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## NOTE

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From:	Presidency
To:	Council

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No. prev. doc.:	9601/16 FISC 89 ECOFIN 521
Subject:	VAT: Use of the reverse charge mechanism – Presentation by the Commission and exchange of views

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## I. INTRODUCTION

1. As one of the legislative measures to tackle VAT fraud, and, more specifically, the missing trader intra-community fraud (MTIC fraud or "carousel" fraud) a reverse charge mechanism (RCM) for VAT has been built into Council Directive 2006/112/EC<sup>1</sup> (the VAT Directive). As a general rule, the VAT Directive specifies that value added tax (VAT) shall be payable by any taxable person carrying out transactions involving the taxable supply of goods or services. For cross-border transactions and for certain domestic high risk sectors, however, the VAT Directive (Articles 194 to 199b) provides for a reverse charge mechanism (RCM), which shifts the obligation to pay VAT to the person to whom the supply is made (i.e. the RCM is a specific method to collect VAT at the end of the supply chain).

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<sup>1</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11.12.2006, p. 1, as amended.

2. In January 2016, at the request of the delegation of the Czech Republic, the ECOFIN Council held an exchange of views on the wider use of the VAT reverse charge mechanism for domestic transactions, as a potential method for combatting VAT fraud in the EU. That discussion took place on the basis of:
- a) the note by the delegation of the Czech Republic "Combatting VAT fraud in the EU: use of the Reverse Charge Mechanism"<sup>2</sup> (which set out the arguments of the Czech Republic in favour of a derogation from the VAT Directive, permitting wider use of the reverse charge mechanism for domestic transactions), and
  - b) the Presidency steering note<sup>3</sup> (where the political debates and legislative developments that took place in the Council over the recent years have been summarised).
3. At that January 2016 meeting, the Council has invited the Commission, in its upcoming VAT Action Plan to, *inter alia*, "analyse whether a well-designed pilot project for specific Member States, wishing to practically apply VAT reverse charge mechanism in a broader scale, would be feasible and permissible, taking into consideration the risks and possible implications of such a pilot project, including the related legal aspects"<sup>4</sup>.

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<sup>2</sup> See doc. 15196/15 FISC 189 ECOFIN 971 LIMITE.

<sup>3</sup> See doc. 15517/15 FISC 198 ECOFIN 1002 LIMITE.

<sup>4</sup> See doc. 5302/16 PV/CONS 1 ECOFIN 28 LIMITE, point 8.

## II. STATE OF PLAY

4. The Commission Communication on the Action Plan on VAT "Towards a single EU VAT Area – Time to decide" (the VAT Action Plan) was published on 7 April 2016<sup>5</sup>. The Commission states in the VAT Action Plan that, in relation to VAT fraud, "some Member States more heavily affected have asked to be allowed to implement a temporary generalised reverse charge system which would derogate from the general principles of the VAT Directive<sup>6</sup>," and that "The assessment of these derogations will be done without prejudice to the proposals for the implementation of the definitive VAT system to be presented by the Commission. The Commission will report on the state of play of this matter by June of this year" (the extract of the relevant part of the VAT Action Plan is set out in Annex I to this note).
5. At the ECOFIN Council meeting of 25 May 2016 the Council held an exchange of views on the VAT Action Plan<sup>7</sup>, adopted the conclusions as a response to the Commission 2016 Action Plan on VAT<sup>8</sup> and agreed to discuss the issue of VAT reverse charge mechanism at its following meeting in June, in the light of a Commission analysis that it was invited to submit.
6. To be noted, that in these conclusions on the VAT Action Plan, the Council<sup>9</sup>:
  - a) recognised that some Member States are more heavily affected by VAT fraud than others and the need to find practical and short-term solutions rapidly;
  - b) took note of the position of the Commission regarding a possible temporary derogation for certain Member States to apply the reverse charge mechanism in a wider scope and that the implementation of such derogation would require legislative measures;

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<sup>5</sup> COM (2016) 148 final. See also:

[http://ec.europa.eu/taxation\\_customs/taxation/vat/action\\_plan/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/action_plan/index_en.htm)

<sup>6</sup> Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>7</sup> See doc. 9046/16 FISC 77 ECOFIN 404 LIMITE.

<sup>8</sup> See doc. 9494/16 FISC 86 ECOFIN 509.

<sup>9</sup> See doc. 9494/16 FISC 86 ECOFIN 509, points 10 to 12.

- c) confirmed that such derogations should not disproportionately hamper the proper functioning of the internal market;
- d) underlined, without prejudice to a definitive VAT system, that the information obtained from a temporary derogation could be useful to decide on the most efficient way of fighting VAT fraud, and
- e) stated that it looks forward to an in-depth analysis by the Commission on possibilities for a temporary derogation, to be presented at the upcoming June ECOFIN.

7. **DELETED**

8. **DELETED**

9. **DELETED**

### **III. THE WAY FORWARD**

10. Against this background, the Council, on the basis of this note and the presentation by the Commission, is invited to:

- exchange views on the possibilities for interested Member States to introduce, as soon as possible, a temporary derogation from general VAT rules, permitting them to apply generalised reverse charge mechanism for domestic transactions.

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**EXTRACT FROM THE VAT ACTION PLAN**

**"3.5. Temporary derogation for Member States to tackle national and structural fraud**

VAT fraud does not affect all EU countries equally; indeed, the VAT gap varies from less than 5% to more than 40%. Some Member States more heavily affected have asked to be allowed to implement a temporary generalised reverse charge system which would derogate from the general principles of the VAT Directive<sup>10</sup>. These requests would aim at addressing an endemic VAT fraud, taking into account the specificities of the Member States in question.

The Commission recognises the need to find practical and short-term solutions to tackle VAT fraud. While going beyond the possibilities of the current VAT Directive<sup>11</sup> and requiring therefore a legislative change, the Commission takes these requests very seriously and will thoroughly assess their political, legal and economic implications before presenting its conclusions. Such derogations should not disproportionately hamper the proper functioning of the single market and would require unanimity in the Council. This assessment will involve detailed analysis so as to ensure a thorough and accurate understanding of the situation and the possible implications of the temporary derogations. The possible impact on business and tax administrations in particular in terms of adjustment costs as well as fraud shifting to neighbouring countries and retail level will be a critical element to be taken into account.

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<sup>10</sup> Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>11</sup> Article 395 of the VAT Directive.

In any case, credible administrative measures exist and have proved their effectiveness for containing fraud in many Member States. Therefore, the Commission also stands ready to help the Member States concerned to improve their tax collection and inspection capacity. Comprehensive reform programmes based on thorough analysis of the VAT gap and fraud schemes in these Member States and building on best practice could be implemented quickly. This could involve Commission financial support and the expertise of national tax administrations with a good record in this field. In addition Eurofisc could help carry out risk analysis, and joint audits could be launched, for which national tax administrations could volunteer.

The assessment of these derogations will be done without prejudice to the proposals for the implementation of the definitive VAT system to be presented by the Commission. The Commission will report on the state of play of this matter by June of this year."

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