

Detailed technical measures for the definitive VAT system

OVERVIEW

The common European value added tax (VAT) system was set up in 1967 and reformed in 1993 in order to adapt it to the entry into force of the internal market. Therefore, the existing rules governing intra-Community trade, which were intended to be transitory, are now 25 years old. VAT is an important source of revenue for both national governments and the EU budget, but the current system is ill-adapted to the challenges of a modern economy. It presents such problems as vulnerability to fraud, high compliance costs for businesses, and a heavy administrative burden for national authorities.

As part of the action plan on VAT, the European Commission adopted a new proposal in May 2018. This proposal would amend the VAT Directive (Directive 2006/112/EC) to introduce the detailed technical measures of the definitive VAT system for the intra-EU business to business (B2B) trade in goods. The present proposal follows another proposal that sets out the basic features of the reform of the common EU VAT system. Some aspects of the previous proposal were taken out of the negotiations to be examined with this one.

Proposal for a Council directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States		
<i>Committee responsible:</i>	Economic and Monetary Affairs (ECON)	COM(2018) 329 25.5.2018
<i>Rapporteur:</i>	Fulvio Martusciello (EPP, Italy)	2018/0164(CNS)
<i>Shadow rapporteurs:</i>	Jeppe Kofod (S&D, Denmark) Roberts Zīle (ECR, Latvia) Thierry Cornillet (ALDE, France) Matt Carthy (GUE/NGL, Ireland) Molly Scott Cato (Greens/EFA, United Kingdom) Barbara Kappel (ENF, Austria)	Consultation procedure (CNS) – Parliament adopts a non-binding opinion
<i>Next steps expected:</i>	Vote in plenary	



Introduction

Value added tax (VAT) is considered one of the most growth-friendly and least distortive forms of taxation, and is one of the primary sources of revenue for both national governments and the European budget.¹ At EU level, it represents 7.0 % of gross domestic product (GDP) and 17.6 % of tax revenues (Eurostat, 2016), and is equal to 11.9 % of the revenue of the EU budget ([draft general budget of the EU](#), 2019). The [current system](#) was set up as a transitional system and entered into force in 1993, at the same time as the internal market. It was generally considered as ill-adapted to the new challenges that the globalisation and digitalisation of the economy pose to economic actors. National authorities spend material and human resources on controls and audits, while businesses' costs are too large due to excessive red tape. As part of the [action plan on VAT](#), the European Commission has prepared several packages of proposals with the objective of adapting the common value added tax system to overcome those difficulties. In October 2017, it adopted a [proposal](#) to introduce the pillars of the definitive VAT system for the taxation of trade in goods between Member States. This proposal, [adopted](#) by the Council in December 2018, was intended to lay the foundations for the definitive VAT system for business-to-business (B2B) cross-border trade in goods, and made three changes to the current system, called 'quick fixes', that, according to the Commission, would improve its operation in advance of the definitive measures being adopted. The proposal analysed in this briefing, issued in 2018, goes beyond that, containing the detailed technical measures to allow for the establishment of the definitive VAT system for B2B transactions for goods.

Context

When the transitional system entered into force in 1993, Member States agreed that the definitive system should be based on **the origin principle**: taxation would occur in accordance with the legislation of the country of origin. At that time, the origin-based system was preferred, with the objective of introducing a system for VAT which would treat the Single Market as if it was a single country. The proposal had [two features](#): on the one hand, cross-border transactions would have been taxed for VAT in accordance with the tax of the country of origin, traders would be able to deduct the input tax (exactly as if it was a domestic transaction); on the other, the system would have been complemented by a clearing system to reallocate to the country of origin the VAT collected through the different steps of transactions that occurred from production to final consumer. These Commission proposals were never adopted, and the transitional system, initially planned for four years, continued. In order to work properly, a VAT system based on the origin principle needs an appropriate level of harmonisation of VAT rates; without such harmonisation, that kind of VAT regime introduces competitive distortions within the internal market as firms would delocalise to the countries with the lowest VAT rates in order to price their goods lower and gain a competitive edge. The level of harmonisation required was never achieved, as derogations and exceptions to the harmonised rules multiplied. Moreover, at that time, it was also difficult to agree politically on a compensation mechanism to redistribute the VAT collected.

