



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 19.7.2006
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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 27(3) of Directive 77/388/EEC

1. BACKGROUND

In accordance with Article 27(1) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment¹, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from that Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. **As this procedure provides for derogations from the harmonised general principles of VAT, in accordance with the consistent rulings from the European Court of Justice, such derogations should be restricted and proportionate.**

By letter registered with the Secretariat-General of the Commission on 27 October 2005, the Republic of Austria has requested to be authorised to introduce measures derogating from Article 21 of Directive 77/388/EEC. In accordance with Article 27(2) of Directive 77/388/EEC, the Commission informed the other Member States by letter dated 8 June 2006 of the request made by Austria. By letter dated 9 June 2006, the Commission notified Austria that it had all the information it considered necessary for appraisal of the request.

By letter registered with the Secretariat-General of the Commission on 18 April 2006, the Federal Republic of Germany has requested to be authorised to introduce measures derogating from Article 21 of Directive 77/388/EEC. In accordance with Article 27(2) of Directive 77/388/EEC, the Commission informed the other Member States by letter dated 7 June 2006 of the request made by Germany. By letter dated 8 June 2006, the Commission notified Germany that it had all the information it considered necessary for appraisal of the request.

2. SUMMARY OF THE REQUESTS

2.1. The Austrian request

Austria would like to introduce the reverse charge in respect of all Business to Business (B2B) supplies of goods or services where the invoice value exceeds €10,000. Where the value of an individual invoice does not exceed €10,000, the reverse charge would be applicable where the supplies to a customer exceed €40,000 in the accounting period.

The reason given by Austria for introducing this request is in the pretext of being a tool to tackle carousel or missing trader fraud, and because it had positive experiences from the introduction of reverse charge in the construction sector. Austria believes that VAT fraud, especially carousel fraud and fraud by means of fictitious invoices, can no longer be prevented using conventional methods. It believes that such a measure would prevent certain types of tax evasion and tax

¹ OJ L 145, 13.6.1977, p.1. Directive last amended by Directive 2006/18/EC (OJ L 51, 22.02.2006, p. 12).

avoidance, such as partial payment of the VAT shown on an invoice or non-payment of the VAT shown on an invoice by taxable persons who disappear without paying the liability to the treasury. Austria also believes that applying the reverse charge would reduce the burden on tax administrations which would otherwise have to pursue the tax due by defaulting taxable persons or carry out inspections before granting VAT refunds. From the perspective of the business, Austria claims that the reverse charge would be beneficial to business as they would no longer have to pre-finance² VAT. In order to counter possible new fraud patterns, Austria wants to impose an obligation on business to provide monthly global turnover figures for individual business customers.

2.2. The German request

Germany would like to introduce the reverse charge in respect of all Business to Business (B2B) supplies of goods or services where the invoice value exceeds €5,000. The taxable person making the supply would confirm the validity of the special VAT identification number of the customer before making a reverse charge supply. This confirmation of validity would be done electronically and on-line. Once the customer number was verified as being valid, the supplier would not account for VAT on the supply, but the purchaser would declare to the authorities the VAT for which he is liable, which he can, under normal circumstances, also declare as deductible input VAT. In addition to the verification of the customer's number, the taxable person making the reverse charge supply would notify the tax authorities electronically each time that he is making a non-taxed supply and declare the value of the supply. From the perspective of the customer, he would have to declare separately in his return the reverse charge supplies received. The tax administration would proceed to cross-check the information received electronically from the supplier with the information declared by the purchaser. In this way, Germany wants to protect itself against new fraud opportunities created by the reverse charge system.

The reason given by Germany for introducing this request is similar to that of Austria, but unlike the Austrian proposal, the German system foresees significant additional reporting by the taxable persons.

3. THE BACKGROUND TO THE REQUESTS – THE PROBLEM OF VAT FRAUD

VAT fraud has long been a concern for the Commission in the context of ensuring that Member States take all the necessary action against fraudsters to avoid distortions of competition in the Single Market. Because of recent budgetary problems, VAT fraud has become a major preoccupation of certain Member States.

The Commission welcomes the fact that Germany and Austria are concerned about a specific type of VAT fraud, known as “carousel” or “missing trader” fraud. This type of fraud has an impact on VAT receipts as a taxable person passes on a VAT credit to another taxable person, and then the former disappears without paying the tax. Germany and Austria believe that this could be solved by applying the reverse charge between taxable persons in respect of domestic supplies within the Member States.

² Depending on the credit terms given to customers, and the periodicity of VAT declarations, taxable persons often have to pay VAT to the treasury before they have collected it from their customers.

