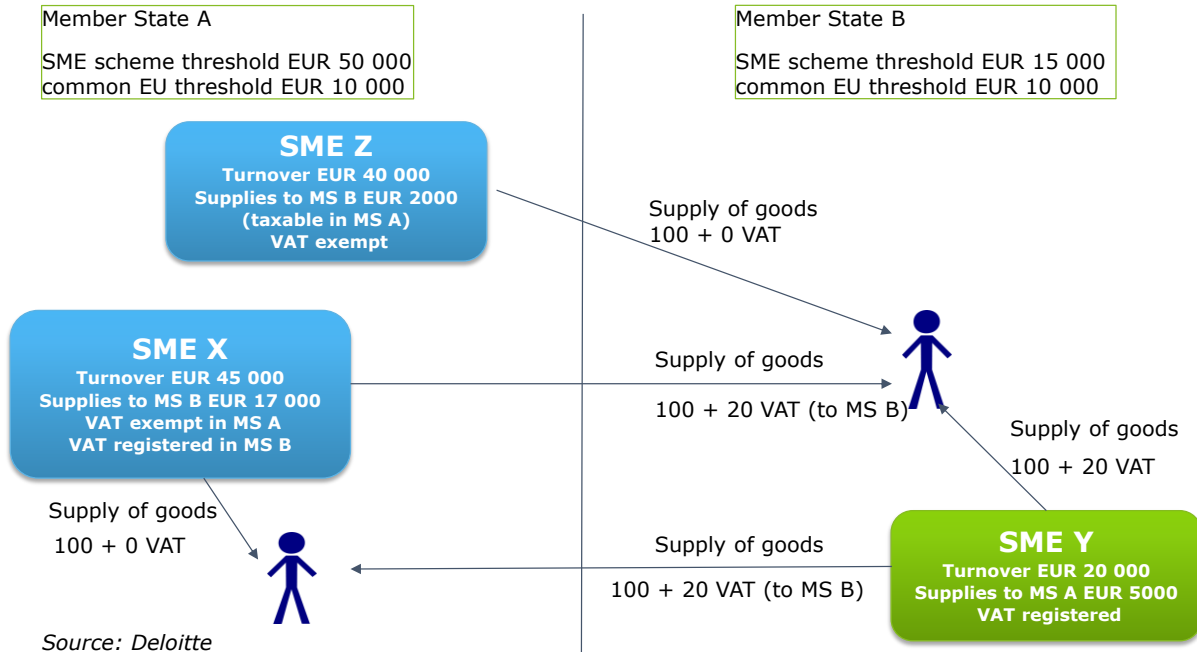
Impact of the common EU threshold and interaction with the SME exemption scheme

The introduction of the common EU threshold and extension of MOSS to all cross-border B2C supplies of goods and services provides significant simplification to SMEs trading cross-border, especially after the abolishment of the distance sales regime. According to the impact assessment of the e-Commerce proposal, up to 430 000 businesses, representing 97% of all micro-businesses trading cross-border, may benefit from the common EU threshold and continue applying their domestic VAT regime (including the SME exemption) to cross-border supplies.

³²³ Commission Proposal COM (2016)757 Modernising VAT for cross-border B2C e-commerce. In agreement with the Commission, the full package of changes proposed to be implemented from 2021 has been included in the baseline scenario, rather than considering a phased implementation of changes from 2018 and 2021.

Figure 36 below illustrates the application of the common EU threshold and its interaction with SME exemption schemes.

Figure 36 – Example of common EU threshold for cross-border supplies of domestic suppliers



As illustrated in Figure 36, the B2C cross-border supplies below the common EU threshold would be added to the domestic supplies of the SME in calculating turnover below its domestic SME exemption threshold. As long as the total turnover of all of these supplies remains below the SME exemption threshold, the business can apply exemption to all of them. However, when the total turnover exceeds the SME exemption threshold, the business has two options:

- To start applying the regular VAT regime to all of its supplies (including applying MOSS for the cross-border B2C supplies);
- To opt out of the application of the common EU threshold and continue applying the SME exemption scheme to domestic supplies (as long as remaining below the exemption threshold), whilst paying and declaring VAT through the application of MOSS for its cross-border B2C supplies.

Where the SME is not applying the SME exemption scheme, it would still receive significant benefit from the common EU threshold, as the SME can apply its domestic VAT rules also to these cross-border supplies, without, for example, the need to register for MOSS.

SMEs whose cross-border B2C supplies exceed the common EU threshold would need to start paying VAT on these supplies at the VAT rate of the Member State of destination. These SMEs may however benefit from up to a 95% reduction of their administrative burden by using MOSS for the fulfilment of their VAT obligations in other Member States, instead of having to apply the VAT rules directly in every

other Member State.³²⁴ Application of the MOSS means that the SME needs to register for VAT only once, in their own Member State through the MOSS portal, and can declare all their supplies taxable in other Member States through one MOSS return, applying the VAT rate of the Member State of destination. Regarding the domestic supplies of these SMEs, they can still continue to apply the SME exemption scheme if eligible, or pay domestic VAT.

The main advantage of the measure is that it reduces (although not fully) the distortions in VAT treatment between SMEs trading domestically or cross-border. By introducing an exemption (or application of domestic VAT rules) to cross-border sales, it may provide additional financial support to SMEs. However, more importantly, the threshold relieves SMEs from the administrative burden of full VAT registration on limited cross-border supplies.

The main disadvantage of the measure is the impact on the Member States' VAT revenue, especially on the revenue of the Member State of destination, which also breaches its sovereignty. An additional threshold introduces also an administrative obligation for businesses to monitor their cross-border supplies.

Use of best practices

This option would support some of the set objectives, such as reduction of the administrative and tax burden for SMEs trading cross-border, by the introduction of the common EU threshold. It would not, however, solve the other issues with the current VAT framework for SMEs, such as the distortion of competition or the administrative burden of domestically trading SMEs and the impact on growth of the “threshold effect” inherent to the SME exemption scheme.

By the use of non-legislative measures, e.g. encouraging the use of best practices, smaller improvements to the taxation of SMEs trading domestically could be realised. Such non-legislative measures could, for example, take the form of recommendations for best practices that Member States could use to apply better targeted SME measures (e.g. use of presumptive tax measures), to increase the effectiveness of the measures (e.g. by providing necessary information and support) or to improve the compliance control (e.g. register SMEs benefitting from the SME exemption scheme, but apply a simplified registration procedure and exemption from other obligations).

Impact of the destination-based regime

The current SME exemption scheme applies in its current form only until a destination-based regime comes into force, as Article 294 regulates that the Council shall decide whether the scheme is still necessary under the definitive regime, and if appropriate then lay down common rules for the implementation of the scheme.

Main advantages and disadvantages

The main advantage of this policy option is the general continuation of the existing system for domestically active SMEs, which constitute the majority of SMEs. Tax authorities or businesses do not need to implement any additional changes to their current systems (other than the changes introduced by the e-Commerce proposal which are related to cross-border supplies) and can continue applying the rules they know and are generally comfortable with.

The main disadvantages of the option are the temporary nature of the SME schemes and the fact that the identified problems with the current system would largely continue to apply and are likely to

³²⁴ https://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en.

increase due to other developments in the VAT system and more widely in the economy (see the above external factors).

Option 2: SME exemption scheme extended to supplies from other Member States and including streamlined simplification measures

Description

The option introduces two significant changes to the existing SME exemption scheme:

- First, the SME exemption scheme would be opened up to cross-border supplies from other Member States that are taxable in that Member State, together with an increase in the maximum exemption threshold in the VAT Directive.
- The second change involves streamlining the simplification measures often used together with the scheme and bringing these into the SME exemption scheme.

A. Adjusting the SME exemption scheme for a destination-based system

The policy option contains the following elements³²⁵:

- **The SME exemption scheme is applied to all EU SMEs (policy element 1.b 2));**
- **The level of exemption threshold is set nationally by the Member States (policy element 1.c 1)),** whilst the maximum level of threshold would be defined and increased on EU level;
- **The threshold is calculated based on supplies in (for domestic SMEs) or to a specific Member State (for non-established SMEs) (policy element 1.d 4));**
- **The scheme is optional for the Member States and for SMEs (policy element 1.f 1))**

The option opens the national SME exemption schemes for non-established SMEs, regarding their supplies taxable in a Member State, in order to provide better alignment with the destination principle.

In order to make the scheme more robust, the **exemption threshold for non-established SMEs** could be a combination of two thresholds – main threshold on supplies into the Member State of taxation, supported by a general turnover threshold, limiting the overall size of the SME.

Although the Member States would retain their right to set their national SME exemption threshold (and potentially increase it by inflation), the **EU legislative basis for thresholds** would need to be replaced by a common rule. Considering wide variations in existing thresholds, it could be set as a combination of a new maximum threshold to accommodate the majority of the Member States, whilst allowing Member States to increase that threshold up until the second higher threshold after consulting the VAT Committee.

Although the SME scheme remains optional for the Member States, when opted for, it would need to apply for both established and non-established SMEs, although the details of application may differ.

B. Streamlining the simplification measures

The policy option contains the inclusion into the SME exemption scheme of minimum simplification measures, with the following elements:

- **Simplified registration process (policy element 3.a 1));**

³²⁵ The list of policy elements (numbered) is presented above in Section 6.2. Please see Annex H for more detailed descriptions of the elements.

- ❑ **Simplified VAT return (policy element 3.a 2))**³²⁶;
- ❑ **Simplified invoicing (policy element 3.a 3));**
- ❑ **Less frequent (annual) filing of VAT return (policy element 2g).**

The option will insert a common minimum set of simplification measures into the SME exemption scheme, applying to businesses notwithstanding their Member State of establishment. It aims to use the existing best practices in the Member States and apply these across all the EU Member States that apply the scheme. The Member States could also apply more extensive simplifications and reliefs, in line with current practice in many member States, if considered appropriate.

The simplification measures are extended to apply to all eligible SMEs, including the ones opting out of the scheme. The Member States will be allowed to apply different simplification measures to businesses in or out of the SME exemption scheme, as well as to domestically established and non-established SMEs, as long as the measures are aligned with the common minimum requirements presented above.

It would need to be taken into account that some simplifications, not directly related to SME scheme, should remain applicable also for other businesses, not eligible for SME scheme.

Rationale

A. Adjusting the SME exemption scheme for a destination-based system

Relevant policy objectives

The suggested option for the exemption threshold is linked to the following **policy objectives**:

- ❑ General objective: to contribute to the smooth functioning of the Single Market.
- ❑ Specific objectives:
 - To reduce distortions between domestic SMEs and SMEs from other Member States;
 - To ensure that the SME exemption scheme is compatible to the extent possible with the destination principle.
- ❑ Operational objective: to define the exemption threshold applicable to domestic suppliers and suppliers from other Member States.

³²⁶ Any proposed legislative changes would take into account the experience from the Council discussions and resulting withdrawal of the proposal for single VAT return COM(2013) 721, see Section 5.1.2 under Evolution of the VAT system – definitive regime.

Problem to be addressed

The main legislative issue with the current VAT framework for SMEs is the territorial application of the schemes, which is not aligned with the destination principle and causes cross-border distortions, as a result discouraging cross-border trade of SMEs. Therefore, such **existing distortions should be reduced to improve smooth functioning of the Single Market for SMEs**, especially for micro-businesses.

Another issue to be solved is the need to review the **EU legislative provisions for the national SME exemption scheme thresholds**, where a common rule is required to replace a great number of country specific agreements, which are currently also very difficult to change when required.

Possible solutions

The **review of the SME exemption scheme** as part of the move to the destination-based taxation system **is inevitable**. Although one of the outcomes could be an abolishment of the scheme, this would not be advisable, as the findings from this study have proven wide popularity and significant benefits of the scheme to SMEs as well as to tax authorities³²⁷. In addition, such abolishment would not correspond to the EU SME policies or the Commission's commitment to propose a 'comprehensive simplification package' to the SMEs.

Therefore, a preferable approach would be **to identify adjustments necessary in order to align the SME exemption scheme with the destination principle** as well as align the national schemes more generally in order to make them more efficient and beneficial for SMEs and tax authorities.

There are many options for how the SME exemption scheme and the exemption threshold could be designed. Below we have explained how the selection of the final design elements for this policy option was carried out³²⁸.

➤ **Application of the SME exemption scheme**

The advantages of the current territorial application of the SME exemption are that the impact of and compliance with the scheme is easier to control by the tax authorities and the scheme (e.g. level of threshold) can be fine-tuned to the domestic market and SME sector. Despite these advantages, the territorial application of the scheme is not sustainable due to the breach with the destination principle and potentially increasing cross-border distortions caused by expansion of cross-border trade by SMEs in the digitalised economy.

The option which allows to make the SME exemption scheme fully compatible with the destination principle is therefore to **open the scheme up to businesses established in other Member States**.

The issue whether to open up the scheme also to non-EU businesses was not considered in this study, as the objective was the adjustment of the existing SME schemes to the EU VAT regime based on destination principle.

Opening up the scheme to non-established businesses has negative impact on the Member States' VAT revenue foregone and will render the compliance control of the scheme more complex. Therefore, the Member States may want to review the design of the SME exemption scheme,

³²⁷ See Section 5.2.2

³²⁸ See Annex H, Elements of the policy options for comprehensive assessment of the elements.

including the level of the threshold and the application of simplification measures to businesses benefitting from the scheme.

Although ideally the scheme should apply the same way to both established and non-established SMEs, a level of differential treatment may be considered necessary (and thus ought to be enabled by the scheme) in order to keep the scheme sufficiently robust and compliance control manageable.

➤ **The level of SME exemption threshold**

The main function of the SME exemption threshold (based on turnover) is to keep the scheme targeted to the SMEs, which most require such a support measure.

In order to provide better alignment of the national SME exemption schemes and simplification to the VAT system, as well as a more level playing field to SMEs, an option would be to set a standard EU level threshold applicable in all Member States. However, it is important to recognise that the national markets, characteristics of SME sectors (e.g. average turnover) and domestic policy environment differ significantly between the Member States. Also, the SME exemption scheme has direct impact on the VAT revenue of Member States, which is fairly limited but still one of the considerations to take into account.

Therefore, a standard EU threshold would have very different impact on Member States and may strongly discourage Member States with lower than average SME turnover to apply the exemption scheme (notwithstanding the political challenges involved in agreeing a standard threshold). Therefore, **the flexibility of the Member States to set the level of SME exemption threshold nationally should be retained.**

Such flexible approach enables the Member States to set the national threshold after careful consideration of the impact on VAT revenue and the administrative cost of VAT collection, as well as on the administrative burden of businesses. It could also allow regular **adjustments of the threshold by the inflation**, in order to retain its value, as long as it does not exceed the set maximum threshold. From the business side, it would unfortunately retain the current complexity of multiple thresholds and the administrative burden relating to monitoring the thresholds, especially if internationally trading SMEs would consider benefitting from more than one national SME scheme. The related administrative burden could be reduced by **providing easy access to reliable information on the thresholds in all Member States**³²⁹.

Even in case of retaining the flexibility to set national thresholds, **some changes in the VAT Directive would be required as part of the transfer to the definitive regime.** Based on Article 294 of the VAT Directive, current 'transitional' provisions need to be replaced by a common rule³³⁰. Therefore, despite the earlier unsuccessful attempts to introduce such common rules³³¹, another attempt would need to be made. Due to the wide differences between the current thresholds and the expected reluctance of many Member States to accept a maximum threshold set by the current highest thresholds, an approach similar to the cash accounting scheme could be considered (.i.e. **setting a lower maximum threshold to accommodate the majority of the Member States, but allowing Member States to increase that threshold up to a higher threshold after consulting the VAT Committee**).

➤ **Basis for the threshold calculation**

³²⁹ This relates to the Commission work on the VAT web portal.

³³⁰ The current legislative basis in the VAT Directive (Articles 284-287) consists of a relatively low maximum threshold of EUR 5 000 and a list of mostly country specific special provisions allowing application of higher thresholds.

³³¹ Commission proposal COM(2004)728, see above in Section 5.2.2. under Evolution of the VAT system.

In addition to the current limitation of the SME exemption scheme to domestically established businesses covered above, it is also mostly based on domestic taxable supplies, even more so after the abolishment of existing distance sales rules by the e-Commerce proposal³³². Therefore, an SME benefitting from the scheme may still be required to register for VAT when starting to trade cross-border, which creates complexities and distortions for SMEs trading cross-border.

There are several options for simplification of the current regime and for reduction of cross-border distortions.

Solution 1: Expanding the SME exemption scheme to cross-border supplies of established SMEs

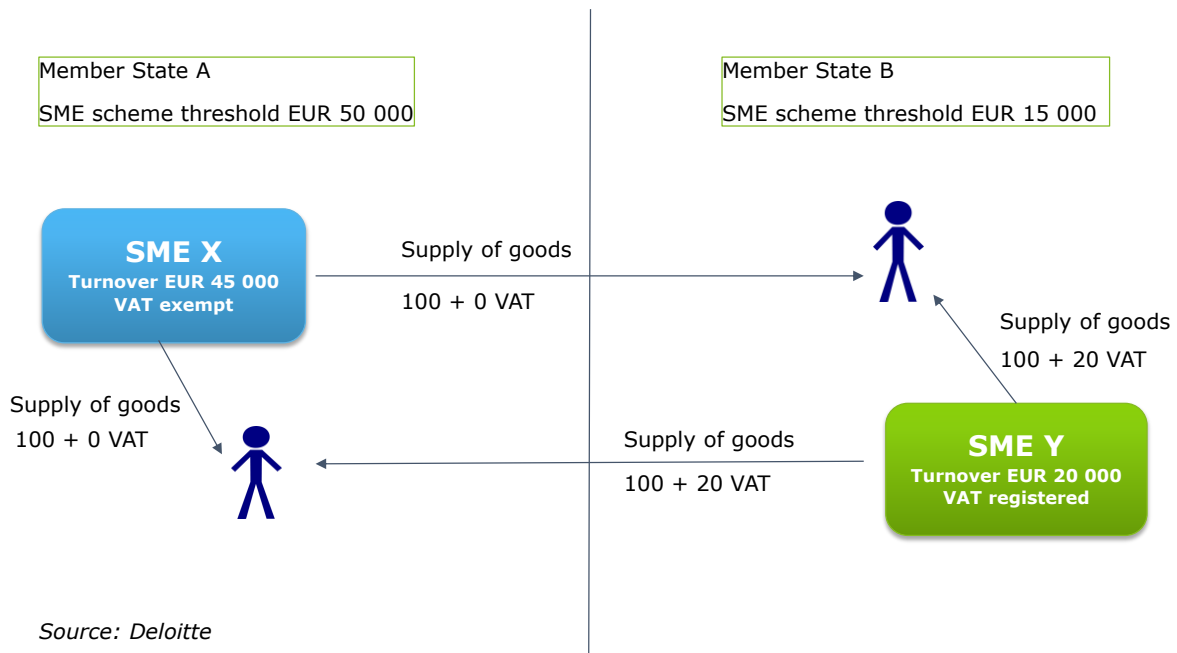
The first option would be to **expand the SME exemption scheme to include also cross-border supplies** (i.e. calculating the threshold on the total turnover of the business). This would provide significant simplification to SMEs, provide level playing field for local SMEs trading domestically or cross-border, and help to target the measure better to businesses of certain size (see Figure 37).