In the [Council conclusions of May 2012](#), Member States recognised that the application of the origin principle was not politically achievable. This recognition was the first step on the way to a definitive VAT system based on the **destination principle**. In such a system, the supply of goods and services is taxed in accordance with the legislation of the country of destination. The destination principle is the regime used in the context of international trade. Contrary to the origin-based regime, it does not create the competitive distortions mentioned earlier and therefore is considered 'neutral'. The VAT collected is not influenced by the location of the economic or geographical structure of the value chain, and therefore it does not introduce distortion in location decisions.

In April 2016, the European Commission launched an [action plan on VAT](#) with a view to adapting the common value added tax system to the economy of the 21st century. One crucial component of the plan is the reform leading towards a definitive VAT system for intra-Community B2B transactions, i.e. transactions where all the parties involved are taxable persons.

According to the Commission, the objectives of the reform are:

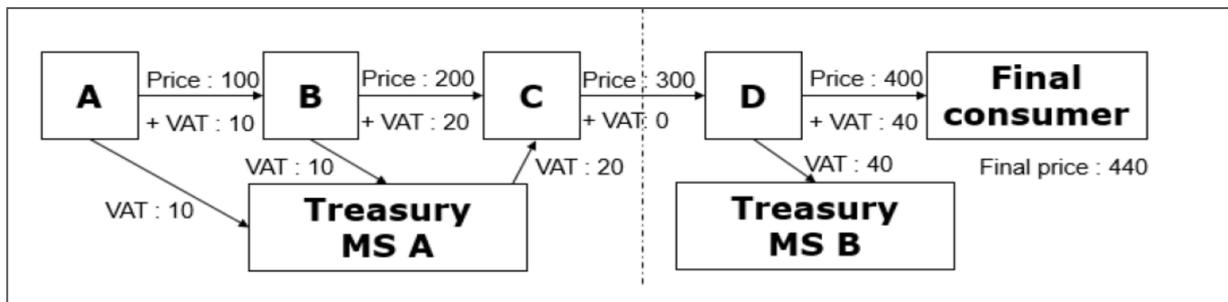
- to tax the sales of goods and services between EU countries in the same way as domestic sales;
- to make the system more robust and simple;
- to reduce the VAT gap due to fraud by €40 billion. The total VAT gap is estimated to be €150 billion, of which around €50 billion is due to fraud;² and
- to reduce business compliance costs, which are now 11 % higher for cross-border transactions than for domestic commerce, by €1 billion.³

The definitive VAT system package for B2B transactions will be proposed in two legislative steps: the first step addresses the VAT treatment of intra-EU B2B supplies of **goods**, and the second step will address intra-EU B2B supplies of **services**. The first legislative step was, in turn, split into two sub-steps. The first sub-step was the 'October 2017 definitive VAT system package', including a [proposal](#) on harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States ('the quick fixes' proposal), adopted by the Council [in December 2018](#). This briefing describes the second sub-step's [proposal](#), which introduces the detailed **technical provisions** for the actual implementation of the definitive VAT system for intra-Union trade in goods. The extension of the definitive VAT system to the supply of services is scheduled to follow the first exercise in monitoring the implementation of the new VAT system for the supply of goods.⁴ The [action plan](#) also includes several packages besides the two mentioned above. In particular, the choice of opting for the destination-based principle allows the introduction of [more flexibility in VAT rates](#); the proposal on this is still under discussion in the Council. As the system will have (as discussed below) to rely on mutual trust among customs authorities, an [amended proposal](#) to [strengthen administrative cooperation](#) in the field of the VAT was adopted by the Council in October 2018. Finally, in order to reduce costs for [small and medium-sized enterprises](#) a [proposal](#) to modernise [VAT for SMEs](#) was also submitted to the Council.

Existing situation

In the current transitional VAT system,⁵ the cross-border trade of goods in B2B transactions is split into two operations: an exempt supply in the Member State of departure of the goods and an intra-Community acquisition taxed in the Member State of arrival. Figure 1 shows an example of successive 'cash flows' under the current transitional system. Note that companies A, B and C are located in the same Member State, so transactions between A and B and between B and C are domestic sales on which VAT will be charged.

