Briefing

EU Legislation in Progress

European Parliament

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Second edition

The 'EU Legislation in Progress' briefings are updated at key stages throughout the legislative procedure.

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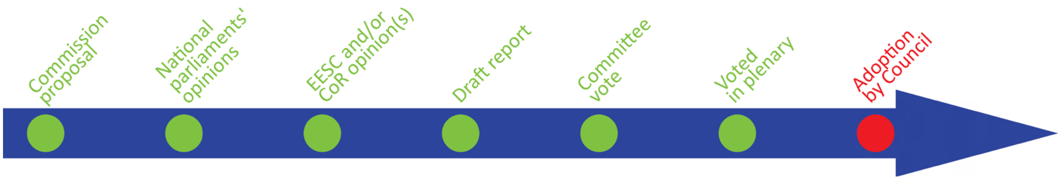
VAT for small enterprises

Value added tax (VAT) is a consumption tax borne by the final consumers and collected by businesses as taxable persons. Businesses have VAT administrative obligations and act as VAT collectors. This generates compliance costs that are higher for small and medium-sized enterprises (SMEs) than for bigger businesses, in spite of the small business exemption, especially in the case of cross-border activities.

The proposal for a revision of the VAT Directive relating to the common system of value added tax as regards the special scheme for small enterprises simplifies the rules, so as to reduce VAT compliance costs for SMEs by introducing simpler measures regarding invoicing, VAT registration, accounting and returns for SMEs, whether they operate in wholly domestic markets only or also across borders in the EU.

The legislative proposal falls under the consultation procedure. The European Parliament adopted its resolution on 11 September 2018, and the proposal is now with the Council.

Proposal for a Council directive amending directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises	
COM(2018) 21, 18.1.2018, 2018/0006(CNS), Consultation Procedure	
Committee responsible:	Economic and Monetary Affairs (ECON)
Rapporteur:	Tom Vandenkendelaere (EPP, Belgium)
Shadow rapporteurs:	Alfred Sant (S&D, Malta) Stanisław Ożóg (ECR, Poland) Caroline Nagtegaal (ALDE, the Netherlands) Paloma López Bermejo (GUE/NGL, Spain) Molly Scott Cato (Greens/EFA, United Kingdom)
Next steps expected:	Adoption by the Council



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Introduction

The Commission action plan on VAT of 7 April 2016 sets out the pillars for modernising the European Union (EU) framework for value added tax (VAT). One of those pillars is a comprehensive VAT simplification package for small and medium-sized enterprises (SMEs), which is closely linked with other parts of the review, in particular those resulting in the application of the destination-based principle.[1]

Existing situation

VAT framework

VAT is a consumption tax borne by the final consumers. At the core of the current EU VAT framework is Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the VAT Directive), which gathers into one piece of legislation all the amendments to the original Sixth VAT Directive.

VAT is charged on the supply of goods and services by a taxable person, unless specifically exempted. The business supplying goods or services (as a VAT taxable person) collects the VAT paid by the consumer, while being able to deduct from the VAT they have collected the amount of tax they have paid to other taxable persons on purchases for their business activities. The additional value of each transaction is collected at each stage of production and distribution (difference between the output VAT and input VAT) and this generates the VAT due to the tax authorities.

As a result, the VAT Directive places a series of administrative obligations on the taxable persons having to collect VAT. These are designed to ensure the correct functioning of the system. Suppliers, be they large, small or medium-sized businesses, have specific VAT administrative obligations as VAT collectors, which generates compliance costs. The administrative obligations for businesses are: the registration, invoicing, accounting (book keeping), reporting (returns) and payment of the VAT to the tax authorities (after collection).

Recent and ongoing changes to the VAT framework include:

> the VAT Directive on place of supply for telecommunications, broadcasting and electronically supplied services, which entered into force in December 2015,[2]

> the e-commerce proposal (12/2016),[3]

1 A description of the interplay is provided in Annex 6 ('Interplay among the legislative proposals on the destination principle and administrative cooperation' to impact assessment to the present proposal(document SWD(2018)0009), a summary of which is available in document SWD(2018)11 in the EU languages.

2 This is partly already implemented for telecommunications, broadcasting and electronically supplied services, which entered into force in 2015 (known as the mini one stop shop – MOSS), Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services (OJ L44, 20.2.2008).