This would have the effect of nullifying the fraud insofar as the potential “missing trader” would not have a VAT liability. However, the rule of thumb in all Member States is that 80% of the VAT is paid by less than 10% of the taxable persons. This means that very little control effort has to be invested by Member States’ tax administrations to be guaranteed the bulk of their VAT revenue.

Very few Member States make figures available on VAT losses due to fraud. Austria estimates that total losses due to VAT fraud amount to 4.4% of total VAT receipts, but they have no accurate estimate of what proportion of this is attributable to MTIC fraud. Germany estimates that it loses in the region of 2% of its VAT receipts as a result of “missing trader” type frauds. These are not insignificant figures and clearly show the importance which has to be given to VAT fraud, and MTIC fraud in particular. For its part, the Commission is responsive to the importance of tax fraud. Reducing tax fraud is therefore an important goal within the Lisbon strategy, since tax fraud not only reduces the revenues necessary for the Member States for the implementation of public services at national level; it also creates unfair competition between traders. In this context the Commission intends to present later this year a Communication to the Council and the European Parliament with a view of developing a new anti-fraud strategy at European level. VAT fraud, and MTIC fraud in particular, will be a major issue of that Communication.

Nevertheless, the figures for missing trader fraud must be looked at in context, particularly when a proposed change in the system of taxation affects both legitimate traders and the fraudsters who exploit the inability of tax administrations to deal with them swiftly and permanently.

It is to be expected that new forms and patterns of fraud would occur after the introduction of a more generalised reverse charge system. Passing down the tax liability would make it more interesting for the last business in the supply chain to disappear. It should also be clearly noted that the reverse charge mechanism is not an answer to “black sales” (i.e. off the record sales) which remain outside the official circuit. For a taxable person, who has to charge VAT at the end of the supply chain, the incentive to obtain “black” supplies will increase as he has to account for the total amount of the VAT and no longer just for the fractionated part in relation to his “value added”.

4. REVERSE CHARGE AS A CONCEPT

Generally speaking, in respect of supplies of goods and services within a Member State, VAT is charged by the supplier. If the customer is a taxable person, then the latter can recover the VAT charged by declaring the input tax in his periodic VAT declaration. The deduction is immediate, i.e. it is not contingent on the supplier having paid over the VAT to the treasury in the first instance. The problem is that if the person issuing the invoice does not pay the VAT to the treasury in the first place, then the treasury gives VAT input credit which it has never received. In addition to liquidations/bankruptcies, Member States have experienced problems with traders who trade for a short time, charge VAT and then disappear without paying the VAT, but in the vast majority of cases (90% to 95% depending on the Member State), the correct amount of VAT is paid at the right time to the authorities.

Currently, a large proportion of the VAT collected by each Member State is paid by a very small group of large, compliant taxable persons. Applying a generalized reverse charge would mean that the tax would be collected from a far larger group of taxpayers, making control proportionally more difficult.

The application of reverse charge of the type being considered by Germany and Austria would require a supplier to check on the status of the customer to establish whether or not he is a taxable person and therefore whether or not VAT should be charged. The current VAT system does not require such a check to be carried out, as VAT is generally charged independently of the status of the customer. Similarly, the requirements to provide monthly global turnover figures for individual business customers (in the case of Austria) and to notify the tax authorities electronically and to declare the value of each non-taxed supply (in the case of Germany) would be new and additional requirements.

5. THE COMMISSION'S VIEW OF THE REQUESTS

When the Commission receives requests in accordance with Article 27, it examines these requests to ensure that the basic conditions for granting such requests are fulfilled i.e. whether the proposed **specific measure** simplifies procedures for taxable persons and/or the tax administration or whether the proposal prevents **certain types of tax evasion or avoidance**. In this context, the Commission has always taken a limited, cautious approach to ensure that derogations do not undermine the operation of the general VAT system. It was in this context that it made the proposal³ in 2005 for the purpose of amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion and avoidance, and repealing certain Decisions granting derogations which would allow all Member States to apply derogations which had proven to be useful and effective.

While the special scheme for gold as provided for in Article 26*b* of the Sixth VAT Directive could be described as an established reverse charge, the application of these provisions are carefully targeted and limited in scope and size and could not therefore be compared with the current requests.

5.1. The German and Austrian requests

In the view of the Commission, the requests received from Germany and Austria attempt to use Article 27 of the Sixth VAT Directive for the purpose of making a fundamental change to the VAT system, and in so doing, eliminating one of its characteristics, which is the fractioned payment. The context behind these requests is the apparent insufficient capability of Germany and Austria to control the businesses engaging in “missing trader” fraud, which results in estimated losses in Germany and Austria of up to 2% of total VAT receipts. Germany and Austria are of the opinion that if a business is not permitted to charge VAT in the first instance, then the incentive to “go missing” disappears.

