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DRAFT REPORT

on ways of achieving a definitive VAT system and combating VAT fraud
(2016/2033(INI))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on ways of achieving a definitive VAT system and combating VAT fraud (2016/2033(INI))

The European Parliament,

- having regard to the action plan on VAT put forward by the Commission on 7 April 2016¹,
 - having regard to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax,
 - having regard to Rule 52 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs and the opinions of the Committee on Budgetary Control and the Committee on Civil Liberties, Justice and Home Affairs (A8-0000/2016),
- A. whereas, under Articles 402-404 of the current VAT Directive, the European Union VAT arrangements in place since 1993 are of a provisional and transitional nature only;
- B. whereas, under Article 113 of the Treaty on the Functioning of the European Union (TFEU), the Council shall, acting unanimously, adopt directives for the completion of the common VAT system and, in particular, the progressive curtailment or revocation of exemptions thereto;
- C. whereas the Commission is required every four years to submit to the European Parliament and the Council a report on the functioning of the current VAT system and, in particular, the transitional arrangements;
- D. whereas VAT, which raised almost EUR 1 trillion in 2014, is a major and growing source of revenue in the Member States and contributes to EU own resources;
- E. whereas the current VAT system is vulnerable to fraud and the estimated 'VAT gap' amounts to around EUR 170 billion annually;
- F. whereas the high administrative costs incurred under the present VAT system, especially with regard to cross-border transactions, could be significantly reduced for small and medium-sized enterprises in particular through the necessary reform;
- G. whereas VAT is a tax on consumption that should only be levied on the final consumer so as to achieve a significant reduction in administrative and financial costs along the supply chain and reduce the possibility of fraud;
- H. whereas, although unanimity in the European Council is required for the definitive VAT system to be established, 23 years after the introduction of the VAT Directive, the so called 'standstill derogations' are outdated;

¹ COM(2016) 0148 final.

- I. whereas, over the past two decades, the Commission has initiated over 40 infringement procedures against more than two-thirds of the Member States for breach of the directive;
- J. whereas no majority can be achieved in favour of the country of origin principle regarding a definitive VAT system, since this would require a higher degree of tax-rate harmonisation to prevent massive distortions of competition;
1. Welcomes the Commission's intention to propose a definitive VAT system by 2017 that is simple, fair, robust, efficient and less susceptible to fraud;
 2. Takes the view that the expert advice on which the Commission's proposals for the programme of action are based contains a number of valuable indicators for a robust, simple and fraud-proof VAT system;
 3. Welcomes the recent Commission communication of 7 April 2016 and the projected additional measures designed to prevent fraud and help improve the existing VAT system;
 4. Objects to the narrowing down of the proposed improvements to parts of the existing system, and calls for fundamental reform with a view to removing or at least substantially reducing the problems affecting it;
 5. Takes the view that the Commission should examine all possible options equally without prejudging the outcome and should include them in the legislative process;
 6. Notes that, over the last 23 years, the unanimity requirement in the Council has greatly hampered the necessary VAT reforms and that concerted efforts are needed to reach agreement on a definitive VAT system;
 7. Notes that it is essential for the Member States to adopt a coordinated tax policy in order to combat tax evasion and tax avoidance more effectively and finally close the existing 'VAT gap';
 8. Takes the view that cooperation between the Member State tax authorities has been inadequate in the past and the activities of Eurofisc have to date failed achieve any satisfactory results;
 9. Calls on the authorities responsible to exchange VAT and excise information in particular and to use all available technical means to record cross-border deliveries of goods and services to end-users;
 10. Supports the aim of the action plan to establish a single European VAT area to buttress a deeper and more equitable single market and in order to help promote employment, growth, investment and competitiveness;
 11. Shares the Commission's view that the VAT system decided upon should be based on the principle of taxation in the country which is the final destination of the goods and

services, given that the country-of-origin principle could not be implemented;

