



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels,
COM(2009) XXX final

Proposal for a

COUNCIL DIRECTIVE

amending Directive 2006/112/EC as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

- **Ground for and objectives of the proposal**

The purpose of this proposal for a Directive amending Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ (hereafter the 'VAT Directive') is to allow the temporary application of the reverse charge mechanism to combat existing fraud in relation to trade with emission certificates and to transactions involving certain fraud-sensitive goods. The application of a targeted reverse charge mechanism should, however, not alter the fundamental principles of the VAT system, such as the fractionated payment, and should therefore be restricted to a pre-defined list of goods and services.

- **General context**

The Commission presented in May 2006 a Communication² with a view to launching an overall debate at EU level on the need for a co-ordinated approach in the fight against fiscal fraud in the Internal Market. Following the Commission's Communication of 23 November 2007³ contributing to the establishment of an anti-fraud strategy within the EU and the report on the state of play within the Anti Tax Fraud Strategy (ATFS) expert group⁴, the Commission presented a Communication on its analysis of more far-reaching measures to change the VAT system in order to fight fraud⁵.

One of the measures, which was analysed in this context, was the establishment of a general reverse charge system. The Commission also demonstrated its willingness, under certain conditions, to propose a pilot project in order to establish whether a type of generalised reverse charge system could be an appropriate response to tackle VAT fraud. However, the ECOFIN Council could not agree on conclusions as regards the issues raised in that Communication. In the absence of a political agreement on the more 'far reaching' measures, the Commission concentrated its efforts exclusively on the so-called 'conventional' measures to enhance the traditional methods in the fight against tax fraud. In this respect, reference should in particular be made to the Communication of the Commission of December 2008 on a coordinated strategy to improve the fight against VAT fraud in the European Union⁶.

However, the present initiative is different from the above pilot-scheme idea.

As fraud is a major concern for the correct functioning of the Internal Market and poses a threat to the Member States' tax revenues, some Member States have requested, by means of a derogation granted by the Council on the basis of Article 395 of the VAT Directive, to combat fraud schemes via a targeted reverse charge system in relation to a particular fraud sensitive sector or to certain goods.

¹ OJ L 347, 11.12.2006, p. 1.

² COM(2006) 254 final, 31.5.2006

³ COM(2007) 758 final, 23.11.2007

⁴ SEC(2007) 1584, 23.11.2007

⁵ COM(2008) 109 final, 22.2.2008 and SEC(2008) 249, 22.2.2008

⁶ COM(2008) 807 final, 1.12.2008

In this context, the most common form of evasion consists in invoicing supplies by a VAT registered supplier who disappears without accounting for this VAT but leaving the customer (also a taxable person) with a valid invoice for deduction. This results in the situation that the treasury does not receive VAT on the supply, but must give the next trader in the chain credit for input VAT. This has in certain cases developed into Missing Trader Intra-Community Fraud (MTIC) which is an organised attack on the VAT system, exploiting that the supplier receives credit for the input VAT through a refund of VAT when his onward supply to a taxable person in another Member State is exempt. In addition, such frauds are often organised in a series of supplies in which the same goods may circulate several times between Member States (so-called carousel fraud) and the treasury may lose several times the amount of tax on a single good. It is to be noted that this type of fraud is, according to information provided by various Member States, extending to services as well.

The reverse charge mechanism results in no VAT being charged by the supplier to taxable customers who, in turn, become liable for the payment of the VAT. In practice, customers (insofar as they are normal taxable persons with a full right of deduction) would declare and deduct at the same time without effective payment to the treasury. In this sense, the theoretical possibility to commit fraud is removed.

With this proposal, the Commission aims at providing the possibility for interested Member States to apply this targeted reverse charge mechanism in relation to a choice, from a pre-defined list, of goods and services which have been identified by Member States as sensitive to fraud. The present proposal for allowing the application of a targeted reverse charge concentrates on the following areas:

First, the Commission has some information on alleged cases of fraud in the area of trading greenhouse emission allowances. Any allegations of fraud, whether in the carbon market or elsewhere, are of course of concern and require an appropriate response. The differences in individual Member States responses have prompted the Commission to prepare this proposal. Although further analysis is still required as regards the precise circumstances and the actual dimension of the fraud problem, the information already provided by several Member States is such that it is appropriate to take swift action and include it in this proposal, which is in the first instance only a temporary measure.