³ COM(2005) 89 of 16.3.2005.

Austria estimates that the result of applying a restricted generalised reverse charge to Austrian taxable persons would affect 7 million invoices issued in Austria, while Germany estimates that their proposal would affect 0.5% of all invoices issued in Germany which nevertheless represents some 130 million invoices. Nevertheless, any taxable person is likely to be affected and to be obliged to run reverse charge in parallel with the “normal” VAT rules.

6. CONCLUSION

The requests from Germany and Austria attempt to use Article 27 for the purpose of making a fundamental change to the VAT system in the sense of a generalised reverse charge, and in so doing, eliminating one of the characteristics of VAT, which is the fractioned payment. It would also mean that taxable persons would effectively have to deal with three different types of tax regime:

- The “classical” VAT system
- The reverse charge system for B2B supplies where certain criteria were fulfilled
- The intra-Community system.

This would add an extra layer of difficulty to the accounting burdens already faced by business. Similarly, additional compliance burdens (verifying the nature of customers and reporting transactions) would be imposed on honest traders operating in areas where fraud is not prevalent. Additionally, the German and Austrian tax administrations would have to invest significantly more resources to control VAT as the number of taxable persons who pay the bulk of the VAT changes from the minority of taxable persons to the majority.

The Commission believes that these requests **fail the tests required by Article 27** insofar as they would make life more complicated, rather than simpler both for taxable persons and tax administrations in addition to providing more, rather than less scope for tax evasion.

The Commission considers that **Article 27 is not a correct legal basis** for proposing a generalised reverse charge of the type proposed by Germany and Austria. The Commission has previously proposed to the Council that Member States be authorised to apply reverse charge, but previous applications were generally different insofar as they applied to **specific sectors** (construction, waste, wood etc), and the reverse charge always **went up the supply chain** (thus only eliminating the weak level at the beginning of the chain), so that the more risky small and ephemeral business did not charge VAT, but this was accounted by the larger, easier to control businesses. The only example of a commodity concerns gold but even this remains a single commodity rather than a whole range of goods touching on various sectors. Furthermore, the measures envisaged by Germany and Austria would affect transactions in all economic sectors including sectors which never have been suspected of being subject to missing trader or carousel fraud. The Commission considers that derogations such as those requested by Germany and Austria do not respect the principle of proportionality as set out in several Court cases.

Moreover, allowing the application by individual Member States of special measures of such scope and with such an impact on businesses would lead to disbanding of the internal market for VAT purposes. Indeed, depending on the value of the supply, the type of product or whatever other criteria which could be envisaged, businesses would be confronted with divergent rules and procedures applicable to internal supplies in different Member States. For this reason, these measures go well beyond the scope of Article 27 of the Sixth VAT Directive.

Furthermore, under the reverse charge system, the financial risk arising from the non-payment of VAT is transferred from the treasury to businesses. It is the latter that bears the risk when deciding whether or not to charge VAT based on validating the status of their customer as a genuine taxable person. Such shift of responsibility from the tax administration to business with potential costs for business runs counter to the Lisbon objectives.

In addition, a reverse charge system weakens considerably the control towards the end of the distribution chain. Consequently, tax administrations would have to significantly increase the number of control officials to deal with the greater risk arising from the tax debt being spread over a larger number of taxable persons. Furthermore, the result of an extension of reverse charge proposed by Germany and Austria effectively introduces a much more complex alternative system to the normal VAT scheme.

The requests received from Germany and Austria attempt to use Article 27 for the purpose of making a fundamental change to the VAT system, and in so doing, eliminating one of its characteristics, which is the fractioned payment. The requests are predicated on the assumption that if a business is not permitted to charge VAT in the first instance, then the incentive to “go missing” disappears, which will result in additional VAT revenue.

However, while the Commission continues to believe that the solution to missing trader fraud can be found in increased VAT control based on risk analysis rather than in changing the basic tax rules, it is not opposed to examining complementary or even alternative instruments. Given the fact that Austria and Germany consider that weaknesses do exist in the current VAT system, the Commission will invest further work in order to determine whether a more general action within the framework of the Sixth VAT Directive is needed.

On this basis, the Commission believes that the correct legal basis which would allow Member States to introduce very broad measures which are intended to counter VAT fraud tax avoidance would be Article 93 of the Treaty.

Accordingly, the Commission concludes that the requests made by Germany and Austria do not fall within the scope of Article 27 of the Sixth VAT Directive, and because of this, **the Commission objects to the derogations requested.**