However, as such application would provide VAT exemption to supplies which by destination principle ought to be taxable in another Member State, it would have direct impact on the VAT revenue of another Member State, which that Member State could not monitor or control. This would breach the principle of sovereignty of the Member State regarding its right to control its own VAT revenue, unless it is based on a common agreement.

It could create also new cross-border distortions. For example, in such a regime an SME could choose to establish itself in a Member State with a high SME exemption threshold and make exempt supplies to a Member State with a low or no threshold, thus creating distortion in the Member State of destination. At the same time, an SME from a country with no SME exemption scheme would not be able to make any exempt supplies to a country with a high national exemption threshold.

³³² Ibid.

Figure 37 – Example of expanding SME exemption scheme threshold to cross-border supplies of domestic suppliers



Solution 2: Introduction of a common EU threshold for cross-border supplies (as in **Baseline scenario**)

An option that would reduce new cross-border distortions of the first approach, whilst still providing significant additional simplifications to SMEs, is the proposed **application of the destination principle together with the introduction of the new common EU threshold**³³³, which would apply only to cross-border supplies of SMEs and be set at a harmonised level across the EU (e.g. at the level of EUR 10 000 foreseen for the common EU threshold). This is already taken into account in the study as part of Option 1 Baseline scenario³³⁴ and this solution therefore does not bring a change on this point as compared to Option 1 Baseline scenario.

Such approach would relieve SMEs having low value or occasional cross-border B2C supplies from the full set of VAT obligations, especially if they benefit from the SME exemption scheme in their Member State. Although introduction of the common EU threshold would still have an impact on the VAT revenues of other Member States, it would be limited due to the low threshold, which would be set at a harmonised level agreed by all Member States.

However, as such approach alone would not yet be aligned with the destination principle, the distortions between domestic and non-established businesses would remain unsolved.

Solution 3: Extension of the SME exemption scheme to the supplies provided into the Member State

Following on from the above analysis, the last approach that could be applied is to combine the proposed common EU threshold with the **extension of the SME exemption scheme to the supplies provided into that Member State**, thus opening the SME exemption scheme to the cross-border

³³³ Ibid.

³³⁴ For the analysis of interaction of common EU threshold and SME exemption scheme see this section above under Rationale of Option 1: Baseline scenario.

supplies of non-established businesses that are taxable in that Member State. This would align the SME exemption scheme to the destination principle and remove distortions between domestic and non-established businesses.

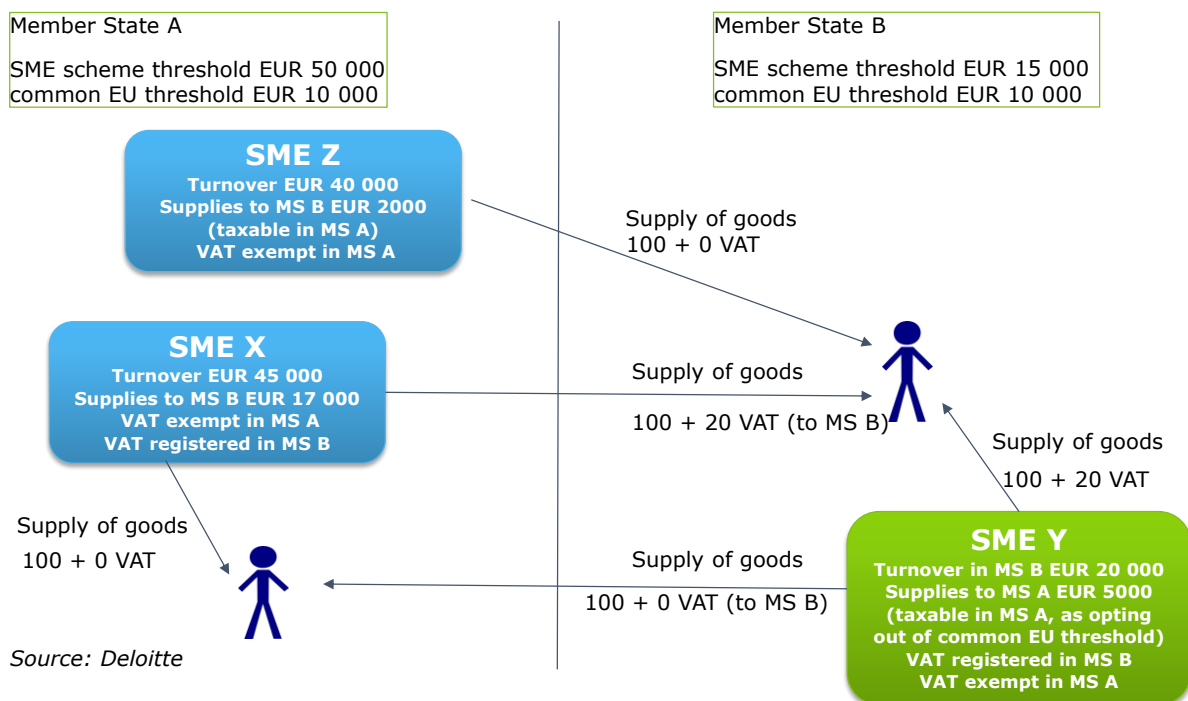
As such cross-border supplies to the Member State of destination may be also covered by the common EU threshold in the Member State of establishment, the SME exemption scheme of the destination Member State would be applied to the businesses whose cross-border supplies exceed the common EU threshold or who have opted out of the common EU threshold in the Member State of establishment.

As an example (see Figure 38), an SME exemption scheme with a threshold of EUR 50 000 of taxable supplies in the Member State A would provide an exemption to a locally established **business Z**, exempting its domestic supplies as well as its cross-border supplies to Member State B, as these cross-border supplies are below the common EU threshold and thus still taxable under the rules of Member State A.

Member State A applies its SME exemption scheme also to the non-established **business Y** (established in Member State B) regarding its supplies that are taxable in Member State A, exempting these supplies up to a value of EUR 50 000 (SME exemption threshold). Business Y is VAT registered and pays VAT in its own Member State B, as it exceeds the SME exemption threshold of Member State B (EUR 15 000). Business Y's cross-border sales to Member State A are below the common EU threshold, but it has opted out from the application of the common EU threshold in Member State B in order to benefit from the SME exemption scheme in Member State A.

At the same time, business X, which is exempt under the SME exemption scheme in Member State A, sells also to Member State B and its cross-border supplies (EUR 17 000) exceed the common EU threshold of EUR 10 000. Therefore, business X is required to pay VAT on its cross-border supplies to Member State B. Business X can use the MOSS portal of Member State A to fulfil its VAT obligations in Member State B.

Figure 38 – Example of expanding SME exemption threshold to supplies into the Member State of destination with optional common EU threshold in the Member State of establishment



The main advantage of this approach is that it is more compatible with the destination principle, resulting from opening up the domestic SME exemption schemes to non-established businesses. It increases the situations where an SME can benefit from an SME exemption scheme when making cross-border supplies: the SME can benefit from the SME exemption scheme in its own Member State up to the level of the common EU threshold, while beyond the threshold it can potentially benefit from the SME exemption scheme in the destination country. In that way, beyond the EU common threshold, the Member State of destination is given control over the impact of the SME exemption scheme on its VAT revenue (if compared to expanding the scheme outwards, see Figure 37).

The main downside of the option for businesses is the complexity of the measure for SMEs, which need to follow the rules of the Member State of destination, especially in comparison to the above first approach of applying the domestic scheme to the cross-border supplies. The downside for the tax authorities is the additional negative impact on VAT revenue, which they can however control by reviewing the exemption threshold.

An additional risk of this approach would be that such application of the SME exemption scheme **could create reverse distortions**, where the SME exemption would be used by a non-established business of significantly larger size that has limited trade in that Member State. In principle this would create also a potential **risk of a cumulative use of SME exemption schemes**. For example a business established in one Member State may apply for a number of SME exemption schemes in different Member States and thus altogether be able to apply the exemption more extensively than the domestic SMEs. It may even create a bias towards cross-border trade.

It is therefore recommended to take into account also the overall size of the business established in another Member State for the SME exemption scheme eligibility in the Member State of consumption.

To achieve this, it could be considered to add an **additional eligibility criterion, such as a threshold for the total turnover of the non-established business**, based for example on a self-declaration by a business of its latest annual turnover (e.g. as part of a simplified VAT registration process). It would be however challenging for the tax authorities to control whether the foreign business actually fills this eligibility criterion, so the related administrative cost for tax authority may be considerable.

It could be argued that in essence, applying the threshold to supplies taxable in the Member State, rather than total turnover, applies equal treatment between foreign businesses trading in the country without creating a local establishment and foreign businesses with a local establishment. Still, consultations with both tax authorities and businesses showed that the risk of reverse distortion is considered to be a significant problem when opening up the SME exemption schemes and should therefore be taken into account.

Based on the above analysis, it has been concluded that despite the inherent complexity of the alignment of existing SME exemption scheme with the destination principle, the last option that **the SME exemption threshold is calculated based on (and exemption applied to) supplies in or to a specific Member State (taking into account the common EU threshold and potentially setting additional general threshold requirement for non-established businesses)**, would deliver the best outcome overall and is thus the preferred approach.

▣ ***Optionality of the SME exemption scheme***

In the current regime, the Member States have the flexibility to decide whether to apply the SME exemption scheme or not. A mandatory SME exemption scheme for Member States would benefit SMEs, especially in the Member States that have currently chosen not to apply the scheme. However, as the scheme provides exemption to SMEs and thus creates revenue loss to the Member States, **it is considered appropriate to retain the flexibility for Member States.**

The SME exemption scheme is currently also optional for SMEs, allowing them to opt out of the scheme if they consider that the standard VAT regime is more beneficial for their business (e.g. because they have significant input VAT cost and/or their customers are mostly VAT registered businesses who can deduct VAT). Administration of the smallest businesses creates disproportionate cost for the tax authorities, which is reduced by the application of the SME exemption scheme. Therefore, the obligation of Member States to allow businesses to opt out of the scheme reduces the control the Member States currently have over the scheme. SMEs' right to opt out of the SME exemption scheme is considered by some tax authorities also to increase the risk of input VAT fraud.

At the same time, the study proved that SMEs need the flexibility to opt out, as the SME exemption scheme is less suitable for businesses in B2B trade and the inability to deduct input VAT (which is a normal consequence of an exemption scheme) is financially damaging to a start up with significant initial capital investments and corresponding growth plans. Given the general policy objective to encourage SME growth, a mandatory SME exemption scheme cannot be retained. **Therefore, the SMEs should also retain the flexibility to opt out of the scheme.**

Preferred solution

Based on the above analysis on all possible options, we recommend to apply the following **changes to the SME exemption scheme:**

- ❑ to extend the SME exemption scheme to businesses established in other Member States;
- ❑ to keep the flexibility of the Member States to set the level of threshold nationally;
- ❑ to review the EU legislative provisions for SME exemption scheme thresholds by setting a lower maximum threshold to accommodate the majority of the Member States, but allowing Member States to increase that threshold up to a higher threshold after consulting the VAT Committee, with a right to adjust the threshold by inflation (as long as it doesn't exceed the maximum);
- ❑ to calculate the SME exemption threshold based on supplies in or to a specific Member State (taking into account the common EU threshold), whilst an additional general turnover based threshold could be considered to define the eligibility of the non-established SMEs; and
- ❑ to retain the optionality of the SME exemption scheme for both Member States and SMEs,

for the following **reasons**:

- ❑ this approach provides better alignment of the SME exemption scheme to the principle of taxation at destination, whilst keeping the measure sufficiently robust for compliance control purposes;
- ❑ it reduces the distortion between domestic and non-established businesses, by enabling non-established businesses to benefit from SME exemption schemes;
- ❑ it provides more flexibility to the Member States to review their SME exemption threshold under the new EU maximum threshold provisions.

B. Streamlining the simplification measures

Relevant policy objectives

The proposed option for the streamlined simplification measures is linked to the following policy objectives:

- ❑ General objective: to contribute to the development of a simple, efficient, neutral and robust VAT system;
- ❑ Specific objective: to reduce VAT compliance costs for SMEs;
- ❑ Operational objective: to provide for simplification measures for SMEs.

Problem to be addressed

Although simplification measures constitute an important component of the SME exemption scheme in practice, these measures are currently regulated outside of the SME exemption scheme in the VAT directive. Therefore, in order to provide more certainty for SMEs regarding the benefits of the scheme, further alignment should be provided, building on the best practices used in the Member States.

Currently the main simplification measures are applied together with the SME exemption scheme, so a business that is eligible for the SME exemption scheme but has decided to opt out loses the tax benefit as well as most of the administrative benefits. Therefore, the eligibility for application of simplifications should be reviewed in order to further encourage growth of SMEs.

Possible solutions

The study confirmed the importance of the simplification measures as a means to reduce compliance costs for SMEs, which is also reflected also in the VAT Action Plan, referring to a proposal on a

'comprehensive simplification package for SMEs'³³⁵. Therefore, proposing a significant change to the SME exemption scheme without a simplification package would not be a viable option.

As a starting point, the **simplification provisions in the EU VAT Directive ought to be brought into the SME exemption scheme**, in order to provide better alignment in the application of the SME exemption scheme in Member States (even if some flexibility is retained on the level of simplifications applied) and thus more certainty to the SMEs on the benefits of the SME exemption scheme. However, when moved, it should be taken into account that the simplifications which are currently applied also to businesses outside the SME scheme (e.g. by applying a different, higher threshold), remain available and could continue to be applied to these businesses.

In order to support the growth of SMEs, for whom the SME exemption is less suited (e.g. as their trade is mostly B2B), the simplification package should be made available for all SMEs eligible for the SME exemption scheme, whether they apply the exemption or have opted out of it. Such simplification could provide significant reduction of administrative burden to the SMEs. It is, however, understandable that the actual simplifications applied to the SMEs who have opted out of the exemption scheme cannot be the same as the ones applied to exempt SMEs, for example they would need still to register for VAT and declare their taxable supplies.

Despite the required flexibility in how the simplifications are applied to different SMEs, it would be possible to provide further alignment on simplification measures more generally, especially between the Member States. Below we have explained how the selection of final design elements for the common set of simplification measures was carried out.

▣ **VAT registration process**

The majority of the Member States (18 out of 26) applying the SME exemption scheme relieve the businesses benefitting from the scheme from all VAT obligations, including VAT registration. However, a number of Member States have considered it necessary to require businesses benefitting from the scheme to still register for VAT.

Relieving businesses from VAT registration obligation keeps them fully out of the VAT system, reducing the administrative cost of the tax authorities from dealing with the registration process and managing a large number of additional registered taxable persons, which do not pay any VAT (due to the exemption). An additional benefit from the relief is that the tax authorities issue fewer 'empty' VAT numbers which could, for example, be fraudulently used for tax exempt purchases from other Member States.

However, the study found that the Member States that register businesses benefitting from the SME exemption scheme have better data on the number of businesses applying the scheme. The Member States that do not register businesses usually use data from alternative sources (e.g. the commercial register or registers for other taxes) in order to estimate the number of businesses benefitting from the scheme. Better data on the number of businesses benefitting from the scheme may help Member States to estimate the impact of the scheme both to businesses and to the Member States' revenue and administrative costs.

³³⁵ Commission Communication on an action plan on VAT (COM(2016) 148): https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_en.pdf consulted on 4 January 2017.

Therefore, the Member States have good reasons for either registering or not registering SMEs applying the SME exemption scheme, depending on their respective priorities and risk assessment. Thus, it seems appropriate to **retain the flexibility of Member States to either register or relieve the SMEs benefitting from the scheme from the VAT registration obligation.**

When the SME exemption scheme is opened up to supplies from other Member States in order to align it with the destination principle, Member States need to consider whether or not to relieve non-established businesses from the VAT registration obligation. Ideally, the same obligations ought to be applied to all businesses, notwithstanding their country of establishment. However, considering significant differences in the compliance risks involved, it could be considered to allow differentiation in VAT registration obligations.

Considering the different needs regarding the registration obligation but keeping in mind the objective to streamline the simplifications applicable to SMEs, it would be appropriate **to include in the SME exemption scheme simplification package a minimum requirement for a simplified VAT registration.**

The simplified registration would be a minimum requirement also regarding the VAT registration of SMEs opting out of the SME exemption scheme or for non-established SMEs, for example in a case where the Member State decides to relieve local SMEs applying the scheme from a registration obligation.

The OECD International Guidelines on VAT/GST Chapter 3 section C.3.3 'Main features of a simplified registration and compliance regime for non-resident suppliers'³³⁶ could be used as a reference regarding the characteristics of a simplified registration and declaration system (with appropriate modifications). The OECD Guidelines suggest that 'an online registration application could be made accessible on the home page of the tax administration's web site, preferably available in the languages of the jurisdiction's major trading partners'. The Guidelines suggest also that the information requested could be limited to necessary details, and provide an example list of such information requirements.

The registration procedure for customs economic operators (EORI)³³⁷ could also be considered as an example of a fairly simple registration procedure.

➤ **VAT return**

A few Member States (8 out of 26) require SMEs applying the exemption scheme to submit a VAT return or a form of sales statement, despite the fact that the supplies of the SME are exempt from VAT.

Such a requirement creates an additional administrative burden for SMEs and limits the overall benefit of the scheme. These VAT returns or sales statements also need to be processed by the tax authorities, which creates additional administrative costs, although most tax authorities process the returns automatically, and the manual processes are limited to the returns considered necessary for additional review. Accordingly, the administrative costs to the tax authorities may not be significant and

³³⁶ OECD International Guidelines for VAT/GST, 2015, available: <http://www.oecd.org/tax/consumption/international-vat-gst-guidelines.pdf>, consulted on 18 June 2016.

³³⁷ Economic Operators Registration and Identification number (EORI), see: https://ec.europa.eu/taxation_customs/business/customs-procedures/general-overview/economic-operators-registration-identification-number-eori_en.

the benefit is the collected data, which enables them to improve compliance control of SMEs benefitting from the exemption scheme, as well as calculate (rather than just estimate) the VAT revenue foregone. Such information may become more valuable to tax authorities when the SME exemption scheme is opened up to supplies from other Member States.