Second, another category of products that has been included in the scope of this Directive is related to mobile telephones and integrated circuit devices. These goods are currently subject of a reverse charge derogation, which had been granted to the United Kingdom on the basis of Article 395 of the VAT Directive and that had been prolonged under specific circumstances⁷. The text of that Commission proposal also serves as a basis for the current proposal for a Council Directive. In the Explanatory Memorandum of its proposal for a Council decision, the Commission explained the very specific circumstances leading to the exceptional granting of this derogation and already announced to be willing to examine the possibility of allowing the application of a targeted reverse charge mechanism by any interested Member State. Notably, it had not been possible so far to determine to which extent the reverse charge mechanism is an appropriate and efficient instrument to tackle fraud in the specific sector concerned. In order to overcome this deficiency any further application needs to be made conditional on a

⁷ Council Decision of 5 May 2009 authorising the United Kingdom to continue to apply a special measure from Article 193 of Directive 2006/112/EC on the common system of value added tax, OJ L 148 of 11.6.2009, p. 14.

full evaluation of its effects. A number of Member States who had shown interest to apply the reverse charge in the sector would be allowed to do so under the current proposal.

Thirdly, the proposal includes other products (perfume, precious metals (such as platinum)) which have, during meetings of working groups on fraud, been signalled by the Member States as goods to which fraud seems to have moved and it is therefore pertinent to include them in this Directive as well.

In procedural terms, Member States should first inform the Commission about their intention of introducing such mechanism. Secondly, the experimental application of a targeted reverse charge will need to be subject to detailed conditions so as to guarantee the functioning of the scheme, avoid potential negative impacts as far as possible and allow for a proper evaluation of the results. Before applying this reverse charge scheme, it is required that the taxable persons who will be affected by the application of this scheme, as a supplier or as a customer, are identified for VAT purposes under an individual number, insofar as this would not already be the case. It is furthermore stipulated that the Member States concerned have to introduce reporting obligations in order to guarantee a sufficient follow-up of the measure in order to provide assurance that the measure is operating effectively. Moreover, to ensure that the application of reverse charge remains targeted and exceptional to the normal VAT rules, the goods and services have been listed and each Member State may choose to apply a reverse charge mechanism to a maximum of three categories of which two can be goods.

The interested Member States should implement effective control measures to monitor and to avoid, as much as possible, all forms of fraud and in particular new forms of fraud which would consist in the spilling over of fraud patterns to other products, to the retail level or to other Member States. For the implementation of these measures, it would be recommendable that the findings on the reverse charge mechanism, as described in the Commission document on measures to change the VAT system to fight fraud⁸, would be taken into consideration.

The experiences stemming from this temporary application of the scheme to fraud sensitive goods or services should allow, on the basis of an information and evaluation procedure as set out in the proposal, a better overall assessment of the usefulness and the proportionality of the targeted application of reverse charge.

2. CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

There was no need for consultation or external expertise. Public consultation, as to the use of reverse charge to combat fraud, was already held in the context of the preceding Commission Communications on VAT fraud (see in particular Consultation paper - Possible introduction of an optional reverse charge mechanism for VAT – Impact on businesses of 13 August 2007⁹).

To achieve a better understanding of the impact of a targeted reverse charge mechanism, this Directive lays down that the Member States, volunteering to apply the scheme, have to determine evaluation criteria in order to allow an assessment of the situation before and at the end of the application period. This Directive opens the possibility for a Member State to apply a targeted reverse charge mechanism under certain circumstances but does not constitute any

⁸ SEC(2008) 249, 22.2.2008

⁹ http://ec.europa.eu/taxation_customs/common/consultations/tax/article_4209_en.htm

obligation in this respect. As the proposed rules provide Member States with an option to apply temporarily for carefully selected goods or services the reverse charge mechanism, it is up to these Member States to carry out detailed impact assessments, as laid down in the Directive.

