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Delegations will find attached document SWD(2016) 457 final.

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Brussels, 21.12.2016  
SWD(2016) 457 final

**COMMISSION STAFF WORKING DOCUMENT**

**IMPACT ASSESSMENT**

**Generalised reverse charge mechanism**

*Accompanying the document*

**Proposal for a Council Directive**

**amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of the generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold**

{COM(2016) 811 final}  
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## 1. INTRODUCTION AND POLICY CONTEXT

### 1.1. Common system of value added tax

The common system of value added tax (VAT) is a major and growing source of revenue in the European Union (EU), raising almost EUR 1 trillion in 2014, which corresponds to 7% of EU GDP or 17.5 % of national tax revenues, including social contributions<sup>1</sup>. One of the EU's own resources is also based on VAT (13% of EU budget in 2014<sup>2</sup>). As a broad-based consumption tax, it is considered as one of the most growth-friendly forms of taxation.

However, huge sums of VAT are being lost each year due to tax fraud and evasion. Research shows that the overall difference between the expected VAT revenue and the amount actually collected (the so-called 'VAT Gap') amounted to nearly EUR 160 billion in the EU in 2014<sup>3</sup>. About EUR 50 billion out of this would be due to carousel fraud (see further explanations below, in particular box 6). This illegally deprives Member States' public budgets of money but also creates unfair competition between compliant and non-compliant businesses.

VAT is governed by the VAT Directive<sup>4</sup>. It ensures that the principles underlying the functioning of this tax apply consistently in all EU Member States in order to prevent distortions of competition and allow free movement of goods and services within the EU.

VAT is assessed on the value added to goods and services that are bought and sold for use or consumption in the EU<sup>5</sup>. VAT is collected fractionally by businesses<sup>6</sup> and, as a consumption tax, is borne ultimately by the final consumer<sup>7</sup>.

This system of partial payments allows the collection of the tax at each stage in the production and distribution chain<sup>8</sup> and ensures the self-policing character of this tax (see box 1 below).

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<sup>1</sup> Eurostat.

<sup>2</sup> Multiannual financial framework 2014-2020 and EU budget 2014. See <http://bookshop.europa.eu/en/multiannual-financial-framework-2014-2020-and-eu-budget-2014-pbKV0413055/?CatalogCategoryID=mpgKABstFogAAAEjbiUY4e5K>

<sup>3</sup> [http://europa.eu/rapid/press-release\\_IP-16-2936\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-16-2936_en.htm?locale=en)

<sup>4</sup> Council Directive 2006/112/EC of 28 November 2006 – as amended (<http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02006L0112-20150101&from=EN>).

<sup>5</sup> Further explanations on the common VAT system can be found here: [http://ec.europa.eu/taxation\\_customs/taxation/vat/what\\_is\\_vat/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/what_is_vat/index_en.htm)

<sup>6</sup> Reference is made to “businesses” for simplification reasons but the correct terminology would be “taxable persons”. The scope of the concept of “taxable persons” can be found in Articles 9 to 13 of the [VAT Directive](#).

<sup>7</sup> A final consumer means for VAT purposes the last person in a production/distribution chain that is not allowed to deduct the VAT he paid on his purchases (contrary to VAT taxable persons who can do so).

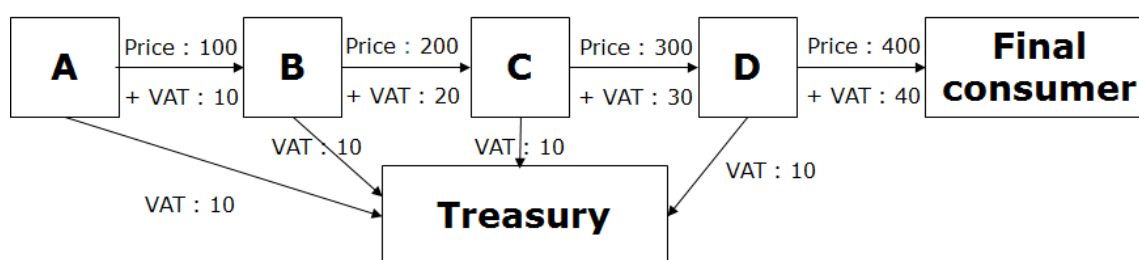
<sup>8</sup> The amount of tax collected at a particular stage corresponds to the tax on the value added at this stage.

### **Box 1: Current VAT system based on fractionated payments**

On each supply made by a business, VAT is charged to its customers at the rate applicable. This business then deducts from the VAT collected from its customers the amount of tax it has paid to other businesses on purchases for its own business activities. Where the customer is also a business, this system is replicated until it reaches the final consumer. At this last stage of the supply chain, the VAT is no more deductible and the tax is definitively vested to the Treasury.

Example: VAT rate is 10%

A, B, C and D are businesses, i.e. taxable persons with right to deduct input VAT



A sells goods to B for 100 and charges 10 VAT which is paid over to the Treasury. B supplies these goods for a total amount of 220 (including 20 VAT) to C. B deducts its input VAT of 10 from the 20 received from C and pays the difference of 10 to the Treasury. C sells these goods on for 330 (including 30 VAT) to D. C deducts its input VAT of 20 from the 30 received from D and pays the difference of 10 to the Treasury. Finally, D sells the goods for 440 (including 40 VAT) to a final consumer. D deducts its input VAT of 30 from the 40 received and pays the difference of 10 to the Treasury.

At each stage, VAT is paid to the Treasury on the added-value; i.e. the difference between the VAT received from the buyer and the price paid to the supplier.

The self-policing character of the VAT system is linked to the need for each customer to pay the VAT to its supplier and to hold an invoice to be allowed to deduct the VAT paid to its supplier who, in turn, is discouraged from evading taxes (as it has issued an invoice). In case of fraud by the retailer or a supplier in the chain, 10 € is lost, but not the total amount of 40 €.

## **1.2. Scope of the proposed initiative: the generalised reverse charge mechanism (GRCM)**

The proposed initiative, which is the subject of this impact assessment, aims at allowing individual Member States to derogate, under certain circumstances, from the common VAT system so as to apply another arrangement for the collection of the tax with a view to better tackle tax fraud, in particular the typical intra-EU cross-border fraud, better known as “carousel fraud”<sup>9</sup>.

<sup>9</sup> The wording “carousel fraud” is used in this document to refer to the typical intra-EU cross-border fraud as further explained under point 2.2.1 below.

This derogation consists of the so-called “*generalised reverse charge mechanism*” (GRCM) implying that the tax due on all business-to-business (B2B) transactions is no more collected via partial payments (as explained under box 1 above) but is instead collected only at the final stage of the supply chain (see box 2 below).

Reverse charge allows concentrating the collection and control of the tax on a particular person (e.g. the customer). It can therefore be useful in sectors<sup>10</sup> highly sensitive to fraud, involving transactions of a huge amount and in which there are mostly B2B transactions. It is particularly useful in situations where purchases are made VAT-free (see notably further explanations on carousel fraud under box 6 below) or where the input VAT of a business is far lower than its output VAT. This is because the reverse charge mechanism prevents the supplier from collecting the VAT and not remitting it to the Treasury.

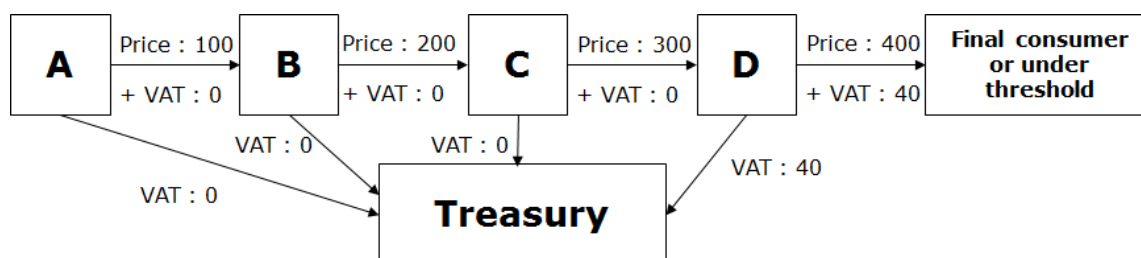
The VAT Directive already allows Member States to apply a reverse charge mechanism but only to particular sectors and under well-defined circumstances (see sectorial reverse charge mechanism under box 3 below). Indeed, such a mechanism constitutes a breach to the fractionated payment system and, as will be developed further on, entails new challenges to tax administrations and businesses in terms of tax collection monitoring.

**Box 2: Generalised reverse charge mechanism (GRCM)**

*Under a GRCM, the payment of the VAT that would be due on the supplies made between businesses is suspended and the VAT is only due at the last stage of the supply chain on the total amount of the value of the final supply. The final supply is either a supply made by a business to a final consumer or a supply made by a business to another business but for an amount that is below a certain threshold<sup>11</sup>.*

*Example: VAT rate is 10%*

*A, B, C and D are businesses, i.e. taxable persons with right to deduct input VAT*



*A supplies goods to B for 100, no VAT is charged and, therefore, no VAT is actually paid over to the Treasury. In the same way, B charges a price of 200 to C without VAT. Again, no actual payment of VAT takes place. C supplies to D for 300, again with no VAT paid to the Treasury. Finally, D supplies for 440 (including 40 VAT) to a final consumer (or to another business but for an amount below a certain threshold) in which case the VAT has to applied. In this situation, the collection of the VAT takes place at the end of the supply chain and for the total amount of VAT due (10% of 400).*

<sup>10</sup> The wordings “sector” and “sectorial” in this document refer to a particular business activity (e.g. supply of immovable property, mobile telephones, telecommunications services) in the same logic as listed in Articles 199, 199a or 199b of the VAT Directive.

<sup>11</sup> Further explanations on this threshold are provided under point 5.3 below.



*Since no VAT is paid between businesses, VAT cannot in principle be evaded. However, in case of fraud by the retailer or the business supplying under the threshold (business D), 40 € is lost, i.e. the total amount of VAT due.*

### **1.3. Comparison of initiative with existing legislation in the area of reverse charge mechanism**

As mentioned above, the VAT Directive already gives the Member States the possibility to apply a reverse charge mechanism under well-defined circumstances (see further explanations in the box 3 below). However, a generalised reverse charge mechanism means that all kind of supplies (in goods and in services) made between businesses (and possibly above a certain threshold) within a Member State would be subject to this mechanism. As will be explained further on, such a “generalised” system avoids that fraud stopped in one sector shifts to another sector. However, this would equate to applying de facto a totally different tax collection system, comparable to a sales tax.

#### ***Box 3: Reverse charge mechanism currently applicable under certain circumstances (sectorial reverse charge mechanism)***

*As a rule, the supplier of a good or a service is considered for VAT purposes as the person liable to pay the VAT to the Treasury (Article 193 of the VAT Directive). Under a reverse charge mechanism this obligation is moved to another person, in general the customer, in which case we refer to a “reverse charge”.*

*The VAT Directive already gives the possibility to Member States to apply a reverse charge mechanism to a limited number of transactions under specific conditions. The reason is either to simplify the tax collection (tax can under certain circumstances be more easily collected from another person, e.g. the customer, the retailer) or the need to prevent fraud in some sectors that are more sensitive (secure the tax by collecting it directly from the person who pays for it).*

*The Member States may apply a reverse charge mechanism in the following sectors:*

- for certain transactions such as construction works, immovable property supplies, used material or waste supplies (Article 199 of the VAT Directive);*
- on a temporary basis for specific supplies such as the transfer of allowances to emit greenhouse gases, mobile phones, integrated circuits, game consoles or cereal supplies (Article 199a of the VAT Directive).*

*In cases of imperative urgency, Member States may also, under certain conditions, be allowed to apply the reverse charge mechanism to particular supplies of goods or services. This is known as the Quick Reaction Mechanism (QRM) foreseen by Article 199b of the VAT Directive, aimed to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses.*

*Finally, Member States can ask for a derogation to apply a reverse charge mechanism to particular sectors on the basis of Article 395 of the VAT Directive. However, according to the case law of the Court of Justice of the European Union (CJEU), measures taken in application of Article 395 of the VAT Directive in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance, have to be*

*necessary and appropriate for realising the specific objective which they pursue and have as little effect as possible on the objectives and principles of the VAT Directive<sup>12</sup>.*

*A detailed description of the sectors to which the reverse charge mechanism applies in each Member State is available in a study carried out for the Commission<sup>13</sup> and further explanations are provided under point 2.1.1.3 below.*

## **1.4. Context of the initiative**

### *1.4.1. Medium term measure to tackle the VAT gap*

The Action Plan on VAT (Action Plan) adopted on 7 April 2016<sup>14</sup> by the Commission sets out the objectives and measures envisaged by the Commission to modernise the EU VAT system. It builds on the work carried out since the Commission Communication on the future of VAT on 6 December 2011<sup>15</sup> that followed the large consultation process initiated by the Commission with its Green Paper on the future of VAT<sup>16</sup>.

The creation of a robust single European VAT area is one of the key actions announced by the Commission in its Action Plan. It will require the setting up of the definitive VAT system<sup>17</sup> for intra-EU B2B cross-border trade (see box 4 below). As agreed by the European Parliament<sup>18</sup> and the Council<sup>19</sup>, this definitive VAT system will be based on the principle of taxation in the country of destination of the goods (the so called “destination principle”) (see explanations in box 4 below).

On the basis of this confirmed objective to implement a definitive VAT regime based on the destination principle, the Commission proceeded with in-depth technical work and broad-based dialogue with the Member States<sup>20</sup> and businesses<sup>21</sup> with a view to examine in

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<sup>12</sup> See for example case C-489/09, *Vandoorne NV*, paragraph 27.

<sup>13</sup> EY, 2014 (see complete reference in Annex 4).

<sup>14</sup> COM(2016)148 final of 7.4.2016.

<sup>15</sup> COM(2011) 851. See [https://ec.europa.eu/taxation\\_customs/business/vat/action-plan-vat/communication-future-vat\\_en](https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat/communication-future-vat_en)

<sup>16</sup> COM(2010) 695. See [https://ec.europa.eu/taxation\\_customs/business/vat/action-plan-vat/communication-future-vat\\_en](https://ec.europa.eu/taxation_customs/business/vat/action-plan-vat/communication-future-vat_en)

<sup>17</sup> The present VAT system applicable to business-to-business intra-EU trade has been in place since 1993 and was supposed to be transitional. This transitional system is too sensitive to fraud and also cumbersome for businesses. Work is on-going on the way to implement a definitive VAT system. For further information on this, see explanations in box 4 below.

<sup>18</sup> See Resolution on <http://eur-lex.europa.eu/procedure/EN/199945>

<sup>19</sup> See in particular point B, 4) of Council conclusions on the future of VAT adopted on 15 May 2012 on [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/130268.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130268.pdf)

<sup>20</sup> Formalised in the GFV (Group on the Future of VAT - see also Annex 2). The GFV provides a forum for discussion with VAT Experts from the Member States on the Commission pre-legislative initiatives and exchange of opinions on the preparation of future VAT legislation.

<sup>21</sup> Formalised in the VAT Expert Group (VEG – see also Annex 2). The VEG is composed of individuals with the requisite expertise in the area of VAT and organisations representing in particular businesses, consumers and tax practitioners.

detail the different possible ways to implement the destination principle, including the implementation of a GRCM<sup>22</sup>.

Preparatory work for the impact assessment on the implementation of this destination principle is ongoing but preliminary results show that taxing intra-EU transactions comes out as the best option when taking into account the reduction in VAT fraud and compliance costs<sup>23</sup>. Therefore, the Commission announced its intention to present a legislative proposal in 2017 for the definitive VAT system for cross-border trade based on this “taxation” option (see box 5 below). During its meeting of 25 May 2016<sup>24</sup>, the Council took note of this intention. This initiative is not subject of this impact assessment. However it is referred to its preliminary results because of its close connection with the initiative that is here being assessed.

#### 1.4.2. *Urgent measures to tackle the VAT gap*

Although preliminary results on the above mentioned taxation option are very promising, preparing and adopting such a major change is likely to take some time. The definitive VAT system would notably require more trust and cooperation between tax administrations<sup>25</sup>. The efficiency in collecting VAT and fighting fraud between tax administrations would therefore need to be aligned to the highest level. In order to ensure a smooth transition for businesses and allow all Member States to reach higher levels of cooperation and administrative capacity, the Commission recognized the need to work in parallel on other linked initiatives, in particular on urgent measures to tackle the VAT gap between expected revenue and revenue actually collected<sup>26</sup>. These include so-called “conventional measures” (points 3.1 to 3.4 of the Action Plan) as well as a temporary derogation for Member States (point 3.5 of the Action Plan).

##### 1.4.2.1. Conventional measures

The Commission announced 20 measures<sup>27</sup> meant to take urgent action on the following fronts in 2016 and 2017:

- Improving cooperation within the EU and with non-EU countries;
- Towards more efficient tax administrations;
- Improving voluntary compliance and tax collection.

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<sup>22</sup> See [Roadmap on Action Plan on VAT](#) for more detailed information on the concept of “definitive VAT system” and work on the different options to implement it.

<sup>23</sup> Compliance costs to businesses relate to those costs that are directly borne by businesses to the management of the VAT rules.

<sup>24</sup> See Council conclusions on [http://www.consilium.europa.eu/press-releases-pdf/2016/5/47244641288\\_en.pdf](http://www.consilium.europa.eu/press-releases-pdf/2016/5/47244641288_en.pdf)

<sup>25</sup> The Member State where the goods arrive would have to rely on the Member State of departure to collect the VAT due on the cross-border supply.

<sup>26</sup> The urgent measures are listed under point 3 of the Action Plan.

<sup>27</sup> [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/2016-03\\_20\\_measures\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/2016-03_20_measures_en.pdf)

In order to help the Member States concerned to improve their tax collection and inspection capacity, the Commission also declared to be prepared to provide specific technical assistance. A summary of how such a technical assistance could be organised and what it should aim at is annexed (see Annex 5).

In this context, the adoption of the Commission proposal for a Directive on the fight against fraud to the Union's financial interests by means of criminal law<sup>28</sup> to cover serious EU-wide VAT fraud and the proposal for a Regulation on the establishment of a European Public Prosecutor's Office<sup>29</sup> may also play a significant role.

#### 1.4.2.2. Temporary derogation for Member States

Some of the above-mentioned “conventional measures” are expected to improve VAT collection in all Member States in the short term. However, part of these measures would need legislation to be adopted unanimously at EU level, which means their implementation might take some more time. As will be shown further on, some Member States are more heavily affected by carousel fraud and therefore the Commission recognised the need to find practical and short-term solutions that would take into account the specificities of the Member States in question. In particular, it accepted to examine in detail the requests from Austria and the Czech Republic, to be granted a temporary derogation to the VAT Directive to apply a GRCM.

It has to be recalled that the application of a GRCM on the basis of Article 395 of the VAT Directive has been the subject of previous requests from Austria, Bulgaria, the Czech Republic and Slovakia, requests that were rejected on legal grounds following the Communication from the Commission to the Council<sup>30</sup>.