It was considered appropriate to **retain to Member States the flexibility to relieve businesses from the submission of VAT returns**. However, as more Member States are likely to review their current reliefs as part of the move to the destination-based regime, it could be considered to include in the SME exemption scheme simplification package a minimum requirement for **a simplified VAT return (for businesses opting out of the scheme) or an alternative annual statement of supplies (for businesses exempt under the SME exemption scheme)**.

As in case of the VAT registration, the OECD International Guidelines may provide a useful reference for a list of information requirements, although they may need an adjustment due to the use for the declaration of exempted supplies.

▣ **VAT invoicing**

The Member States currently have flexibility to require SMEs benefitting from the exemption scheme to issue invoices, as simplification measures are not included in the scheme. A few Member States (8 out of 26) currently require this.

Requiring invoicing, as a VAT obligation, does not seem essential, considering that the supplies are exempt from VAT and a form of invoice would be issued in any case due to general accounting requirements. In addition, the existing VAT invoicing requirements (i.e. the content of the invoice) of the Member States differ, which can further increase the administrative burden, especially for cross-border trading SMEs. An invoicing requirement is even less justified for B2C supplies. It was therefore considered whether the policy option could include a simplification disallowing the Member States to require invoices to be issued under the VAT regime by businesses benefitting from the SME exemption scheme.

However, taking into account the new environment of the destination based regime, which may increase the relevance of an invoice within the VAT system, it was considered more appropriate to include in the SME exemption scheme simplification package that Member States should as a minimum allow **a simplified invoice for B2B supplies by SMEs and for B2C supplies of SMEs opting out of the scheme, and provide a relief from invoicing obligation on B2C supplies of SMEs exempted under the scheme**.

For simplified invoicing, for example, the VAT Directive could provide that in these cases only the information required pursuant to Article 226b of the VAT Directive must be entered on invoices in respect of supplies under the SME scheme.

▣ **Filing of VAT return**

In addition to the minimum requirement for a simplified VAT return or sales statement covered above, it could be considered to include in the SME exemption scheme simplification package as a minimum simplification requirement **less frequent (e.g. annual or twice a year) filing of VAT returns or an alternative statement of supplies**.

As in case of other simplifications above, the Member States could continue to relieve businesses from submitting such VAT returns or statements, however, as a result of opening the scheme to

foreign traders, they may want to review their current set of reliefs and consider requiring at least an annual VAT return or statement of supplies.

Preferred solution

Based on the above analysis on all possible options, we recommend to apply the following **changes regarding the simplification measures**:

- ✘ to bring a common set of minimum simplification measures into the SME exemption scheme (Member States would be allowed to provide further or more extensive simplifications);
- ✘ to apply the simplification package to all businesses eligible for the SME exemption scheme, notwithstanding whether they apply the scheme or decide to opt out;
- ✘ to include in the package a minimum simplification requirement for a simplified VAT registration;
- ✘ to include in the package a minimum simplification requirement for a simplified VAT return (for businesses opting out of the scheme) or an alternative annual statement of supplies (for businesses exempt under the SME exemption scheme);
- ✘ to include in the package a minimum simplification requirement for a simplified invoice for B2B supplies and for B2C supplies of businesses opting out of the scheme, and disallow invoicing on B2C supplies of businesses exempted under the SME exemption scheme; and
- ✘ to include in the package as a minimum simplification requirement less frequent (e.g. annual or twice a year) filing of VAT returns or an alternative statement of supplies,

for the following reasons:

- ✘ such changes streamline the existing simplification measures used together with the SME exemption scheme and provide a minimum package of simplification measures for an SME exemption scheme in the definitive regime, providing thus further reductions of the administrative burden of SMEs;
- ✘ the extension of simplification measures to SMEs eligible for the SME exemption scheme but opting out has potential to provide them a significant administrative burden reduction and thus encourage their growth.

General simplifications of the VAT system, such as fully electronic registration and declaration systems, with full access to necessary information, and available and affordable simple tax accounting software would provide further reductions to the administrative burden for businesses as well as reductions of administrative costs for tax authorities.

It is also important to keep in mind the significant simplifying effect, and thus the importance of the other VAT policy developments, such as the extension of the one-stop-shop to cross-border B2C supplies of goods and the development of the EU VAT web portal, which are crucial for SMEs trading or planning to start trading cross-border.

Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons

Description of the policy option

This option builds on option 2 and introduces in addition a mandatory VAT treatment as non-taxable persons for 'occasional traders' in order to provide certainty to traders and reduce the administrative cost and revenue impact for tax authorities. The measure would be optional for Member States and as it is not part of the SME exemption scheme, it could also be introduced independently of the scheme.

The policy option contains the following elements (in addition to the elements of option 2):

- Occasional traders are treated for VAT purposes as non-taxable persons (policy element 4.a 1))

The following high level definition of the 'occasional trader' has been designed as part of the study (see the analysis below):

- Private individuals and other non-legal persons (i.e. bodies without legal personality, such as some non-profit organisations), who
- Carry out an economic activity on an occasional basis or whose economic activity is incidental, where
- The amount of VAT potentially collected would be minimal (or negligible), and where
- Their treatment as non-taxable persons would not create significant distortions of competition.

The 'occasional traders' would be kept fully out of the VAT system. Therefore, the traders have no VAT related obligations, including on intra-EU purchases (intra-EU acquisitions), and would have no right to register for VAT or claim input VAT refunds, unless they prove planned or existing continuous and non-incidental business activity.

Rationale of the policy option

Relevant policy objectives

The suggested policy option is linked to the following policy objectives:

- General objective: to contribute to the development of a simple, efficient, neutral and robust VAT system;
- Specific objectives: to reduce the margin for tax fraud; to reduce VAT compliance costs for SMEs;
- Operational objective: to introduce measures facilitating the VAT treatment of occasional traders by national tax administrations.

Problem to be addressed

As described above, the current SME exemption scheme is optional for businesses³³⁸. The fact that Member States are not allowed to prevent an SME from opting out of the scheme can be

³³⁸ See Section 4.2.1 on the SME exemption scheme.

administratively burdensome for the tax authorities as well as potentially causing additional revenue loss.³³⁹

As explained in the problem assessment, the **right to opt out of the scheme is sometimes abused** also by:

- businesses aiming to abuse the system by fraudulent input VAT claims (as part of missing trader or carousel fraud); or
- individuals (or non-profit organisations, nano-businesses) with very limited sales activity, aiming to benefit from input VAT deductions, where compliance control of their input VAT claims is complex and burdensome (e.g. input VAT deduction on the use of private (or non-business) assets for business purposes (car, home, solar-panels)).

For example, individuals installing solar panels for the needs of their household and supplying the surplus electricity to the network³⁴⁰, has caused concerns in the Netherlands, where wide recent application of similar practices in combination with the local graduated relief scheme has created an especially undesirable outcome for the tax authorities.³⁴¹

A second slightly different issue to be addressed, especially regarding individuals with occasional sales (usually through sharing economy platforms), is **lack of certainty** on whether their sales qualify as **economic activity** and whether the person is **regarded as a taxable person**, and consequential unintentional (or intentional) non-compliance. Compliance control of such traders is also disproportionately burdensome for tax authorities.

Although purely fraudulent activities and ‘*black economy*’ need specific mitigation and anti-fraud measures³⁴², which are not a focus or objective of this study, the consequences of the uncertainty described above could be reduced by certain changes to the VAT legislation.

It could be argued that the most equitable treatment for new forms of economy, such as sharing economy, and individuals engaged in it (especially on continuous basis), would be similar to any other taxable activity or taxable person. However, it is also fair and justified for both tax authorities and the individuals to keep some individuals and their transactions (especially where incidental and occasional) out of the VAT system³⁴³. The main problem is how to define and apply the concept of ‘economic activity’ and ‘taxable person’ in Article 9 of the VAT Directive. Despite some existing case law³⁴⁴, there is still a considerable level of uncertainty on this.

A common interpretation of Article 9 seems to be that in certain circumstances, even if certain supplies of goods and services are considered economic activities, the supplier is not considered a taxable person. The latter interpretation is usually linked to the combination of Article 9 and Article 12(1), which allows Member States to regard as taxable person anyone who carries out certain transactions

³³⁹ The study proved that the category of VAT registered businesses with the smallest sales turnover has negative VAT revenue (i.e. tax authorities are refunding more VAT than they collect from these businesses) in 9 out of 28 Member States, see above Section 3.4 on VAT revenues generated by SMEs.

³⁴⁰ See CJEU judgment of 20 June 2013 in case C-219/12 *Finanzamt Freistadt Rohrbach Urfahr*.

³⁴¹ Based on information from the tax authority, in 2014 there were 46 000 new taxable persons registered with VAT loss from initial input VAT deduction of EUR 38 million and in 2015, 56 000 new taxable persons and VAT loss of EUR 49 million. See above Section 4.2.2 on VAT graduated relief scheme.

³⁴² For example, wide use of e-commerce platforms for day-to-day trading without registration of such business activities for VAT or other tax purposes

³⁴³ The VAT Committee Guidelines from the 105th meeting contain a unanimous agreement of the VAT Committee that supplies of goods and services made by individuals to other users through sharing economy platforms for monetary consideration shall qualify as taxable transactions and be subject to VAT if the individual in supplying those goods or services carries out an economic activity qualifying him as a taxable person under Article 9 of the VAT Directive.

³⁴⁴ Such as C-219/12 *Finanzamt Freistadt Rohrbach Urfahr*; C-62/12 *Kostov*; C-230/94 *Enkler etc.*

(mainly linked to immovable property) on an occasional basis, indicating that under Article 9 these persons would not be considered as taxable persons and thus the need for such additional provision.

A third point confronting occasional traders is that even if they are currently eligible for the SME exemption scheme, in a number of Member States, even with the simplifications as put forward under option 2, they are still confronted with an administrative cost due to certain VAT obligations.

Concept of the ‘occasional trader’

Different approaches could be taken to provide further clarity and certainty in situations described above and in targeting the measure. For example the measure could apply to all nano-businesses below a set threshold, which would be relatively simple to implement and reduce the problem, especially regarding unjustified input VAT deductions. However, it may be disproportionate and have undesirable consequences for genuine starting businesses, discouraging entrepreneurship.

A preferred option would be, therefore, to design a policy measure, which targets a more specific group of traders. Based on the identified problems, this measure should apply mainly to occasionally or incidentally trading individuals, as well as perhaps small non-profit organisations. For example, such a measure could apply to the individuals caught by the 2015 place of supply changes for electronic services, who have only occasional unplanned cross-border transactions for very low income. The option could apply also to individuals whose taxable activity is only incidental (i.e. a ‘side-product’ of a non-taxable activity), such as the individuals installing solar panels and selling surplus electricity.

The key challenge is to define the group of traders it would apply to, especially if the aim is to cover both the individuals who see themselves as traders (and would like to be part of the VAT system, but perhaps should not) as well as the ones who do not. The definition ought to be sufficiently precise to ensure that application of measure is well aligned across the EU and would not create cross-border distortions (or only a theoretical/negligible distortive impact).

As described above, there is no existing EU legal definition suitable for these purposes. Therefore, we have suggested below a new high level definition, designed based on our understanding of the general principles of the existing case law on Articles 9 and 12(1) of the VAT Directive and on the objectives of the measure, as explained above.

An EU level definition of the ‘occasional trader’ could thus contain the following elements:

- ✘ aiming to target specific group of traders – private individuals and other non-legal persons (such as non-profit organisations) and
- ✘ aiming to target persons with the intention to deploy very limited, occasional or incidental, economic activity,
- ✘ whilst limiting impact to VAT revenue and containing a safeguard against market distortions.

The Member States would be able to fine tune the definition in their national legislation to ensure for example alignment with the tax treatment for income tax purposes (e.g. in Belgium where the thresholds and conditions align with “diverse income” rules for income tax), and if considered appropriate the national application could be consulted with the VAT Committee (which is especially relevant in case of any potential cross-border impact).

Possible solutions

The next question is the type of VAT treatment applied to this identified group of ‘occasional traders’. There are two main options:

- ❑ To subject the qualifying traders to mandatory SME exemption scheme, i.e. apply exemption to all their sales with blocked input VAT deduction and no right to opt out; or
- ❑ To keep them fully out of the VAT system by treating them as non-taxable persons (similarly to e.g. private individuals).

There are some significant differences between the two approaches, which are described below:

Solution 1: Mandatory SME exemption scheme

Where the business or person is exempted under the SME exemption scheme, it still remains a taxable person for VAT purposes, even when it is not registered for VAT and is relieved from all or most VAT obligations. As a taxable person, the business may become subject to VAT obligations for any business activities (supplies or purchases) that do not fall under the SME exemption scheme. Such activities could be for example supplies to other Member States (e.g. occasional e-services to consumers in other Member States) or purchases from taxable persons in other Member States (possibly subject to intra-EU acquisition provisions or the reverse charge).

Therefore, on the one hand it would not be very difficult for a trader to find an alternative way to become subject to VAT registration obligation, on the other hand, the traders that benefit from being exempt may still need to register for VAT due to an occasional cross-border transaction, although the introduction of the common EU threshold would reduce such cases.

From the perspective of tax authorities, this would provide some reduction of the administrative burden, but may not be the most efficient way to tackle the perceived problems, especially regarding traders aiming to abuse the VAT system.

Regarding suitability for the definitive regime based on the destination principle, the measure could be designed to be fully compatible with it, as in principle it would only adjust the optionality of the SME exemption scheme, without impacting place of supply rules or being linked to the place of establishment or place of residence of the trader. In practice however, the compliance control of such occasional traders established outside of the Member State, would be highly challenging.

Solution 2: Treatment as a non-taxable person

As alternative, occasional traders could be considered to fall outside of the Article 9 concept of 'taxable person' and be treated as non-taxable persons, keeping them fully out of the VAT system. A combined application of this measure and Article 12(1) would also need to be taken into account.

So occasional traders would be treated as regular individuals, who for example occasionally sell their private assets online, with no VAT obligations, but also with no right to register for VAT or claim back input VAT, which would keep the traders unjustifiably benefitting from the VAT registration generally out of the VAT regime.

Such approach would provide also certainty for individuals engaging in occasional business activity (especially where it may involve an occasional cross-border transaction), such as hobby traders via online platforms (provided it still qualifies as occasional or incidental activity).

Regarding purchases, they would be always treated as final consumers, with no VAT obligations to the tax authorities.

The option would benefit tax authorities by reducing their administrative costs (e.g. by reducing the number of voluntary VAT registrations as well as VAT registrations on occasional cross-border transactions if registration is not required under the SME exemption scheme). It may improve compliance control (although controlling sharing economy would be still challenging) and potentially have a positive impact on VAT revenue. A disadvantage for tax authorities is the complexity of legislating the measure and providing guidance on its scope.

The main disadvantage for qualifying traders is the lack of option to register for VAT and apply the regular VAT regime, including deduction of input VAT. However, should the trader find that the regime is not appropriate for them, they could prove to the tax authorities that they do not fall under this measure, e.g. that their planned or existing economic activities are continuous or not incidental.

Regarding suitability for the taxation at destination principle, the measure is not fully compatible with it, as it is applied by a Member State where the trader is established or has its place of residence, and would have an impact on an occasional cross-border transaction to another Member State (as such transactions would be also considered as a non-economic activity and therefore the place of supply rules would not apply). However, it is expected to have near no or minimal impact as the measure is targeted at traders with only occasional or incidental sales and even fewer transactions to other Member States.

Preferred solution

Based on the above analysis on two possible solutions, **we recommend to apply mandatory treatment of 'occasional traders' as non-taxable persons, as an optional measure for Member States**, for the following reasons:

- ✘ It can provide more certainty to occasional traders regarding their tax obligations, particularly when they engage only in incidental transactions through a sharing economy platform;
- ✘ It allows a full relief of VAT obligations, beyond what is foreseen in the SME exemption scheme as required simplification;
- ✘ It is potentially a more robust anti-avoidance measure, as it would be harder for trader to manipulate the measure and the burden of proof for disapplication of the measure would lie on the trader;

- Despite a theoretical cross-border impact, it is likely to be minimal, therefore the measure could be also optional for Member States, in order to provide them flexibility to apply it only when considered necessary.

Option 4: Option 3 plus measure for transition period reducing the negative impact of the 'threshold effect'

Description of the policy option

This option builds on option 3. In addition, it introduces a measure into the SME exemption scheme for a transition period, reducing the negative impact of the 'threshold effect'. The measure would be optional for the Member States and for businesses (who can still opt out of the SME exemption scheme).

The policy option contains the following additional elements:

- Flexible threshold (policy element 1.k);
- Transitional period (policy element 1.l).

The option introduces a transitional measure to support SMEs exceeding the SME exemption threshold. As such measure is meant to support the transfer to full taxation, it is designed to provide support for a time limited period, with an additional anti-abuse measure linked to the extent to which the threshold is exceeded.

The option allows a business that exceeds the national SME exemption threshold to continue using the exemption for one year, unless its turnover grows fast and also exceeds the second higher threshold (set 50% higher than the exemption threshold), before the end of the extension year. This extension year allows the business a set time period to prepare for the application of the full set of VAT obligations both financially and administratively. Businesses would be allowed to continue applying SME exemption scheme after the transition period, if their sales have again reduced below the threshold

Rationale

Relevant policy objectives

The suggested policy option is linked to the following policy objectives:

- General objective: to contribute to the creation of an environment that is conducive to SME growth;
- Specific objective: To reduce the negative impact of the 'threshold effect';
- Operational objective: To introduce flexibility regarding the application of the SME exemption threshold.

Problem to be addressed

Based on the analysis carried out in the study, the growth of SMEs is currently discouraged by the way most VAT exemption thresholds are applied – businesses exceeding the turnover threshold are immediately obliged to register for VAT, meet the standard VAT obligations and charge VAT on all their supplies. This is essentially due to the design of most schemes, which are based on thresholds.

SMEs have indicated that growth is hindered due to the fear of going above the threshold (i.e. SMEs are not increasing their turnover)³⁴⁵. Further, as in the case of any scheme with a threshold, an uneven playing field exists (at local level) between the businesses falling below the threshold and those just above the threshold (i.e. outside of the scheme), especially in domestic B2C trade, as businesses exempt from VAT can apply lower consumer prices.

Possible solutions

Regarding options to address such an impediment to growth, the consultations with stakeholders (including businesses and the OECD) as well as literature review³⁴⁶ indicate that a ‘threshold effect’ could be significantly reduced by a gradual introduction to full taxation, for example by including some flexibility to the application of the scheme.