Figure 1: Intra-EU transactions under the current transitional VAT system



Source: European Commission (2016), [Commission staff working document – Impact assessment: Generalised reverse charge mechanism](#), SWD(2016) 457 final, p.13

As mentioned above, this two-operations system is difficult to administer for national authorities and cumbersome for businesses. In addition, it opens up opportunities for fraud, as the exempt supply breaks the chain of fractioned payments that is one of the principal features of a well-functioning VAT system. In particular, in the framework of B2B transactions, the system has fallen prey to 'carousel fraud' (see Box 1). Because of this type of fraud and other abuses of the current system, the total amount of VAT lost across the EU in 2016 was estimated at €147.1 billion. This represents a loss

of 12.3 % of the total expected VAT revenue. In order to combat this VAT gap, and also introduce simplifications in the system, the Commission submitted the proposal to discard the transitional VAT system and proposed a new definitive VAT system, based on the destination principle.

Box 1: An example of 'carousel fraud' or the 'missing trader fraud'

A company A in Member State 1 sells goods to company B in Member State 2 without charging VAT, as it is an intra-Community supply exempt from VAT. Company B however then sells to company C adding the VAT. Company C, which is also a broker, sells on the goods to company D. Company C therefore asks for the refund of the VAT paid to B when acquiring the goods. Company C also pays to the authorities the VAT that company D paid when acquiring the goods from C. Finally, company D exports and sells the goods back to company A in the other Member State. As this final transaction is again an intra-Community supply, company D does not charge VAT to A and asks the authorities for a refund of the VAT paid to company C. Across all these transactions, the authority has lost the amount of VAT that company B (the 'missing trader') has charged company C but has not given back to the authority.

Parliament's starting position

The position of Parliament was set out in its [resolution of 13 October 2011 on the future of VAT](#) and its resolution of 24 November 2016, [Towards a definitive VAT system and fighting VAT fraud](#). In the first resolution, Parliament called on the Commission to present a proposal to address the modernisation of the VAT system, and on Member States to step up cooperation on fighting VAT fraud and reducing the VAT gap, while recognising the need for rapid changes in legislation to prevent fraud and address the loss of tax revenue. In the second resolution, Parliament welcomed the Commission's announcement to propose a definitive VAT system by 2017, and supported the objective of making it simple, fair, robust, efficient and less susceptible to fraud, emphasising that a simple VAT system with few exemptions would help with the proper functioning of the digital single market. Last but not least, Parliament supported the Commission's idea of adopting **the principle of destination** and implementing a system of VAT where intra-Community sales of goods and services would be taxed at the rate of the country of destination, but the tax would be collected in the country of origin and then transferred to the country of destination. Moreover, it noted that the certified taxable person concept and the one-stop shop were essential components of this model.

Council's starting position

In [its conclusions on the future of VAT of 15 May 2012](#), the Council supported the European Commission's objective of an EU VAT system that is '[simpler, more efficient and neutral, robust and fraud-proof](#)' and acknowledged the need to simplify the current system in order to reduce compliance costs and administrative burdens both for businesses and for national tax administrations. More importantly, it recognised that the application of the origin principle envisaged by Directive 2006/112 was not politically achievable, and invited the Commission to study possible ways of implementing the destination principle. In [its conclusions of 25 May 2016](#), Council agreed on the need to modernise and improve the EU's VAT system with those objectives in mind, while also emphasising the need to keep the EU's business environment competitive, fight VAT fraud, reduce the VAT gap and lessen the VAT compliance burden for business. Finally, and considering that the reforms needed to achieve a definitive VAT system would take some time, in [the conclusions of 8 November 2016](#), it asked the Commission to present proposals to amend the current VAT system in particular with regard to four aspects that would become known as [the quick fixes](#).

Preparation of the proposal

The European Commission launched the debate in 2010 with its green paper, [On the future of VAT – Towards a simpler, more robust and efficient VAT system](#), followed by a [consultation](#) that resulted in more than 1 700 contributions from national tax authorities, stakeholders and academia. These contributions fed into a second communication, [On the future of VAT – Towards a simpler, more robust and efficient VAT system tailored to the single market](#), which set out the desirable

features of the definitive system and the priorities for the years ahead. The dialogue with Member States and stakeholders continued in the Group on the Future of VAT (GFV) and the VAT Expert Group (VEG). In April 2016, the Commission brought all this work together in a third communication, [On an action plan on VAT – Towards a single EU VAT area – Time to decide](#), and got positive feedback from Council, Parliament and the Economic and Social Committee. In view of the position of those institutions and after [a second public consultation](#) that lasted from December 2016 to March 2017, the Commission began the process of moving towards the definitive VAT system, first with the [October 2017 package](#), which included the proposal to set the basis of the reform (the 'cornerstones'), and then with the present proposal that should complete the reform of cross-border trade of goods in B2B commerce. Both proposals are based on the same [impact assessment](#).