As announced in its Action Plan, and further to discussions at the ECOFIN meeting of 25 April 2016, the Commission assessed the political, legal and economic implications of such derogation and presented its conclusions at the ECOFIN meeting of 17 June 2016. These conclusions were not overwhelmingly positive as risks were identified as regards new forms of carousel fraud, shift of fraud towards other Member States or to the retail level and increased burden on business. Concerns on all these issues were also raised by stakeholders, including respondents to the Green Paper consultation (see Annex 2) and in particular in the context of the REFIT platform<sup>31</sup>. The Stakeholder group, notably business representatives, opposed to the application of an optional GRCM, arguing that it cannot solve VAT fraud and that it creates instead barriers to the internal market and increases regulatory burden.

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<sup>28</sup> COM(2012) 363, 11.07.2012, Proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law.

<sup>29</sup> COM(2013) 534, 17.07.2013, Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office.

<sup>30</sup> COM (2015) 538 of 28.10.2015

<sup>31</sup> [http://ec.europa.eu/smart-regulation/refit/refit-platform/docs/recommendations/opinion\\_taxation\\_1a.pdf](http://ec.europa.eu/smart-regulation/refit/refit-platform/docs/recommendations/opinion_taxation_1a.pdf)

However, as argued by a group of Member States in the GFV and in the Council, the Commission acknowledged that a temporary derogation might be useful in the short term, provided that it does not disproportionately hamper the proper functioning of the internal market. In addition, it was made clear that the granting of such derogation should be without prejudice to the proposals for the implementation of the definitive VAT system to be presented by the Commission.

In the context of a global political agreement on the Anti-Tax Avoidance Directive proposal (ATAD)<sup>32</sup>, the Commission therefore made the following statement to the ECOFIN minutes of 17 June 2016:

*"The Commission commits to present, before the end of the year, a legislative proposal allowing individual Member States to derogate from the common system of value added tax so as to apply a generalised reverse charge mechanism to domestic supplies above a defined threshold and preserving the Internal Market."*

This political commitment of the Commission forms the basis of the content as well as the timing of the legislative initiative to which the present impact assessment is linked. For the reasons explained above, it is to note that the purpose of the legislative proposal is limited in scope and in time, as work shall continue in building the definitive VAT system. The initiative is meant to be a temporary measure aiming at helping individual Member States in their fight against fraud, as announced in the Action Plan, pending the implementation of a definitive VAT system.

***Box 4: Transitional and definitive VAT system - Origin-based and destination-based definitive VAT system***

*At the time the common system of VAT was established<sup>33</sup>, the commitment was made to establish a definitive VAT system operating within the European Union (EU) in the same way as it would operate within a single country. The need to abolish physical borders between Member States by the end of 1992 made it necessary to reconsider the way in which trade in goods was taxed in the EU. The goal was that goods would be taxed in the country of origin (Member State of departure of the goods), so that the same conditions that apply to domestic trade would apply to trade within the EU, perfectly reflecting the idea of a genuine internal market.*

*Since the political and technical conditions<sup>34</sup> were not ripe for such a system, transitional VAT arrangements were adopted. These arrangements split the cross-border movement of goods into two different transactions: an exempt intra-EU supply and an intra-EU acquisition taxed in the country of destination. This system is de facto based on the taxation in the Member State of destination of the goods (Member State of arrival of the goods).*

<sup>32</sup> See details on [https://ec.europa.eu/taxation\\_customs/business/company-tax/anti-tax-avoidance-package\\_en](https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en)

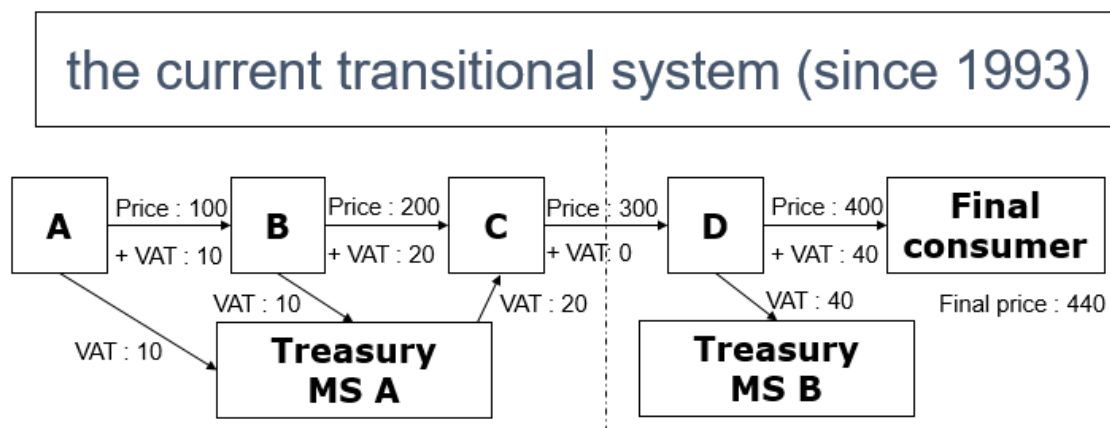
<sup>33</sup> First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax.

<sup>34</sup> An origin based system requires a clearing system to reattribute VAT receipts to the Member State of consumption. It implies a high degree of confidence between Member States and a high level of harmonisation of rates and exemptions, in order to avoid distortions of competition.

*These rules were regarded as temporary (initially 4 years) and present an important drawback: allowing goods to be bought abroad free of VAT increases the opportunity for fraud.*

*Since the basic requirements for an origin-based system have proved not to be achievable more than 20 years later, despite several attempts in that direction, the Commission, in agreement with the European Parliament and the Council, decided to work on implementing the destination principle for intra-EU supplies of goods. After having examined in detail the possible options for implementing the destination principle, the Commission announced its intention (see Action Plan), and the Council took note of it, to present a legislative proposal in 2017 for the definitive VAT system for cross-border trade based on the best scoring option, i.e. the so-called “taxation” option. This option consists in taxing all intra-EU transactions (while still tracking the flow of the goods), just like would be the case for domestic transactions. This option is meant to put an end to carousel fraud. To note that the European Parliament is currently examining the VAT Action Plan but has not adopted a resolution on the text yet.*

**Box 5 – Intra-EU transactions: current transitional VAT system and definitive VAT system**

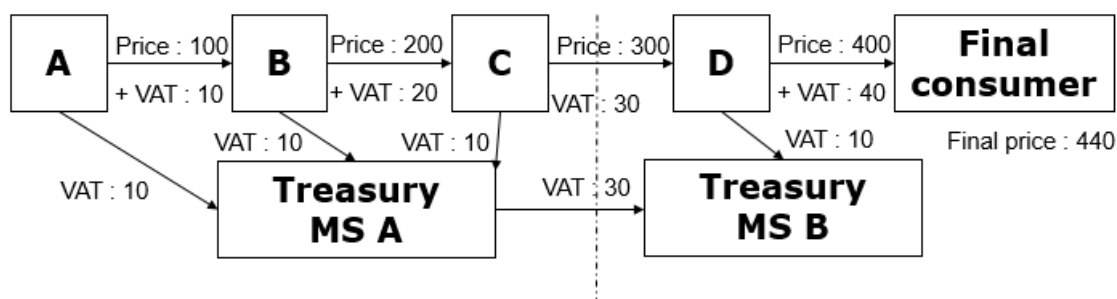


*In a cross-border B2B transaction (in the graph transaction between C and D), C in Member State A sells goods to D in Member State B without VAT being added, because cross-border transactions are exempt from VAT (the fractioned payment taking place in the preceding stages, A-B-C, is interrupted between C and D). The VAT is paid to the Treasury of Member State B when the product has been sold to the final consumer.*

*This VAT system is open to fraud, e.g. where the ‘retailer’ in Member State B could buy the goods VAT free then charges VAT to the final consumer, but does not pay the VAT to the Treasury. This is the typical EU cross-border fraud (carousel fraud) linked to the current transitional VAT system.*

## definitive VAT regime – destination based

**Taxation of intraEU supplies in the same way as domestic operations**



In a cross-border B2B transaction (in the graph transaction between C and D), C in Member State A sells goods to D in Member State B. D in Member State B pays the supplier the sale price + VAT at the rate applicable in Member State B (the fractioned payment taking place in the preceding stages, A-B-C, is no more interrupted between C and D). This VAT is collected by the Treasury of Member State A and transferred to the Treasury of Member State B. This system reduces carousel fraud linked to goods being purchased VAT-free.

## 2. WHAT IS THE PROBLEM AND WHY IS IT A PROBLEM?

### 2.1. The problem

#### 2.1.1. VAT fraud affecting more specifically certain Member States

Tax fraud affects all Member States but the specific problem that the present initiative intends to tackle is that some Member States are more heavily affected than others, in particular by carousel fraud.

##### 2.1.1.1. Current VAT gap, carousel fraud and domestic fraud

The size of the VAT fraud is difficult to measure but the VAT gap<sup>35</sup> offers a useful indicator. The overall EU VAT gap is estimated at almost EUR 160 billion revenue loss each year<sup>36</sup>, out of which about EUR 50 billion<sup>37</sup> would be due to carousel fraud alone<sup>38</sup>.

<sup>35</sup> The VAT Gap is a measure of VAT compliance and enforcement that provides an estimate of revenue loss due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies, as well as miscalculations. The VAT gap is defined as the difference between the VAT revenue expected (the VAT Total Tax Liability or VTTL) and the VAT actually collected by national authorities. It is expressed in both absolute and relative terms.

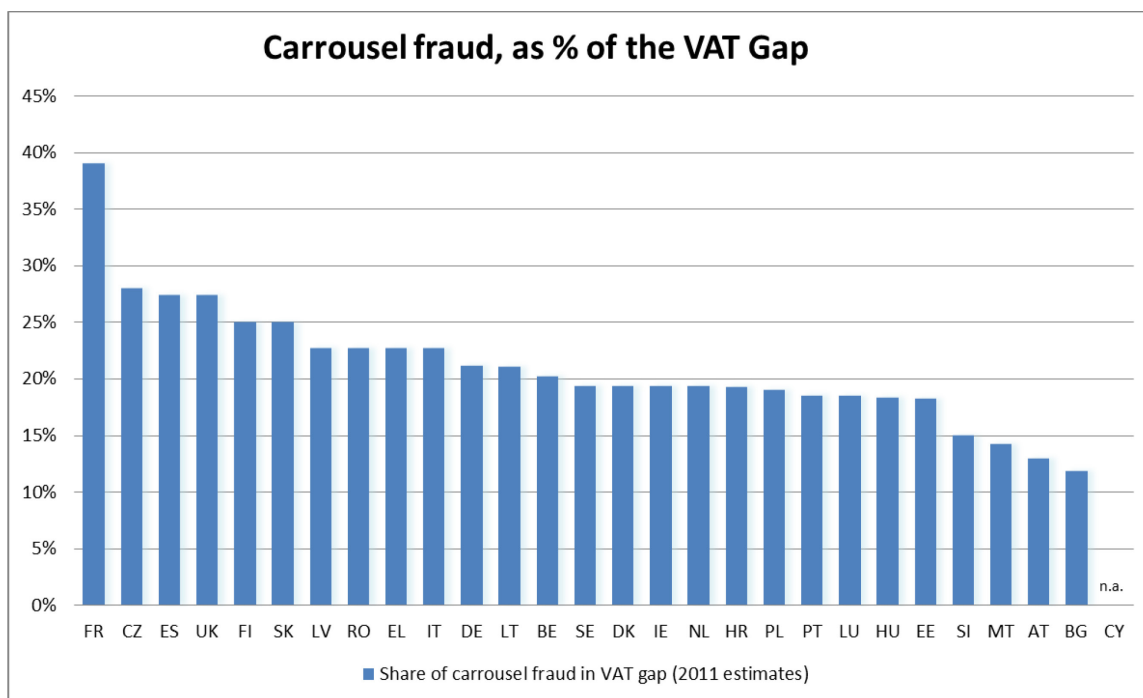
<sup>36</sup> CASE, 2016 (see complete reference in Annex 4).

<sup>37</sup> EY, 2015 (see complete reference in Annex 4).

<sup>38</sup> See further explanations in box 6 below.

The carousel fraud portion of the VAT gap ranges from 12% in Bulgaria to 39% in France (see Figure 1 below on share of carousel fraud in VAT gap). On average (weighted average), it is estimated that 24% of the overall VAT gap proportion is considered to be due to carousel fraud. The rest of the VAT gap is attributed to losses of revenue due to domestic fraud and evasion, tax avoidance, bankruptcies, financial insolvencies, as well as miscalculations.

**Figure 1 – Share of carousel fraud in VAT gap (source "Own calculations" based on EY, 2015 study)**

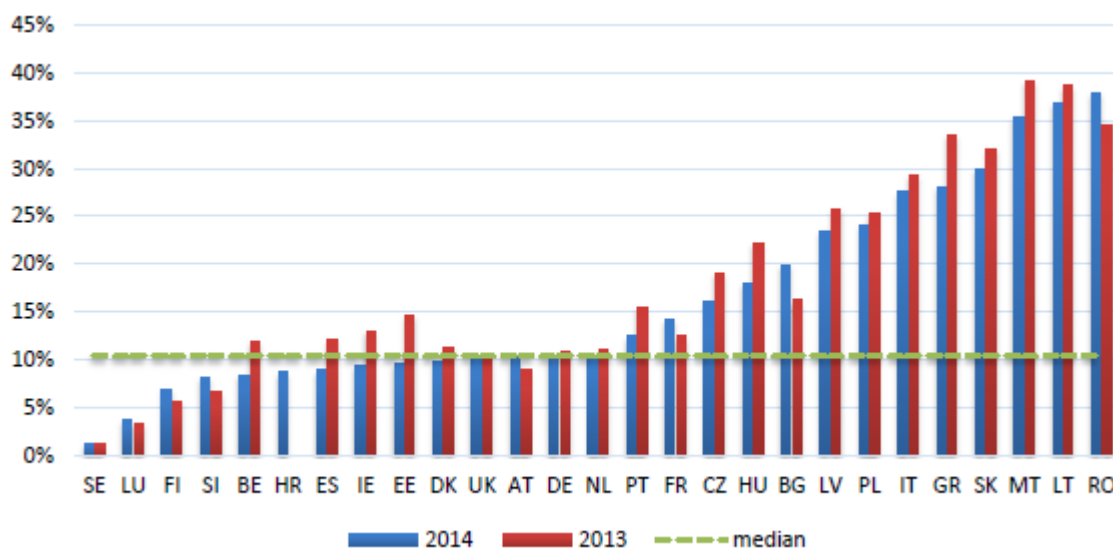


The VAT gap varies considerably between Member States<sup>39</sup>. The smallest gaps are observed in Sweden (1.24%), Luxembourg (3.80%), and Finland (6.92%). The largest Gaps are registered in Romania (37.89%), Lithuania (36.84%) and Malta (35.32%). Overall, half of the EU-27 Member States record a gap below 10.4% (see Figure 2 below).

<sup>39</sup> CASE, 2016.



**Figure 2: VAT Gap as a percent of the VAT Total Tax Liability (VTTL) in EU-27 Member States, 2014 and 2013 (source CASE, 2016)**



2.1.1.2. Evolution of the VAT gap and carousel fraud in individual Member States

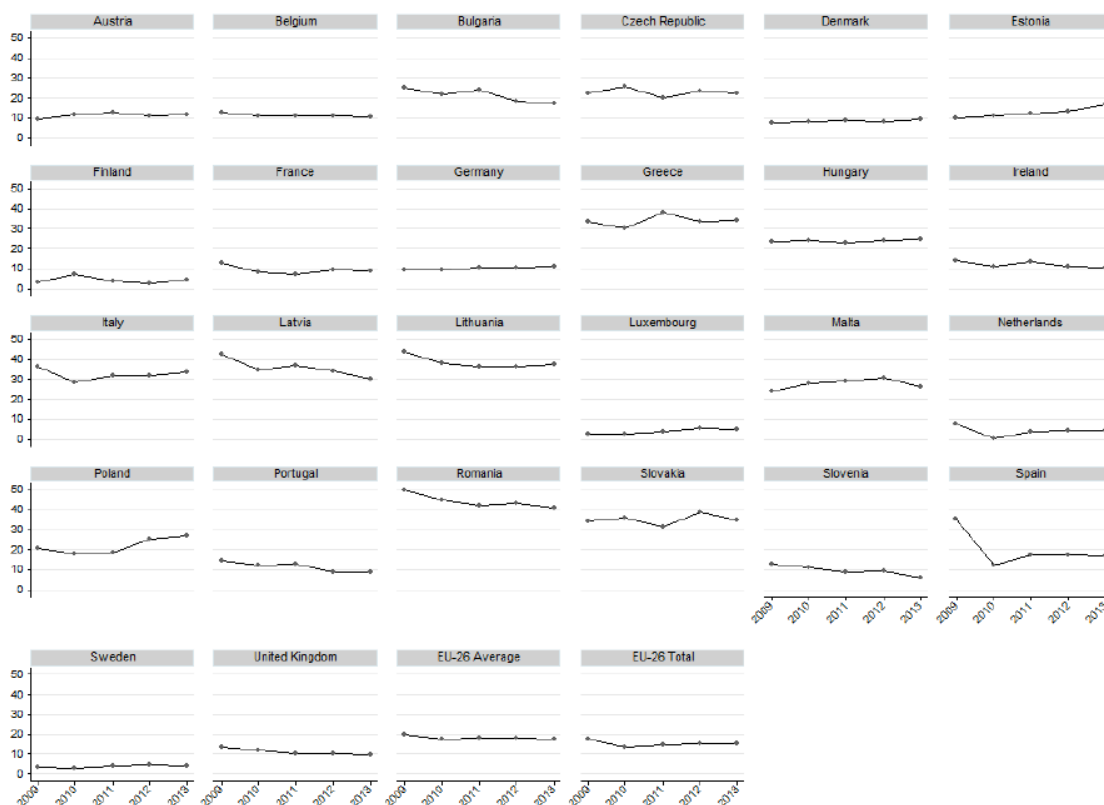
Monitoring at EU level of VAT collection by individual Member States is relatively recent as the first study on the VAT gap dates back from 2009. Methodology has been continually improved and the annual updates of the study always included the latest revised figures. Although the Commission is working on methods to extract data on fraud from the VAT gap, this information is still not available today. The above estimations on carousel fraud were provided by one specific study and, contrary to the VAT gap study, no further data on its trend evolution is available.

The trend of the VAT Gap over the period 2009-2013 is shown in Figure 3 below. Member States have tended to slightly reduce their gap compared to the beginning of the period (at the depth of the recent recession). For the EU-26 as a whole, the VAT gap declined by 4 percentage points, from 19 to 15 percent<sup>40</sup>.

Information on the VAT gap and on carousel fraud for the period 1993-2009 (the period that followed the entry into force of the present intra-EU system put in place at the time the internal borders were dismantled) is not available, although it is likely that carousel fraud (which finds its roots in the way this system is designed) has taken a few years to appear and to develop.