A form of **flexible threshold** of the SME exemption scheme is already applied by some Member States (e.g. Belgium and the UK) and this additional flexibility is considered helpful by SMEs for reducing the ‘threshold effect’. Such a measure usually sets a second higher threshold and allows businesses exceeding the SME scheme threshold temporarily to continue using the SME scheme, provided they do not exceed that higher threshold.

There are several other ways a transition to full taxation could be applied. Another option would be the use of a **graduated relief**, already applied by some Member States (using different approaches). However, as seen from the analysis of the existing schemes, their complexity has made them generally ineffective as a transitional measure.^{347 348}

Most of the other options that could be used to reduce the threshold effect, such as different forms for **discounting (or refunding) part of the VAT paid**³⁴⁹, would be by nature budgetary measures and therefore regulated outside of the VAT system.

Following the above considerations, a simpler approach could be taken in designing a policy measure for addressing the ‘threshold effect’ and encouraging the growth of SMEs – allowing **temporary continuation of the SME exemption scheme** beyond exceeding the SME exemption threshold, to smooth the transfer to full taxation. The main disadvantage of the option is that it would have negative impact on the VAT revenues of Member States. The measure may also increase the complexity of compliance controls for tax authorities.

As such a measure is intended to be transitional, but it ought to have an endpoint. An endpoint could be either time-related (e.g. 1 year) or turnover-related (e.g. up until exceeding the threshold by a fixed percentage). A solely turnover-related measure would only introduce a higher threshold and a solely time-related measure may be abused or have a larger than expected impact on VAT revenue. Therefore, a combined endpoint of time period and maximum percentage by which the SME threshold can be exceeded would be most appropriate.

³⁴⁵ For the assessment of the ‘threshold effect’, see the above Section 5.4.3.

³⁴⁶ For example OECD, Taxation of SMEs in OECD and G20 countries 2015, p. 106, consulted on 20 June 2016 at http://www.oecd-ilibrary.org/taxation/taxation-of-smes-in-oecd-and-g20-countries_9789264243507-en.

³⁴⁷ See Section 4.2.2.

³⁴⁸ Harju etc, concludes that additional tax incentives, such as gradual tax relief, do not have much impact on the threshold effect. However this study is based on a scheme in a single country (Finland) and thus influenced by the specific characteristics of that gradual relief scheme (e.g. great complexity).

³⁴⁹ For example, standard discount on VAT payable or fixed input VAT refund, as described in Section 4.2.5 on Other simplifications under ‘standard deduction of VAT’.

Such transitional measure could benefit further from streamlining the existing application of a flexible threshold for temporary hikes in supplies, allowing businesses to continue applying SME exemption scheme after the transition period, if their sales have again fallen below the threshold.

A step further would be to allow businesses to opt back into the SME exemption scheme also later, if their sales have reduced and it is anticipated that the threshold will not be exceeded within the next two years (as a minimum), e.g. on winding down a small business. However, this is already possible and does not thus require additional legislative changes.

Further alignment on cash flow support measures could be also considered for businesses after the transition period, such as flexibility in VAT payments (e.g. optional prepayments where these are mandatory, staggered payments or payments by instalments) and alignment in cash accounting schemes (especially regarding administrative requirements). However, these measures would go beyond the changes to the SME scheme.

Preferred solution

Based on the above analysis, **we recommend to introduce an optional measure for Member States for a transition period to be inserted into the SME exemption scheme** reducing the negative impact of the ‘threshold effect’, which would:

- allow a business exceeding the threshold to continue using the SME exemption scheme for one year or until its turnover exceeds the threshold by 50%, whichever condition is met first; and
- allow a business to continue using the SME exemption scheme after the transition period, if their sales have again reduced below the threshold,

for the following reasons:

- it removes the existing obstacle of a sudden financial and administrative impact when the SME exemption threshold is exceeded, allowing a slower and gradual transfer to full taxation;
- it has thus the potential to greatly encourage the growth of SMEs.

Key features of the policy options and main advantages and disadvantages

The table below provides a summary of the key features of the final policy options and their main advantages and disadvantages.

Table 18 – Key features of the SME exemption scheme in policy options

Feature	Option 1 (baseline scenario)	Option 2	Option 3	Option 4
Territoriality	Applies to businesses established in a Member State	Applies to all EU businesses	Applies to all EU businesses (except occasional traders)	Applies to all EU businesses (except occasional traders)
Threshold level	Set nationally	Set nationally	Set nationally	Set nationally
Threshold basis	Turnover taxable in the Member State	Turnover taxable in the Member State (including supplies into the Member State)	Turnover taxable in the Member State (including supplies into the Member State)	Turnover taxable in the Member State (including supplies into the Member State)
Optionality	Optional for Member States and for businesses	Optional for Member States and for businesses	Optional for Member States and for businesses; not applicable to occasional traders	Optional for Member States and for businesses; not applicable to occasional traders
Tax benefit	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold	VAT exemption for supplies below the threshold
Simplifications	None in the SME exemption scheme, but in practice optionally applied with SME scheme	Minimum level of simplified registration, VAT return and invoicing for businesses eligible for SME exemption scheme (including when opting out). Abolished B2C invoicing within the scheme. Member States can offer further relief.	In addition to option 2 : Full relief from VAT obligations for occasional traders.	Same as option 3.
Additional measures	Includes common EU threshold of EUR 10 000 for cross-border B2C supplies, below which the business may apply domestic	Common EU threshold. Member State can introduce threshold for overall turnover	In addition to option 2 : Mandatory treatment of occasional traders as non-	In addition to option 3 : Flexible SME exemption scheme threshold for 1 year or until exceeding by 50%,

Feature	Option 1 (baseline scenario)	Option 2	Option 3	Option 4
	VAT rules, including SME exemption scheme ³⁵⁰	for non-established SMEs.	taxable persons	whichever is met first
Main advantages	Simplification for cross-border B2C trade provided by common EU threshold	Reduces cross-border distortions; brings simplifications into the SME exemption scheme, extends simplifications to businesses opting out of the scheme	In addition to option 2: Occasional traders are exempt from all VAT obligations; More certainty in tax treatment of occasional traders for businesses and tax authorities Reduction of administrative costs of tax authorities	In addition to option 2 and 3: Potential reduction of threshold effect for businesses, thus encouraging their growth
Main disadvantages	Continuation of identified problems, likely to increase in future. Lack of review of SME exemption scheme as part of move to a destination-based system	less flexibility in choice of simplification measures for Member State (i.e. required to provide at least minimum simplifications); Potential new simplification processes complicating the system by adding special measures	In addition to option 2: Occasional traders cannot register for VAT and deduct input VAT, unless they prove non-eligibility Complexity for tax authorities to legislate and control the measure	In addition to option 2 and 3: Negative impact on VAT revenue of member States. May increase the complexity of VAT system and compliance control

³⁵⁰ Commission Proposal COM(2016)757 Modernising VAT for cross-border B2C e-commerce.

7 Assessment of the policy options

For each of the policy options, this section presents the estimated impacts for businesses, Member States and the wider economy.

The detailed description of the methodology and assumptions used for the estimation of impacts is provided in Volume II, Annexes I to K.

7.1 Introduction to the impact assessment

Table 19 below summarises the four policy options covered by the assessment, as developed in Section 6.

Table 19 – List of proposed policy options

Baseline scenario
Option 1: Baseline scenario (status quo with measures from the e-Commerce proposal)
Policy options
Option 2: SME exemption scheme extended to supplies from other Member States and including streamlined simplification measures
Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons
Option 4: Option 3 plus measures for transition period reducing the negative impact of the 'threshold effect'

The results of the impact assessment analysis are presented for each policy option, in comparison with the baseline scenario. The analysis covers the following areas, with both quantitative and qualitative impacts reported:

- Short summary of the **main provisions included**;
- **Impact on businesses**, which includes the analysis of the number of businesses impacted and of their compliance costs;
- **Impacts on Member States**, which encompasses the analysis of the impact on VAT revenues, as well as on compliance, legislative framework and administrative costs³⁵¹;
- **Impacts on the wider economy**, which includes impact on GDP, aggregate output, output of impacted SMEs, SMEs' cross-border trading activity, labour productivity, prices and consumers' demand; and

³⁵¹ It should be noted that the quantification of administrative costs for tax authorities was not possible as separation of costs for VAT-related tasks only was not possible in the baseline scenario.

- An overview of the main impacts estimated (**key findings**).

The baseline scenario (option 1) represents the starting point, against which the other policy options are evaluated. Option 1 is based on the status quo of SME schemes and measures for SMEs presented in Section 4, and on the main provisions of the e-Commerce proposal³⁵².

The analysis focuses on the specific sub-set of SMEs that are likely to be directly impacted by the provisions of the policy options. This sub-set of businesses have been identified as those below the turnover threshold of EUR 100 000, estimated to represent approximately 32 million businesses.³⁵³

This section only presents the final results of the impact analysis. The detailed explanations of the methodology and assumptions used for the estimation of the policy options' impacts are provided in Volume II, Annex I.

It should be noted that during the finalisation of this report (in January 2017 after policy option analysis had been conducted), Sweden introduced an SME exemption scheme. This is therefore not taken into account in the assessment of the policy options.

7.2 Option 1: Baseline

The baseline scenario builds on the current legislative framework of the VAT Directive and integrates the changes proposed in the e-Commerce proposal³⁵⁴. The details of the main provisions for SMEs under the baseline can be found in Section 6.2.3.

7.2.1 Compliance costs for businesses

In the baseline scenario, the estimated overall compliance cost that small businesses face to comply with VAT obligations amounts to almost **EUR 68 billion** per year. This figure includes three main groups of businesses and their related compliance costs (within the specific sub-set on which the analysis focuses, i.e. businesses with turnover below EUR 100 000³⁵⁵), namely:

- Businesses using domestic SME exemption schemes;
- Businesses using domestic standard VAT regimes; and
- Businesses engaged in cross-border trade.

The compliance costs for businesses trading domestically only and for those engaged in cross-border trade are described below.

Businesses trading domestically

³⁵² Ibid, available:

https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_757_en.pdf.

³⁵³ More details are provided in Section 3 of the report (Volume I) and on Volume II Annexes I to K.

³⁵⁴ Commission Proposal COM(2016)757 Modernising VAT for cross-border B2C e-commerce

³⁵⁵ These businesses are the focus of the analysis and estimates since they have the potential to be impacted by the policy options under consideration. The estimates of the burden are therefore based on a sample of businesses with turnover below this threshold, but these figures may not be representative of the costs incurred by larger businesses, which are therefore not reflected in the total.

The table below provides an overview of the relevant information obligations and additional costs for businesses trading domestically only, and the related average costs (including advisory costs).

Table 20 – EU average annual compliance costs for businesses within and outside of the SME exemption scheme (Baseline scenario)

Member State	Within the SME exemption scheme		Outside of the SME exemption scheme	
	Relevant IOs/costs	Overall costs (annual basis)	Relevant IOs/costs	Overall costs (annual basis)
EU Average	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ VAT payment (domestic) ➤ Bookkeeping <p>Hidden costs: monitoring threshold</p>	<p>Average across all Member States: EUR 550 of which hidden costs are EUR 193</p> <p>(this average reflects the fact that some Member States impose no or few of the listed IOs to businesses within the scheme; the average cost in Member States where the listed obligations are applied is EUR 1 083, of which advisory fees: EUR 500</p>	<ul style="list-style-type: none"> ➤ VAT registration ➤ Invoicing (re domestic) ➤ VAT declarations/returns ➤ VAT payment (domestic) ➤ Bookkeeping 	<p>EUR 2 964</p> <p>(of which advisory fees: EUR 1 023)</p>

Source: Deloitte calculation based on average compliance costs for businesses included in fieldwork

Based on this analysis, the overall **compliance costs** for different type of businesses are as follows:

- **Businesses in the SME exemption scheme** represent around **11.2 million businesses** across the EU, and are estimated to have an overall compliance cost of **EUR 6.1 billion**. However, this varies across Member States based on the different obligations applied. While the weighted average compliance cost was estimated to be around EUR 550, it can range from EUR 190 in Member States where businesses are exempted from most VAT-specific obligations, to EUR 1 800 in the most burdensome Member States.
- **Businesses eligible for the SME exemption scheme but who decide to opt out** represent **5.7 million businesses** across the EU and are estimated to have an overall compliance cost

due to VAT obligations of **EUR 16.9 billion**.³⁵⁶ These businesses operate under the **standard VAT regime**, with the typical EU compliance cost estimated at approximately **EUR 2 970 per year**. It however ranges from around EUR 870 to EUR 2 970 based on the frequency of obligations, complexity of legislative framework in Member States, advisory costs and additional costs (such as IT).

- **Businesses not eligible for the SME exemption scheme** also operate in the standard VAT regime. Those with a turnover below EUR 100 000 are estimated to represent an additional **15 million businesses** facing overall VAT compliance costs of **EUR 44.5 billion, or EUR 2 970 per business per year on average**.

Businesses trading cross-border

Within the baseline scenario, (as per the e-Commerce proposal³⁵⁷) SMEs engaged in intra-EU B2C trade have different options for accounting for and paying VAT, depending on whether their total turnover from intra-EU trade falls below or above the common EU threshold of EUR 10 000. SMEs can:

- Treat their intra-EU B2C sales as domestic supplies (provided their value is below EUR 10 000) and be subject to VAT obligations in their home country;³⁵⁸
- Declare and pay VAT using the MOSS; or
- Register for VAT in the Member State(s) of destination, and be subject to the standard VAT regime in this country (or countries).

SMEs eligible for the SME exemption scheme domestically tend to have very limited B2C cross-border activity; available evidence suggests that about 15% of all SMEs trade cross-border, and that 67% of SMEs trading cross-border make B2B supplies.³⁵⁹

Under the baseline scenario, available evidence suggests that SMEs eligible to benefit from the SME exemption scheme domestically will do so in order to minimise their VAT obligations.³⁶⁰ In this instance, their compliance costs for cross-border sales will be included in their domestic costs, and will not be considered in the cross-border elements of the calculations.³⁶¹

When SMEs' cross-border B2C sales exceed EUR 10 000 or if they cannot benefit from the SME exemption scheme domestically, the option of using the MOSS is likely to be the most pragmatic and effective, given the limited compliance costs of the system and the application of domestic rules.³⁶²

It is therefore estimated that the **costs of complying with VAT obligations for businesses trading cross-border** amount to about **EUR 400 million** or about EUR 690 per business per year, for the approximately 580 000 SMEs that may potentially benefit from the options under consideration.

³⁵⁶ Businesses may decide to opt out of the SME exemption scheme for many reasons. An analysis of the reasons for opting in or out of the scheme is provided in Section 4.

³⁵⁷ Commission Proposal COM(2016)757 Modernising VAT for cross-border B2C e-commerce.

³⁵⁸ In this case, sales might be exempt from VAT if the business is eligible and opts for the SME exemption in its home country.

³⁵⁹ More details on the methodology and assumptions used to estimate the cross-border activity of SMEs are provided in Volume II, Annex I, Section I.2 'General Assumptions', 'Cross-border transactions in scope'.

³⁶⁰ It is also possible that such businesses decide to opt for the MOSS immediately, for instance if they plan to expand their intra-EU trade, or if they already use the MOSS for TBE services.

³⁶¹ See Volume II, Annex I for more details on the methodology used.

³⁶² Based on the evidence available on the costs of different schemes.

Overall impact on businesses' compliance costs

Under option 1, the overall **compliance costs** that businesses would face to comply with VAT obligations equals **EUR 67.9 billion**.

7.2.2 Administrative Costs for Member States

Existing studies point out the difficulty in assessing administrative costs of tax authorities associated only with the administration of VAT-related tasks.³⁶³ This study experienced similar difficulties, mainly due to the fact that tax authorities are managed by department (or function) rather than by tax, making it speculative if not impossible to attribute costs only to administration of the SME schemes for SMEs.

Based on a review of the literature however, it is found that the administration of VAT for SME schemes is likely to be very low in comparison to VAT revenues. For example according to annual accounts of HMRC, the collection of VAT accounted for approximately 0.6% of the tax revenues in 2015.³⁶⁴ The OECD notes that this 'cost of collection' ratio³⁶⁵ is becoming more commonplace across tax authorities, however does not provide an analysis of this ratio by type of tax.³⁶⁶

Based on OECD estimates in 2011, the average cost of collection ratio of tax administrative cost versus tax revenues among EU Member States³⁶⁷ was approximately 1%.³⁶⁸ Unfortunately this data does not allow for estimation of the proportion of costs related specifically to the administration of SME schemes.

7.2.3 Compliance and fraud in Member States

As described in Section 5.4.3, the main compliance and fraud concerns with the current SME schemes relate to the **under-declaration of sales** in order to stay below the SME exemption threshold – evidenced by the 'bunching' of businesses with turnovers just below the threshold³⁶⁹ – and abuse of the right for voluntary VAT registration to make fraudulent input VAT claims.

Compliance control of businesses benefitting from the SME exemption scheme is challenging due to the **full or extensive relief from VAT obligations** that is often applied, which generally means that the tax authorities have very limited information on the number of such businesses and their turnover. At the same time, the benefits of the SME exemption scheme for tax authorities, through keeping a large number of the smallest businesses out of the VAT regime and enabling better allocation of resources, still exceed these risks. Many Member States therefore consider that their **general compliance measures are sufficient and appropriate**. The compliance control of voluntarily VAT

³⁶³ Barbone et al (2012), The Costs of VAT: A Review of the Literature, p. 5 available : <http://icepp.gsu.edu/files/2015/03/ispwp1222.pdf>.

³⁶⁴ HMRC annual report and accounts 2015 – 2016 p. 52, available: <https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2015-to-2016>

³⁶⁵ Cost of collection ratio "is computed by comparing the annual costs of administration incurred by a revenue body, with the total revenue collected (after refunds) over the course of a fiscal year" (OECD definition 2015)

³⁶⁶ OECD (2015) Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies p. 178, available: http://www.oecd-ilibrary.org/taxation/tax-administration-2015_tax_admin-2015-en.

³⁶⁷ Excluding Bulgaria and Croatia.

³⁶⁸ Average is based on figures collected by OECD in 2011. See table 5.3 of *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, available: <https://www.oecd.org/site/ctpfta/taxadministrationdatabase.htm> .

³⁶⁹ However, 'bunching' is not always evidence of tax avoidance, as it may be caused also by businesses knowingly reducing their sales.

registered SMEs and their input VAT claims is challenging due to the related disproportionate administrative cost for tax authorities.