3. LEGAL ELEMENTS OF THE PROPOSAL

The Directive amends the VAT Directive.

Because of the uncertainty of the effects of the measure and its derogation from the fundamental principle of the fractioned payment, a specific legal basis for such a temporary application of reverse charge for certain goods and services is the best way forward and in line with the principles spelled out in the Commission's Communication on possible measures to change the VAT system to fight fraud¹⁰. Furthermore, Article 395 of the VAT Directive cannot be considered as a sufficient basis for a further and wider application in different Member States of a targeted reverse charge mechanism in relation to certain goods or services. Therefore, the objective of combating fraud via a reverse charge mechanism can be better achieved at Community level via a Directive which offers the possibility to Member States to apply a reverse charge mechanism to domestic supplies of certain goods and services. This does therefore not go beyond what is necessary to achieve the objective.

4. BUDGETARY IMPLICATION

The proposal has no negative impact on the Community budget.

5. ADDITIONAL INFORMATION

The proposal includes a sunset clause.

¹⁰ COM(2008) 109 final, 22.2.2008

Proposal for a

COUNCIL DIRECTIVE

amending Directive 2006/112/EC as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament¹¹,

Having regard to the opinion of the European Economic and Social Committee¹²,

Whereas:

- (1) Council Directive of 28 November 2006 2006/112/EC on the common system of value added tax¹³ specifies that value added tax (VAT) shall be payable by any taxable person carrying out transactions involving the taxable supply of goods and services. In the case of cross-border transactions, and for certain domestic high risk sectors such as construction or waste, it is foreseen, however, to shift the obligation to pay VAT onto the person to whom the supply is made.
- (2) Given the seriousness of VAT fraud, innovative approaches should be explored to address this problem in the most efficient way. Member States should therefore be allowed to apply a mechanism whereby the obligation to pay VAT shifts onto the person to whom the taxable supply of goods or services is made, on a temporary basis, to supplies of certain categories of goods and services, even where these categories are not listed in Article 199 of Directive 2006/112/EC or subject to specific derogations granted to Member States.
- (3) The introduction of such a mechanism targeting supplies of certain categories of goods or services, as opposed to its general application, should not adversely affect the fundamental principles of the VAT system, such as fractionated payment, and should therefore be restricted to a pre-defined list of goods and services.

¹¹ OJ C , , p. .

¹² OJ C , , p. .

¹³ OJ L 347, 11.12.2006, p. 1.

- (4) The pre-defined list, from which Member States may choose, should be restricted to supplies of goods and services which, according to recent experience, are particularly susceptible to fraud. In order to ensure that the introduction of such mechanism may effectively be assessed and that its impact is carefully monitored, Member States should be limited in their choice.
- (5) Before the mechanism may be applied, it is necessary that taxable persons supplying or receiving the goods or services in the pre-defined list are always identified for VAT purposes. Furthermore, Member States choosing to apply the mechanism should introduce specific control measures and reporting obligations on both the supplier and the customer so as to ensure the effective operation and monitoring of the application of that mechanism and detect and prevent all new forms of tax fraud.
- (6) Member States should produce an evaluation report on the application of the mechanism before the end of the application period so as to enable a timely assessment of its efficiency.
- (7) In order to assess the effect of the application of the mechanism on fraudulent activities in a transparent manner, evaluation reports by Member States should be based on pre-defined criteria established by Member States. Any such evaluation should clearly assess the level of fraud before and after the application of the mechanism and any shifts in trends of fraudulent activities, including supplies of other goods and services, supplies at the retail level and supplies in other Member States.
- (8) The report should also evaluate compliance costs for taxable persons and implementation costs incurred by Member States, including those entailed by control and audit measures.
- (9) In order to provide all Member States with the option of applying such a mechanism, a specific amendment to Directive 2006/112/EC is appropriate.
- (10) Since the objective of the proposed action is to address VAT fraud through temporary measures which derogate from existing Community rules, it can only be achieved at Community level. The adoption of a Community measure is therefore in compliance with the principle of subsidiarity, as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary in order to achieve its objectives.
- (11) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 2006/112/EC is amended as follows:

- (1) The following Article 199a is inserted:

Article 199a

1. Member States may, until 31 December 2014 and for a minimum period of two years, introduce and apply a mechanism whereby the VAT due on supplies of the categories of goods and services listed in Annex VI A is payable by the person to whom those goods and services are supplied.