12. Calls for technical developments in the digital world to be incorporated in the existing tax models when the VAT system decided upon is introduced, so that the system will be fit for the 21st century;
13. Notes that the current plethora of VAT rates causes great uncertainty for companies involved in cross-border trading;
14. Notes that the current system of reduced VAT rates is inefficient in terms of social policy and redistribution, as is confirmed by the Court of Auditors in its most recent report;
15. Takes the view that the complete abolition of minimum tax rates as an alternative, as advocated by the Commission, might cause considerable distortions of competition and problems in the single market and can only be sanctioned if the reverse charge procedure is introduced for all levels and types of VAT and not only for individual sectors which are particularly susceptible to fraud;
16. Calls instead for a single list of reduced goods and services to be compiled which would allow far fewer exemptions than is currently the case;
17. Takes the view that the present complicated system could be considerably simplified if the goods and services eligible for reduced tax rates were determined jointly at EU level;
18. Calls for products to be subject to the country-of-destination principle of equal taxation irrespective of what form they take or what platform they are purchased on and whether they are delivered digitally or physically;
19. Calls on the Member States to apply VAT equally to private and public companies in areas in which they compete with each other;
20. Notes that the application of a general reverse charge procedure might enable cross-border carousel fraud to be largely eradicated and would significantly reduce the administrative costs for SMEs;
21. Calls on the Commission to conduct pilot projects to test out a general reverse charge procedure in terms of cost, implementation problems and long-term advantages, as some Member States have offered to carry out or have called for;
22. Takes the view that national tax administrations must take greater responsibility for ensuring tax compliance and reducing opportunities for evasion in the reverse charge procedure and in the general implementation of the country-of-destination principle;
23. Notes that a 'one-stop shop' is essential if the country-of-destination principle is to be imposed and made less prone to fraud; calls for a clear definition of which Member State is responsible for tax inspection in the case of cross-border transactions;
24. Calls for all proposals to be studied in order to keep turnover tax for companies, in particular SMEs, cost-neutral as far as possible and to minimise the administrative

burden;

25. Welcomes the Commission's announcement that it will submit an SME package for VAT in 2017;
26. Calls in the short term for a comprehensive internet portal for companies and end-users to find, clearly and easily, information on the VAT rates applicable to individual products and services in the Member States;
27. Takes the view that the VAT reform plans announced by the Commission in the action programme must be subject to comprehensive and qualitatively-sound impact assessments with input from science, tax administrations and companies in the EU;
28. Calls for a treaty change so that the ordinary legislative procedure, with co-decision by Parliament and the Council, can be introduced in the context of the VAT Directive;
29. Instructs its President to forward this resolution to the Council, the Commission and the Member States.

EXPLANATORY STATEMENT

The European Union VAT system in place since 1993 was designed as a provisional arrangement. It was intended that ‘the taxation of trade between Member States’ be superseded by a definitive arrangement based on the principle of taxing goods and services in the country of origin. It is stipulated that the Council shall adopt directives for the completion of the common VAT system and, ‘in particular, the progressive curtailment or revocation of exemptions thereto’. The Commission is required every four years to submit to the European Parliament and the Council a report on the functioning of the common VAT system in the Member States and, in particular, the transitional arrangements.

The Commission communication of 7 April 2016 on an action plan on VAT, stating that the time for reform had come, marked the end of much foot-dragging on the road to a single EU VAT area.

VAT, which raised almost EUR 1 trillion in 2014, is a major and growing source of revenue in the EU. It represents approximately 7% of the Union’s gross domestic product and it provides part of the EU’s own resources. From the outset, the current VAT system has been vulnerable to fraud. Despite numerous initiatives, this problem has so far proved intractable. The Commission estimates that fraud is responsible for an overall ‘VAT gap’ of approximately EUR 170 billion per year, at least EUR 50 billion of which is lost through cross-border fraud.

The need for unanimity among the Member States has proved a particular obstacle to reform of the VAT system. Those Member States which both continue to defend their original old systems and under-perform in terms of their anti-fraud obligations and checks have, until now, delayed or blocked thoroughgoing reform measures.

A comprehensive report on possible proposals for VAT reform has been prepared by an internationally recognised firm of consultants: it sets out a total of five options. Two of these could lead, in a short space of time, to a perceptible reduction in cross-border VAT fraud. The Court of Auditors has also produced a report critically considering the current derogations and proposing that zero-rate VAT should apply only to foodstuffs, while minimum rates should otherwise be largely standardised. For the first few months of 2016 there was no minimum 15% VAT rate because the Commission had been late in submitting the proposal to extend its validity.

In the Commission’s action plan, it declares its intention to bring forward a legislative proposal for definitive VAT arrangements based on the principle of taxation in the country of destination of the goods and services. This marks a decisive shift away from the originally stipulated principle of taxation in the country of origin, which has proved unworkable on account of various problems and instances of distortion of competition. In practical terms it means that the taxation rule whereby suppliers of goods collect the VAT from their customers will be extended to cover cross-border business, significantly reducing the scope for VAT fraud.