The introduction of the **common EU threshold** for SMEs that have limited cross-border sales is expected to improve compliance among such businesses as it will be significantly easier for them to comply with domestic rules (including the extension of the SME exemption scheme to these supplies), especially regarding cross-border B2C supplies of e-services, which currently require immediate VAT registration through the MOSS system. For cross-border B2C supplies of goods, the impact of the proposed measures on compliance is more mixed, as the current distance sales rules are more beneficial (although perhaps more complex to monitor) for larger SMEs than the new common EU threshold, given that the distance sales threshold on a per country level range from EUR 35 000 to EUR 100 000.

7.3 Option 2: Extension of exemption threshold to supplies from other Member States and streamlined simplification measures

7.3.1 Structure and aim of the policy option

Option 2 introduces two significant changes to the application of the SME exemption scheme:

- Domestic SME exemption schemes are extended to supplies from non-established businesses; and
- Simplification measures are available to all businesses eligible for the SME exemption schemes, whether they opt in or out, or trade domestically or cross-border (i.e. the streamlined simplification package).

The set of obligations included in the streamlined simplification package is a crucial driver of the compliance costs for businesses, and hence the impacts on Member States and the wider economy.

The impacts of this option on businesses, Member States and the wider economy are described in turn below.

7.3.2 Impact on businesses

The extension of the SME exemption scheme in each Member State to non-established businesses affects those businesses that:

- Trade cross-border;
- Have a value of sales taxable in a single, foreign Member State that falls below the VAT exemption threshold in place in that Member State; and
- Choose to opt for the SME exemption scheme in the Member State of destination, instead of:
 - Opting out and paying VAT in the Member State of destination while being subject to the simplified VAT obligations in place in that Member State;
 - Declaring VAT via the MOSS; or
 - If eligible, using the common EU threshold on their B2C cross-border supplies and being subject to the VAT rules in the Member State of origin (home country rules).

The second part of this option introduces a package of streamlined simplification measures for VAT in each Member State. This will affect those businesses that:

- Are eligible for the SME exemption scheme in their country of establishment, or in another Member State in which they make cross-border supplies, whether they choose to opt in or out of the scheme.

Under option 2, Member States are **required to offer the same set of obligations to domestic and non-domestic businesses**. While they have alternative means to monitor domestic businesses (such as through registration for other tax purposes), this is not necessarily the case for non-established businesses. It is therefore possible that Member States currently relieving exempted and domestic businesses from many VAT-related obligations may decide to apply these obligations to improve monitoring of non-established businesses.

There is **inherent uncertainty around the changes Member States may make** to their requirements following the extension of the SME exemption scheme to non-established businesses. For the purposes of this analysis, three different scenarios were considered:

- A **generalised simplification scenario**, under which the streamlined simplification package moves towards a very simple set of obligations, i.e. where compliance costs in every Member States are similar to the lowest range in the status quo;
- A **medium simplification scenario**, where the set of obligations includes registration, reporting and simplified bookkeeping (and VAT returns and payment for non-exempt businesses); and
- A **minimal simplification scenario**, where the measures introduced align with the highest set of obligations allowed under the option.

The table below summarises the set of obligations included in each of the scenarios above.

Table 21 – Scenarios for streamlined simplification packages

	Generalised simplification scenario	Medium simplification scenario	Minimal simplification scenario
Relevant obligations			
Using SME exemption scheme	<ul style="list-style-type: none"> ☑ VAT registration; ☑ Bookkeeping 	<ul style="list-style-type: none"> ☑ VAT registration; ☑ VAT return; ☑ Bookkeeping 	<ul style="list-style-type: none"> ☑ VAT registration; ☑ Invoicing; ☑ VAT return; ☑ Bookkeeping
Opting out of SME exemption scheme	<ul style="list-style-type: none"> ☑ VAT registration; ☑ VAT return; ☑ VAT payment; ☑ Bookkeeping 	<ul style="list-style-type: none"> ☑ VAT registration; ☑ VAT return; ☑ VAT payment; ☑ Bookkeeping 	<ul style="list-style-type: none"> ☑ VAT registration; ☑ Invoicing; ☑ VAT return; ☑ VAT payment; ☑ Bookkeeping

Source: Deloitte elaboration

As well as these specific obligations, businesses making use of the SME exemption scheme face the **hidden cost of monitoring the threshold**, as in the baseline scenario (option 1).

The **extension of the SME exemption scheme** to non-established businesses may also imply **additional learning costs** for businesses or for their accountants and advisors. Such costs are estimated to amount to approximately **EUR 1 500**, i.e. the one-off cost of training³⁷⁰ on SME exemption schemes (including eligibility requirements and reporting obligations) in place in neighbouring countries. It is likely that accountants and advisors will distribute the costs of such training across their overall client base, with minimum impact on individual businesses' advisory costs. In the medium-term, ongoing learning costs are likely to become running costs, as for updates on national schemes.

Volume II, Annex I sets out the methodology used to estimate the number of businesses affected by each of the proposed measures under this option. These estimates then form the basis for the overall assessment of the impact on the administrative burden and the wider economy. These impacts are described below.

Overall impact on businesses' compliance costs

Under option 2, the analysis suggests that the overall **compliance costs** that businesses would face to comply with VAT obligations range from **EUR 53.2 billion** to **EUR 62.7 billion**, a reduction of between 8% and 22% compared to the baseline scenario.

The table below provides an overview of the impacts on the number of businesses impacted and their compliance costs under the different scenarios envisaged for the streamlined simplification packages.

³⁷⁰ It is assumed that accountants do not have to become certified in other Member States.

Table 22 – Businesses' compliance costs under policy option 2

	General simplification			Medium simplification			Minimal simplification		
	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)
Businesses trading domestically									
Businesses exempt from VAT	297	11 200 000	3.3	716	11 200 000	8.0	1 044	11 200 000	11.7
Businesses in simplified regime	887	5 700 000	5.1	975	5 700 000	5.6	1 047	5 700 000	6.0
Businesses in standard VAT regime	2 964	15 000 000	44.6	2 964	15 000 000	44.6	2 964	15 000 000	44.6
Businesses trading cross-border³⁷¹									
Businesses using MOSS	690	120 000	0.08	690	290 000	0.20	690	460 000	0.32
Businesses in cross-border exemption scheme	297	460 000	0.14	716	290 000	0.21	1 044	120 000	0.12
Overall compliance costs	53.2			58.6			62.7		
% change from baseline scenario	-22%			-14%			-8%		

Source: Deloitte estimates

³⁷¹ As previously mentioned, this only include businesses whose cross-border sales do not fall under the common EU threshold and under the domestic VAT exemption threshold.

Impact on businesses trading domestically

On aggregate, this option is estimated to **reduce the compliance costs of domestically trading SMEs**. However, the impact will **differ across businesses and between Member States**, depending on the current measures applied.³⁷² In fact, some SMEs may face an increase in compliance costs in Member States with minimal obligations if tax authorities extend the current requirements in order to improve monitoring of non-domestic businesses; the introduction of the simplification package is intended to mitigate this impact. The following estimates were obtained:

➤ **Impact on businesses using the SME exemption scheme.** The compliance costs for these businesses are estimated to range between around **EUR 300** per year to around **EUR 1 040** (and about **EUR 720** under the medium simplification scenario), compared to a weighted average cost in the baseline scenario of **EUR 550**. This represents:

- A decrease in compliance costs under the maximum simplification scenario of 46% decrease on average (ranging from a decrease of -260% to an increase of 35% depending on the Member State);
- An increase in compliance costs under the medium simplification scenario (31% on average, ranging from -50% to +73%, depending on the Member State).
- An increase in the minimal simplification scenario of 91% on average (ranging from -4% to 82%, depending on the Member State), as domestic businesses may become subject to additional obligations.

➤ **Impact on businesses outside the SME exemption scheme.** The compliance costs for eligible businesses opting out of the SME exemption scheme are estimated to range between approximately EUR 890 to EUR 1 050 per year (EUR 975 under the medium simplification scenario). Compared to the baseline cost of close to EUR 3 000 this represents a decrease in costs across all simplification scenarios.

Impact on businesses trading cross-border

In addition to the options outlined in the description of the baseline, **businesses trading cross-border** may now be eligible to benefit from the SME exemption scheme in the Member State of destination. Those businesses eligible are estimated to represent between 2% and 7% of all EU businesses.³⁷³

In practice, those SMEs whose cross-border sales fall under the common EU threshold, and who are eligible for the SME exemption scheme in their domestic market (including these cross-border sales) will be exempt already and therefore do not require the opening up of the exemption scheme in the other markets in which they trade. It is therefore estimated that the number of businesses actually benefitting from the policy option could amount to about 580 000, representing 1.4% of all EU businesses.³⁷⁴

³⁷² See Section 4.2 for a full overview of the obligations currently applied in each Member State.

³⁷³ For more details on the calculations, see Volume II, Annex I, Section I.4.

³⁷⁴ For more details on the calculations, see Volume II Annex I, Section I.4.

Among these businesses, the **cost of VAT compliance will depend on whether they opt to use the MOSS or to register in the Member State of destination** (either within or outside the scheme). The results of the SCM analysis indicate that use of the MOSS costs on average **EUR 690** per year whereas the cost of VAT registration in another Member State may vary between close to **EUR 300 and EUR 1040**, depending on the simplification package applied. The take-up of MOSS versus the SME exemption scheme is therefore expected to vary with the level of simplification adopted by Member States; different scenarios are therefore considered.³⁷⁵

Table 22 above shows the resulting impact on the compliance costs, depending on the simplification measures used and the number of businesses choosing each option.

7.3.3 Impact on Member States

Impact on VAT revenues

Extending the SME exemption scheme to supplies from other Member States has potentially negative impacts on VAT revenues, as SMEs currently paying VAT on their cross-border sales may now become exempt from doing so. While 1.4% of businesses may take advantage of this option, they represent a limited proportion of the EU turnover as they must be small enough for their cross-border sales to fall below the SME exemption threshold. The turnover at stake, which is the value of cross-border sales that would no longer be subject to VAT following the introduction of this policy option, represents 0.02% of the overall turnover generated by businesses in the EU.

The resulting fall in VAT revenue could therefore be up to EUR 665 million, which represents a decrease of 0.06% compared to the current level of net VAT revenue collected by Member States in the EU.

The following table shows the impact at a Member State level. Note that the overall EU decrease in revenue was allocated to individual Member States based on their share of inbound trade from other Member States (called “EU imports” hereafter), as Member States most impacted by extending their domestic threshold to non-established businesses will be the ones with higher imports. More details on the calculations can be found in Volume II, Annex I.

Table 23 – Change in VAT revenue collected due to policy option 2 by Member State

Member State	Absolute change in net VAT revenue collected due to the policy change, in EUR million	Percentage change in net VAT revenue collected due to the policy change
EU-28	-664.9	-0.06%
Austria	-24.0	-0.02%
Belgium	-47.5	-0.18%

³⁷⁵ In the medium simplification package compliance costs for MOSS and the exemption scheme are similar, and the choice of businesses is expected to depend on other factors. Given the inherent uncertainty, for the purpose of the analysis 50% of trading businesses are assumed to opt for the MOSS system and 50% for the SME exemption scheme. Under the generalised simplification scenario, the compliance costs related to the SME exemption scheme are lower than those for MOSS, and are likely to induce a larger share of businesses to opt for the scheme. For the purpose of the analysis, 80% of trading businesses are assumed to use the SME exemption scheme and 20% are assumed to use MOSS. The numbers are reversed under the minimal simplification scenario. See Table 22 for the exact numbers.

Member State	Absolute change in net VAT revenue collected due to the policy change, in EUR million	Percentage change in net VAT revenue collected due to the policy change
Bulgaria	-3.8	-0.10%
Croatia	-3.2	-0.07%
Cyprus	-0.8	-0.05%
Czech Republic	-21.8	-0.34%
Denmark	-11.9	-0.05%
Estonia	-2.4	-0.16%
Finland	-8.8	-0.06%
France	-78.7	-0.04%
Germany	-138.7	-0.07%
Greece	-5.1	-0.04%
Hungary	-14.2	-0.09%
Ireland	-9.9	-0.14%
Italy	-48.1	-0.06%
Latvia	-2.3	-0.15%
Lithuania	-3.8	-0.08%
Luxembourg	-3.4	-0.09%
Malta	-0.8	-0.15%
Netherlands	-46.4	-0.10%
Poland	-27.5	-0.10%
Portugal	-10.3	-0.07%
Romania	-10.8	-0.09%
Slovakia	-11.6	-0.68%
Slovenia	-4.2	-0.17%
Spain	-38.0	-0.07%
Sweden	-19.4	-0.06%
United Kingdom	-67.5	-0.04%

Source: Deloitte estimates

The table above shows that the impact on Member States varies from a decrease in VAT revenues of 0.02% in Austria to 0.68% in Slovakia. The differences observed across Member States are impacted by two factors:

- The share of EU imports of each country: the higher the share, the higher the impact; and
- The level of net VAT revenue collected before the impact: the higher the amount of VAT revenue collected, the lower the impact.

For example, Slovakia represents 1.8% of EU imports but only 0.2% of all VAT revenue collected. It is therefore proportionally more impacted by the change in policy than countries with a lower share of imports and higher share of VAT revenues, such as Portugal (1.5% and 1.4% respectively).³⁷⁶

Any potential negative revenue impact could be mitigated by adjusting the SME exemption threshold, so that the SME scheme changes are potentially revenue neutral. However, such downwards adjustment would have an impact on the domestic businesses currently benefitting from the SME scheme.

Impact on compliance and fraud

The policy option increases the complexity of the SME exemption scheme by opening it to businesses established in other Member States, especially when applied together with the proposed common EU threshold. Therefore, it is likely to increase the tax authorities' cost of compliance control, as the compliance risks will change.

The impact on avoidance or abuse/fraud relating to the SME exemption scheme will largely depend on the national design of the measure, for example which simplification measures are included in the scheme and how they are applied. The option should not have a significant impact on the compliance of domestic businesses, unless the current simplification measures are significantly changed. If the Member State applies currently a wide relief from VAT obligations together with the SME scheme, but decides to withdraw some reliefs when reviewing the SME exemption scheme (e.g. requiring VAT registration in order to apply the same rules for domestic and foreign businesses), it is likely to have a mixed impact on compliance. The tax authorities would have better information and control on businesses benefitting from the SME exemption scheme by having them register³⁷⁷, however there will be also businesses that would not comply with such registration obligations and continue trading fully outside the VAT regime.

Extending the simplification measures to SMEs that have opted out of the SME exemption scheme is likely to improve voluntary compliance by reducing the administrative burden of businesses. However, the extent of applied simplification has to be assessed against any potential increase in compliance risk from a reduction of the VAT obligations on VAT-registered and VAT-paying businesses and, for example, the collection of less data or a longer delay in collecting data (e.g. replacing quarterly returns with an annual return).

Regarding the compliance control of foreign businesses, the expansion of the scheme to foreign businesses changes the abuse and fraud risks associated with the scheme. Therefore, Member States are likely to review their current SME schemes in order to introduce some limited processes for foreign businesses that would seek to benefit from the domestic SME exemption scheme (e.g. simplified VAT registration with application for the SME exemption scheme and simplified annual sales statements). The option will also increase the need for administrative cooperation between the tax authorities of different Member States, as even with some registering and reporting processes it will be challenging for the tax authorities to control the compliance of foreign businesses trading in their Member State. The potential increased abuse and fraud risks need to be also assessed and

³⁷⁶ Source: Deloitte estimates based on data obtained from tax authorities and public sources.

³⁷⁷ However, potential abuse and fraud risk arising from increased allocation of VAT registration numbers to non-established businesses ought to be taken into account, such as use of invoices for redirection of the place of supply to a different country (with a potentially lower VAT rate).

taken into account, such as foreign businesses artificially splitting in order to fall under the SME scheme, as evidenced recently in the UK regarding the UK flat rate scheme³⁷⁸.

Legislative impact

As a result of this policy option, the tax authorities will need to make legislative changes in their current SME exemption schemes, unless they have decided not to apply one. The main required legislative change is to allow businesses established in other Member States to benefit from the SME exemption scheme.

Any other legislative changes will be optional for Member States, as they retain the flexibility to apply the SME exemption scheme or not, and to set a national SME exemption threshold.

Regarding simplification measures, some of the Member States may need to review the simplification measures currently applied to the SMEs benefitting from the SME exemption scheme, however for the majority of Member States, it is likely that the current set of simplification measures is already compatible with the simplification package included in the SME exemption scheme.

Member States may wish to make further legislative changes, e.g. to adjust the SME exemption threshold or amend the set of simplification measures as a result of the extension of the SME exemption scheme to supplies from other Member States.

Impact on administrative cost

The impact of the policy option on the administrative cost of the Member States will depend on the simplification measures the Member State decides to apply as part of the SME scheme.

The set administrative obligations of the SMEs (or the related simplifications and abolition of these obligations) will need to be balanced against the interests of the tax authorities in controlling compliance with the scheme and tackling any risks of abuse, especially after the SME exemption scheme is extended to supplies from other Member States. However, the policy option introduces a minimum set of simplification measures that would need to be taken into account when reviewing the current SME scheme. This simplification package, if implemented, is likely to have mixed impact on tax authorities at least in the short term, as new processes would need to be set up and new forms designed, which create a one-off administrative cost, but may provide administrative savings later on (in comparison to a full set of administrative obligations). However, the initial adaptation costs are likely to reduce in the medium term, so that the redesigned processes will become 'business as usual).

It is likely that in comparison to the current VAT framework, the administrative costs of tax authorities will increase (as compliance control will become more complex), but as said, the extent of this increase is under the control of the Member States, which will retain wide flexibility and can introduce (or retain) more extensive simplification measures than included in the policy option, should they find it appropriate.

³⁷⁸ HMRC guidance Tackling aggressive abuse of the VAT Flat Rate Scheme - technical note <https://www.gov.uk/government/publications/tackling-aggressive-abuse-of-the-vat-flat-rate-scheme-technical-note/tackling-aggressive-abuse-of-the-vat-flat-rate-scheme-technical-note>.

7.3.4 Impact on the wider economy

By reducing the administrative burden on businesses and enabling SMEs trading cross-border to benefit from SME exemption schemes in the country of destination, this option may have a positive impact on the wider economy.

This is estimated using a general equilibrium model of the EU economy, as described below.

- The extension of the domestic SME exemption scheme to exporting businesses will reduce the costs of trade for those businesses. By removing VAT, this can potentially reduce the prices charged by such businesses and make them more competitive. This is captured in the model as a reduction in the average VAT rate paid by businesses trading cross-border.
- The proposed simplification measures will benefit both domestic and exporting businesses. While not changing the VAT payment due, these proposals can reduce labour costs and hence prices in those markets that currently have significant obligations for businesses using the exemption scheme. This is captured as a reduction in the labour time dedicated to administrative tasks, which can increase labour productivity and enable businesses to reduce prices.
- Finally, the fall in VAT revenues due to the domestic SME exemptions being extended to exporting firms negatively impacts government spending and investment, thus potentially reducing consumer demand or GDP.