3 Proposals for modernising VAT for cross border e-commerce: Council Directive (EU) No 2017/2455 of 5 December 2017 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, and Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax (OJ L 348 29.12.2017).

> the definitive VAT system proposal (October 2017) – under discussion,[4] and

> the revision of the VAT rate provisions (January 2018), under discussion.[5]

SMEs

SMEs are defined using staff headcount, and either turnover or balance sheet total. The Commission recommendation of 6 May 2003 on the definition of micro, small and medium-sized enterprises sets out thresholds determining medium-sized, small and micro-enterprises.[6] Businesses with annual turnover below €2 million account for around 98 % of businesses, 15 % of turnover and 25 % of net VAT revenues in the EU. Businesses with a turnover of less than €50 000, meanwhile, represent 69 % of all businesses in the EU (and produce a negligible or even negative amount of VAT revenue) and also include a large proportion of SMEs with an annual turnover of less than €5 000 (nano-businesses).[7]

The ceiling figure is not an absolute figure applied in all fields. This is in particular the case with regard to the VAT rules that target businesses operating on a much smaller scale.[8]

Currently the VAT Directive includes special schemes (Title XII). One of these is the 'Special scheme for small enterprises' (referred to as the SME scheme and set out in Chapter 1 of Title XII), which includes a simplified procedure for 'Charging and collection' (Section 1) and 'Exemptions or graduated relief' (Section 2).[9] It allows Member States to opt for two sets of measures specifically for small businesses, to which can be added measures outside the special schemes.[10] In short, the measures available are the following:

> **simplified procedures for charging and collecting VAT** (part of the special scheme), such as a flat-rate scheme, applied in a Member State. Some Member States offer such a scheme on condition of a maximum turnover or to certain business sectors;

4 Proposals on a single VAT area of 4 October 2017.
5 Proposal for a directive amending Directive 2006/112/EC as regards rates of value added tax of 18 January 2018 (COM(2018) 20 final)
6 'The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million', Annex Article 2.
7 See data provided in the study on the options for reviewing the VAT special scheme for small enterprises Volume 1 p. XIV and data provided in Volume 2 Annexes B, C and D for details.
8 A table comparing the communication definition and the definition for VAT purposes is provided in the impact assessment, p.15.
9 The scheme is monitored in accordance with Section 3 'Reporting and review' of Title XII of the VAT Directive.
10 A presentation of the 'Measures for SMES available in the VAT Directive' is provided in Annex 5 to the impact assessment.

> **an exemption for small enterprises** (part of the special scheme, Articles 281 to 294 of the VAT Directive) with an annual turnover below a certain threshold (SME exemption) meaning that the Member State may decide to release them from certain or all VAT obligations. Even when such an exemption is set in national provisions, the business may decide not to apply it. The exemption is limited to sales in the enterprise's own Member State (provided it is not excluded by the VAT Directive). As the thresholds are set nationally, they vary from one Member State to another. When growing above the threshold, the SME loses access to the simplification measures. The special scheme also offers the possibility for Member States to apply graduated relief (yet in this case the enterprise cannot benefit from the release from VAT obligations);[11] and

> **simplified measures** (outside the special schemes). These relate to the following VAT obligations: registration, invoicing, accounting, reporting (returns and recapitulative statements), and payment (namely a cash accounting scheme).[12]

Despite the small business exemption that is widely applied, the compliance cost for SMEs remains higher than for bigger companies, in particular in the case of cross-border business, because the exemption is limited to the Member State in which the enterprise is established and because of the complexity and diversity of rules on VAT obligations across the EU. A summary of the implementation of the scheme and simplification measures is provided in the impact assessment accompanying the proposal.[13]