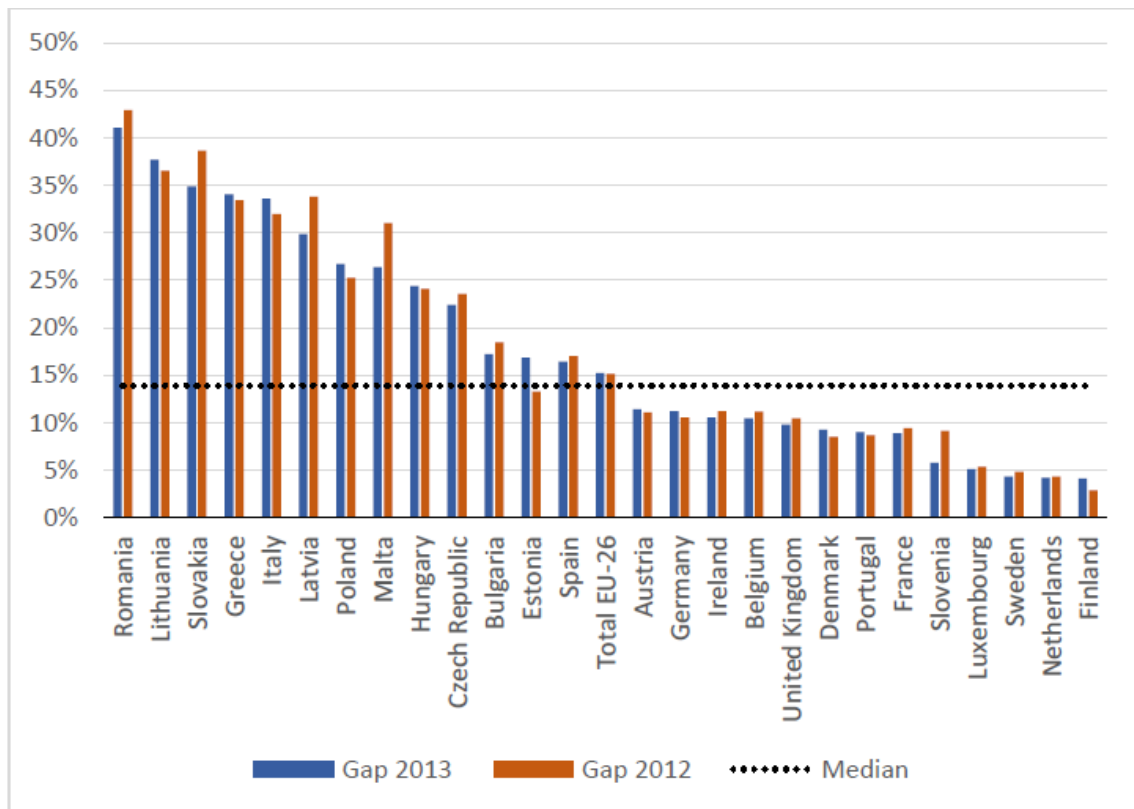
<sup>40</sup> CASE, 2015 (see complete reference in Annex 4).

**Figure 3 – VAT Gap in the EU-26 countries, 2009-2013 (source CASE, 2015)**



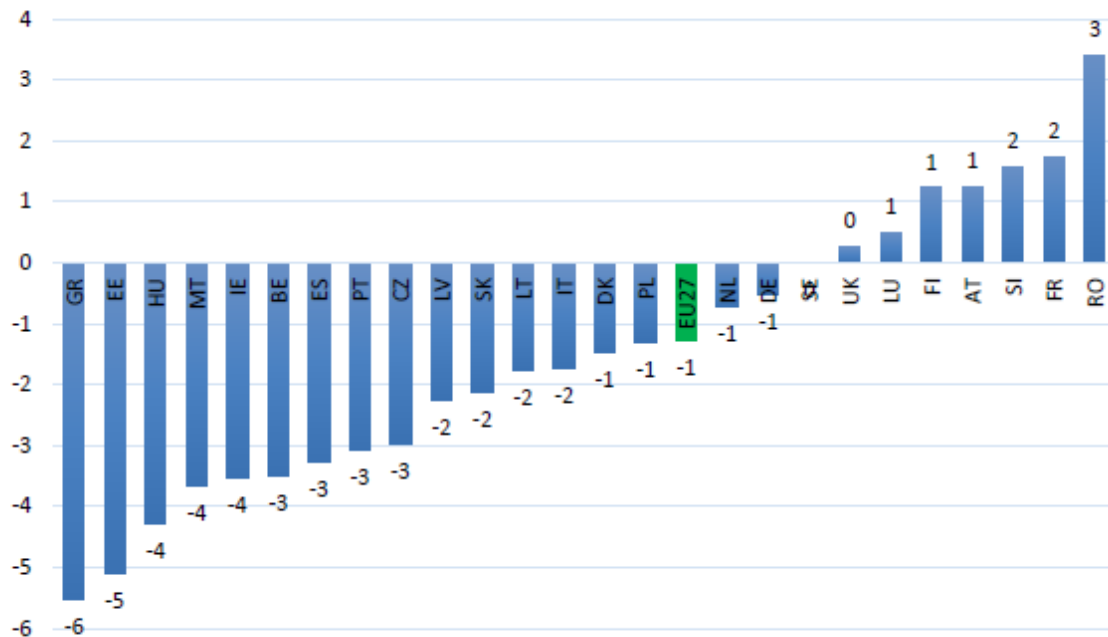
In 2013, the VAT Gap in individual Member States ranged from a minimum of 4 percent in Finland, the Netherlands and Sweden, to a maximum of 41 percent in Romania (see Figure 4 below). Over the period 2012-2013, overall, 15 Member States decreased their VAT Gap, with the largest improvements noted in Latvia, Malta and Slovakia. 11 Member States saw an increase in the VAT Gap, generally of small magnitudes, with the highest deteriorations in Estonia and Italy.

**Figure 4 – VAT Gap in the EU-26 countries, 2012-2013 (source CASE, 2015)**



In 2014, the VAT Gap reached 14% on average. Compared to 2013, changes in the rank of the Member States were, in general, not large. Estonia experienced the largest change in the EU-wide rank (from 14th to 7th place in 2014 – see Figure 2 above). The VAT gap decreased in 18 Member States, with the largest improvements noted in Greece, Estonia and Hungary (see Figure 5 below). However 8 out of the 26 Member States, namely the United Kingdom, Luxembourg, Finland, Austria, Slovenia, France, Romania, and Bulgaria, saw an incline in their share of the VAT Gap, with the largest deteriorations in Romania and Bulgaria (see Figure 2 above and Figure 5 below).

**Figure 5: Percentage Point Change in VAT Gap (2014 over 2013) (source CASE, 2016)**



### 2.1.1.3. Efficiency of the measures to combat fraud - Sectorial reverse charge mechanism

The year 2014 saw numerous changes in tax enforcement and monitoring which contributed to reducing the VAT gap in several Member States, such as anti-smuggling measures, electronic reporting functionalities and limits on cash transactions<sup>41</sup>.

Although the VAT gap shows an encouraging downwards trend, it is still a staggering figure (EUR 160 billion) and individual performances of Member States vary enormously when it comes to VAT compliance.

#### *Taking stock on sectorial reverse charge mechanism*

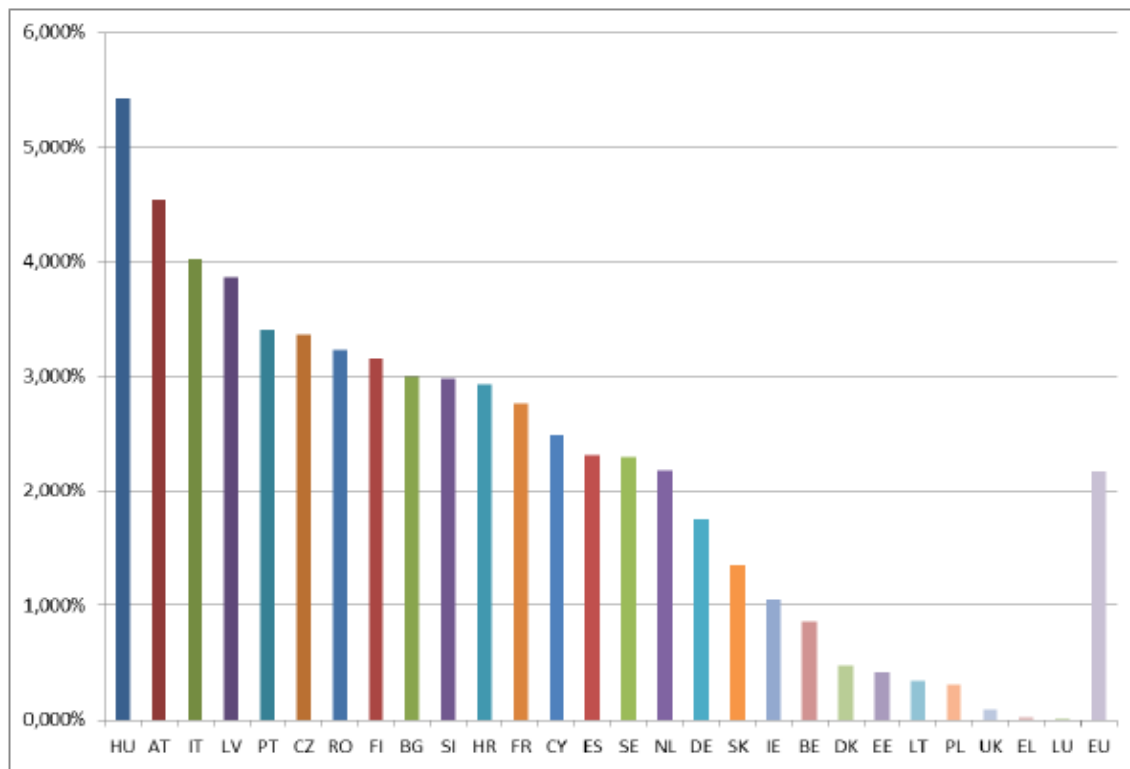
In about half of the Member States (16)<sup>42</sup>, the currently applied reverse charge mechanism represents between 1% and 4% of their respective overall economy i.e. GVA<sup>43</sup>. There are however some exceptions such as Hungary, Austria and Italy where the application of the reverse charge mechanism are wider. This brings the average for the countries covered to 2.17% (see Figure 6 below).

<sup>41</sup> CASE, 2016. To note that no such information is available at EU level for the years before.

<sup>42</sup> EY, 2014.

<sup>43</sup> According to the Eurostat definition, Gross Value Added (GVA) can be defined as output at market prices minus intermediate consumption at purchaser prices. GVA can be broken down by industry. The sum of GVA at basic prices for all industries plus taxes on products minus subsidies on products gives the gross domestic product (“GDP”). The GVA of the total economy usually accounts for more than 90 % of GDP.

**Figure 6: Importance of the applied reverse charge mechanism in all Member States compared to the overall economy based on the 2011 available data (source EY, 2014)**



In 2014, the reverse charge mechanism has been extended to new sectors in 6 Member States, namely Denmark, Germany, Italy, Hungary, Austria and Romania.

A small decline in the VAT gap was observed in Denmark, Germany, Italy (1 percentage point) and a larger one in Hungary (4 percentage points). A slight increase in the VAT gap was observed in Austria (1.2 percentage points) and a larger one in Romania (4 percentages points).

On this basis, it is difficult to draw conclusions on the efficiency of the extension of the application of the reverse charge mechanism, in particular because other anti-fraud measures have been implemented by those Member States at the same time. The significant improvements in Hungary are linked to the introduction of numerous measures to fight VAT fraud and evasion (e.g. reclassification of a number of goods subject to reduced rates, increased powers of VAT inspectors). In Romania, despite the application of the reverse charge mechanism in several sectors (supply of energy, for green certificates and in the wood industry) and a good economic environment, the VAT gap increased greatly and is still the highest in the EU.

Experience with the sectorial reverse charge mechanism has shown that fraudsters immediately adapt to changes in legislation and therefore switch fraudulent activities from one sector to another (e.g. from supply of greenhouse gas emission certificates to supplies of gas and electricity, from mobile phones to tablet PC, from cereals to metals). It has even

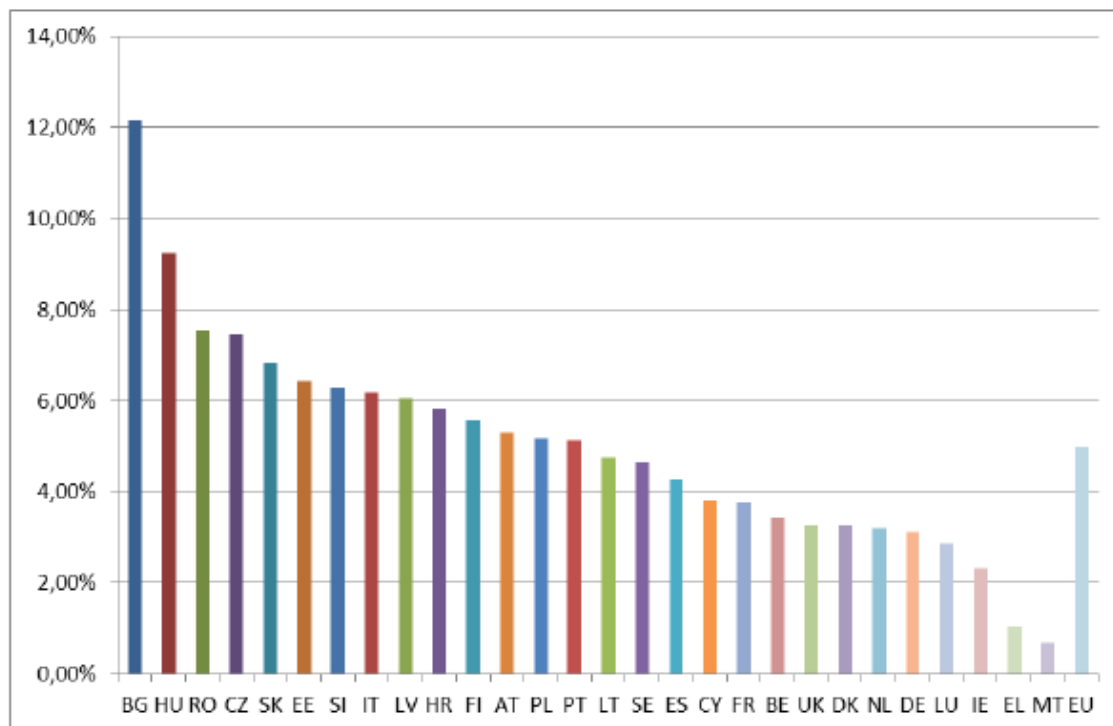
happened that fraud in a sector has shifted to other Member States. For instance, the application of the reverse charge mechanism in Romania led to a shift of fraud to Hungary as regards certain cereals. Also, the application of reverse charge on greenhouse gas emission allowances in France led to a shift of this fraud to Belgium and the application of reverse charge on mobile phones in the United Kingdom led to this fraud shifting to the Netherlands and Germany.

Tax administrations may not have the possibility to adapt so quickly because of the current constraining legal framework. The list of goods and services to which reverse charge can apply (Article 199 of the VAT Directive) has been amended twice in order to add products. The possibility for Member States to apply derogations limited in time has also been introduced (Article 199a of the VAT Directive) in order to curb fraud in new sectors (greenhouse gas emission allowances, gas and electricity, microprocessors, etc.).

The problem is that these lists of products are “static”, i.e. Member States can choose to apply them but cannot extend the list to other products. Specific derogations (based on Article 395 of the VAT Directive) can also be granted by the Council. However, the granting of such derogations takes time to be adopted (8 months). The “Quick Reaction Mechanism” (QRM) introduced in 2013, allows Member States to apply reverse charge on specific products in case of imperative urgency (sudden and massive fraud leading to considerable and irreparable financial losses). Although this mechanism is quick, it nevertheless needs to fulfil some very strict legal requirements. For the time being, only one request has been received by the Commission (from Hungary) but did not fulfil the basic legal criteria in order to enable the application of the QRM.

Even if the reverse charge mechanism would be applied to all possible sectors under the current law, the importance of this mechanism would range between 2% and 7% in the majority of the Member States (23). The average of all Member States is at 4.99% (see Figure 7 below).

**Figure 7: Importance of the reverse charge mechanism if applied to all sectors in all Member States compared to the overall economy based on the 2011 available data (source EY, 2014)**



The fact that Member States face different levels of VAT fraud shows that the application of the common VAT system presents different national challenges in terms of tax collection and might therefore indicate that not only EU-wide solutions may be required. Even if reverse charge can currently help Member States to stop fraud arising in a particular sector, this fraud can quickly shift to another sector or even to another Member State.

*2.1.2. Derogating measures to individual Member States can affect the integrity of the internal market*

The second problem that needs to be tackled is to avoid negative impacts of individual measures to tackle VAT fraud on the integrity of the internal market.

Concretely, two types of risks need to be addressed:

- The risk of having anti-fraud measures affecting negatively compliance costs to businesses. As will be detailed further on, the GRCM is indeed always accompanied by new reporting obligations compensating the fact that VAT is no more collected on certain supplies.
- The risk of having anti-fraud measures in one Member State shifting fraud to neighbour Member States. As will be detailed further on, the GRCM means the possibility to buy goods "VAT free" in the Member State applying the GRCM. These goods can then notably end up on the black market of other Member States as there are no border controls within the EU.

## 2.2. Problem drivers

VAT fraud can have multiple causes. It represents a continuous challenge for Member States as fraudsters have the potential to quickly adapt to changes in, for instance, trade patterns, technology, legislation framework, audit methods, etc. However, two main causes have been identified. The first one is more general and has an EU-wide dimension as it is made of typical EU cross-border fraud (carousel fraud) linked to a loophole in the current VAT legislation. The other one is more specific and linked to individual Member States' tax administration control capacities.

### 2.2.1. *Driver 1: Endemic weakness of current intra-EU VAT system*

On average, slightly less than one quarter of the overall VAT gap proportion<sup>44</sup> is considered to be due to carousel fraud. Carousel fraud finds its roots in the endemic weakness of the current VAT system, which was meant to be transitional (see further explanation in box 4 above), that allows for goods being able to be bought cross-border VAT-free.

The current VAT system splits every cross-border sale of goods between businesses into an exempted supply in the Member State of departure and a taxable acquisition in the Member State of arrival (see further explanation in box 5 above). It is like a customs export-import scheme, but lacks equivalent border controls and is therefore the root of carousel fraud (see box 6 below). Such fraud occurs when a supplier pretends to have transported the goods to another Member State but the goods are in fact consumed VAT-free locally or especially when a client of a cross-border transaction purchases goods or services VAT-free and charges VAT without remitting it to tax authorities while his/her customer can deduct it.

The Commission and also the Member States are fully aware of this flaw in the current VAT system. In order to address carousel fraud, the Commission intends to establish the principle of taxation to all cross-border transactions just as is the case for domestic supplies. A proposal will be made to this purpose by the end of 2017<sup>45</sup>.

However, reaching an agreement in Council<sup>46</sup> and implementing such a change will only happen in the medium to long term. Although a series of short time measures will be proposed by the Commission<sup>47</sup>, it might take time until these measures are agreed and implemented so that they might not provide for an urgent solution, in particular in those Member States with the highest VAT gap.