In its communication, the Commission states that: ‘Above all, political leadership is needed, to overcome the deep-rooted obstacles that have blocked progress in the past and finally adopt the reforms needed to combat fraud, remove administrative barriers and reduce regulatory costs to simplify life for Europe’s businesses.’ It considers that the complexity of the system makes it difficult for Member States to ensure compliance.

The Commission takes the view that EU companies are at a competitive disadvantage as against third-country suppliers which can supply VAT-free goods to consumers in the EU under the exemption for imports of small consignments. It has therefore undertaken to present a proposal to modernise VAT for cross-border e-commerce. This will centre on the introduction of a one-stop shop mechanism for online sales of tangible goods to final consumers; a common EU-wide simplification measure to help small start-up e-commerce businesses; and the removal of the VAT exemption for imports of small consignments from non-EU suppliers.

To achieve these aims, the Commission proposes improved cooperation between the EU and third countries, an approach also urged by the Court of Auditors on the grounds that the tools for administrative cooperation between tax administrations are under used. The Eurofisc network is deemed inadequate in this regard and not ambitious enough. Measures proposed include cooperation among the Union’s 28 tax administrations and customs authorities and voluntary agreements between companies and tax administrations.

Also on the Commission’s agenda are temporary derogations for Member States to tackle national and structural fraud. Some Member States more heavily affected by VAT fraud have therefore asked to be allowed to implement a temporary generalised reverse charge system which would permit derogation from the general principles of the VAT Directive.

In terms of moving towards a modernised rates policy, the Commission emphasises that the VAT Directive already sets out general rules framing Member States’ freedom to set VAT rates – rules intended to guarantee, above all, the ‘neutrality, simplicity and workability of the VAT system’. The national legislators determine independently their standard rate for all goods and services subject to VAT and decide jointly on a minimum rate. They permit two reduced rates, set at 5% or more, for certain goods and services listed in the VAT Directive. ‘Standstill derogations’, dating back to the establishment of the system or to the years in which Member States joined the Union, and permitting rates significantly lower than 5% in some cases, have outlived their relevance 23 years on from the introduction of the VAT Directive.

The Commission notes that, given the long time-lags for adopting changes in EU legislation, Member States have, in the past, frequently been in breach of the rules, and that it has initiated more than 40 infringement procedures against more than two-thirds of the Member States for breach of the directive. It therefore proposes to set out a reform giving more freedom to Member States while relieving the EU of unnecessary litigation. The Commission has not explored whether this may be inconsistent with competition neutrality or may lead to unfair tax practices.

VAT is a tax on consumption, to be borne by the final consumers of goods or services. One of its chief characteristics is therefore the principle of neutrality, whereby companies should not, if possible, bear the burden of VAT, and all commercial transactions should be taxed, with

only strictly limited derogations permissible.

All VAT reform plans must be subject to comprehensive and qualitatively sound impact assessments with input from researchers and EU tax administrations and companies, with a view to significantly reducing the bureaucracy involved for companies, right from the negotiation stage through to implementation at national level.

Conclusion

The proposed initiatives and the timetable for them certainly do not represent a decisive breakthrough. Eschewing comprehensive reform of the transitional system in place for more than 20 years, the Commission has settled for proposals to strengthen cooperation, aspirations for greater mutual trust among tax administrations, ‘agenda setting’ and further evaluation.

A permanent VAT system could be created by extending reverse charging to all business-to-business transactions Europe-wide. The entire procedure for prior charges and refunds would become redundant under such a model. Where no money is changing hands there is no scope for fraud. There would thus be considerably less distortion of competition.

Moreover, a huge burden would be lifted off companies both financially and in terms of red tape. Accounting would be significantly facilitated. Companies would no longer have to ‘pre-finance’ prior VAT charges. The competitive advantages enjoyed by large companies capable of using VAT refunds as a financial instrument would be lessened. Many instances of non-payment of VAT as a result of insolvency could also be avoided.

A comprehensive reverse charging procedure would, moreover, make for simplification and standardisation, as current arrangements for the coexistence of normal charging, charging on the basis of actual earnings and reverse charging would be largely curtailed. Cross-border traffic, currently subject to varying rules with regard to simplification and registration requirements, would also be facilitated.

The Commission’s reluctance to back the comprehensive application of such a system is incomprehensible. It has already proved highly successful in sectors particularly vulnerable to fraud in a number of Member States. The case has not been made that it is unworkable on a broader scale.