Parliament's starting position

In its resolution adopted on 24 November 2016, Parliament welcomed the Commission's VAT action plan initiative and, on the proposal to define a special VAT scheme for SMEs, stressed the need for gradual implementation of the framework, owing to the generation of higher administrative/compliance costs (including information technology costs). Parliament stressed in particular the need to address the difficulty SMEs have in determining what can be described as a product or a service, since Member States have different interpretations. It also focused on the need to reduce VAT fraud and assess carefully the consequences of the reverse charge mechanism, and to consider how to minimise the administrative burden of turnover taxes for SMEs and the complex filing system. On this point it called for unified VAT filing, harmonised reporting requirements and deadlines. It also called for VAT rules to be simplified and made easier to follow for SMEs, and for support to be offered to each Member State for the adaptation and management of VAT procedures. Parliament stressed the issue of the VAT threshold for e-commerce sales (the lack of harmonisation entailing high transaction costs for SMEs) and acknowledged the proposals regarding the extension of the VAT mini one-stop shop (VAT MOSS) as part of the action plan.[14]

11 Article 272(1)(d) of the VAT Directive.
12 A presentation with reference to the specific VAT provisions is provided in the impact assessment Annex 5, pp.102-103.
13 Tables reviewing measures in each of the 28 Member States are provided in Annex 9: SME exemption thresholds in the EU (April 2017), Annex 10 'Special VAT SME measures applied in the Member States' and Annex 11 'VAT obligations linked to the SME exemption per Member State' (pp. 126-131).
14 Directive and regulation adopted on 5 December 2017, see footnote 3 above.

Council starting position

In the conclusions it adopted on the VAT action plan on 25 May 2016, the Council welcomed the Commission initiative to reduce the cost to SMEs of VAT compliance. However, the Council also insisted that this simplification should lead neither to an escalation of tax fraud risks nor to a disproportionate rise in administrative costs.

Proposal

Preparation of the proposal

The options for reviewing the special VAT scheme for small enterprises were analysed in a study prepared for the Commission in 2017. It reviews the use by Member States of the possibility to design special schemes, which has resulted in a patchwork of differing national SME schemes accompanied by a varied set of administrative simplifications for SMEs. This assessment incorporates the most recent developments and ongoing proposed changes to the VAT framework (see above).

The preparatory work preceding the adoption of the proposal by the Commission on 18 January 2018 is recapitulated in Annex I of the impact assessment, which provides in particular a list of studies supporting the impact assessment.

Annex II of the impact assessment describes the stakeholder consultations and summarises the main conclusions. The open consultation ran from 20 December 2016 to 20 March 2017, and confirmed the stakeholders' interest in and support for further EU action in the area of VAT and SMEs.[15]

In order to provide adequate remedy, four options[16] were considered in the preparation of the proposal and they are described and assessed in the impact assessment attached to the proposal.

The changes the proposal would bring

The 18 January 2018 proposal for a Council directive amending Directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises seeks to simplify the rules and reduce VAT compliance cost for SMEs. The aim is to level the playing field for all SMEs (irrespective of whether they are established in the Member State where the VAT applies) operating both domestically and in cross-border markets.

The scope of the proposal is to review the exemption in the special scheme for SMEs laid down in Articles 281 to 294 of the VAT Directive (the 'SME scheme') and other measures outside the scheme that allow various VAT obligations to be simplified. This means that the other provisions for SMEs (namely simplified procedures for charging and collecting VAT) are not amended by the 18 January 2018 proposal.[17] Several

15 The results are also summarised in Annex 2 to the impact assessment, pp. 82-86.
16 The four options are the following: 1. leaving the current VAT rules unchanged and including the necessary provisions in e-Commerce; 2. extending the VAT exemption for SMEs to include supplies from other Member States and simplifying the VAT obligations; 3. in addition to this extension, adopting measures that seek to diminish the damaging impact of the shift from exemption to taxation; 4. providing additional mandatory common treatment of sporadic traders. See impact assessment pp. 50-71. Option three was selected as the preferred one, as it is expected that when adopted it will reduce compliance costs by 18 % and have a positive impact on SME output and a positive effect on voluntary compliance, leading to a positive revenue effect in the long term.
17 A summary is provided in the impact assessment's Figure 1: Measures for SMEs available in the VAT Directive, p. 17.

of the amendments relate to technical adjustments, updates and references to the SME exemption in other provisions of the VAT Directive.

The new Article 280a (Article 1(8) of the proposal) defines a 'small enterprise' as 'any taxable person established within the Community whose Union annual turnover is no higher than €2 000 000' (or equivalent in national currency) and also provides definitions for Member State and EU turnover in order to facilitate application of the provisions.