The changes the proposal would bring

This proposal aims to replace the current two-transaction system – the exempt supply of goods and the VAT liable intra-Community acquisition – with a one-transaction system: taxed intra-Union supply of goods. Therefore, all references to 'intra-Community acquisition', including entire chapters, would be deleted throughout the VAT Directive. Moreover, Article 14 would be amended so as to introduce the concept of '**intra-Union supply of goods**'. Paragraph 5 of Article 14 would exclude certain supplies of goods from this definition: (i) the supply of goods with assembly or installation pursuant to Article 36, (ii) the supply of goods that are exempt under Articles 148 and 151 (inter alia referring to goods for the fuelling and provisioning of certain vessels and aircraft, goods in diplomatic and consular arrangements and goods for international organisations), and (iii) the supply of goods by a taxable person covered by the common flat-rate scheme for farmers. A new Article 35a would establish the place of supply of an intra-Union supply of goods as the place where the transport of the goods to the customer ends. This provision, combined with the amendment of Article 14, would establish the application of the destination principle. In the new system, the **person liable for payment of VAT** would normally be the supplier. The reverse charge mechanism, making the buyer liable for payment of VAT, remains an option for supply of services under the revised Article 194. For supply of goods, under the new Article 194a, the buyer becomes responsible for the VAT payment only if the supplier is not registered in the Member State of acquisition, and the person to whom the goods are supplied is a **certified taxable person (CTP)** according to the new Article 13a. A firm would be considered a reliable taxpayer if it complies with a certain number of requirements mentioned in Article 13a and can obtain CTP status. [Authorised Economic Operators \(AEO\)](#) for customs purposes are considered to meet the CTP requirement and can obtain CTP status if they apply for it. CTP firms however will not automatically satisfy AEO requirements (AEO status has further requirements with respect to compliance with technical standards).

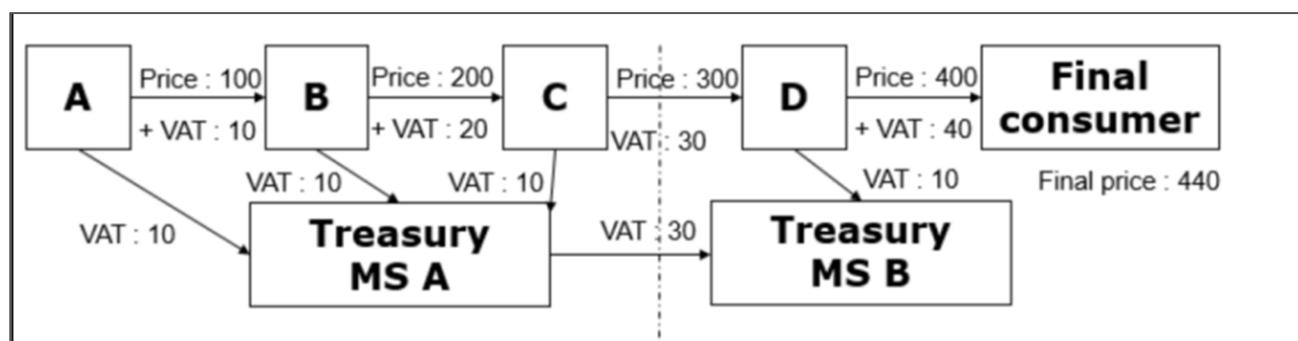
Changes to Articles 369a to 369za would amend the provisions for **the special scheme for taxable persons established in the EU but not in the Member State of consumption**, allowing for the extension of the single registration scheme for declaration, payment and deduction of the tax, known as the One-Stop-Shop (OSS), to B2B transactions in goods. The OSS will allow to put a stop to the need for suppliers to register for VAT purposes in all the countries in which the firm sells to customers thus substantially reducing the administrative costs for firms deriving from the 'destination' principle-based VAT regime. Under the OSS, the firm will pay the national authorities of the Member State where it is located; it is then up to that fiscal authority to transfer the VAT to the treasury of the Member State of consumption. Currently, the [mini one-stop-shop \(MOSS\) scheme](#) applies to telecommunications, broadcasting and electronic services providers to supply those services all over the EU while being registered in only one Member State. More recently, [Council Directive \(EU\) 2017/2455](#), amending the VAT Directive, and [Council Regulation \(EU\) 2017/2454](#), amending the VAT Administrative Cooperation Regulation, have extended the MOSS scheme to all cross-border B2C e-commerce, which is now referred to as One-stop-shop or OSS and which should be effective from 1 January 2021.⁶ The extension of the OSS would be fundamental to reducing the otherwise increased administrative costs of suppliers from having to register in