The table below shows the estimated net impact on the wider economy resulting from the policy change. Given that the businesses affected by the policy account for a small fraction of EU turnover – the extension of the SME exemption scheme affects businesses that account for 0.03% of turnover; the simplification measures affect businesses that generate 0.91% of turnover – the overall impact on the price level is small. However, the reduction of the administrative burden enables a significant increase in labour productivity.

Table 24 – Summary table of the wider economic impact of option 2

	Generalised simplification	Medium simplification	Minimal simplification
Impact on GDP	0.11%	0.07%	0.04%
Impact on aggregate output	0.13%	0.08%	0.05%
Impact on output of impacted SMEs	14.0%	9.0%	5.0%
Impact on SMEs' cross-border trading activity (percentage change in total value of cross-border trade)	13.5%	13.5%	13.1%
Impact on labour productivity	0.14%	0.09%	0.05%
Impact on prices	-0.10%	-0.08%	-0.05%
Impact on consumer demand	0.14%	0.09%	0.05%

Source: Deloitte estimates

This analysis shows that the reduction in the administrative burden – especially for smaller businesses that do not use SME exemption schemes but can benefit from the simplification measures – can have a **positive impact on GDP**.

While the overall impact is not large given that these businesses only make a small proportion of overall output, it represents a significant increase in the activity of these businesses. For example, **the activity of domestic-focussed SMEs is estimated to increase by up to 14%** under this option due to the significant reduction in administrative costs and the associated increase in their productivity and competitiveness. However, there is a concern that the administrative burden may increase for businesses that currently use the SME exemption scheme, due to the additional reporting requirements brought in to improve compliance among non-domestic businesses. While this creates a more level playing field between those that are inside and outside of the scheme, it may reduce the competitiveness of smaller SMEs.

For businesses that trade cross-border, the ability to use the SME exemption scheme in the country of destination can reduce VAT costs by over 12% and the administrative burden associated with cross-border trade by up to 30%. Together, these impacts may enable **increases in cross-border activity by affected SMEs of up to 13.5%**, as they are better able to compete with SMEs in the countries with which they trade. However, given that SMEs contribute a small proportion of intra-EU trade the overall impact is estimated to be less than 0.1%.

Consumers and workers can also benefit from the reduction in the administrative burden and the extension of the SME exemption scheme, which can **reduce prices and increase consumption**. While the effect on the overall price level is small, since the businesses affected by the policy option have very little market power, it may nonetheless lead to a **small increase in aggregate demand** as well as **increasing competition** and the range of products available to EU consumers. By reducing the time spent in unproductive tasks, the reform also has the potential to increase labour productivity, which in turn can **increase real wages** and **reduce working hours**.

7.4 Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons

7.4.1 Structure and aim of the policy option

This policy option builds on option 2. In addition to the extension of the SME exemption threshold to non-established businesses and to the introduction of a streamlined simplification package, it proposes to treat **occasional traders as non-taxable persons**.

Businesses identified as occasional traders are fully kept out of the VAT system, and as such do not have any VAT-related obligations, including on intra-EU purchases. As a consequence, those businesses will have no right to register for VAT or claim input VAT refunds, unless they prove planned or existing continuous and non-incidental business activity.

The impacts of such provisions on businesses, Member States and the wider economy are described below.

7.4.2 Impact on businesses

Overall impact on businesses' compliance costs

Under option 3, the overall compliance costs that businesses face to comply with VAT obligations are estimated at approximately **EUR 56.5 billion**, a 17% reduction compared to the EUR 68 billion estimated under the baseline scenario³⁷⁹. This reduction is essentially due to the fall in the number of businesses subject to VAT-related obligations.

The table below provides an overview of the impacts on the number of businesses and their compliance costs.

Table 25 – Businesses' compliance costs under option 3 for businesses with less than EUR 100 000 of turnover, excluding occasional traders

	Cost per 1 business (1 MS) EUR	Previous compliance cost of an occasional trader	No businesses of	Compliance cost (EUR billion)
Businesses trading domestically				
Businesses exempt from VAT	[716 – 1 043] ³⁸⁰	83	7 400 000	7.7
Businesses in simplified regime	[975 – 1 208] ³⁸¹	342	4 200 000	5.0
Businesses in standard VAT regime	[2 964 – 3 104] ³⁸²	1 114	14 000 000	43.4
Businesses trading cross-border				
Businesses using MOSS	690		290 000	0.20
Businesses in cross-border exemption scheme	716		290 000	0.21
Overall compliance costs				56.5
% change from baseline scenario				-17%

Source: Deloitte estimates

This policy option is expected to have the **most impact on domestic businesses**, as it is targeted at traders with only occasional or incidental taxable activities (e.g. individuals or non-profit organisations), although it may depend also on the nature of activity (e.g. e-commerce transactions are more likely to be cross-border).

³⁷⁹ Comparison limited to the situation where the medium simplification package for businesses eligible for the SME exemption scheme applies under this option.

³⁸⁰ Since the businesses falling out of the VAT system had lower than average VAT compliance costs, the average compliance cost of businesses remaining may be higher than previously estimated. However, it is uncertain where these businesses lie on the distribution so a range is reported.

³⁸¹ Ibid.

³⁸² Ibid.

Identifying these occasional traders is a challenging task, as no granular data is available to analyse the frequency of SMEs' economic activity. Based on the information received from tax authorities on the number of sole traders, it is estimated that around **40% of businesses with less than EUR 5 000 turnover could classify as occasional traders**, suggesting that 15.1% of all EU businesses could be impacted by this policy option. As a consequence, the businesses directly impacted by this policy option are estimated at about **6.4 million businesses**, out of which 3.8 million (or about 60%) were already exempt from VAT under domestic schemes.

The impact of the option on the businesses identified will, however, vary depending on their current VAT status and the simplification measures currently applied in their Member States. Occasional traders registered for VAT (e.g. in order to deduct input VAT on certain purchases relating to the limited business activity, such as the purchase of solar panels) may be asked to provide evidence on whether they qualify as an occasional trader.

As above, the compliance costs for occasional traders was calculated based on a set of VAT obligations, taking into account the in-house cost only, as it is unlikely that occasional traders use accountants for VAT purposes. These costs were based on the medium simplification package for businesses eligible for the SME exemption scheme and on standard regimes where no exemption scheme is offered.

The following obligations were considered:

- ☒ VAT registration;
- ☒ Invoicing;
- ☒ VAT payment (for businesses outside the scheme only);
- ☒ VAT return; and
- ☒ Bookkeeping.

Monitoring the threshold was not considered due to the nature of occasional traders who, by definition, do not have frequent activity. The compliance costs were estimated at around EUR 80 for businesses exempted from VAT, about EUR 340 for businesses eligible to the scheme but opting out and using the simplification package, and about EUR 1 110 for businesses where no exemption scheme is offered.

7.4.3 Impact on Member States

Impact on VAT revenues

In addition to the impacts arising from option 2, this measure could further impact VAT revenues for governments. Since the smallest businesses as a whole, including occasional traders, often generate negative VAT revenue, preventing them from recovering VAT on their inputs, and as such addressing VAT fraud, may increase governments' revenue. However, it is not clear whether the negative VAT revenues are indeed due to occasional traders or to businesses that would still have the option to opt out of the scheme. The overall direction of the impact on revenues is therefore uncertain³⁸³; but it is expected to be limited.

³⁸³ As some traders currently paying output tax may also be excluded from the system.

To estimate the potential magnitude of the impact, the VAT revenue contribution from businesses with less than EUR 5 000 of turnover, as obtained from tax authorities in different Member States, was considered. The businesses that on average brought negative revenues were calculated to generate about -1.3% of the overall net VAT revenue collected.³⁸⁴ Given that only 40% of these businesses are estimated to potentially classify as occasional traders, it is estimated that the **positive revenue impact** of this additional measure could be an increase in revenues of **up to 0.52%**. Similarly, those businesses that on average brought positive revenues were calculated to generate about 0.6% of the overall net VAT revenue collected.³⁸⁵ Hence, the **negative revenue** impact of this additional element of the policy option could be a decrease in revenues of **0.24%**.

The overall impact of option 3 on VAT revenues at the EU level, incorporating the effects described as part of option 2³⁸⁶, is estimated to be between a **decrease of 0.30%** and an **increase of 0.46%**, and is therefore limited. The potential impact on each Member State is presented in the table below. It was calculated by allocating the overall change in revenue at the EU-level from this additional measure to individual Member States based on the share of businesses impacted, and accounting for the change in revenue associated with Option 2.

Table 26 – Change in VAT revenue collected due to policy option 3 by Member State

Member State	Absolute change in net VAT revenue collected in EUR million due to option 3 (percentage change)	Absolute change in net VAT revenue collected in EUR million due to option 3 (percentage change)
	– Lower bound	– Upper bound
EU-28	-3 161.2 (-0.30%)	4 743.7 (0.46%)
Austria	-57.5 (-0.06%)	48.6 (0.05%)
Belgium	-77.7 (-0.29%)	17.9 (0.07%)
Bulgaria	-15.7 (-0.40%)	22.1 (0.56%)
Croatia	-12.3 (-0.28%)	16.5 (0.38%)
Cyprus	-4.5 (-0.30%)	7.1 (0.47%)
Czech Republic	-111.4 (-1.74%)	172.2 (2.69%)
Denmark	-74.5 (-0.30%)	123.7 (0.49%)
Estonia	-11.2 (-0.74%)	16.8 (1.11%)
Finland	-55.6 (-0.36%)	92.5 (0.61%)
France	-817 (-0.46%)	1521.1 (0.85%)
Germany	-312.5 (-0.15%)	237.9 (0.12%)
Greece	-62.8 (-0.50%)	119.8 (0.95%)
Hungary	-73.8 (-0.46%)	114.9 (0.71%)

³⁸⁴ This is based on data obtained for Belgium, Denmark, Estonia, Finland, Ireland, Italy, Lithuania, Malta, Poland, Slovenia, Spain and Sweden. Slovakia was excluded from the calculations as they were found to be an outlier in terms of the magnitude of the negative net VAT revenues generated by this group of businesses, for which the tax authorities were unable to provide an explanation.

³⁸⁵ This is based on data obtained for Bulgaria, Czech Republic, France, Hungary, Latvia and the Netherlands.

³⁸⁶ Businesses treated as occasional traders under this option are unlikely to have already been considered in option 2 as impacting the VAT revenues: the targeted occasional traders are not likely to have many sales in other Member States, and if so they are likely to be eligible to treat their sales as domestic due to the common EU threshold, and benefit from the VAT exemption in their country of establishment. Hence, while some businesses could technically be impacted by both measures, these are considered to be negligible.

Member State	Absolute change in net VAT revenue collected in EUR million due to option 3 (percentage change) – Lower bound	Absolute change in net VAT revenue collected in EUR million due to option 3 (percentage change) – Upper bound
Ireland	-23.6 (-0.33%)	19.8 (0.28%)
Italy	-193.1 (-0.22%)	265.9 (0.31%)
Latvia	-11.1 (-0.73%)	16.8 (1.11%)
Lithuania	-15.4 (-0.31%)	21.3 (0.43%)
Luxembourg	-6.6 (-0.17%)	3.7 (0.09%)
Malta	-3.8 (-0.74%)	5.8 (1.12%)
Netherlands	-147.6 (-0.31%)	172.7 (0.37%)
Poland	-161.9 (-0.60%)	263.7 (0.98%)
Portugal	-71.9 (-0.49%)	123.3 (0.84%)
Romania	-45.5 (-0.39%)	64.2 (0.55%)
Slovakia	-60.7 (-3.57%)	94.6 (5.56%)
Slovenia	-12.9 (-0.54%)	14.7 (0.62%)
Spain	-254 (-0.49%)	429.9 (0.83%)
Sweden	-116.1 (-0.35%)	190.1 (0.58%)
United Kingdom	-350.9 (-0.23%)	546.5 (0.35%)

Source: Deloitte estimates

Apart from the differences between Member States driven by Option 2, the **discrepancies** observed can be due to:

- The share of businesses impacted in a given country compared to the overall number of businesses impacted, as this is the basis on which the EU change in VAT revenue is allocated to Member States. Hence, the higher the share, the higher the impact; and
- The level of net VAT revenue collected before the impact: the higher it is, the lower the impact will be in proportional terms.

For example, 2% of the impacted businesses are estimated to be established in Slovakia, which as a whole only generates 0.2% of all net VAT revenues collected in the EU. It is therefore disproportionately more impacted compared to other Member States by this policy option.

Impact on compliance and fraud

The policy option is expected to have a **positive impact on compliance**, as for example the impacted occasional traders who may be currently non-compliant (as they are perhaps not aware that they ought to register for VAT), can legally stay out of the VAT system. The risk of businesses abusing the measure by claiming to fall under it and trading outside of the VAT regime is considered low, as in the majority of countries such businesses could in any case benefit from the SME exemption scheme, which ought to be generally more beneficial for them including, for example, the right of voluntary VAT registration. The risk of abuse may be slightly higher in the Member States that have no SME exemption scheme but decide to apply this measure, as in such a case this occasional trader measure would be for the trader the only way to trade without any VAT obligations.

The policy option is expected also to have a **positive impact on reducing abuse and fraud** by reducing voluntary VAT registrations and related input VAT fraud risk. Enabling tax authorities to keep such traders out of the VAT system would allow tax authorities to better target their compliance control resources and reduce the cost thereof.

Legislative impact

As the policy option is optional for Member States, they are not required to make any additional legislative changes as a result of this policy option (other than included changes based on policy option 2). They have, however, an option to legislate for the mandatory treatment of occasional traders as non-taxable persons, thus excluding these traders from the VAT system.

The main **legislative challenge is to define ‘occasional traders’** for national purposes and provide relevant guidance to potentially impacted persons.

The Member State would need also to legislate for the transition from the current VAT treatment to the treatment as a non-taxable person, especially where the trader is already registered for VAT. For example, the Member State may require a trader who has registered voluntarily to provide evidence that they are not an ‘occasional trader’ or a trader who has been obliged to register (e.g. for MOSS) to prove that they fall under this measure.

Impact on administrative cost

The policy option is expected to have a **mixed but overall positive impact** on the tax authorities’ administrative costs. The tax authorities would have a one-off administrative cost from introducing and

managing the transition to the new regime, e.g. reviewing a number of existing VAT registrations that may be impacted by the measure. The ongoing administrative costs of tax authorities would be reduced, as the measure is expected to reduce the number of voluntary registrations, therefore the tax authorities would need to manage and control smaller number of taxpayers.

7.4.4 Impact on the wider economy

Given that those businesses impacted by this option generally contribute a very small volume of total EU output, about 0.02%, the addition of this policy to those proposed under Option 2 has only a **small impact on the wider economy**. The table below summarises the impacts of option 3 on the wider economy, which are generally slightly greater than those estimated under option 2 (Table 27).³⁸⁷

Table 27 – Summary table of the wider economic impacts of Option 3

	Option 3
Impact on GDP	0.09%
Impact on output	0.10%
Impact on output of impacted SMEs (i.e. occasional traders)	10.9%
Impact on SMEs' cross-border trading activity (percentage change in total value of cross-border trade)	13.5%
Impact on labour productivity	0.11%
Impact on prices	-0.09%
Impact on consumer demand	0.11%

Source: Deloitte estimates

Given that the businesses affected by this option contribute a very small amount to EU-wide turnover, **the additional economic impact associated with the reduction of the VAT burden on these firms is small compared to the impact of option 2**. However, the fact that occasional traders are now relieved of all VAT-related obligations leads to a further reduction in the overall compliance costs of businesses. Increasing the competitiveness of these businesses potentially enables them to **increase their activity by up to 11%**; however, activity will still be constrained by the fact that significant increases may require these businesses to formally register for the SME exemption scheme (or for VAT), thereby increasing their administrative costs. As a result of these countervailing impacts, the overall impact on output is expected to be small.

³⁸⁷As described above, there is significant uncertainty about the potential revenue impacts of this option, given that the net revenues contributed by this group are generally negative. This is due to a combination of start-up activity (which will not be affected by this Option) and fraud (which this Option can help combat). This policy may therefore increase overall tax revenues. However, given that these additional revenues come from reduced fraud rather than from an increased burden on legitimate traders, this will not affect the VAT rate on the supplies of these traders or the prices faced by consumers. It is therefore assumed for the purpose of the wider economic impact analysis that the impact on VAT revenues from this option is aligned with the contribution of these traders to turnover.

7.5 Option 4: Option 3 plus measures for transition period reducing the negative impact of the ‘threshold effect’

7.5.1 Structure and aim of the policy option

This option builds on policy option 3 and extends the SME exemption scheme to businesses that are above the threshold for the scheme but:

- Exceed the SME exemption threshold for less than a calendar year; and
- Have turnover that does not exceed the SME exemption threshold by more than 50%.³⁸⁸

The impacts of such provisions on businesses, Member States and the wider economy are described below.

7.5.2 Impact on businesses

Overall impact on businesses’ compliance costs

Under option 4, the analysis suggests that the overall compliance costs that businesses face to comply with VAT obligations amount to approximately **EUR 56.1 billion**, i.e. an 18% reduction compared to the EUR 68 billion estimated in the baseline scenario³⁸⁹. Such reduction is due to the lower number of businesses subject to VAT-related obligations.

The table below provides an overview of the impacts on the number of businesses and their compliance costs.

Table 28 – Businesses’ compliance costs under option 4

	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)
Businesses trading domestically			
Businesses exempt from VAT	[716 – 1 043]	7 400 000	7.7
Businesses in simplified regime	[975 – 1 208]	4 200 00	5.0
Businesses in transitional period	1 325	260 000	0.34
Businesses in standard VAT regime	[2 964 – 3 104]	13 700 000	42.6
Businesses trading cross-border			
Businesses using MOSS	690	290 000	0.20
Businesses in cross-border exemption scheme	716	290 000	0.21
Overall compliance costs			56.1
% change from baseline scenario			-18%

Source: Deloitte estimates

³⁸⁸ See Section 6.2.3 for more details.

³⁸⁹ Comparison limited to the situation where the medium simplification package for businesses eligible for the SME exemption scheme applies under this option.

The option **reduces the tax burden** for SMEs by temporarily extending the exemption and reduces compliance costs by retaining the simplification measures. The impact is temporary for a given business, as the measure can be applied only for the duration of one year, and it is expected to have general positive impact on SME growth, by providing them with a transition period in order to prepare for the full VAT regime and consequential tax and administrative burden.