#### ***Box 6: Carousel fraud***

*VAT carousel fraud occurs in many different ways and the schemes become more difficult every time and include both goods and/or services. What they have in common is that they exploit situations in which goods and/or services can be bought free of VAT by purchasers.*

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<sup>44</sup> EY, 2015.

<sup>45</sup> See point 4 of the Action Plan.

<sup>46</sup> Any legislative proposal on VAT matters needs to be adopted by the Council acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee.

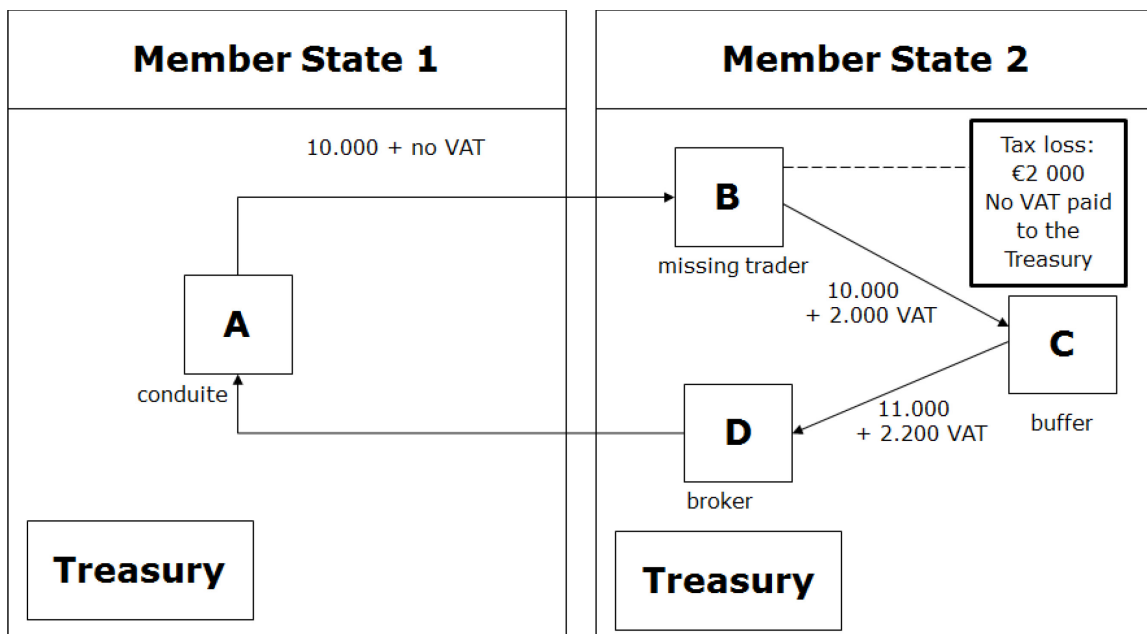
<sup>47</sup> See point 1.4 above and point 3 of the Action Plan.



The basic and simplified mechanism usually contains the following transactions (see scheme below; VAT rate is 20%):

- Company A (so-called “conduite” company), registered in Member State 1, makes an exempted intra-community supply to company B (so-called “missing trader”) registered and located in Member State 2. VAT is accounted for on the acquisition but deducted in the same VAT return so that no actual payment of VAT has to be made to the tax authorities.
- Company B subsequently makes a domestic supply to company C (so-called “buffer”). Company B charges VAT on the invoice sent to company C, collects it but does not pay the VAT to the treasury of Member State 2. Company B will rapidly disappear.
- Company C is usually used as an intermediary company to distort VAT investigations (in a three-company carrousel there is no buffer company).
- Company C resells on the domestic market the goods to company D (broker) which will deduct the VAT charged on its purchases. D will eventually make an intra-community supply to company A in Member State 1 in order to ask for the refund of the VAT charged on its purchases.

In most cases there are more than one company in this position of the carrousel.



Following the scheme, the missing trader will not declare and/or pay the charged VAT to the Treasury.

At the end of the chain, the broker company will claim a refund because he makes an intra-community supply to another Member State. At this moment money leaves the Treasury that was not received from the missing trader earlier in the chain.

The loss of VAT receipts can be unlimited, and the profit of the fraudulent chain can be easily shared between all the participants even if the real VAT loss does not occur where the conduite company is located.

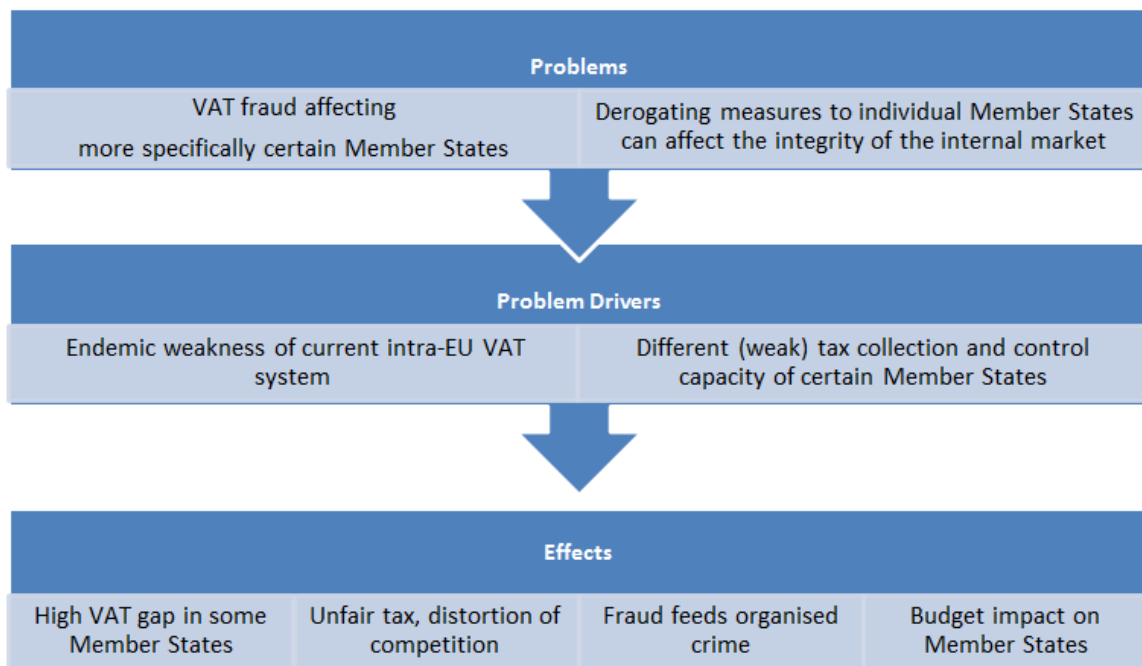
*In practice this simplified scheme can be combined with all possible MTIC VAT fraud (missing trader intra-community fraud) mechanisms and developed over the borders of several Member States and eventually third countries.*

2.2.2. *Driver 2: Different (weak) tax collection and control capacity of certain Member States*

VAT fraud does not affect all EU Member States equally. As already mentioned before, the VAT gap varies from 1.24% to 37.89%. The difference in the VAT gap between Member States finds its roots in very diverse collection and control capacities of the tax administrations. In the framework of the European Semester<sup>48</sup>, in which the Commission undertakes a detailed analysis of EU Member States' economies and provides tailored advice to Member States, special attention is paid to the fight against tax evasion and avoidance and to improving tax administration. Some Member States (Bulgaria, Poland and Romania) were specifically recommended in 2016<sup>49</sup> to improve their tax collection by fighting against tax fraud and evasion (notably in VAT) and the shadow economy but also by improving tax compliance. Although some progress has been made in some Member States, high tax evasion and low levels of tax compliance remain a challenge for several other Member States (the Czech Republic, Italy, Latvia, Romania and Slovakia)<sup>50</sup>.

**2.3. Problem tree**

The problems, problem drivers and effects are summarised below.



<sup>48</sup> [http://ec.europa.eu/europe2020/making-it-happen/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/index_en.htm)

<sup>49</sup> See Country-specific Recommendations on [http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)

<sup>50</sup> See Country reports 2016 on [http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index\\_en.htm](http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm)

Concerning the budget impact on Member States, it is to note that VAT fraud does not impact the overall level of the EU budget. Although VAT fraud reduces the Member States' VAT contribution to the EU (one of the EU own resources is based on VAT), since the EU budget must be in balance, expenditure not covered by amounts yielded from other revenues must be offset by contributions based on the Gross National Income (GNI) of each EU Member State. While VAT-fraud does not impact the overall level of the EU budget, a loss to one own resource is still a loss, even if it is remedied by another resource in view of the principle of budgetary balance.

#### **2.4. Evolution of the problem without action at EU level**

As further explained under the description of the baseline option below (see point 5.2 below), without any intervention at EU level, those Member States more heavily affected by fraud might not be able to address the urgent need for specific anti-fraud initiatives.

They will have to rely exclusively on other short term measures (measures at EU level presented in the Action Plan, as well as conventional measures<sup>51</sup> and technical assistance<sup>52</sup>).

However, even the short term measures might take some time to be implemented.

In the meantime, fraud might be stable but it could also not decrease quickly enough.

In the longer term, it is expected that the definitive VAT system based on the taxation of intra-EU transactions will efficiently curb carousel fraud at an EU level by addressing the root of the problem (see box 4 and box 5 above). Such a reform has the potential according to a recent study<sup>53</sup> to increase tax revenues by about EUR 40 billion per year. This proposal will be made in 2017 but will take several years to be agreed upon and fully implemented.

Without a proposal on the GRCM, fraud might continue to severely affect during several years the budget of notably the most vulnerable Member States because of their lower collection and control capacity. This would have negative consequences on fiscal consolidation and competitiveness of honest businesses.

### **3. WHY SHOULD THE EU ACT?**

According to the principle of subsidiarity, as set out in Article 5(3) of the Treaty on European Union (TEU), action at EU level may only be taken if the envisaged aims cannot be achieved sufficiently by the Member States alone and can therefore, by reason of the scale or effects of the proposed actions, be better achieved by the EU.

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<sup>51</sup> Overall, conventional measures do not change the current VAT rules in the way the 'reverse charge' does, but are focussing on increasing the audit and enforcement capacity of the tax administration e.g. by an improved (de-)registration process for taxable persons, by increasing the number of audits, via an enhanced use of electronic data, by applying already existing legal possibilities such as on 'joint and several liability' between supplier and customer, etc.

<sup>52</sup> See also point 1.4 before.

<sup>53</sup> EY, 2015.

The application by individual Member States of a GRCM cannot be considered as a 'normal derogation' within the meaning of Article 395 of the VAT Directive as it entails a fundamental change to the VAT system. It is not possible for these Member States to address the problem in a very short term without a proposal to amend the VAT Directive.

Therefore, the possibility for individual Member States to apply a GRCM requires a proposal by the Commission to amend the VAT Directive to allow for such a derogating system.

The legal basis is Article 113 of the TFEU<sup>54</sup> that states that:

*“The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.”*

The envisaged proposal respects the principle of subsidiarity as its purpose is to allow Member States to adopt rules on a voluntary basis. Allowing temporarily individual Member States to apply a GRCM would in practice mean enable the coexistence, although temporary, of two different VAT systems within the EU, which could create difficulties for the functioning of the internal market. However, considering that some Member States have not sufficient means to secure in the short term their domestic VAT receipts, the intended derogation is inspired by the purpose and scope of Article 27 of the TFEU. This article explicitly foresees the possibility of temporary exceptions from the internal market rules which must, however, cause the least possible disturbance to the functioning of the internal market.

Although other means to address the problem and its drivers are possible and are already envisaged, the time needed for them to be implemented might not be quick enough for certain Member States to address their VAT receipts losses. According to the principle of proportionality, the initiative should not go beyond what is necessary to meet the objectives of the Treaties, in particular the smooth functioning of the single market. The envisaged initiative might in this respect be challenging as it is not targeted to harmonise VAT but to improve its collection in some Member States. However, positive impacts on the internal market are expected from increased fiscal consolidation in these Member States. Moreover, as will be explained further on, the decision to grant a derogation to a particular Member State would be subject to the fulfilment of several criteria, amongst which are that the Member State in question does not have the administrative capacity to effectively tackle fraud and is confronted with a strong increase (or shift) of VAT fraud. Assessment of the situation (including any disproportionate increase in compliance costs to business) in each Member State requesting a derogation will be carried out in conformity with the proportionality principle.

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<sup>54</sup> Treaty on the Functioning of the European Union.

## 4. WHAT SHOULD BE ACHIEVED?

### 4.1. General objectives

The general objectives are:

- (G1) To contribute to fiscal consolidation within the EU – *ensuring that taxes due are collected to feed national and EU budgets*
- (G2) To ensure fair taxation – *ensuring that all business are treated equally in order to avoid distortion of competition*
- (G3) To preserve the functioning of the internal market – *ensuring that compliance costs to businesses<sup>55</sup> are not excessively high, especially for SMEs*

### 4.2. Specific objectives

The specific objectives are:

- (S1) To reduce the VAT fraud, in particular carousel fraud, in specific Member States – *Taking into account the specificities of Member States in terms of level of fraud and control capacities*
- (S2) To minimize general increase in administrative burden – *Minimizing the increase in compliance costs to business and in administrative costs<sup>56</sup> to tax administrations*
- (S3) To avoid fraud shifting – *Ensuring that tax fraud does not move from one sector<sup>57</sup> to another or from one Member State to another*

**Table 1 - Linking the objectives to the problem**

Specific objectives	General objectives	Link to the problem
Reducing VAT fraud, in particular carousel fraud), in specific Member States by taking into account the specificities of Member States in terms of level of fraud and control capacities	Helps fiscal consolidation within the EU ( <i>increases effectiveness of the tax system</i> )  Contributes to fairness of taxation system	Helps Member States more heavily affected to fight against VAT fraud

<sup>55</sup> Compliance costs relate to those costs that are directly borne by businesses to the management of the VAT rules.

<sup>56</sup> Administrative costs are those costs that are borne directly by tax administrations (and indirectly by all taxpayers) to the management of the VAT rules.

<sup>57</sup> Recall that “sector” means a particular business activity – see footnote 10

<p>Minimizing general increase in administrative burden by:</p> <ul style="list-style-type: none"> <li>- minimizing increase in compliance costs to business</li> <li>- minimizing increase in administrative costs to tax administrations</li> </ul>	<p>Preserves the functioning of the internal market</p> <p>Does not hamper fiscal consolidation within the EU</p>	<p>Reconcile application of specific tools with integrity of the internal market</p>
<p>Avoid fraud shifting by ensuring that tax fraud does not move from one sector to another or from one Member State to another</p>	<p>Preserves the functioning of the internal market</p> <p>Contributes to fairness of taxation system</p>	<p>Preserves the functioning of the internal market</p>

#### 4.3. Consistency with other EU policies and with the Charter for fundamental rights

The objective of fighting tax fraud and tax evasion to help securing revenues e.g. for public investment or for lowering taxes and to increase fairness of taxation is part of the fiscal priorities set out by the Commission for 2016 (Annual Growth Survey 2016 - Strengthening the recovery and fostering convergence)<sup>58</sup>.

Reducing administrative burden, particularly for SMEs, is also an important objective highlighted in the EU's growth strategy for the coming decade (Europe 2020 - A strategy for smart, sustainable and inclusive growth<sup>59</sup>).

The proposed initiative and its objectives would be consistent with the EU SME policy as set by the Small Business Act (SBA), in particular principle VII on helping SMEs to benefit more from the opportunities offered by the Single Market. It would be consistent with the Single Market Strategy (SMS) which referred to the single European VAT area mentioned in the Action Plan. It would also be consistent with the EU objectives under REFIT<sup>60</sup>.

The challenge would be to limit contradictions with these objectives as much as possible and to the minimum extent of what is needed to achieve fight against fraud and ensure fiscal consolidation in the short to medium term.

The objectives envisaged do not affect fundamental rights.

<sup>58</sup> Annual Growth Survey 2016: Strengthening the recovery and fostering convergence (COM(2015) 690 final). See [http://ec.europa.eu/europe2020/pdf/2016/ags2016\\_annual\\_growth\\_survey.pdf](http://ec.europa.eu/europe2020/pdf/2016/ags2016_annual_growth_survey.pdf)

<sup>59</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:2020:FIN:EN:PDF>

<sup>60</sup> Regulatory Fitness and Performance programme.

## 5. WHAT ARE THE VARIOUS OPTIONS TO ACHIEVE THE OBJECTIVES?

### 5.1. Scope of the changes proposed – concept of “person liable for payment of VAT”

As explained before, the VAT system is based on fractioned payments ensuring that the VAT is collected at each stage of the production and distribution chain. This constitutes the basis of the functioning of the VAT system as defined in Article 1 of the VAT Directive<sup>61</sup>.

As also explained before (see box 3 above), under such a system the supplier is considered as “*the person liable for payment of VAT to the tax authorities*” because he collects the VAT from his customers. Under a reverse charge mechanism, the person liable for payment of VAT to the tax authorities is moved to the acquirer. As mentioned before, reverse charge is already possible under the VAT Directive in certain circumstances (sectorial reverse charge mechanism).

The proposed initiative aims at extending this reverse charge mechanism to all supplies of goods and services that take place on the domestic market of specific Member States. The reverse charge mechanism is indeed mainly used by Member States in case they have to fight fraud developing in a particular sector in the meantime they adapt their control capacities. However, if this mechanism can prove to be helpful from a short term perspective, in time, fraudsters will adapt and target other sectors. By applying the reverse charge to all sectors, the proposed initiative intends to avoid fraud shifting from one sector to another.

It is recalled that the initiative that is here being assessed consists of a derogation to the common VAT system. It is limited in scope and in time as its purpose is to temporarily help those Member States more heavily affected by fraud.

The options described below (except the baseline) have in common the following features:

- They will be applicable in individual Member States on a voluntary basis;
- They are limited to B2B domestic supplies above a certain threshold (see box 7 below);
- They are limited in time (see box 8 below for further details);
- They include similar mandatory flanking measures (see box 8 below for further details). These measures aim at ensuring the effective operation and monitoring of the application of the GRCM within the concerned Member States and the surveillance of its impact on other Member States.

### 5.2. Option 1: Baseline

The baseline reflects the current legal framework including all the initiatives that are soon to be adopted by the Commission and the proposals announced by it in its Action Plan<sup>62</sup> (see detail under point 1.4 above).

This means that the VAT system as it currently exists will continue to apply while incorporating the different improvements that will be agreed in the Council to make the VAT system notably more robust to fraud.

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<sup>61</sup> Article 1(2) of the VAT Directive provides that “*On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.*”

<sup>62</sup> See further details in the Action Plan.

Short term and medium term anti-fraud measures (other than reverse charge) will still be tabled this year or will be tabled in 2017<sup>63</sup>. In total, the Commission intends to present 20 measures to tackle the VAT gap in addition to providing specific technical assistance to Member States. The most important ones are:

- Improving cooperation between tax administrations within the EU and with non-EU countries;
- Increasing efficiency of tax administrations;
- Improving voluntary compliance and tax collection.