When choosing which goods and services shall be subject to that mechanism, Member States are limited to three of the categories listed in Annex VI A of which a maximum of two must be categories of goods.

2. A Member State choosing to introduce the mechanism provided for in paragraph 1 shall:

- (a) ensure that any taxable person supplying or receiving goods or services to which the mechanism applies, is identified by means of an individual number insofar as the taxable person is not already identified in accordance with Article 214(1);
- (b) introduce appropriate and effective reporting obligations on any taxable person supplying goods or services to which that mechanism applies, as to enable, for each transaction, the identification of that taxable person and the taxable person to whom the supplies are made, of the type of goods or services supplied, and of the tax period and value of these supplies;
- (c) impose transaction-based or global reporting obligations on any taxable person receiving goods or services to which that mechanism applies for cross-checking purposes against information submitted by the supplier;
- (d) introduce appropriate and effective control measures to monitor and mitigate current forms of fraud, as well as to prevent the emergence of fraudulent activities in respect of other goods or services, at the retail level or in other Member States.

3. Member States shall inform the Commission of the application of the mechanism referred to paragraph 1 prior to the introduction of any such mechanism and shall provide the following information to the Commission:

- (a) a statement on the scope of the measure applying the mechanism and a detailed description of accompanying measures, including reporting obligations on taxable persons and control measures;
- (b) evaluation criteria to enable comparison between fraudulent activities in relation to the goods and services listed in Annex VI A before and after the application of the mechanism, fraudulent activities in relation to other goods and services and in other Member States before and after the application of the mechanism, and any increase in other types of fraudulent activities before and after the application of the mechanism, particularly at the retail stage;
- (c) date of commencement and period to be covered by the measure applying the mechanism.

4. Member States applying the mechanism provided for in paragraph 1 shall, on the basis of the evaluation criteria provided for under point (b) of paragraph 3, submit a report to the Commission no later than one year before the expiry of the measure applying the mechanism. The report shall clearly indicate the information to be treated as confidential and the information which may be published.

The report shall provide a detailed assessment of the measure's overall effectiveness and efficiency, in particular as regards:

- (a) the impact on fraudulent activities in relation to supplies of goods or services covered by the measure;
- (b) the possible shift of fraudulent activities to other goods or services;
- (c) the possible shift of fraudulent activities to other Member States;
- (d) the possible shift of fraudulent activities to the retail level;
- (e) the compliance costs for taxable persons resulting from the measure;
- (f) the cost of implementation of the measure for Member States, including the cost of control and audit measures;

(2) The Annex to this Directive is inserted as Annex VI A.

Article 2

Member States choosing to apply the mechanism provided for in point (1) of Article 1 shall communicate the provisions of the measure applying the mechanism to the Commission before the commencement date of its application.

Article 3

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

Article 4

The Directive shall apply until 31 December 2014.

Article 5

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council
The President*

ANNEX

'Annex VI A

List of goods and services referred to in Article 199a

Part A – Goods

- (1) Mobile telephones, being devices made or adapted for use in connection with a licensed network and operated on specified frequencies, whether or not they have any other use;
- (2) integrated circuit devices such as microprocessors and central processing units in a state prior to integration into end user products;
- (3) perfume;
- (4) precious metals where they are not covered by the special arrangements for second-hand goods, works of art, collector's items and antiques pursuant to Articles 311 to 343 or the special scheme for investment gold pursuant to Articles 344 to 356.

Part B – Services

Allowances to emit greenhouse gases as defined in Article 3 of Directive 2003/87/EC(*), transferable in accordance with Article 12 of that Directive, and other allowance units that may be used by operators for compliance with the same Directive.

(*) OL J 275, 25.10.2003, p. 32.'