multiple Member States, considering that only transactions involving CTP buyers would be covered by the reverse charge mechanism. The OSS would also be available to taxable persons not established in the EU if they use an intermediary established in the Union. Also, if the annual turnover of persons using the scheme is more than € 2 500 000, they would have to submit VAT returns monthly instead of quarterly. Finally, the VAT return would need to provide additional information compared with the current requirements.

Under Article 67, the VAT would be chargeable on the issue of the invoice, or no later than the fifteenth day of the month after the chargeable event occurred.

As this proposal would establish the definitive system only for trade in goods, Article 402 would be amended to keep a transitional system for trade in services. Figure 2 below, shows how the transaction presented earlier in the current transitional VAT system (see figure 1 above) would be modified by the proposed definitive VAT regime.

Figure 2: Intra-EU transactions under the proposed new definitive regime



Source: European Commission (2016), [Commission staff working document – Impact assessment: Generalised reverse charge mechanism](#), SWD(2016) 457 final, p. 14

Advisory committees

In its [opinion on the action plan on VAT](#), adopted on 13 July 2016, the European Economic and Social Committee (EESC) expressed the view that implementation of the definitive VAT system should occur 'within a reasonable time-frame', also regarding services, and was in favour of the new system being based on the destination principle. Work on this proposal was carried out in the Implementing the definitive VAT system study group. The rapporteur is Krister Andersson (Employers – Group I, Sweden) and the co-rapporteur Giuseppe Guerini (Diversity Europe – Group III, Italy). The Committee adopted its [opinion](#) in plenary on 24 January 2019.

National parliaments

The [subsidiarity deadline](#) for national parliaments to submit comments on the proposals was 24 September 2018. The German [Bundesrat](#) issued an opinion in the framework of political dialogue mentioning concerns with respect to CTP status and to the OSS frameworks.

Stakeholders' views⁷

BusinessEurope published, before the issue of the technical measures proposal, [a position paper](#) welcoming the Commission's proposal for a definitive VAT system for cross-border trade but expressing disagreement on several areas. According to them, the proposed model would increase compliance costs for businesses, and simplification should not only apply to CTPs but to all operators. Criteria for obtaining CTP status should be harmonised across the Union. In addition, they were strongly against deciding on key aspects of the definitive VAT system before examining the technical provisions, i.e. they opposed the two-step legislative timing. The issues connected with the CTP concept come back in several comments (see for example the [opinion of Tax Advisers Europe](#), [PwC tax policy bulletin](#), [Friedrich Ebert Stiftung](#)). The first concern is that the requirements

are too vague, which could lead to unequal enforcement, leading also to possible distortions (through preference to establish a business in a country where enforcement and monitoring is more relaxed). In the opinion issued by [UEAPME](#), concerns were raised on the difficulties that small and medium-sized enterprises could have in obtaining CTP status. Small enterprises covered by the exemptions for small enterprises would not be able to apply for CTP, but it is less clear what could be the difficulty for other small and medium-sized enterprises (SME) not covered by the exemptions. Other concerns were raised with respect to the OSS. The extension is necessary to lower the administrative costs that suppliers will face under the new regime. Indeed, now suppliers will be liable to pay VAT on their EU cross-border supplies while this was exempted before; moreover, they have to pay it to the Member State in which transport ends. In the absence of the OSS and accounting for the fact that the reverse charge mechanism would only be maintained in the case of CTP buyers, a supplier would need to register in all the Member States in which it supplies. The OSS avoids those extra costs of registration. The [PwC tax policy bulletin](#) raises doubts with respect to the possibility of extending the OSS to B2B transactions by 1 July 2022 as it considers that the 2021 e-Commerce Package OSS (the OSS covering B2C transactions) will need to be in place and functioning smoothly before it can be expanded again to cover the definitive VAT regime for B2B transactions. Finally, even with the OSS, the new system could increase costs for both firms and national authorities, as both actors will need to know the VAT rates and rules in other Member States.