A proposal for the definitive VAT system for cross-border trade is planned in 2017 which is expected to tackle the VAT gap at EU level as a longer term measure.

All these measures aim at creating a coherent and robust single European VAT area. However, even the short term measures will need a certain time to be agreed and effectively implemented in all Member States. Fraud might be stable but it could also not decrease quickly enough in certain Member States.

Member States are well aware of the loophole in the current VAT treatment of intra-EU trade that leads to carousel fraud. In combatting carousel fraud, exchange of information between Member States is crucial. Therefore, there is a need to speed up and to improve this exchange of information and to adapt control measures while, in the meantime, the definitive regime is being implemented.

Exchange of information works well between some Member States (Member States that have a long experience in multilateral controls with other – in general neighbouring - Member States) but it is not the case with others. Some Member States have national legislation constraints (e.g. data protection) that, at present, prevent them from exchanging particular information or, at least, delay this process.

It is expected that this situation would gradually improve, thanks to the above mentioned set of measures announced by the Commission, but again, this might take some years to be adopted in Council and then implemented by the Member States.

In the immediate future, some Member States might not benefit from exhaustive and on-time information.

Member States also have different tax control capacities (linked to their internal organisation, legal, human and technical resources) meaning that some Member States are more effective in controlling fraudulent schemes than others. Technical assistance to these Member States is and will be provided (this is currently already the case for Greece, Cyprus and Slovakia) but this also needs time to be put in place and become effective.

The proposal for the definitive VAT system, scheduled for 2017, is expected to put an end to carousel fraud. However, it is only a long term solution as this package is expected to take some years to be adopted by the Council and to be fully implemented.

### **5.3. Discarded option: Derogation to apply a GRM without any threshold**

Under a GRM, in B2B transactions, VAT is no longer charged by the supplier to the acquirer but is accounted for by the acquirer, who can in principle deduct it at the same

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<sup>63</sup> See indicative timeline under point 7 of the Action Plan.



time. No VAT is actually paid to the treasury before the final sale to the end consumer (the last B2C<sup>64</sup> transaction).

In case reverse charge would have to be applied whatever the amount of the transaction might be, this would mean that the supplier would need to ascertain transaction per transaction (i) whether his customer is a taxable person or not and (ii) in case he is a taxable person, apply the reverse charge mechanism. Therefore, even when selling for a small amount, all businesses would have to adapt their accountancy system in order to be able to apply the reverse charge mechanism in B2B transactions (e.g. adapt record keeping of payments, check VAT status of the acquirer and obtain and subsequently store the necessary documentation, provide for new reporting obligations – see flanking measures under box 8 below) as well as the normal system in B2C transactions. This would add much complexity in situations like for instance when a business pays for a taxi, a toll or when it buys food or, in more general terms, products which can easily be used for both business and private purposes (e.g. a computer). Since these products are sold in e.g. supermarkets, it would be for persons, such as a cashier in a store, to decide - on the spot - whether the VAT should be charged or not. This would create an unworkable situation for staff that is not qualified or in a position to check (in less than a few minutes) the taxable status of a customer, lead to numerous administrative mistakes and create opportunities for fraudsters who would be tempted to present any VAT registration number in order to obtain goods 'VAT free' (see in this respect role and control of the threshold in box 7 below).

Increased administrative costs might, in particular, be problematic for SMEs<sup>65</sup> for which the costs are relatively higher (e.g. in particular as regards the adaptation of IT systems). A number a business associations have expressed their concerns in this respect<sup>66</sup>.

The main objective of the GRM is to fight against carousel fraud, i.e. fraud committed on transactions involving real or simulated EU cross-border transactions combined with domestic transactions. This type of fraud is generally committed by criminal organisations seeking to quickly gain huge amounts of money. It is therefore characterised by transactions involving important flows of money occurring within a short period of time so that tax administrations, with inadequate control performance, fail to react timely to stop the fraud.

Applying a GRM to all B2B transactions, even those consisting in small amounts, would add unnecessary administrative burden (either for businesses or tax administrations) as what is targeted is carousel fraud which usually involves high value transactions.

Also, the political commitment of the Commission<sup>67</sup> explicitly refers to the application of a GRM to domestic supplies above a defined threshold.

For all these reasons this option has been discarded at an early stage.

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<sup>64</sup> Business-to-consumer.

<sup>65</sup> To note that a distinction should be made between SMEs below and above the VAT exemption threshold for small enterprises. Only SMEs above the exemption threshold are considered as normal VAT taxable persons that have to apply VAT to their supplies. See Annex 3 for further explanation.

<sup>66</sup> E.g. Opinion of the VAT expert group (VEG) on the Action Plan on VAT – Creating a definitive regime – 20 May 2016; Austrian Federal Economic Chamber (WKÖ) – General reverse charge – position paper – November 2015; BusinessEurope – General reverse charge – 18 November 2015 (see Annex 3).

<sup>67</sup> See point 1.4 “context of the initiative”.

Notwithstanding this, implementing a GRCM with a threshold is also challenging. In B2B transactions, a distinction would need to be made between transactions above the threshold (to which reverse charge would apply) and below the threshold (to which the normal system would apply). Compliance costs would here be associated to the management of the threshold. In addition, the risk is that transactions would artificially be split up. Supplies could then take place below the threshold, escape controls and continue to give rise to carousel fraud. However, a balance between the risk of fraud and the simplicity of the application of the mechanism may be achieved by fixing the threshold at the appropriate level (see further explanations on this threshold under box 7 below).

**Box 7: Level of the threshold**

*As explained under point 5.3 above, the purpose of applying a GRCM in respect of any supply of goods or services above a certain threshold is:*

- 1) to target the bulk of transactions (high value) that could lead to carousel fraud;*
- 2) to minimize impact on compliance costs to businesses, in particular the smallest ones;*
- 3) to avoid that fraudsters present any VAT registration number in order to obtain goods 'VAT free'.*

*In fixing the level of the threshold, account should be taken of all these issues. In addition, attention should be paid to the fact that the authorisation to apply a GRCM might be extended to more than one Member State.*

*The Member States having initially requested a derogation to apply a GRCM<sup>68</sup> asked for such a threshold to be set at EUR 10,000 per invoice.*

*According to these Member States, given this high threshold, the smallest companies would generally not be affected<sup>69</sup>. Nowadays medium and large sized companies apply electronic bookkeeping systems where the basic data of the customer and the supplier are already recorded. Therefore the change of the system is more or less limited to a simple adaptation of the IT bookkeeping system.*

*At the very least, this relatively high level should exclude the smallest retailers. This would limit the impact on microbusinesses that should in principle not be affected by the changes.*

*This threshold is likely to exclude most of the B2C transactions which should also limit the risk that consumer goods (to the exclusion of high value goods) are purchased without VAT (in case a non-business purchaser presents himself as a business).*

*In this respect, a link should be made with the cash payment limitations introduced in more and more Member States<sup>70</sup> in order to fight against money laundering, drug trafficking and*

<sup>68</sup> Austria and the Czech Republic.

<sup>69</sup> Recall in addition that only businesses that do not benefit from the VAT exemption scheme might be affected by the changes envisaged (see Annex 3).

<sup>70</sup> <http://www.europe-consommateurs.eu/en/consumer-topics/financial-services/banking/means-of-payment/cash-payment-limitations/>

*terrorist activities. When cash payments are limited to a certain threshold (cash payment threshold), any purchase that would be made under the reverse charge mechanism could be tracked, provided that the reverse charge threshold is equal or above the cash payment threshold. Currently, in the EU, cash payment limitations vary from EUR 1,000 to EUR 15,000 (and the tendency is to decrease such a threshold). In addition, Regulation (EU) No 1889/2005(94) of the European Parliament and of the Council introduced controls on cash entering or leaving the EU and a duty to declare any sum of money or equivalent of more than EUR 10,000. Setting the threshold to this amount for the GRCM would therefore make sense both at the level of one of the requesting Member States (e.g. in Austria payments exceeding EUR 10.000 have now to be made via bank transfer) as well as for any other Member State.*

*Therefore, such a threshold is expected to be capable of targeting transactions at risk, while not affecting other transactions more than necessary, in particular involving smaller businesses and the majority of B2C transactions.*

#### **5.4. Option 2: derogation to apply a GRCM above a certain threshold only for preselected Member States**

Under option 2, the GRCM would apply to B2B domestic supplies of goods and services above a certain threshold within the concerned Member States. This threshold would, in principle, be set at EUR 10,000 exclusive of VAT per invoice<sup>71</sup>.

The “normal” VAT system (see outline under option 1 and box 1 and box 5 above) would apply to all other transactions, i.e. B2C transactions or transactions equal or below the threshold. The other Member States would also continue to apply the 'normal' VAT system.

For each supply, the supplier will need to determine whether he has to charge VAT or not to his customer, i.e. check the status (and be capable to prove it) of his customer (a “business” or another “consumer”).

A derogation would be granted to preselected Member States on a voluntary basis (for instance, Austria and the Czech Republic who submitted the latest request<sup>72</sup>).

Mandatory flanking measures accompanying the implementation of the derogation are detailed in box 8 below.

Two sub-options could be envisaged:

##### *5.4.1. Option 2a: reverse charge mechanism applies to any domestic supplies of goods and services.*

The Member States to which the derogation is granted can choose which supplies of goods or services that are above the threshold will be subject to the reverse charge mechanism. This sectorial approach should however respect the principle of fiscal neutrality<sup>73</sup>.

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<sup>71</sup> See further explanations on this threshold under box 7 above.

<sup>72</sup> Recall that a previous request, under Article 395 of the VAT Directive, to apply a GRCM was submitted by Austria, Bulgaria, the Czech Republic and Slovakia but denied on legal grounds (see previous mentioned Communication COM (2015) 538 of 28.10.2015).

5.4.2. *Option 2b: reverse charge mechanism applies to all domestic supplies of goods and services*

The Member States to which the derogation is granted must ensure that all supplies of goods and services that are above the threshold are subject to the reverse charge mechanism.

5.4.3. *Discard of option 2a*

Option 2a means that the concerned Member State can choose which supplies of goods or services that are above the threshold will be subject to the reverse charge mechanism.

As explained under point 1.3 above (box 3), this sectorial approach already exists today for a limited number of goods and services.

This approach is motivated by the occurrence of fraud in a particular sector and is generally limited in time because it does not correspond to the normal functioning of the VAT system and can therefore hamper the good functioning of the internal market. While such a sectorial approach might be helpful as a short term measure, its efficiency on a medium term seems questionable (see opinion from Member States and stakeholders including respondents to the Green Paper consultation in Annex 2). In fact, fraudsters adapt quickly to these measures and fraud is moved from one sector to another (see box 9 below).

A genuine GRCM, applicable to all supplies of goods and services within the concerned Member State, as conceived under option 2b would on the contrary avoid that fraud is moved from one sector to the next.

Also, having a sectorial approach would add significant complexity to the VAT system of the concerned Member State, leading to increased compliances costs (43% increase according to a recent study on the assessment of the optional reverse charge) to business (see opinion from business representatives, including respondents to the Green Paper consultation, and REFIT platform in Annex 2) and administrative burden to tax administrations.

In addition, the request from Austria and the Czech Republic to apply a reverse charge mechanism covers all sectors and the political commitment of the Commission relates to a “generalised” reverse charge mechanism<sup>74</sup>.

For all these reasons, option 2a has been discarded at an early stage. Only option 2b is further analysed under 6.2.2.

***Box 8 – Flanking measures and duration of the derogation***

*The derogation should be granted for a period of maximum 5 years.*

*As is currently the case with the sectorial reverse charge derogation, Member States authorised to apply the GRCM should introduce specific reporting obligations on*

<sup>73</sup> Means that goods and services that are the same or similar must be treated the same for tax purposes to avoid any distortion of competition.

<sup>74</sup> See point 1.4. « Context of the initiative ».

*businesses so as to ensure the effective operation and monitoring of the application of that mechanism and detect and prevent all new forms of tax fraud. In particular, they shall ensure that all transactions (in goods and in services) above or below the defined threshold are reported to the tax authorities by the suppliers. Member States shall ensure that reporting obligations are fulfilled by businesses by electronic means in order to minimize burdens on business and make tax controls more efficient.*

*In order to assess the effect of the application of the GRCM on fraudulent activities in a transparent manner, pre-defined evaluation criteria should be established by these Member States so as to enable an assessment of the level of fraud before and after the application of the GRCM.*

*To closely monitor the impact on the internal market, all Member States should present an interim report (within 2 years) and a final report (after 5 years) so as to enable an assessment of the impact on fraud, compliance costs to businesses and a possible shift in trends of fraudulent activities. EU-wide criteria will also be established to this purpose.*

### **5.5. Option 3: derogation to apply a GRCM above a certain threshold for any Member State fulfilling certain pre-defined criteria**

Under option 3, the possibility to apply the GRCM, as described under option 2 (same functioning and flanking measures), would not be granted to preselected Member States but would instead be open to any Member State asking for it and fulfilling certain predefined criteria. The Commission would receive implementing powers in order to adopt such derogations.

The aim of setting predefined criteria is to confine the application of the GRCM to few Member States in order to prevent disruption of the internal market.

These criteria would be linked to the actual level of the VAT gap, as well as of carousel fraud, in a given Member State and to the failure of other control measures in this Member State to curb such fraud. Since the application by a given Member State of the GRCM could entail a risk of fraud shifting to other Member States, in particular neighbour Member States, the possibility to apply such a GRCM should also be open to these Member States under similar conditions.

In doing so, option 3 ensures that the possibility to apply the GRCM is restricted to Member States that are heavily affected by fraud, in particular carousel fraud, or for which a substantial risk of fraud shifting is likely to take place.

Hence, subject to equal treatment, some Member States would be allowed to apply the GRCM either to tackle actual fraud or later on, in case fraud would move from neighbouring Member States due to the derogation being applied by them.

Therefore, in order to limit the effects on the internal market and to ensure that the application of the GRCM respects the principle of proportionality, the derogation could be granted on the basis of the situation in the requesting Member State resulting from the following criteria:

- The level of the VAT gap, as well as of carousel fraud, and the insufficiency of other control measures to combat that fraud in the concerned Member State;

or

- A substantial risk of fraud shifting to the concerned Member State because of the application of a GRCM in another Member State and in case other control measures would be insufficient to combat that risk of fraud.

In granting any derogation, the Commission would pay special attention that accompanying measures envisaged by the requesting Member State do not disproportionately increase compliance costs to businesses.

A safeguard clause should also be provided in the Commission implementing decision allowing the derogation in order to enable the Commission to revoke this decision if negative consequences appear in several Member States or in the internal market as a whole.

The same two sub-options could be envisaged:

*5.5.1. Option 3a: reverse charge mechanism applies to any domestic supplies of goods and services.*

The Member States to which the derogation is granted can choose which supplies of goods or services that are above the threshold will be subject to the reverse charge mechanism. This sectorial approach should however respect the principle of fiscal neutrality.

*5.5.2. Option 3b: reverse charge mechanism applies to all domestic supplies of goods and services*

The Member States applying the mechanism must ensure that all supplies of goods and services that are above the threshold are subject to the reverse charge mechanism.

*5.5.3. Discard of option 3a*

For the same reasons explained under option 2 (see point 5.4.3 above), option 3a has been discarded at an early stage. Only option 3b is further analysed below.

**6. WHAT ARE THE IMPACTS OF THE DIFFERENT POLICY OPTIONS AND WHO WILL BE AFFECTED?**

**6.1. Methodology**

The initiative is the result of a political commitment taken on 17 June 2016 to present a proposal to allow a temporary derogation for a GRCM for certain Member States before the end of 2016.

Due to timing constraints, no specific tool or methodology was developed for the assessment of the impact of these options. For the same reason, no independent study could either be launched. However, a number of studies in the field of fraud and reverse charge already existed (see list in Annex 4) of which the results were used in this impact assessment. In addition, the replies received by the Commission to the questionnaire sent by it to the two requesting Member States<sup>75</sup> also served the analysis. These results were complemented by a qualitative analysis on which this impact assessment mainly relies.

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<sup>75</sup> See Annex 6.

## 6.2. Analysis of the impacts of each of the options

The envisaged initiative is limited in scope and in time<sup>76</sup>. Because of its basic features, its impact is circumscribed to businesses and tax administrations and would only influence the way VAT is collected by these two stakeholders.

Consumer prices can be impacted in case compliance costs to businesses are increased and those costs are passed through the final consumer. However, as will be developed further on, the application of the GRCM might also have positive effects in terms of cash flow for businesses which are likely to compensate the negative effects. Consumer prices are therefore not expected to be impacted substantially by the initiative.

The social and environment impacts should be negligible or even zero.

The analysis of the policy options concentrated on the following economic impacts:

- Impact on carousel fraud and tax collection;
- Impact on compliance costs to business;
- Impact on administrative costs to tax administrations;
- Impact on the functioning of the internal market;

In addition, the way the different options interlock with the VAT reform process announced in the Action Plan aiming to further improve the functioning of the internal market has also been taken into account.

### 6.2.1. *Option 1: baseline*

Section 1 explains the context of the proposed initiative and section 2 outlines in detail the problem and problem drivers of the baseline. In summary, some Member States are more heavily affected than others by fraud and in particular by carousel fraud. This is due to the combination of two main factors: a legislative loophole at EU level (the way the current intra-EU VAT system works) and the tax control/collection capacity of individual Member States. The baseline offers a comprehensive and definitive solution to all Member States, notably, in terms of fighting carousel fraud (see previous description of definitive VAT system for which a separate impact assessment will be carried out). However, it is to be viewed as a medium to long term solution.

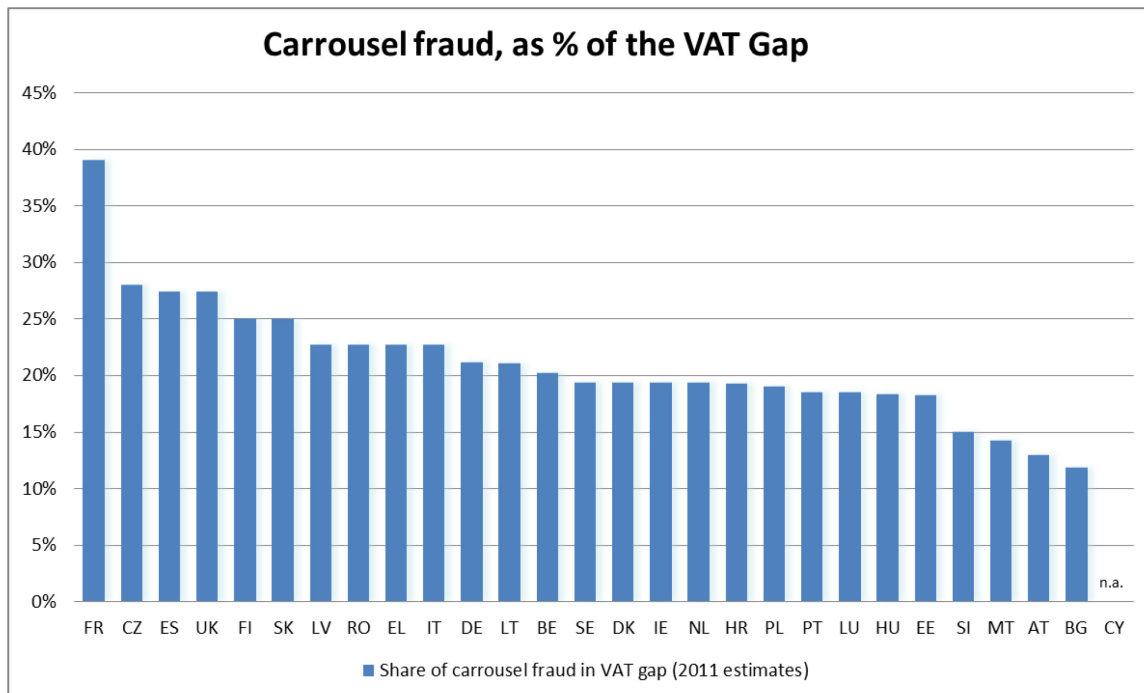
1. **Level of carousel fraud** - Carousel fraud at EU level is estimated at about EUR 50 billion. Some Member States seem to be more affected than others by carousel fraud. The graph below shows that in six Member States<sup>77</sup>, carousel fraud amounts to 25% or more of their VAT gap.