The proposal does away with graduated tax relief on account of its complexity. The amendments adapt the VAT Directive accordingly (Article 1 points 9, 10 and 16 of the proposal). Article 1(11) of the proposal deletes VAT Directive Article 283(1) on the exclusion of non-established enterprises from the exemption.

Amended VAT Directive Article 284 (Article 1(12) of the proposal) establishes the scope of the exemption. Exemption remains optional and Member States may set their Union (i.e. single market) turnover threshold to a maximum level of €100 000, with a specific level for sector-based thresholds (€85 000). A non-established small enterprise must meet two conditions to benefit from exemption in another Member State: its turnover in that particular Member State ('Member State annual turnover') must be below the threshold of the exemption applicable there and its overall turnover in the single market ('Union annual turnover') must be below €100 000. In these cases, the Member State where the small enterprise is established is responsible for collecting all relevant information on its turnover, such as the precise declaration of Union annual turnover, and inform tax authorities of other Member States to which the SME supplies goods or services.

An amendment to VAT Directive Article 288 (Article 1(14) of the proposal) clarifies transactions to be taken into account when calculating the annual turnover with a view to applying the exemption.

A new Article 288a (Article 1(15) of the proposal) sets a transitional period of one year for small enterprises benefiting from SME exemption, when their turnover becomes superior to the threshold, provided that their turnover remains within the applicable threshold plus 50 %.

A new Section 2a is added (Article 1(18) of the proposal) to the simplification measures for exempt and non-exempt enterprises. Subsection 1 sets simplifying obligations for enterprises in the exemption scheme and states that Member States will retain the option to exempt small enterprises from other obligations mentioned in Articles 213 to 271 of the VAT Directive (relating to identification of the taxable person, invoicing, accounting, returns and recapitulative statements). Subsection 2 makes available a set of simplifying rules for small enterprises that do not benefit from SME exemption, in order to reduce compliance costs. Those non-exempt small enterprises mentioned might have elected not to opt for the exemption or those with a turnover under €2 000 000 (threshold defined by the new Article 280a of the VAT Directive). It provides for simplified procedures for obtaining an identification number, for the storage of invoices, the return period and interim payments.

Views

Advisory committees

The European Economic and Social Committee (EESC) adopted its opinion on the VAT reform package (II), which includes the proposal on the special scheme for small enterprises, at its May plenary session.

National parliaments

The subsidiarity deadline for national parliaments to submit comments on the proposal was 19 March 2018. No reasoned opinion was issued; there were political dialogues with the German Bundesrat, the Portuguese Assembleia da República and the Romanian Senate, and an exchange of information with the Spanish Cortes Generales.

Stakeholders' views

Stakeholders expressed their views in the consultation relating to the proposal referred to above.

Legislative process

The legislative proposal falls under the consultation procedure.

In the European Parliament, the Economic and Monetary Affairs (ECON) committee prepared the opinion. Tom Vandenkendelaere (EPP, Belgium) was appointed rapporteur and issued a draft report on 17 May 2018 to which amendments were tabled by 6 June 2018. The committee voted on the report on 11 July 2018. Parliament adopted its report in plenary on 11 September 2018. It approved the proposal, with amendments.

The plenary resolution aims at rendering the VAT exemption regime EU-wide instead of only national. To make this feasible it proposes harmonising the upper and lower thresholds for VAT exemptions. It also proposes to render it mandatory for Member States not to require a VAT return for VAT-exempted enterprises. The creation of an online portal through which enterprises willing to avail themselves of the VAT exemption in another Member State should register would complement the framework.

The amendments also propose setting up a one-stop shop for VAT returns, thus simplifying the language challenge encountered by SMEs when trading cross-border. The amendments also delete the proposed annual VAT return for small companies, due to its potential negative side effects.

Finally, the resolution proposes that the date of implementation of this proposal could be advanced, since it is not dependent on the broader revision of the VAT framework.

In the Council, the proposal was presented by the Commission at the 23 January 2018 ECOFIN Council. The working party on tax questions (indirect taxation – VAT) began its examination of the proposal in February 2018.

References

EP supporting analysis

Milan Remáč, Definitive VAT system and fighting VAT fraud, EPRS, European Parliament, October 2017.

Other sources

Common system of value added tax: special scheme for small enterprises, Legislative Observatory (OEIL), European Parliament.

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