Legislative process

In the **European Parliament**, the proposal follows the consultation procedure, which means the Parliament's opinion is non-binding. It has been assigned to the Economic and Monetary Affairs Committee (ECON) (Rapporteur: Fulvio Martusciello, EPP, Italy). The ECON committee adopted its [report](#) on 22 January 2019. The report introduces a number of suggestions for amendments, in particular with respect to the CTP concept. The first concern appears to be the harmonised application and interpretation of the CTP status requirement and its monitoring. To that effect, some amendments suggest that the Commission adopts an implementing act with further guidance on the interpretation, as well as issues guidelines on withdrawal and monitoring of status. Another amendment would request Member States authorities to review granted CTP status every 2 years. The amendments further insist on the exchange of information with respect to CTP status granted or refused; in particular, the report suggests that CTP status and its changes appear in the VAT Information Exchange System (VIES), and that tax authorities disclose to their counterparts in other Member States whenever they refuse an application and the grounds for doing so. Other amendments seem to aim at a stricter application of the CTP. For example, one amendment requires evidence of financial solvency of the applicant during the three years prior to application and would require the applicant to possess a bank account in a financial institution in the Union. Another amendment requires that applicants, that have been refused CTP status or whose CTP status is withdrawn, would not be able to reapply within six months. A further amendment introduces proportional sanctions if a CTP holder does not disclose within one month any factor which could have affected the CTP status. The report goes as far as to deny CTP status to an applicant denied AEO status during the last three years, even though AEOs have to comply with additional requirements compared to CTP. Finally, another suggested amendment deals with concerns regarding the capacity of SMEs to apply for CTP status; the amendment requests the Commission to institute a tailored procedure for SMEs. Besides the amendments concerning CTP, the report also suggests that the Commission, in cooperation with the Member States, creates by 1 June 2020 a multilingual Union VAT web information portal which would allow businesses and consumers to have access to accurate information on VAT rates. Such a portal would also allow business and consumers to receive automated notifications on changes and updates with regard to Member States' VAT rates. The committee report also amends the provision regarding Eurofisc. The report further requests that any proposals, submitted by the Commission to the Council with respect to these provisions, should also be submitted to the Parliament. It also adds a new article requesting that four years after the adoption of the present directive, the Commission must present a report on

the implementation and application of its new provisions. It also requests that two years after adoption, the Commission shall present to Parliament and Council a report on the effectiveness of the exchange of information between Member States' tax administrations.

In the **Council**, the proposal is being examined at working party level by the Working Party on Tax Questions – Indirect Taxation.

EP SUPPORTING ANALYSIS

Remáč M., [Definitive VAT system and fighting VAT fraud](#), implementation appraisal, EPRS, European Parliament, October 2017.

OTHER SOURCES

Crawford I., Keen M., and Smith S., 'Value Added Tax and Excises', in *Dimensions of Tax Design – The Mirrlees Review*, Institute for Fiscal Studies, Oxford University Press, 2010.

James K., *The Rise of the Value-Added Tax*, Cambridge Tax Law Series, Cambridge University Press, 2015.
[Operation of the definitive VAT system for the taxation of trade between Member States](#), Legislative Observatory (OEIL), European Parliament.

ENDNOTES

¹ See the [Impact assessment accompanying the proposal for a Council directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States](#), SWD(2017) 325, European Commission, 4 October 2017.

² The VAT gap was estimated in the [Study and reports on the VAT gap in the EU-28 Member States: 2017 final report](#), September 2017. The estimation of VAT fraud and compliance costs was made in the report [Implementing the 'destination principle' to intra-EU B2B supplies of goods – Feasibility and economic evaluation study](#), European Commission, June 2015.

³ Ibid.

⁴ More details about the timing of the VAT reform can be found in the communication [On the follow-up to the Action Plan on VAT – Towards a single EU VAT area – Time to act](#), COM(2017) 566, European Commission, October 2017.

⁵ Based on three pieces of legislation: Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ([the VAT Directive](#)); Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax ([the VAT Administrative Cooperation Regulation](#)); Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax ([the VAT Implementing Regulation](#)).

⁶ When these amendments enter into force the MOSS will be referred as the OSS.

⁷ This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'EP supporting analysis'.

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