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<sup>76</sup> For further explanation on this, see point 1.4 “Context of the initiative”.

<sup>77</sup> France, Czech Republic, Spain, United Kingdom, Finland and Slovakia.

**Figure 8 – Share of carousel fraud in VAT gap (Source: "Own calculations" based on EY, 2015 study)**



The implementation of the definitive VAT system is expected to reduce carousel fraud at EU level by 80%, representing about EUR 40 billion additional VAT receipts for the Member States. However, until its implementation, the evolution of carousel fraud is uncertain. Envisaged short term measures to fight against fraud<sup>78</sup> should in the meantime help preventing VAT fraud and improve VAT collection in the same way as recent reform measures introduced against tax non-compliance in the Member States (e.g. electronic reporting, limits on cash transactions and other anti-fraud or anti-smuggling measures) have shown their capacity to reduce the VAT gap<sup>79</sup>. However, even the short term measures may take some time to show results and in the meantime, fraud may be stable or continue to increase in certain Member states.

*In a best-case scenario carousel fraud would be stable in the short term or is even improved thanks to the envisaged other short term measures. 80% of carousel fraud would be removed in the medium/long term with the introduction of the definitive VAT system.*

*In a worst-case scenario, there would be no reduction of carousel fraud in affected Member States in the short term and carousel fraud could even continue to increase in the longer term until the introduction of the definitive VAT system. 80% of carousel fraud would be removed in the medium/long term with the introduction of the definitive VAT system.*

<sup>78</sup> See Action Plan and point 1.4 above.

<sup>79</sup> CASE, 2016. In 2014, most of the Member States experienced an increase in their VAT collection capacity, the most significant results being observed in Belgium, the Czech Republic, Germany, Estonia, Ireland, Greece, Spain, Hungary and Malta.



2. **Compliance costs to business** - Cost to businesses of complying with VAT obligations is substantial according to most studies and varies substantially across countries<sup>80</sup>. Because much of the cost of complying with VAT is fixed (i.e. incurred regardless of the level of sales), compliance costs are relatively more burdensome for small businesses: compliance costs could represent 3.9% of turnover for unincorporated businesses but only 1.5% of turnover for firms with more than six employees. Compliance costs are also particularly high for cross-border trade. VAT obligations are 11% higher than the VAT compliance costs associated with domestic trade<sup>81</sup>.

The proposal for a definitive VAT system should help reduce compliance costs to business mainly due to simplifications in cross-border trade. In the meantime, compliance costs could remain stable or be slightly increased, depending on the scope of anti-fraud measures adopted by individual Member States to prevent existing fraud.

*In a best-case scenario, the set of measures to be proposed by the Commission in the short term would improve tax collection in all Member States with no impact on compliance costs. Simplification measures to be introduced by the definitive VAT system would reduce compliance costs to businesses in the medium/long term.*

*In a worst-case scenario, compliance costs would increase in the short term due to anti-fraud measures (other than reverse charge) being taken by individual Member States. Simplification measures to be introduced by the definitive VAT system would reduce compliance costs to businesses in the medium/long term.*

3. **Administrative costs to tax administrations** – Member States' tax authorities incur costs related to the management of the obligations imposed to their businesses acting as taxpayers (e.g. processing VAT registrations, reviewing VAT returns and other reporting obligations, providing information, handling and implementing of new legislation) and to the control of the application and the collection of the VAT (e.g. carrying out risk analysis, undertaking audits). These costs are specific to each Member State as they depend upon the organisation of its tax authorities. However, the more a legislation is susceptible to fraud, the more it is difficult and therefore costly to manage for tax authorities. It can prompt Member States to impose new obligations to their businesses that they would also need to implement and follow-up. This can lead to more complexity which, in turn, can create new opportunities for tax evasion and fraud.

*In a best-case scenario, the implementation of the set of measures to be proposed by the Commission in the short term would improve tax collection in all Member States with no significant impact on administrative costs to Member States and no need for other anti-fraud measures. As is the case with any new legislation, the introduction of the definitive VAT system in the medium/long term would require some additional costs in the year of its implementation (e.g. additional work for tax officials, implementation of IT systems).*

*In a worst-case scenario, administrative costs could slightly increase in the short term due to anti-fraud measures (other than reverse charge) being taken complementarily by individual Member States in case the proposed measures do not prove to be*

<sup>80</sup> IFS et al., 2011 (see complete reference in Annex 4).

<sup>81</sup> EY, 2015.

*sufficiently efficient in the short term. This would however depend upon the scope of anti-fraud measures adopted by individual Member States to prevent existing fraud. The implementation of the definitive VAT system in the medium/long term would require some additional costs in the year of its implementation.*

4. **Functioning of the internal market and extent to which further improvements can be made to the VAT system under the Action Plan-** The baseline is perfectly in line with the Commission’ agenda announced in its Action Plan aimed to improve the functioning of the current VAT system and therefore the functioning of the internal market. It proposes a gradual progression towards the definitive VAT system with short and longer term initiatives.

6.2.2. *Option 2b: derogation to apply a GRCM to all domestic supplies of goods and services above a certain threshold only for preselected Member States*

Estimation of the impacts of this option mainly relies on data that have been specifically requested to and provided by Austria and the Czech Republic<sup>82</sup>, i.e. the Member States that submitted the latest request for such derogation.

6.2.2.1. Analysis of the impacts of option 2b

Summary – The extent to which the specific policy objectives will be met
<p><b>Overall : Objectives partially met</b></p> <ol style="list-style-type: none"> <li>1. Reducing VAT fraud in specific Member States – <u>Very uncertain but could be met</u> if sufficient controls are put in place in order to monitor the functioning of the GRCM and prevent new domestic types of fraud to appear too quickly in the Member State benefiting from the derogation.</li> <li>2. Minimising general increase in administrative burden – <u>Not met</u>. Although the increase of running costs will be limited in the two countries because most obligations are already in place and despite the protection effect of the threshold on the smallest businesses, set up costs will be incurred twice.</li> <li>3. Avoid fraud shifting to other sectors and other Member States – <u>Not met</u>. No fraud shifting between sectors but major risk of fraud shifting between Member States.</li> </ol>
Economic impacts
Impact on carrousel fraud and Member Sates’ tax revenue
<p>Implementation of the GRCM may create gains for the budget of the Member State having introduced it if new fraud patterns (see box 9 below) take a few years to appear (as it seems to have been the case in 1993 when the fiscal frontiers were dismantled for VAT). In particular fraud might shift “down the chain” and concentrate (for the total amount of the VAT due) to the retail stage which is normally more difficult (more numerous) and burdensome to control (see notably Taj opinion in Annex 2). “VAT free” obtained goods could be sold on with VAT but without remitting the tax subsequently or end up on the black market, either of the Member States applying the GRCM or any (neighbouring) Member State; in particular of a Member State with higher VAT</p>

<sup>82</sup> See Annex 6. A study published by the Ministry of Finances of the Czech Republic “Closing VAT Gap through reverse Charge Mechanism (2015)” is available on <http://www.mfcr.cz/en/news/news/2016/collection-of-the-tax-conference-23757>.

rates, allowing fraudsters to maximize the benefit when selling these goods on to private consumers with VAT or to have a larger competitive advantage over those that apply the VAT when selling without VAT on the black market. It is difficult to assess to what extent these phenomena will take place but, as mentioned before, it could be pointed out that this phenomenon has already been experienced in practice in relation to existing sectorial reverse charge derogations (e.g. in the sector of cereals in South Eastern Europe). Therefore, existing fraud in a Member State applying the GRCM is likely to quickly migrate to Member States which did not implement the GRCM. A number of Member States<sup>83</sup> as well as business organisations<sup>84</sup> expressed their fears in respect of tax fraud shifting to their country.

According to the Czech Republic, two thirds of its VAT gap<sup>85</sup> would stem from carousel fraud, i.e. roughly EUR 2.2 billion. In the first year of introduction of the GRCM, a decrease in tax revenue by EUR 1.2 billion is expected due to a change in cash flow<sup>86</sup>. On the other hand, a rise in tax revenue by EUR 1.1 billion due to the elimination of carousel frauds is estimated. In the further years, a positive impact is expected due to the elimination of carousel frauds. According to the Czech Republic, reporting obligations, such as electronic filing of invoices or VAT control statements, should solve the risk of fraud shifting at the end of the distribution chain. Individual invoices are matched in the system of VAT control statements and the potential problems are detected with the sensibility set at the level of the invoice. Based on the data from the VAT control statements and electronic filing of invoices and using mechanisms of administrative cooperation the Czech Republic would be in a position to provide other Member States with the information and data they could use when applying their own anti-fraud measures. It would not exclude fraud shifting to other Member States as effective anti-fraud measures have in principle the effect of shifting fraud to another destination.

Austria, whose VAT gap is already under the EU average, namely 10.17%, did not provide budget estimates. Referring to a study<sup>87</sup>, Austria predicts that carousel fraud would be eliminated entirely. The only disadvantage pointed out would be micro fraud but this new risk was assessed as negligible compared to the estimated benefits from such a new system. Considering that carousel fraud would amount to 13% of the Austrian VAT gap<sup>88</sup> this would represent additional VAT revenue of about EUR 375 billion. Concerning cash flow, Austria considers there will be no difference between the current system and the GRCM. Therefore, no negative effects are expected with regard to the state budget. Concerning the shift of fraud to the retail stage, Austria does not expect problems as due to the structure of its retailers (retail stage is to a large extent marked by a few big companies), the number of taxable persons accounting for the bulk of the VAT would not substantially increase. As for the shift of fraud to other Member States, Austria ascertains that the reporting system and risk analysis will prevent a shift of fraud to other Member States.

Without practical experience, it is however not possible for the Commission to assess the analysis made by Austria and the Czech Republic but two scenarios can be envisaged:

***In a best-case scenario, reduction of carousel fraud in the Member State applying the GRCM might be expected in the short term if sufficient controls are in place. On a longer term, new risks***

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<sup>83</sup> Meeting of the Group on the Future of VAT (GFV) of 5 February 2016.

<sup>84</sup> See Annex 2.

<sup>85</sup> The Czech Republic has a VAT gap of 16.14% which places the country slightly above the EU average (EU-26 Member States VAT gap at 14.06%) but much lower than the average value in CEE (Central and Eastern Europe). See CASE, 2016.

<sup>86</sup> Recall that under a GRCM the VAT is collected only at the end of the supply chain.

<sup>87</sup> PPS Schönberger Study.

<sup>88</sup> Based on average estimate of MTIC fraud proportion in EY, 2015.

*of fraud are likely to develop in the Member State applying the GRCM in particular in case of insufficient controls. The net impact is difficult to predict without real experience but it could be well positive in case the new risks of fraud expected in the longer term would not develop before the implementation of the definitive VAT system. However, fraud is very likely to migrate in the short term to other Member States (as this phenomenon has actually been experienced several times and in a very quick way).*

*In a worst-case scenario, new risks of fraud are likely to develop in the Member State applying the GRCM at the same time the reduction of carousel fraud is expected in this Member State. The net impact would be almost nil. Fraud is in any case also likely to migrate in the short term to other Member States.*

#### **Impact on compliance costs to business**

Specific measures to avoid new forms of fraud are needed under a GRCM (see box 10 below). Set-up costs for the year of introduction of the GRCM were assessed<sup>89</sup> in 2008 at EUR 1.6 billion to EUR 2 billion for Germany alone, and recurring costs at EUR 100 to 200 million per year, which is the equivalent of EUR 500 million to EUR 1 billion a year at the level of the EU in 2016. Although the threshold above which the reverse charge should apply would help excluding from this system the smallest businesses<sup>90</sup>, it will nevertheless imply that most businesses (those that have transactions below and above the threshold and those that are involved in both B2B and B2C transactions) might have to deal with two different systems: the current one and the reverse charge. Taking into account that the initiative is meant to be a temporary derogation to the VAT Directive, similar one-off costs are expected to revert back to the current VAT system. A recent EU-wide study on the impact of the optional reverse charge<sup>91</sup> has concluded that the reverse charge mechanism implies an increase by 43% of compliance costs to businesses, although a generalized reverse charge is expected to generate less compliance costs as the same scheme would apply across sectors. Most business associations as well as the REFIT platform have expressed their concerns in respect of the expected increase in compliance costs to business linked to the possible application of a GRCM<sup>92</sup>. It should also be anticipated that the CJEU might develop on specific cases linked to the application of the GRCM in two Member States only. This can add a layer of complexity in the application of the scheme. The increased compliance costs and additional complexity of the VAT system will affect those businesses that are active in the Member State applying the GRCM. Additional obligations (anti-fraud measures other than GRCM) could be imposed to their businesses by Member States not applying the GRCM in order to limit fraud shifting to their country.

According to the Czech Republic, the setting of the threshold for the application of the GRCM in tax and accounting systems could cause a slight increase in costs for VAT payers. However, no other increase in costs for VAT payers is expected as obligations that already exist should be used within the GRCM as well. The Czech Republic already has an electronic VAT listing system (so-called 'VAT control statement') which contains data about each individual invoice. All registered taxable persons have, since 1 January 2016, to file a listing of all received and provided supplies, regardless whether they have been supplied under reverse charge or not. This enables the tax

<sup>89</sup> COM (2008) 109 final.

<sup>90</sup> Only small businesses that are not covered by the VAT exemption scheme might be affected by the changes proposed (see Annex 3).

<sup>91</sup> EY, 2014.

<sup>92</sup> Opinion of the VAT expert group (VEG) on the Action Plan on VAT – Creating a definitive regime – 20 May 2016; Austrian Federal Economic Chamber (WKÖ) – General reverse charge – position paper – November 2015; BusinessEurope – General reverse charge – 18 November 2015. In a meeting (5 February 2016) of the Group on the Future of VAT (GFV), several Member States shared the concerns raised by their businesses on increased compliance costs linked to implementation of a generalised reverse charge mechanism (Annex 2).

administration to crosscheck invoices. VAT returns and “VAT control statements” are already submitted exclusively by electronic means. An electronic filing of invoices will be introduced soon in order to allow the control of the end of the distribution chain. This will happen regardless the implementation of the temporary GRCM. No specific cost is expected for non-established taxable persons because, thanks to a simplification measure<sup>93</sup>, they will not be touched by the domestic reverse charge.

According to Austria, given the high threshold, small companies will generally not be affected by the GRCM. Nearly all medium and large-sized companies apply electronic bookkeeping systems where the basic data of customer and supplier are already recorded. Therefore the change of the system is more or less limited to a simple adaptation of the IT bookkeeping system. Austria foresees a monthly recapitulative statement of the supplier and the purchaser in which they both have to indicate the monthly total amount of supplies and purchases under reverse charge with respect to all business partners. This should enable an automatic reconciliation of data from the recapitulative statements with VAT declarations in view of a subsequent inquiry by tax administration as to have discrepancies examined. Payments above the threshold of EUR 10,000 are obligatory to be made by bank transfer. If non-established taxable persons are either suppliers or recipients of transactions covered by the GRCM, their compliance costs will be negligible or reduced.

*In a best-case scenario, as would normally be the case for Austria and the Czech Republic, part of the obligations which are necessary in the context of a GRCM have already been put in place. No large increase of obligations can therefore be expected in the short term. Also, the threshold will avoid that microbusinesses are affected. It remains however that very high set up costs will be incurred twice (in the short and the long term) and that most businesses will need to manage two systems (above and below the threshold) pending adoption of the definitive system. Overall, the impact on compliance costs will be largely negative and this explains the negative position of business organisations on this subject (see Annex 2).*

*In a worst-case scenario, the necessary obligations to accompany the GRCM are not in place and would still need to be fully implemented in a very short term. Anti-fraud measures adopted by other Member States (other than those applying the GRCM) might further increase compliance costs to businesses active in these Member States.*

#### **Impact on administrative costs to tax administrations**

Besides the need to change legislation and adapt were necessary administrative practice (see flanking measures in box 8 above), Member States wishing to implement a GRCM will have to implement and control the new system for transactions above the threshold, as well as continue managing the current system for transactions below the threshold. Mandatory electronic reporting and modern audit solutions should facilitate the inspection tasks but the control of the reverse charge chain cannot be done exclusively via listings. Due to increased risk of fraud shifting to Member States that have not implemented the GRCM, additional administrative costs are expected for these Member State in order to put in place additional measures to cope with this fraud shifting. A number of Member States confirmed<sup>94</sup> the negative impact on their control capacity in case of tax fraud shifting to their country.

According to the Czech Republic no additional costs for the tax administration are expected.

Austria foresees one-off costs in the course of the implementation period and in training staff but

<sup>93</sup> Implementation of the option foreseen in Article 194 of the VAT directive that allows Member States to provide that where a taxable supply of goods or services is carried out by a taxable person not established in the Member State in which the VAT is due, the person liable for the payment of VAT is the recipient of such supply. See also annex 3.

<sup>94</sup> Meeting of the Group on the Future of VAT (GFV) of 5 February 2016.

was unable to provide any figure.

*In a best-case scenario, increase in the short term in administrative costs to tax administrations linked to the implementation, running and control of the GRCM will highly depend upon the actual level of efficiency of the Member State's tax administration. This efficiency is linked to its structure, organisation and level of computerisation. In Austria and the Czech Republic, limited or no increase in administrative costs is expected. In the longer term, the Member States applying the GRCM would need to end the application of the GRCM and adapt to the definitive VAT system. It is expected that Member States wishing to implement the GRCM have budgeted the costs of its implementation. As the GRCM remains an option to the Member States, no further costs (other than those provisioned) would be expected.*

*In a worst-case scenario, the other Member States (those not applying the GRCM) would need to reinforce their control capacities and maybe introduce anti-fraud measures (other than the GRCM) to limit fraud shifting to their country.*

### **Impact on the functioning of the internal market**

The application of a GRCM even by a single Member State means that two different VAT systems will run in parallel within the EU: the current fractioned VAT system in twenty-six Member States and a GRCM (a kind of sales tax) in two Member States.

The functioning of the internal market is expected to be impacted from a business and Member States 'perspective in the following way.