The number of businesses impacted by this additional measure was calculated by estimating the number of businesses in each Member State whose turnover lies between their domestic thresholds and 150% of this threshold, and has done so for less than one year. Information obtained from tax authorities in several Member States³⁹⁰ on the percentage of businesses within their VAT exemption threshold and 150% of this threshold that are newly registered was used to estimate that only 11.2% of the businesses within the relevant bracket could be eligible for the transition scheme. This implies that on average each year, 0.6% of all EU businesses would be impacted by this additional measure.

The table below shows the proportion of businesses impacted in each Member State.

Table 29 – Proportion of businesses impacted by implementing a transition period to the SME exemption scheme, EU-level and by Member State

Member State	Proportion of businesses impacted by implementing a transition period to the SME exemption scheme
EU-28	0.6%
Austria	0.3%
Belgium	0.8%
Bulgaria	0.6%
Croatia	1.0%
Cyprus	0.5%
Czech Republic	0.3%
Denmark	0.3%
Estonia	0.6%
Finland	0.4%
France	0.5%
Germany	0.8%
Greece	0.4%
Hungary	0.8%
Ireland	0.8%
Italy	1.3%
Latvia	0.5%
Lithuania	0.5%*
Luxembourg	0.5%

³⁹⁰ Belgium, Finland, Ireland, Malta.

Member State	Proportion of businesses impacted by implementing a transition period to the SME exemption scheme
Malta	0.8%
Netherlands	0%**
Poland	1.3%
Portugal	0.5%
Romania	0.7%
Slovakia	0.4%
Slovenia	0.6%
Spain	0%**
Sweden	0%***
United Kingdom	0.7%

*Note: Mint Global data did not identify enough businesses in the Czech Republic and Lithuania to obtain reliable estimates on the proportion lying between the threshold and 150% of it. In these two instances, EU-estimates of this proportion were collected from Mint Global instead and applied to the Czech Republic and Lithuania percentages.

**Note: the Netherlands and Spain do not have the SME exemption scheme in place, hence no businesses in their countries will be impacted by the extension of the threshold for a temporary period.

***Note: Sweden introduced the scheme from January 2017, after the assessment was carried out. Therefore the basis for the assessment was that there was no SME exemption scheme in place in Sweden

Source: Deloitte estimates based on data from tax authorities and Mint Global

The variation of the proportion of businesses impacted between Member States depends on several factors, such as the thresholds in place, the number of businesses overall within the different turnover brackets used in this analysis, and the proportion of businesses lying within the relevant brackets, identified using Mint Global data.³⁹¹

Overall, the number of **businesses impacted** (i.e. benefitting from the transitional period) in a given year is estimated to be around **260 000** at EU level. Once breaching the threshold, such businesses are expected to use the transitional period to prepare for the full set of VAT obligations, which includes at least some of the following:

- Understanding of the VAT system (use of advisors/accountants);
- Change from annual to quarterly (or even monthly) accounting;
- Providing information to the tax authorities; and
- Re-calculation of sales prices (and possible new pricing policy).

It is therefore estimated that the **compliance costs** for this group of businesses will **be higher** during the transitional period than under the streamlined simplification package. The compliance costs are estimated at about **EUR 1 325** (i.e. 36% higher than the estimated costs for a business using only the streamlined simplification package). This way, the further expected increase to the full set of VAT obligations (quantified at approximately EUR 2 964 per year) is expected to be less significant.

However, there is also the risk, mentioned by some of the stakeholders interviewed, that businesses will not take full advantage of this transitional period, but will postpone the preparation to the full set of VAT obligations to the very last moment.

³⁹¹ See Volume II, Annex I for more details on the methodology used.

7.5.3 Impact on Member States

Impact on VAT revenues

The policy option is likely to have **negative impact** on the VAT revenue of the Member States, as the measure extends the application of the exemption. However, in the longer term the revenue impact has the potential to be positive, as a result of the reduced ‘threshold effect’, such as clustering below the threshold due to limitation (or under-declaration) of sales, and as a result of the positive impact on the growth of SMEs.

The direct impact of this measure is calculated by estimating the average turnover generated by the businesses impacted in each Member State and applying an effective VAT rate. Using this methodology, it is estimated that VAT revenues at the EU level could decrease by 0.18% due to option 4 alone. Combining this with the revenue impact of policy options 2 and 3, the overall impact of this option on VAT revenues collected in the EU could be a decrease of 0.48% up to an increase of 0.28%; these lower and upper bounds reflect the uncertainty surrounding the revenue impact of Option 3 discussed above. The impact on each Member State is outlined in the table below.

Table 30 – Impact of policy option 4 on VAT revenues collected, EU-level and by Member State

Member State	Absolute change in net VAT revenue collected in EUR million due to the implementation of the transition period only (percentage change)	Absolute change in net VAT revenue collected in EUR million due to option 4 (percentage change) – Lower bound	Absolute change in net VAT revenue collected in EUR million due to option 4 (percentage change) – Upper bound
EU-28	-1 853.5 (-0.18%)	-5 014.7 (-0.48%)	2 890.2 (0.28%)
Austria	-24.9 (-0.03%)	-82.4 (-0.08%)	23.7 (0.02%)
Belgium	-24.5 (-0.09%)	-102.2 (-0.39%)	-6.6 (-0.03%)
Bulgaria	-7.5 (-0.19%)	-23.2 (-0.59%)	14.6 (0.37%)
Croatia	-9.9 (-0.23%)	-22.2 (-0.51%)	6.6 (0.15%)
Cyprus	-0.8 (-0.05%)	-5.3 (-0.35%)	6.3 (0.42%)
Czech Republic	-14.2 (-0.22%)	-125.6 (-1.96%)	158.0 (2.47%)
Denmark	-2.3 (-0.01%)	-76.8 (-0.31%)	121.4 (0.49%)
Estonia	-1.9 (-0.13%)	-13.1 (-0.87%)	14.9 (0.99%)
Finland	-3.7 (-0.02%)	-59.3 (-0.39%)	88.8 (0.58%)
France	-379.3 (-0.21%)	-1196.3 (-0.67%)	1141.8 (0.64%)
Germany	-59.9 (-0.03%)	-372.4 (-0.18%)	178.0 (0.09%)
Greece	-6.5 (-0.05%)	-69.3 (-0.55%)	113.3 (0.89%)
Hungary	-21.2 (-0.13%)	-95.0 (-0.59%)	93.7 (0.58%)
Ireland	-29.0 (-0.41%)	-52.6 (-0.74%)	-9.2 (-0.13%)
Italy	-361.9 (-0.42%)	-555.0 (-0.64%)	-96.0 (-0.11%)
Latvia	-5.1 (-0.34%)	-16.2 (-1.07%)	11.7 (0.77%)

Member State	Absolute change in net VAT revenue collected in EUR million due to the implementation of the transition period only (percentage change)	Absolute change in net VAT revenue collected in EUR million due to option 4 (percentage change) – Lower bound	Absolute change in net VAT revenue collected in EUR million due to option 4 (percentage change) – Upper bound
Lithuania	-8.8 (-0.18%)	-24.2 (-0.49%)	12.5 (0.25%)
Luxembourg	-2.4 (-0.06%)	-9.0 (-0.23%)	1.3 (0.03%)
Malta	-1.4 (-0.28%)	-5.2 (-1.02%)	4.4 (0.84%)
Netherlands	0 (0%)	-147.6 (-0.31%)	172.7 (0.37%)
Poland	-209.5 (-0.78%)	-371.4 (-1.38%)	54.2 (0.20%)
Portugal	-7.3 (-0.05%)	-79.2 (-0.54%)	116.0 (0.79%)
Romania	-28.7 (-0.25%)	-74.2 (-0.64%)	35.5 (0.30%)
Slovakia	-20.0 (-1.18%)	-80.7 (-4.75%)	74.6 (4.38%)
Slovenia	-9.9 (-0.42%)	-22.8 (-0.96%)	4.8 (0.2%)
Spain	0 (0%)	-254.0 (-0.49%)	429.9 (0.83%)
Sweden	0 (0%)	-116.1 (-0.35%)	190.1 (0.58%)
United Kingdom	-613 (-0.40%)	-963.9 (-0.63%)	-66.5 (-0.04%)

Source: Deloitte estimates

Similar to the number of businesses impacted, the differences observed on the revenue impact across countries can be explained by the level of the threshold (the higher the threshold, the higher the impact, as businesses impacted will have higher turnover), and the number of businesses identified within the relevant turnover bracket. While the precise magnitude differs, the overall impact on revenues is limited for Member States.

Impact on compliance and fraud

This policy option is expected to have a **positive impact on voluntary compliance** by **reducing under-declaration** of sales by SMEs that have been avoiding exceeding the SME exemption threshold. The risk of abuse of the measure is considered limited due to its time-limited scope and the possibility for a Member State to control compliance, for example by requiring businesses to apply for (or notify) application of the measure. However, the option may increase the complexity and costs related to compliance control by adding an extra measure to the SME exemption scheme.

Legislative impact

Member States wishing to apply this optional policy measure, would need to make **limited additional legislative changes** to their SME exemption scheme in order to implement it. There may be also a need for a transitional measure on the implementation of the change, e.g. a fall back rule for SMEs that have exceeded the threshold briefly before the measure was implemented.

Impact on administrative cost

The policy option should **not have significant impact on the administrative cost of the tax authorities**, although there may be a limited one-off cost from introduction of the measure and a limited increase in administrative cost in relation to compliance control of the transitional measure.

7.5.4 Impact on the wider economy

This option can have a further **positive impact on the wider economy** through the impact on the administrative costs of firms and the extension of the SME exemption to additional fast-growing SMEs.

As with policy Option 2, both of these impacts are captured in the economic model.

- The extension of the SME exemption scheme to those businesses that have recently exceeded the threshold reduces the administrative costs for these firms, enabling them to dedicate more labour time to productive activities.
- The fact that these businesses continue to benefit from the VAT exemption gives them a competitive advantage and allows them to charge lower prices. The impact on the overall price level is expected to be small, since these businesses have little market power, but it nonetheless creates additional opportunities for growth for these firms.

The table below shows the estimated impact on the wider economy resulting from policy option 4.

Table 31 – Summary table of the wider economic impacts of option 4

	Option 4
Impact on GDP	0.09%
Impact on output	0.10%
Impact on output of impacted SMEs (i.e. businesses in the transitional period)	16.1%
Impact on SMEs' cross-border trading activity (percentage change in total value of cross-border trade)	13.5%
Impact on labour productivity	0.11%
Impact on prices	-0.11%
Impact on consumer demand	0.12%

Source: Deloitte estimates

This option has the potential to have the **greatest impact on prices and output compared to the other policy options considered**, since it extends the benefits of the SME exemption scheme to larger, fast-growing SMEs. While the overall impact on output is small, for those businesses affected by the policy, the transition period may enable an increase in activity of over 16% by encouraging growth. This is due both to the fact that they do not need to charge VAT on supplies, potentially reducing prices by 0.11%, and the significant reduction in compliance costs, albeit limited in time, from an estimated EUR 3 000 to EUR 1 300. Given that these SMEs would be able to smooth the fixed costs associated with full VAT registration over a longer period, it can also make it easier for these businesses to compete with larger SMEs that are more accustomed to VAT obligations.

This also creates wider benefits, including a small increase in consumer spending and enhanced labour productivity compared to the baseline.

8 Conclusions

8.1.1 The SME environment and SME schemes

The main findings and conclusions regarding the current SME environment are as follows:

- SMEs³⁹² represent the **majority of active businesses** in the EU, making up around 98% of all businesses. However, the proportion of businesses of different sizes varies across the Member States.
- SMEs are predominantly active in the **wholesale and retail trade, construction, and professional, scientific and technical** activities sectors.
- Despite their representative importance, SMEs generate just **15%** of the total turnover in the EU and **25%** of net VAT revenues.³⁹³
- The lack of clear evidence on cross-border activities does not allow for definitive conclusions on cross-border trade of SMEs (within and outside of the SME schemes). However, analysis of various sources suggests that around **10% to 30% of SMEs are trading cross-border**.
- Despite having a relatively small impact on EU-level turnover and VAT revenue, SMEs face **disproportionate compliance costs** for VAT obligations compared to larger businesses. This may discourage market entry for businesses and impair growth and competition across the EU. This justifies the motivation for SME schemes and simplification measures that lessen the burden imposed on SMEs.
- Although Member States have a certain level of flexibility in the way that SME VAT schemes and measures under the VAT Directive³⁹⁴ are applied, it was found that the SME specific schemes and measures (such as SME exemption and flat rate schemes) **apply in practice mainly to businesses with turnovers of under EUR 50 000** (except cash accounting which has higher thresholds).
- The **SME schemes** vary across the Member States in terms of thresholds, other eligibility criteria and practical application.

The **main conclusions** with respect to the SME schemes and measures are presented below.

It should be noted that the overall findings with respect to the compliance costs for businesses associated with each type of scheme are based only on a sample of businesses³⁹⁵ applying the scheme within a selection of Member States.³⁹⁶

³⁹² For the purpose of the study, a specific definition of SMEs is adopted, which refers only businesses with an annual turnover not exceeding EUR 2 million, i.e. micro-businesses, according to the EU Recommendation 2003/361 EC. <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32003H0361&from=EN>, consulted on 4 January 2017.

³⁹³ Estimates derived from data obtained from tax authorities and public sources. See Volume II, Annexes B, C and D for details.

³⁹⁴ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11.12.2006, e.g. Articles 281 and 282.

³⁹⁵ The number of businesses/tax advisors interviewed in each Member States varied from 2 to 9.

³⁹⁶ Investigation of costs within and outside of special schemes was conducted in UK, Spain, Belgium, Italy, Poland, Estonia, France and Romania.

SME Exemption Scheme

- Applying in 26 Member States, the **SME exemption scheme** can be considered as an effective measure overall due to its broad application by businesses in most Member States and its reduction of compliance costs for businesses applying it.
- **Compliance costs** for businesses within the scheme are reduced by up to 60% compared to the costs incurred by businesses in the regular VAT regime (i.e. not applying any SME scheme or simplification measure).
- **The SME exemption scheme** provides businesses with significant benefits in terms of reduced tax and administrative burdens. The optionality provides businesses the flexibility to opt out of scheme if less suitable. For **tax authorities**, the scheme lowers the administrative costs.
- Downfalls are associated with the **SME exemption scheme** such as: the right to deduct input VAT, the disproportionate 'threshold effect' for businesses breaching the threshold and the loss of VAT revenue for tax administrations.

VAT Graduated Relief Scheme

- The VAT graduated relief scheme, applying in three Member States, is not regarded as an effective measure as potential savings (approx. up to 48%) in compliance costs are not proportionate to the complexity of application.
- The main **advantage** of the graduated relief scheme is the reduced administrative burden, although the reduction can be limited. Also, the optionality of the scheme provides flexibility to businesses to apply it when considered sufficiently beneficial. Although tax authorities benefit from reduced administration for businesses applying the scheme, loss of VAT revenue is sustained.

Flat Rate Scheme

- The effectiveness of the **flat-rate scheme** varies across the three Member States it is used in due to the different modes of application in the Member States examined. In 2 of the 3 Member States **compliance costs** under the flat-rate scheme were significantly lower (up to 90% in Spain). However, in one Member State, businesses using the flat-rate scheme actually bear more compliance costs than businesses in the normal regime (approx. increase of 2%).
- The main **advantages** of the flat-rate scheme are the potential for simpler VAT calculations and relief from some administrative obligations. The scheme may provide also unintended limited tax benefits for businesses with less than average input VAT cost. Optionality also helps businesses to choose the scheme most suitable for their purposes.
- However, the key **drawback** of this scheme for tax authorities is the ability of businesses to manipulate the VAT due in order to pay less VAT overall, which creates unintended VAT revenue loss.

Cash Accounting Scheme

- There is no agreement on the effectiveness of the **cash accounting scheme** among the 24 Member States that apply it. However, the scheme is important for the specific group of businesses encountering cash-flow management issues.

- The overall take-up of the cash-accounting scheme among eligible businesses is low³⁹⁷ and the compliance cost is higher than businesses outside of the scheme (approx. 30%). Thus, the main advantage to businesses is the potential to capitalise on better cash flow.
- An important **drawback of the cash accounting scheme** is the fact that businesses have to keep additional records to monitor the cash flow. Such additional record-keeping increases compliance costs for businesses. It has been noted also that the scheme can be prone to fraud if applied only to outputs.

Additional Simplification Measures

Regarding additional simplification measures (i.e. annual recapitulative statements, annual accounting, simplified reporting, standard deduction of input VAT, domestic reverse charge, right to issue simplified invoices), the overall **nature and application of such measures are diverse** and it is difficult to draw a general assessment of their effectiveness. However, tax authorities are generally satisfied in terms of their effectiveness as there is less administration and audit from their side. Businesses also consider them generally as positive, especially with respect to reduction in the periodicity of returns.

8.1.2 Problem Assessment

Overall, the SME environment was found to be a complex one, defined by fragmentation between the Member States, business sectors and business size.

As external factors, i.e. independent events and trends that influence the environment wherein SMEs operate, but that are not affected by the policy intervention but can possibly limit or increase a policy option's positive effect, the following were noted:

- technological developments and new trends in trading;
- evolution of the VAT system towards taxation at destination;
- role of subsidiarity in EU VAT policy development;
- interplay with specific EU VAT legislative developments, specifically: the place of supply rules for TBE services (2015 changes)³⁹⁸, the e-Commerce proposal³⁹⁹ and the EU VAT web-portal⁴⁰⁰.

The **drivers** of problems in the current environment were found to be two-fold: drivers associated with **the nature of SMEs** and drivers associated with the **VAT framework**:

Regarding the former, it was found that SMEs, by nature, have **less resources than larger companies**, not only to manage VAT obligations but for every area of the business. Traditional problems include a lack of financing, difficulties exploiting technologies, constrained managerial capabilities, low productivity and difficulties coping with the regulatory burden. In the VAT area (and taxation in general), it was found that SMEs tend to rely heavily on tax advisors and accountants to handle this area of the business. Regarding the **VAT framework**, it was found that the **complexity of national rules on VAT obligations**, the **complicated design** of SME schemes, the **different rules**

³⁹⁷ This can be partly explained by very general eligibility criteria combined with a specific benefit needed by small group of businesses.

³⁹⁸ See: https://ec.europa.eu/taxation_customs/business/vat/telecommunications-broadcasting-electronic-services_en

³⁹⁹ Ibid.