#### ***Business 'perspective***

Businesses acting as suppliers or acquirers in one of the Member States applying the GRCM will have to adapt and comply with the obligations linked to the new system. When also active in another Member State (a Member State not applying the GRCM), they will have to comply with the normal VAT rules.

Businesses in the Member States applying the GRCM will have a different cash-flow situation compared to businesses in the other Member States. The cash flow impact will however depend on the business-model of the enterprise and will be influenced by the import/export situation of the company as well as payment lead times toward both suppliers and customers. Based on case-studies, the average cash flow impact for SMEs is expected to be negative, while the average impact on large enterprises would be positive<sup>95</sup>.

#### ***Member State 'perspective***

A decrease in the VAT receipts during the implementation period is likely to happen in the Member States that will introduce the GRCM because of the cash flow effect that might not be (fully) compensated by a reduction in carousel fraud. This could affect negatively the yearly budgetary targets of these Member States on their way towards fulfilling their Medium-Term Objective (MTO)<sup>96</sup>.

New risks of fraud are likely to develop at domestic level in the Member States opting for a GRCM but these new risks might only develop after a few years. The final impact is difficult to predict

<sup>95</sup> Pricewaterhousecoopers, 2007 (A) (see complete reference in Annex 4).

<sup>96</sup> As part of the Stability Programmes and Convergence Programmes, a Medium-Term Objective (MTO) is a budgetary target set for each Member State which is defined in structural terms. Member States must also set out yearly targets on the way towards the MTO and forecast the expected path of their debt-to-GDP ratios. See more information on [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/convergence/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/convergence/index_en.htm)

without a real experience.

VAT fraud is likely to shift to the Member States that do not have a GRCM. This fraud is expected to shift in the first instance to the neighbour countries and may then spread progressively to other countries. Member States not applying the GRCM might therefore undergo a negative budgetary impact either because of new types of fraud and/or because of additional costs to adapt and reinforce their control capacities.

***Disturbance to the functioning of the internal market resulting from divergent obligations imposed to businesses and from unequal treatment of Member States in a similar situation is expected. Disturbance would start as from the application of the GRCM by at least one Member State and would last until adoption of the definitive VAT system.***

#### **Link with the VAT reform process**

The implementation of the GRCM in preselected Member States is at odds with the implementation of the single European VAT area (as announced in the Action Plan) in all Member States. It entails twice implementing expenditures (set-up costs to implement the GRCM and similar costs to revert to the normal VAT system that will be based on the principle of taxation of all transactions) for both businesses and Member States. Part of these costs could however be outweighed by gains in terms of VAT collection improvements in the Member States applying the GRCM.

***The initiative is at odds with the Commission's overall strategy to improve the VAT system in all Member States. Given its foreseeable negative impact on the internal market, it is somewhat inconsistent with the political commitment of the Commission.***

#### **Environmental and social impacts**

Negligible or even zero<sup>97</sup>.

6.2.3. *Option 3b: derogation to apply a GRCM to all domestic supplies of goods and services above a certain threshold for any Member State fulfilling certain pre-defined criteria*

As for option 2, estimation of the impacts of option 3 relies in part on data provided by Austria and the Czech Republic<sup>98</sup>. No such specific data is available for the other Member States.

6.2.3.1. Analysis of the impacts of option 3b

#### **Summary – The extent to which the specific policy objectives and the political commitment of the Commission will be met**

**Overall: Objectives partially met - Political commitment met**

1. Reducing VAT fraud in specific Member States – Very uncertain but could be met if sufficient controls in place to monitor the functioning of the GRCM and prevent new domestic types of fraud to appear too quickly in the Member State applying the GRCM. However, only real experience can give a final estimation of this impact.

<sup>97</sup> See second paragraph under point 6.2 above.

<sup>98</sup> See Annex 6.

2. Minimising general increase in administrative burden – Not met. Although the increase of running costs will be limited in the two countries because most obligations are already in place and despite the protection effect of the threshold on the smallest businesses, set up costs will be incurred twice. In other countries, the impact will be even more negative as these obligations are not always in place now.
3. Avoid fraud shifting to other sectors and other Member States – Met.

### **Economic impacts**

#### **Impact on carousel fraud and Member States' tax revenue**

The same impacts as those pointed out under option 2b are expected, i.e. expected curbing of carousel fraud in the (higher number of) Member States applying the GRCM, new risks of fraud in these Member States. However, in case of effective fraud shifting to other Member States, these Member States could be allowed to also apply the GRCM. This should contribute to help limiting the extension of carousel fraud to these Member States. However, VAT receipts could be lost in the meantime the fraud shift is detected and the derogation is implemented in the concerned Member States.

*In a best-case scenario, reduction of carousel fraud in a higher number of Member States can be expected in the short term if sufficient controls are in place. Fraud migration to other Member States would be curbed. On a longer term, new risks of fraud are likely to develop in the Member State applying the GRCM in particular in case of insufficient controls. Final impact on fraud is difficult to measure without practical experience but it could be well positive in case the new risks of fraud expected in the longer term would not develop before the implementation of the definitive VAT system.*

*In a worst-case scenario, new risks of fraud are likely to develop in a higher number of Member States applying the GRCM. At the same time, the reduction of carousel fraud is expected in these Member States. The net impact would be almost nil even where fraud migration to other Member States would be curbed.*

#### **Impact on compliance costs to business**

The same impacts as those pointed out under option 2b are expected, i.e. new reporting obligations leading to set-up costs (and costs to revert back to the normal VAT system), increase in compliance costs to businesses. Since the GRCM might be implemented in more than two Member States, the probability that a business will be active in these additional Member States would be higher. This would mean complying with more numerous specific (and probably different) obligations in the Member States.

*In a best-case scenario, in the same way as under option 2b, the smallest businesses may not be impacted by the changes in the short term, and increase in compliance costs to businesses may also be limited in Member States having already requested to apply the GRCM (as in Austria and in the Czech Republic part of these costs have already been incurred). However, in the medium term, an increase in compliance costs (approaching 43%) to businesses active in other Member States (those that would have introduced the GRCM because of fraud shifting to their Member State) is more than likely. Indeed, these other Member States could be forced to apply the GRCM although no such specific reporting obligations as those already implemented in the initial Member States exist. However, large set up costs would in any case be incurred twice by all businesses of all Member States applying the GRCM or been active in such Member States. These businesses would also need to manage two parallel systems (above and under the threshold).*

*In a worst-case scenario, the increase in compliance costs in the other Member States (others than those having "initially" implemented the GRCM) happens already in the short term leading*



*to a possible more chaotic and therefore costly implementation.*

#### **Impact on administrative costs to tax administrations**

The same impacts as those pointed out under option 2b are expected, i.e. new administrative costs for the Member State applying the GRCM to implement it and to adapt control capacity (however, the extent of the increase highly depend upon actual efficiency of tax administration). The difference is that while under option 2b, the setting up of the GRCM results from a decision taken by the Member State on the basis of its actual ability to implement such a system (e.g. already high level of computerisation), under option 3b, other Member States might be forced to put in place such a heavy mechanism in order to fight against fraud shifting to their Member State although their ability to implement this mechanism might need important improvements (more administrative costs not initially foreseen).

*In a best-case scenario, the same impacts in the short and longer term as those mentioned under option 2b are expected, i.e. limited or no increase in administrative costs in Austria and the Czech Republic. In the medium term, the other Member States (those not applying the GRCM) would need to reinforce their control capacities and maybe introduce anti-fraud measures (other than the GRCM) to limit fraud shifting to their country. Increase in administrative costs is expected in the Member States "forced" to implement the GRCM although actual level of efficiency is expected to improve at the same time thanks to the set of measures that will be proposed by the Commission.*

*In a worst-case scenario, the increase in administrative costs to the other Member States (those that did not "initially" ask for applying the GRCM) happens already in the short term.*

#### **Impact on the functioning of the internal market**

The same impacts as those pointed out under option 2b are expected, i.e. difficulties linked to the running in parallel of two different VAT systems within the EU (increased complexity of the rules, cash flow impacts on businesses and tax administrations). However, the risk of fraud shifting is mitigated by the fact that the Member States at risk will be given the possibility to react by being allowed to also apply the GRCM.

*Equal treatment of Member States in a similar situation leads to limitation of fraud shifting between Member States which is less detrimental for the functioning of the internal market. Limited disturbance would start as from the application of the GRCM by at least one Member State and would last until adoption of the definitive VAT system.*

#### **Link with the VAT reform process**

The same impacts as those pointed out under option 2b are expected, i.e. opposite direction to the implementation of the single European VAT area in all Member States, with extra implementation expenditures, partially outweighed by gains from improved VAT collection in the Member States applying the GRCM. In addition, option 3b might present a risk of spill-over effect of the GRCM. More than two Member States might have implemented the GRCM which would imply that more businesses and more tax administrations will be affected. However, the criteria to be fulfilled in order for a Member State to be granted the derogation to apply the GRCM should limit the use of such instrument to what is necessary to attain the objective of reducing carousel fraud while preserving the internal market. Also, the safeguard clause enabling the Commission to revoke a derogation should mitigate any negative impact on the internal market.

*The initiative is at odds with the Commission's strategy to improve the VAT system in all Member States. However, since its impact on the internal market should be under control, it is consistent with the political commitment of the Commission to allow individual Member States to apply a GRCM on the basis of a derogation while safeguarding the internal market.*

#### **Environmental and social impacts**

Negligible or even zero<sup>99</sup>.

6.2.4.

*Common explanations to option 2b and option 3b*

***Box 9: New risks of fraud linked to the introduction of a GRCM***

*An independent study<sup>100</sup> carried out for the Commission on the new risks of fraud generated by the introduction of the reverse charge mechanism has shown that fraud might arise not only at a cross-border level but also at a purely domestic level. A table summarising the current forms of fraud which are likely to increase with the reverse charge mechanism and those which can be considered as new forms of fraud is available in Annex 7.*

***Forms of fraud likely to increase***

*By enabling operators to acquire goods VAT-free, the reverse charge mechanism represent an incentive for replicating existing forms of fraud, but highly concentrated at the retail level where the whole collection of VAT occur.*

*The possibility to acquire goods without any VAT being paid enhances the interest of operators (or even any person), who may not be entitled to reclaim totally or partially the VAT charged on their purchases, to perform all forms of hijacking of VAT identification numbers in order to benefit of such VAT-free acquisition.*

*Moreover, the risk which the reverse charge mechanism increases, concerns not only the fact that VAT would not be paid, but also that there would be a higher incentive for fraudulent operators to divert VAT to themselves or to sell goods to the black market. Existing fraudulent schemes would just be replicated at a purely domestic level without the need to interpose an intra-Community supply in between (to make purchases VAT-free) and prove the evidence of the transport from a Member State to another one. Indeed, VAT free obtained goods could be sold on with VAT but without remitting the tax subsequently or end up on the black market, either in the Member State applying the mechanism or in any (neighbouring) Member State that did not implement it. In particular, this could happen in Member States with higher VAT rates as to maximize the benefits of the fraudster when these goods are sold on to private consumers with VAT or, when sold in 'black', to have a larger competitive advantage over those that apply the VAT.*

*It is difficult to assess to what extent these phenomena will take place but it could be pointed out that this phenomenon has already been experienced in practice in relation to*

<sup>99</sup> See second paragraph under point 6.2 above.

<sup>100</sup> Pricewaterhousecoopers, 2007 (B) (see complete reference in Annex 4).

existing sectorial reverse charge mechanism derogations (e.g. in the sector of cereals in South East Europe<sup>101</sup>).

According to the mentioned study, existing forms of fraud, far from being counteracted, will most likely increase.

### ***New forms of fraud***

The study also evidenced that the existence of a threshold to apply the reverse charge mechanism would be the causing factor of specific schemes such as the artificial splitting of the taxable amount of a transaction in order to circumvent this threshold and to collect VAT from the customer without remitting it to the Treasury.

### **Box 10: Additional compliance costs linked to the introduction of a GRCM**

When goods can be obtained 'VAT free' and can be sold under conditions whereby the VAT is effectively charged to and paid by the client, the self-policing character of the current VAT system needs to be replaced by another control system. This control system should notably guarantee that all domestic transactions are tracked (see flanking measures in box 8 above).

The application of the two different VAT systems (the GRCM in the participating Member States and the current one in the rest of the Member States) within the internal market is expected to imply substantial costs for businesses in the Member States applying the GRCM<sup>102</sup> in order to change invoicing, accounting and declaration obligations. Set-up costs for the year of introduction of the measure were assessed<sup>103</sup> in 2008 at EUR 1.6 billion to EUR 2 billion for Germany alone, and recurring costs at EUR 100 to 200 million per year, which is the equivalent of EUR 500 million to EUR 1 billion a year at the level of the EU in 2016. Taking into account that the initiative is meant to be a temporary derogation to the VAT Directive, similar costs are expected to revert back to the current VAT system.

Increased complexity for taxable persons is expected in order to manage the threshold and to decide whether to apply the VAT or not. For each supply under the GRCM, suppliers will need to ascertain the VAT status of the acquirer and to obtain and subsequently store the necessary documentation. Increased administrative costs might, in particular, be problematic for SMEs for which compliance costs are relatively higher (e.g. adaptation of IT systems where those systems become mandatory). A recent study on the impact of the

<sup>101</sup> Application of the reverse charge mechanism in Romania which led to a shift of fraud to Hungary as regards certain cereals (Council implementing Decision 2011/363/EU of 20 June 2011 authorising Romania to introduce a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 163, 23.6.2011, p. 26) and Council Implementing Decision 2012/624/EU of 4 October 2012 authorising Hungary to introduce a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 274, 9.10.2012, p. 26).

<sup>102</sup> The GRCM will affect the established businesses as well as non-established taxable persons as they both might have to deal with two different VAT systems.

<sup>103</sup> COM (2008) 109 final.

optional reverse charge<sup>104</sup> has concluded that the reverse charge mechanism implies an increase by 43% of compliance costs to businesses. Part of these costs would however not be incurred under a generalized scheme (no need to distinguish VAT treatment per sector).

According to an external study<sup>105</sup>, specific means to combat new forms of fraud are required under a reverse charge mechanism. These can include, notably, the need:

- To issue domestic sales and purchase listings for all domestic transactions;
- To adapt invoicing, accounting and declaration obligation;
- To implement or adapt IT services;
- To comply with the use of a specific R number<sup>106</sup>;
- To comply with a computerised Taxable Person's identity card showing that the taxable person is a bona fide trader.

## 7. HOW DO THE OPTIONS COMPARE?

### 7.1. Summary assessment of the impacts

The table below analyses and evaluates the various impacts across the three options.

The main elements of each option have been weighed (0: no significant impact, +: positive impact, -: negative impact) according to their respective expected impacts. Further explanations on these impacts are summarized under letter "E-Overall assessment" below.

Key impacts	Baseline	Option 2b	Option 3b
<i>A-Effectiveness of options vs policy objectives</i>			
<b>Reducing VAT fraud</b> , in particular carousel fraud, in specific Member States by taking into account the specificities of Member States in terms of level of fraud and control capacities	<b>Best-case scenario Outcome: 0</b> Carousel fraud is stable or even reduced in the <u>short term</u> and 80% of carousel fraud could be removed in the <u>medium/long term</u> with the introduction of the	<b>Best-case scenario Outcome: -</b> Reduction of carousel fraud in the Member States applying the GRCM in the <u>short term</u> . New patterns of fraud (e.g. fraud shift to the retail stage) appear on a	<b>Best-case scenario Outcome: 0</b> Reduction of carousel fraud in more Member States applying the GRCM in the <u>short term</u> . New patterns of fraud (e.g. fraud shift to the retail stage) appear on a

<sup>104</sup> EY, 2014.

<sup>105</sup> Pricewaterhousecoopers, 2007 (B).

<sup>106</sup> R number is a special VAT ID number issued by the VAT authorities, which allows taxable persons to buy under application of the reverse charge. The format of the R number is exactly the same as a normal VAT ID number, except with a special "R" prefix.

	<p>definitive VAT system</p> <p><b>Worst-case scenario</b> <b>Outcome: 0</b></p> <p>No reduction of carousel fraud in most affected Member States in the <u>short term</u> and carousel fraud could even continue to increase in the <u>longer term</u> until the introduction of the definitive VAT system</p>	<p><u>longer term</u> but coincide with the implementation of the definitive VAT system</p> <p><b>Worst-case scenario</b> <b>Outcome: 0</b></p> <p>New risks of fraud develop in the <u>short term</u> in the Member States applying the GRCM at the same time as the reduction of carousel fraud and prolong in the <u>longer term</u> until implementation of definitive VAT system</p>	<p><u>longer term</u> but coincide with the implementation of the definitive VAT system</p> <p><b>Worst-case scenario</b> <b>Outcome: 0</b></p> <p>New risks of fraud develop in the <u>short term</u> in more Member States applying the GRCM at the same time as the reduction of carousel fraud and prolong in the <u>longer term</u> until implementation of definitive VAT system</p>
<p><b>Minimizing increase in compliance costs to business</b></p>	<p><b>Best-case scenario</b> <b>Outcome: 0</b></p> <p>Set of measures to be proposed by the Commission in the <u>short term</u> improves tax collection in all Member States with no impact on compliance costs. Simplification measures to be introduced by the definitive VAT system should reduce compliance costs to businesses in the <u>medium/long term</u></p> <p><b>Worst-case scenario</b> <b>Outcome: 0</b></p> <p>Compliance costs</p>	<p><b>Best-case scenario</b> <b>Outcome: -</b></p> <p>In the <u>short term</u>, in the Member States applying the GRCM, the impact on the smallest businesses will be very limited due to the threshold. New obligations on other businesses should be limited in the Member States in which the reporting obligations which are necessary to the GRCM are already in place. In the <u>longer term</u>, new costs to revert back to the normal VAT system will coincide with the implementation of</p>	<p><b>Best-case scenario</b> <b>Outcome: --</b></p> <p>Same as option 2b but in a wider number of Member States (more businesses impacted). This would include Member States where the reporting obligations are not yet in place (because GRCM is applied as a consequence of fraud shifting to their country), implying medium term additional costs to their businesses.</p> <p><b>Worst-case scenario</b> <b>Outcome: ---</b></p>

	<p>increase in the <u>short term</u> due to anti-fraud measures (other than reverse charge) being taken by individual Member States. Simplification measures to be introduced by the definitive VAT system should reduce compliance costs to businesses in the <u>medium/long term</u></p>	<p>the definitive VAT system.</p> <p><b>Worst-case scenario Outcome: ---</b></p> <p>The necessary obligations accompanying the GRCM are not in place and would need an urgent implementation. Anti-fraud measures (other than GRCM) adopted by the rest of the Member States increase compliance costs to their businesses</p> <p>In the <u>longer term</u>, large set up costs will be incurred twice (to revert back to the normal VAT system).</p>	<p>Same as option 2b but in a wider number of Member States</p>
<p><b>Minimizing increase in administrative costs to tax administrations</b></p>	<p><b>Best-case scenario Outcome: 0</b></p> <p>Implementation of set of measures proposed by the Commission in the <u>short term</u> does not increase significantly costs to tax administrations. In the <u>medium/long term</u>, additional administrative costs are expected in the year of implementation of the definitive VAT</p>	<p><b>Best-case scenario Outcome: -</b></p> <p>Administrative costs in the <u>short term</u> are expected to be limited in the Member States applying the mechanism. Administrative costs linked to the end of the GRCM are expected in the <u>longer term</u>.</p> <p><b>Worst-case scenario</b></p>	<p><b>Best-case scenario Outcome: --</b></p> <p>Same as option 2b: administrative costs are expected to be limited in Member States been the firsts to apply the mechanism</p> <p><b>Worst-case scenario Outcome: ---</b></p> <p>Increased administrative costs</p>