⁴⁰⁰ COM(2011) 851, Communication on the future of VAT, towards a simpler, more robust and efficient VAT system tailored to the Single Market.

for domestic and foreign traders and suppliers, and the diversity of national SME schemes across the EU contribute to creating a complex environment for SMEs.

Stemming from these drivers are the **problems for SMEs**. The key problems for SMEs in this context are the **high compliance costs related to VAT**, especially in cross-border trade, causing cross-border **distortions of competition**, and the sudden increase of such obligations when breaching the eligibility threshold for the SME scheme, causing the **threshold effect**. The key problem for tax authorities is the **loss of VAT revenue** from provided tax benefits and non-compliance.

Effects refer to the current and future consequences of the problems acknowledged. The effects identified include:

- not realising the full potential of the **Single Market**;
- SMEs being **discouraged to grow**;
- SMEs being **discouraged to trade cross-border**; and
- existence of an **uneven playing field** for EU businesses.

8.1.3 Assessment of the policy options

The **design of policy options** took into account overall policy objectives, as well as the findings of the study in the problem assessment. The design exercise first established a broad set of elements that would be required to meet particular problems. Then, the most suitable elements for the delivery of the policy objectives were used in designing each individual policy options. A clear rationale for the sustaining of certain elements and disregarding of others was also established per each option.

Based on the analysis of the different SME schemes, the policy options investigated were focused on the SME exemption scheme, which is the most widely used regime and is perceived as the most effective regime for businesses and Member States. Further, recently proposed legislative measures directly impacting the SMEs⁴⁰¹ (especially the abolition of the distance selling thresholds in cross-border B2C e-commerce, and the introduction of a common EU threshold) were taken into account by adding the measures to the current legislative framework in order to create a new baseline scenario.

⁴⁰¹ Ibid.

The options designed are as follows:

Baseline scenario
Option 1: Baseline scenario (status quo with measures from the e-Commerce proposal) ⁴⁰²
Policy changes
Option 2: SME exemption scheme extended to supplies from other Member States and including streamlined simplification measures (i.e. “Simplification Package”)
Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons
Option 4: Option 3 plus measures for transition period reducing the negative impact of the ‘threshold effect’

The study effectively assessed the designed policy options with regards to their **impact on businesses**, on **Member States** (VAT revenues and level of compliance), and impacts on the **wider economy**.

For the assessment, a number of **key assumptions** were adopted which are paramount to the comprehension of the findings and can be found in **Volume II, Annex I**.

Impact on businesses

The table below provides an overview of the main impacts of the four policy options covered by the study with respect to the compliance costs for businesses, as well as indicating the number of businesses impacted by the options. The size of businesses considered in scope of the policy options assessment concerned businesses with an annual turnover up to EUR 100 000.

⁴⁰² Commission Proposal COM(2016)757 Modernising VAT for cross-border B2C e-commerce

Table 32 – Summary table of impacts on businesses of policy options 2-4

	Option 2			Option 3			Option 4		
	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)	Cost per 1 business (1 MS) EUR	No of businesses	Compliance cost (EUR billion)
Businesses trading domestically									
Businesses exempt from VAT	716	11 200 000	8.0	[716 – 1 043]	7 400 000	7.7	[716 – 1 043]	7 400 000	7.7
Businesses in simplified regime	975	5 700 000	5.6	[975 – 1 208]	4 200 000	5.0	[975 – 1 208]	4 200 000	5.0
Businesses in transition period	N/A	N/A	N/A	N/A	N/A	N/A	1 325	260 000	0.34
Businesses in standard VAT regime	2 964	15 000 000	44.6	[2 964 – 3 104]	14 000 000	43.4	[2 964 – 3 104]	13 700 000	42.6
Businesses trading cross-border									
Businesses using MOSS	690	290 000	0.20	690	290 000	0.20	690	290 000	0.20
Businesses in cross-border exemption scheme	716	290 000	0.21	716	290 000	0.21	716	290 000	0.21
Overall compliance costs			58.6			56.5			56.1
% change from baseline scenario			-14%			-17%			-18%

With respect to the baseline scenario, **all policy options reduce the compliance costs for businesses and therefore contribute to the remediation of the negative effects of the current SME exemption scheme**, though to a different extent (from 14% to 18%):

- Through the simplification package and the extension of the SME exemption scheme to non-established businesses, **Option 2** impacts directly on the compliance costs of all businesses, trading domestically as well as cross-border. The change in compliance costs will depend on the extent to which Member States simplify or increase the VAT-related obligations of SMEs, as they may wish to improve monitoring within the scheme once it is opened to non-established firms. Under a medium simplification scenario, there could be an overall decrease in compliance costs of 13.9%, differently distributed across types of businesses:

 - Businesses eligible but opting out of the SME exemption scheme could see their compliance costs fall from about EUR 3 000 a year to around EUR 720;
 - Businesses within the SME exemption scheme could see their compliance costs increase from c. EUR 550 to EUR 720 on average. This varies by Member State, from a 50% decrease to a 73% increase.

- Under **Option 3**, the loss of VAT-related obligations for occasional traders no longer treated as taxable persons leads to an overall reduction of 17% in compliance costs compared to the baseline. About 6.4 million businesses are estimated to be impacted by this option, 60% of which were already exempt from VAT under the SME exemption scheme domestically.

- The transitional period offered under **Option 4**, which allows SMEs to remain within the SME exemption scheme for a limited period of time, leads to a reduction in compliance costs of 18% compared to the baseline. About 260 000 businesses are estimated to be impacted by this additional measure; however the impact is only temporary. It is expected to have a positive impact on SME growth by providing them with transition period in order to prepare for full VAT regime and consequential tax and administrative burden.

Impact on Member States

The impact of policy options on Member States is assessed on VAT revenues as well as on level of compliance and fraud. A comparison of the options is provided below.

Impact on VAT revenues

The table below provides an overview of the main impacts of the four policy options with respect to VAT revenues collected across the EU. It should be noted that the overall impact is low under each option, given the small proportion of VAT revenues generated by the SMEs (micro-businesses) in scope of the SME exemption scheme.

Table 33 – Summary table of impacts on VAT revenues of policy options 2-4

	Option 2	Option 3	Option 4
Impact on VAT revenues (% change)	-0.06%	-0.06% (-0.24% to +0.30%)	-0.24% (-0.48% to 0, 28%)

Overall, the policy options considered have negative but limited impacts on VAT revenues in the EU:

- Opening the SME exemption scheme to supplies from other Member States in **Option 2** implies that some SMEs currently paying VAT on their cross-border sales will be exempt from

doing so. This could lead to a loss of EUR 665 million, representing a 0.06% decrease compared to the net VAT revenues currently collected.

- **Option 3** could further impact the VAT revenues collected as occasional traders are taken out of the tax base. However, the overall direction of the impact is uncertain: whilst the option will help address abuse of the VAT system, as businesses with almost no activity that recover VAT on their inputs will be treated as non-taxable persons, some businesses currently generating positive revenues could also be taken out of the tax base. Therefore, the impact is expected to be limited to a 0.24% decrease or a 0.30% increase with respect to the baseline.
- **Option 4** however is likely to have a negative impact on the VAT revenue of Member States, as the measure extends the application of the SME exemption scheme, albeit for a limited period of time. Combining this with the revenue impact of policy options 2 and 3, the overall impact of this option on VAT revenues collected in the EU could be a decrease of 0.48% up to an increase of 0.28%.

Impact on level of compliance and fraud

Overall, the policy options have mixed impacts on compliance and fraud, with **Option 2** likely to increase the complexity of the SME exemption scheme, while **Option 3** and **Option 4** are more likely to reduce the risk of non-compliance and to increase voluntary compliance, respectively.

Policy Option 2 is likely to increase the complexity of the SME exemption scheme, therefore increasing the tax authorities' cost of compliance control, as the compliance risks will change. The option will also increase the need for administrative cooperation between the tax authorities of different Member States, as even with some registering and reporting processes it will be challenging for the tax authorities to control the compliance of foreign businesses trading in their Member State. However, the extent of this increase will depend on the implementation of the simplified measures by Member States as they will retain wide flexibility in this regard.

Policy Option 3 is expected to have a positive impact on compliance, as it reduces the risk of non-compliance for occasional traders (as they are perhaps not aware that they ought to register for VAT). The risk of businesses abusing the measure by claiming to fall under it and trading outside of the VAT regime is considered low. In the majority of countries, such businesses could in any case benefit from the SME exemption scheme. It ought to be generally more beneficial for them, including, for example, the right for voluntary VAT registration. The policy option is expected to have also a positive impact on reducing abuse and fraud, by reducing voluntary VAT registrations and related input VAT fraud risk, as a result it should reduce also the administrative cost of tax authorities.

Finally, **Policy Option 4** is expected to have a positive impact on voluntary compliance by reducing under-declaration of sales by SMEs that have been avoiding exceeding the SME exemption threshold. Similarly positive, the option is not expected to have a major impact on the administrative costs of tax authorities. Nevertheless, there may be a limited one-off cost from introduction of the measure and a small increase in administrative costs in relation to compliance control of the transitional measure.

Impact on the wider economy

The table below provides an overview of the impacts of the policy options on the wider economy.

Table 34 – Summary table of the wider economic impacts of policy options 2-4

	Option 2	Option 3	Option 4
Impact on GDP	0.07%	0.09%	0.09%
Impact on output	0.08%	0.10%	0.10%

Impact on output of impacted SMEs	9.0%	10.9%	16.1%
Impact on SMEs' cross-border trading activity	13.5%	13.5%	13.5%
Impact on labour productivity	0.09%	0.11%	0.11%
Impact on prices	-0.08%	-0.09%	-0.11%
Impact on consumer demand	0.09%	0.11%	0.12%

The policy options under consideration are likely to have a small but generally positive impact on the wider economy, as the SMEs targeted only represent a small proportion of overall output:

- Overall, **Policy Option 2** presents positive impacts for SMEs in terms of their administrative burden and cross-border trading activity and outputs. For Member States however, there is likely to be a small decrease in the amount of VAT revenue collected because of more businesses being able to take advantage of the VAT exemption. The decreased amounts could amount to a loss of up to EUR 665 million across the EU. However, this option is expected to enable an increase in the activity of affected businesses, with their overall output increasing by about 9% and cross-border activity by about 13.5%. This increase in activity can increase the range of products available to consumers and increase competition. In turn this is estimated to slightly decrease prices while increasing consumer demand.
- Similarly positive, **Option 3** is estimated to increase the output of impacted SMEs by approximately 11%. Since these businesses make up a very small fraction of overall economic activity this has only a limited impact on the price level and the wider economy over and above the impact created by Option 2. In this case, prices are expected to decrease by 0.09%, increasing consumer demand by 0.11%.
- Finally, **Policy Option 4** is estimated to reduce the administrative burden for SMEs by approximately 18%, with the output of impacted SMEs increasing by approximately 16%. Since the introduction of a transitional period affects businesses with somewhat higher turnover, this option has a more significant additional impact on prices compared to Option 3. Prices are expected to decrease by 0.11% and consumer demand to increase by 0.12%.

Summary of the impact of the policy options

The table below provides an overview of the impacts of each option in comparison.

Table 35 – Summary of impacts of policy options 2, 3 and 4

Type of impact	Impact in comparison to the baseline (% increase or decrease) ⁴⁰³		
	Option 2	Option 3	Option 4
Change in administrative burden for SMEs (%)	-14%	-17%	-18%
Change in administrative burden for SMEs (EUR/year)	-9.1 billion	-11.2 billion	-11.6 billion
Impact on VAT revenues (%)	-0.06%	-0.06% (-0.24% to +0.30%)	-0.24% (-0.48% to 0.28%)

⁴⁰³ Based on the "medium simplification" scenario

Type of impact	Impact in comparison to the baseline (% increase or decrease) ⁴⁰³		
	Option 2	Option 3	Option 4
Impact on VAT revenues (EUR/year)	-664.9 million	-3.1 billion to + 4.7 billion	-5 billion to + 2.8 billion
Impact on compliance and fraud	Increases complexity of scheme; Challenging for Member States to monitor	Reduces risk of sole traders being non-compliant	Encourages voluntary compliance
Impact on GDP	0.07%	0.09%	0.09%
Impact on aggregate output	0.08%	0.10%	0.10%
Impact on output of impacted SMEs	9%	10.9%	16.1%
Impact on SMEs' cross-border trading activity (percentage change in total value of cross-border trade)	13.5%	13.5%	13.5% ⁴⁰⁴
Impact on labour productivity	0.09%	0.11%	0.11%

Effectiveness of the Options in meeting policy objectives

The policy options respond to the policy objectives formulated during the study and based on EU policy priorities and documents in several ways. Some policy options have a more positive impact on the objectives than others. Table 36 illustrates the extent to which the policy objectives are met by each option by allocating a number of tick marks (✓) from one to three. Three ticks indicates the highest positive impact, while one indicates that the impact on the policy option is positive. There are some options that do not meet certain objectives and may actually have negative impacts. In this case, no ticks are given. Option 1 has not been marked as it represents the baseline scenario.

Table 36 – Policy objectives vs policy options

Specific Objectives	Option 1	Option 2	Option 3	Option 4
To reduce distortions between domestic small suppliers and small suppliers from other Member States		✓✓✓	✓✓✓	✓✓✓
To ensure that the SME schemes are compatible, to the extent possible, with the destination principle		✓✓✓	✓✓✓	✓✓✓
To reduce VAT compliance costs for SMEs		✓	✓✓	✓✓✓
To reduce the margin for tax fraud			✓	✓✓
To reduce the negative impact of the 'threshold effect'				✓✓

⁴⁰⁴ Note that option 3 and 4 do not impact VAT obligations related to cross-border trade and as such do not have an impact on the level of cross-border trade in the EU.

Overall, it was found that only **Option 4** meets all of the policy objectives.

Regarding the reduction of **distortions between domestic small suppliers and small suppliers from other Member States**, all options have an equally positive impact because they allow suppliers from other Member States to use the SME exemption scheme available in other Member States, meaning that domestic and foreign businesses are faced with the same compliance costs. Although Option 3 could cause very small distortions between occasional traders and registered traders, both domestic and foreign occasional traders would be treated the same. Similarly, as Option 4 intends to further reduce administrative burden to some businesses (i.e. those within the transitional period), the distortions that could occur between businesses inside the transitional period and those outside the period are the same for domestic traders and traders from other Member States.

Similarly, **all options have an equally positive effect** on the objective of ensuring that the scheme is **compatible with the destination principle**, given the opening up of schemes to businesses from other Member States.

For the **reduction of VAT compliance costs**, Option 4 is the most positive. This is due to the introduction of the transitional period for SMEs breaching the VAT exemption threshold. Option 3 would also positively meet this objective, although to a lesser extent. Although the exclusion of occasional traders allows these type of traders to avoid any VAT-related compliance costs, Option 4 goes a step further with the transitional relief. Option 2 has even less features and therefore does not reduce the compliance costs as much as the other two options, although it does have some positive impact since foreign business can also opt to use the exemption scheme in other Member States.

The **reduction of the margin for tax fraud** is most positively met with Option 4 as it allows for businesses to become acquainted with the VAT scheme during the transitional period, as well as allowing occasional traders to stay outside of the VAT system. It is also expected to encourage voluntary compliance in this regard. Option 3 also positively impacts this objective since occasional traders do not need to register or account for VAT. Option 2 is not expected to have a positive impact on the margin for VAT fraud, since opening up the SME exemption scheme to businesses from other Member States increases the complexity, and it will be challenging.

With regard to the objective of reducing the **negative impact of the threshold effect**, Option 4 has the most positive impact since it is the only option that allows for a transitional measure between being VAT exempt and having to comply with full VAT obligations. Options 2 and 3 are not regarded as having any effect on the threshold effect.

8.1.4 Overall Conclusions of the Study

Despite being met with significant barriers to accurate data on the activities of SMEs and the application of SME schemes, this study has effectively illustrated the **current environment for SMEs in a domestic and cross-border setting**. It was found that despite making up the majority of businesses in the EU, SMEs are faced with disproportionate administrative burdens for VAT-related tasks. In this regard, the need for simplified schemes and measures to cater for the small business was found to be well-founded.

Regarding the functioning of SME schemes, the predominantly **domestic nature of eligibility and application**, define the scope of effectiveness of such schemes. The domestic application of these schemes can distort competition in the EU and disincentives growth in SMEs. Contributing to the disincentive to grow, is also the threshold effect of breaching such schemes (which are mainly characterised by thresholds of turnover within a certain period).

The digitalisation and development of **new trends in trading**, such as e-commerce and the sharing economy, have led to an important increase of SMEs trading across borders within the EU and to the rise of occasional traders who are also frequently active across borders. Meanwhile, the **evolution of the EU VAT system** towards taxation at destination will expose SMEs trading across borders more and more rapidly to situations where their supplies are taxed outside their Member State of establishment. This has been experienced by many SMEs as a consequence of the place of supply change for TBE services in 2015 and is also inherent to the proposed changes on cross-border B2C supplies of goods in 2021. The baseline scenario (Status Quo) therefore took into account these planned changes.

Many elements were discovered that could tackle a number of the problems faced by SMEs in the Status Quo (for example, opening up the SME exemption scheme to other Member States; treatment of occasional traders as non-taxable persons and measures for transition period when breaching thresholds). The study found that **options** comprising these elements do **positively impact in the compliance costs of SMEs** as well as on the wider economy, to varying degrees. Also, with the decrease in compliance costs for SMEs, the impact on the Member States decreases. However, introducing more complexity into the scheme increases the potential for non-compliance and fraud. Naturally, the extension of the SME exemption scheme to supplies from other Member States, decreases the intake of VAT revenues. However, given the limited contribution of SMEs to the EU net VAT revenues, the overall impact is not significant.

When options are compared against the **policy objectives**, it appears that the option with the highest amount of change (**Option 4**) best meets the set policy objectives, highlighting that to tackle all relevant issues it may be necessary to extend the SME exemption scheme to supplies from other Member States, introduce a transition period for businesses breaching the exemption thresholds as well as treating occasional traders as non-taxable persons.

HOW TO OBTAIN EU PUBLICATIONS

Free publications:

- one copy:
via EU Bookshop (<http://bookshop.europa.eu>);
- more than one copy or posters/maps:
from the European Union's representations (http://ec.europa.eu/represent_en.htm);
from the delegations in non-EU countries
(http://eeas.europa.eu/delegations/index_en.htm);
by contacting the Europe Direct service (http://europa.eu/europedirect/index_en.htm)
or calling 00 800 6 7 8 9 10 11 (freephone number from anywhere in the EU) (*).

(*). The information given is free, as are most calls (though some operators, phone boxes or hotels may charge you).

Priced publications:

- via EU Bookshop (<http://bookshop.europa.eu>).