	<p>system.</p> <p><b>Worst-case scenario</b> <b>Outcome: 0</b></p> <p>Costs to tax administration slightly increase in the short term due to anti-fraud measures being taken by the Member States.</p> <p>In the medium/long term, additional administrative costs are expected in the year of implementation of the definitive VAT system.</p>	<p><b>Outcome: --</b></p> <p>Increased administrative costs are expected in the rest of the Member States in order to curb fraud shifting to their country by means of anti-fraud measures (other than GRCM) already in the <u>short term</u></p>	<p>are expected in the rest of the Member States in order to curb fraud shifting to their country (through anti-fraud measures other than GRCM) or to implement the GRCM in the <u>short term</u></p>
<b>Avoid fraud shifting</b> by ensuring that tax fraud does not move:			
- from one sector to another	<p><b>Outcome: 0</b></p> <p>Fraud can shift between sectors due to the application of the current sectorial reverse charge</p>	<p><b>Outcome: ++</b></p> <p>Fraud is no longer expected to shift between sectors in the Member States applying the mechanism</p>	<p><b>Outcome: ++</b></p> <p>Fraud is no longer expected to shift between sectors in the Member States applying the mechanism</p>
- from one Member State to another	<p><b>Outcome: 0</b></p> <p>Fraud can shift but to a limited extent between Member States because of the absence of the application by a Member State of a GRCM</p>	<p><b>Outcome: --</b></p> <p>Fraud is expected to shift to other Member States (neighbour countries with poor/weaker tax control capacities) without any possibility to</p>	<p><b>Outcome: +</b></p> <p>Fraud could shift to other Member States (neighbour countries with poor/weaker tax control capacities) but be stopped once the GRCM is applied by these</p>

		react	Member States
<b><i>B-Impact on internal market</i></b>			
	<b>Outcome: 0</b> No negative impact on the internal market	<b>Outcome: ---</b> Impact on the internal market is negative.	<b>Outcome: 0</b> Impact on the internal market is limited. In case of negative impact on several Member States, safeguard clause would allow to revoke a derogation
<b><i>B-Interaction between political commitment and VAT reform process</i></b>			
	Baseline is consistent with the single European VAT area but does also not address immediate fraud problems in certain Member States in line with the political commitment	Option 2b is at odds with the single European VAT area. It addresses the immediate problem of certain Member States. It is not perfectly in line with the political commitment because of its negative impact on the internal market	Option 3b is at odds with the single European VAT area but addresses the immediate problem of certain Member States. It is in line with the political as it should preserve the internal market

## 7.2. Identification of the preferred option

### 7.2.1. *Overall assessment of the options and selection of the preferred option*

The analysis above provides mixed outcome when the impacts of the options are regarded either as short term or medium/long term solutions.

In the medium/long term, the baseline is, from an economic point of view, the preferred option. It results from in-depth consultations, studies and analyses that started in 2011 with the Green Paper and the Communication on the future of VAT. It is also the most consistent way to improve the functioning of the current VAT system. However, its estimated results in terms of reducing fraud, compliance costs to businesses and improving the current VAT system can only be expected in the medium to long term. It therefore does not solve the



urgent problems of fraud of specific Member States in the short term and does not meet the political commitment of the Commission (17 June 2016 ECOFIN).

Option 2b and option 3b may in a best case scenario provide short term solutions in terms of reducing carousel fraud in the Member States applying the mechanism although their final impact is very uncertain and could even be nil in a worst-case scenario. Both options have negative implications on administrative burdens and are therefore subject of major concerns from businesses, including from the EU REFIT platform. They are also both at odds with the objective to set up a single EU VAT area based on the principle of taxation of all transactions.

As Option 2b would allow the buying of all goods "VAT free" without any border control to stop these goods entering the markets of other countries, this option would cause a major shift of their carousel fraud to other Member States (particularly neighbour countries with weaker tax control capacity). These Member States would not have the possibility to apply such a system while fraud might be impossible for them to be circumvented in the very short term by traditional anti-fraud measures.

Option 3b would offer all Member States<sup>107</sup> the possibility to apply the GRCM, either because of their current fraud/control situation<sup>108</sup> or in case they prove that the application of the GRCM in other Member States would cause a shift of fraud to their own country. This option would have the advantage of giving all Member States the same instrument to fight against carousel fraud when other means prove not to be sufficient.

Option 3b is therefore the only option which fulfils the political commitment of the Commission to grant such derogation to Member States without creating risks for the internal market.

#### 7.2.2. *Benchmark*

The purpose of the derogation to apply a GRCM is to help Member States more heavily affected by fraud, in particular carousel fraud, to curb such fraud. However, the introduction of the mechanism is expected to bring these Member States closer to the tax collection capacities of the rest of the Member States. Although, as mentioned before, fraud is by definition difficult to measure, a positive change in the trend of their VAT gap or the amount of its carousel fraud towards the EU average could be an indication of the efficiency of the measure. However, this would also need to be assessed against any possibly disproportionate increase in compliance costs to business.

### **8. HOW WOULD ACTUAL IMPACTS BE MONITORED AND EVALUATED?**

Since the initiative is a temporary measure meant to fight in the short term against carousel fraud (until a definitive VAT system is adopted), its effects need to be closely monitored as regards its efficiency already during its implementation period. Because of its potential side-effects (e.g. increase in compliance costs to businesses, development of new types of fraud, fraud shifting to other Member States), a close monitoring should be ensured not only by the Member States applying the mechanism but also by the rest of the Member

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<sup>107</sup> But on the basis of predefined criteria (see point 5.4 above).

<sup>108</sup> See description of predefined criteria under point 5.4 above.

States. This monitoring should allow eventual adjustments to the mechanism in case of substantial negative impact on the functioning of the VAT system within the internal market (safeguard clause allowing the Commission to repeal a granted derogation). The monitoring would also serve in case of need to extend the mechanism to other Member States (option 3b).

Therefore, an interim report (within 2 years of implementation) as well as a final report (after the 5 years implementation period) shall be submitted to the Commission by all Member States.

## **8.1. Monitoring by the Member States applying the reverse charge mechanism**

### *8.1.1. Reporting obligations*

Member States choosing to apply the generalized reverse charge mechanism should introduce specific electronic reporting obligations on all taxable persons so as to ensure the effective operation and monitoring of the application of that mechanism and detect and prevent all new forms of tax fraud during the 5 years implementation period. The Member States applying the mechanism shall inform the Commission of all the measures taken in this respect.

### *8.1.2. Interim and final report*

In order to assess the effect of the application of the mechanism on fraudulent activities in a transparent manner, pre-defined evaluation criteria should be established by these Member States so as to enable an assessment of the level of fraud before and after the introduction of the mechanism.

In order to ensure the monitoring of the efficiency and effectiveness of the mechanism during its implementation period, Member States applying the GRM shall submit an interim report to the Commission, within 2 years of implementation, on the basis of the above mentioned evaluation criteria.

This report shall provide a detailed assessment of the mechanism's effectiveness and efficiency so far, in particular as regards the impact on fraud, the possible shift of fraud to the retail level and the compliance costs for taxable persons resulting from the mechanism.

After the end of the 5 years implementation period, the Member States applying the GRM shall submit to the Commission a final report on the overall effectiveness and efficiency of the mechanism in particular as regards the impact on fraud and the compliance costs for taxable persons resulting from the mechanism.

## **8.2. Monitoring by the Member States not applying the reverse charge mechanism**

To closely monitor the impact on the internal market of the application of the GRM by some Member States and allow eventual adjustments, all the other Member States shall also submit an interim report (within 2 years of implementation) and a final report (after 5 years of implementation) to the Commission. These reports should enable an assessment of the impact on fraud, compliance costs to businesses and possible shift in trends of fraudulent activities.

### **8.3. Monitoring by the Commission – Operational objectives**

On the basis, notably, of the interim reports provided by all Member States, the Commission would follow-up the implementation of the mechanism. Besides evaluating the direct effect of the mechanism on fraud, this should allow the Commission to take the necessary measures, either consisting in terminating the derogation in case of disruption of the functioning of the internal market or in extending it to other Member States.

#### *Operational objectives*

As the main objective of the derogation is to fight against fraud, in particular carousel fraud while preserving the internal market (no substantial increase in compliances costs to business, no shift of fraud to other Member States), the achievement of the following operational objectives will be monitored:

#### **1) Positive effect on the VAT gap trend**

The indicator used will be the annual VAT gap study<sup>109</sup>.

#### **2) Reduction in the amount of fraud, in particular carousel fraud**

The indicator would be set up by the Member States and cross-checked with information from Eurofisc<sup>110</sup>, SCAC<sup>111</sup>, fraud cases in National/European Courts of Justice and feedback from stakeholders.

#### **3) No disproportionate increase in compliance costs to business**

Analysis will rely on data provided at national level (by the Member States) and cross-checked with information from Eurofisc, SCAC and stakeholders.

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<sup>109</sup> Study carried out by an external contractor for the Commission in close cooperation with the Member States.

<sup>110</sup> [Eurofisc](#).

<sup>111</sup> Standing Committee on Administrative Co-operation (SCAC).

## **9. ANNEXES**

### **9.1. Annex 1: Procedural information concerning the process to prepare the impact assessment report and the related initiative**

### **9.2. Annex 2: Stakeholder consultation**

### **9.3. Annex 3: Who is affected by the initiative and how?**

### **9.4. Annex 4: Methodology**

### **9.5. Annex 5: short term measures to enhance tax compliance and strengthen the fight against vat fraud**

This Annex describes how the Commission can provide technical assistance to help the Member States to improve their tax collection and inspection capacity.

### **9.6. Annex 6: Replies from Austria and the Czech Republic to the questionnaire sent by the Commission**

This Annex contains the replies from Austria and the Czech Republic respectively received on 24 and 25 May 2016 in reply to a questionnaire that the Commission sent on 4 May 2016, further to the requests from these Member States to be granted a derogation to apply the generalise reverse charge mechanism.

### **9.7. Annex 7: Summary table on the new forms of fraud linked with reverse charge mechanism**

This Annex contains a table summarising the current forms of fraud which are likely to increase with a reverse charge system and those which can be considered as new forms of fraud. It is extracted from the Pricewaterhousecoopers, 2007 (B) study (see complete reference in Annex 4).

### **9.8. Annex 8: Meeting report of the ISSG on a temporary application of the VAT reverse charge mechanism**

**Annex 1: Procedural information concerning the process to prepare the impact assessment report and the related initiative**

**1. Agenda planning and Work Programme References**

The proposal for a generalised reverse charge mechanism is linked to the VAT Action Plan.

TAXUD is the lead DG for the initiative. The Agenda Planning Reference is [2016/TAXUD/027]. The Inception Impact Assessment was published on [not published yet].

**2. Inter-Service Steering Group**

The first meeting of the Inter-Service Steering Group has taken place on 15 September 2016 [see minutes in Annex 8].

The following directorates and services were present: SG, SJ, BUDG, CNECT, ENV, ENER, JUST, GROW and OLAF. The feedback received from these directorates and services has been taken into account in the report.

**3. Consultation of the Regulatory Scrutiny Board**

The Impact Assessment Report was submitted to the Regulatory Scrutiny Board for a first time on 27/09/2016 and a meeting took place between the Board and DG TAXUD on 26/10/2016. On 28 November, the Regulatory Scrutiny Board gave a positive opinion with recommendations for improvements. The report was adjusted in order to integrate the Board's recommendations.

The main issues were addressed in the following way:

<b>Board recommendations</b>	<b>What has been done?</b>	<b>Where?</b>
(1) Better structure the comparison of options. The report should clarify why worst-case scenarios were considered only for reducing VAT fraud and not for the other aspects, such as compliance cost increase or costs to tax administrations. Moreover, it should also make clear why short-term and long-term risks are only considered for VAT fraud reduction. The report should better explain the results of the comparison of options 2b and 3b, given that the assessment of the options appears to be the same even though the score is different.	<p>Worst cases scenarios for compliance costs and costs to tax administrations have been added.</p> <p>Short and long-term risks are considered for fraud but as regards e.g. compliance costs, a distinction is made between recurrent costs and costs to change and revert back to and from the GRCM (not really 'risks' but certainties).</p> <p>Differences regarding option 2b and 3b are already explained as regards the number of Member States potentially involved in the GRCM which has its effect on the score.</p>	<p>Section 6.2.1 (points 3 and 4)</p> <p>Sections 6.2.2.1 and 6.2.3.1 (under "Impact on compliance costs to business", "Impact on administrative costs to tax administrations", "Impact on the functioning of the internal market")</p>

		Section 7.1 (summary table)
(2) Each option should be compared against a baseline. The scores should reflect the positive or negative assessment of the options compared against the baseline. So the baseline should be scored at zero and the scores of the options adjusted accordingly.	The scoring for the baseline has overall been set at zero and the options have been re-scored along this benchmark.	Section 7.1 (summary table)
(3) It should identify risks related to potential additional elements introduced by Member States that may increase administrative burden or may have negative cross-border effects.	No new risks, in addition to those already established, were identified but risks linked to potential additional anti-fraud measures adopted by the Member States are better explained through the new best and worst-case scenarios developed for compliance and administrative costs.	Same sections as under point (1) above
(4) Stakeholder views should be further referenced throughout the report, including also the points raised in the consultation for a Green Paper on the possible introduction of an optional reverse charge mechanism.	In addition to the nine references to the stakeholder views, another three were added, in particular as regards results of the Green Paper consultation.	See pages 10, 34 and 35

#### 4. Commission Group on the Future of VAT

The Group on the Future of VAT (GFV)<sup>112</sup> provides a forum for discussion with VAT Experts from the Member States' tax administration on the Commission pre-legislative initiatives. This group provided on 5 February 2016 the Commission with a comprehensive view of the opinions on the possible implementation and application of a generalized reverse charge mechanism. At that time, a considerable number of Member States were rather opposed to the initiative.

<sup>112</sup> The Group on the Future of VAT provides a forum for discussion with VAT Experts from the Member States on the Commission pre-legislative initiatives and exchange of opinions on the preparation of future VAT legislation.

## **Annex 2: Stakeholder consultation**

The current initiative results from a political agreement made at the ECOFIN of 17 June 2016 during which the Commission committed to present, before the end of the year, a legislative proposal allowing individual Member States to derogate from the common system of value added tax so as to apply a generalised reverse charge mechanism to domestic supplies above a defined threshold and preserving the internal market.

Given this constraining timing aspect, and the fact that, otherwise, much awaited (anti-fraud) proposals remain or will be blocked at the Council, no specific stakeholder consultation has taken place as regards the possibility for a derogating measure regarding the possible application of a generalised reverse charge mechanism in certain Member States.

Notwithstanding this, the Commission has a clear understanding of the problems and possible solutions - including on the aspects of reverse charge - as the current process is linked to a reform of the VAT system which already started in 2010.

At that time, an open public consultation took place on the 'Green Paper on the future of VAT' - Towards a simpler, more robust and efficient VAT system"<sup>113</sup> (COM(2010)695), and which resulted in around 1700 contributions; providing a detailed view of problems linked to the VAT application in the different Member States.

According to the outcome of the abovementioned public consultation, it appears that the complexity of the current VAT system creates high administrative burdens, in particular related to the arrangements for intra-EU trade.

On one side, a considerable group of respondents supported the implementation of the destination principle by One-Stop-Shop arrangements (OSS). On the other side, a similar number of participants to the consultation supported the use of the reverse charge mechanism as a possible solution to carousel fraud or cash-flow problems, avoiding the gap between the payment and the deduction of the tax.

The majority of respondents pointed out that it would be desirable to ensure the same treatment to domestic and cross border transactions, establishing the same obligations in the light of legal certainty and simplification. In particular, SMEs are the most affected by the complexity of the administrative burdens, in particular as regards the reporting obligations connected to such measure.

The stakeholders involved in the public consultation, in particular governments and public authorities, provided some remarks in relation to the procedure requested for the implementation of the reverse charge mechanism at national level for certain sectors. The mechanism can be granted after a derogation request under article 395 of the VAT directive. According to these stakeholders, the criteria in Article 395 are too broad and

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<sup>113</sup> See consultations page:  
[http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/future\\_vat/summary\\_vat\\_greenpaper.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/summary_vat_greenpaper.pdf)

insufficiently clear to assess whether a derogation on reverse charge would be granted or not.

However, a number of respondents, including businesses, consider that the derogation is a good instrument to address national needs due to its efficiency and flexibility.

In conclusion, the reverse charge mechanism (generalised or targeted) was considered by several respondents as an effective measure to eliminate missing trader fraud. However, in order to tackle the VAT gap and to reduce the compliance costs and the administrative burdens, other measures with the same potential effectiveness exist and should, according to these respondents, be envisaged. For example, a number of stakeholders were in favour of an optional OSS as a simplification measure rather than the reverse charge.

In June 2015, four Member States submitted a request under article 395 of the VAT Directive in order to be authorised by the Commission to apply the reverse charge mechanism to any taxable supply where the overall amount (exclusive of VAT) exceeds EUR 10,000. The request was however refused on legal grounds.

The strengths and weaknesses of the reverse charge mechanism, as implemented within the current system, as a domestic measure to combat VAT fraud have been examined in depth by the Group of the Future of VAT (GFV- representing Member States<sup>114</sup>) and the VAT Expert Group (VEG -representing businesses, academics and accounting professions<sup>115</sup>).

From the perspective of Member States<sup>116</sup>, the sectorial reverse charge is an effective measure to combat tax fraud, in particular MTIC frauds. However, regarding the options proposed for the definitive regime after the Communication on the future of VAT, they would have preferred a further analysis in order to decide whether the reverse VAT mechanism would be a suitable choice to improve the current system.

From the perspective of tax practitioners<sup>117</sup>, the further implementation of the sectorial reverse charge would not remove the VAT fraud, it would just shift the fraud from one Member State to another with a 'domino' effect, or from one sector to another.

Further, tax administrations and business representatives have discussed the issues related to the possibility to implement a generalised reverse charge mechanism during a meeting of the Group on the Future of VAT and of the VAT Expert Group in February 2016 which have provided the Commission with a comprehensive view of different opinions on the possible implementation and application of such a system.

As regards Austria and the Czech Republic (the two Member States that requested authorisation to apply a generalised reverse charge system via a change to the VAT

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<sup>114</sup> The Group on the Future of VAT provides a forum for discussion with VAT Experts from the Member States on the Commission pre-legislative initiatives and exchange of opinions on the preparation of future VAT legislation.

<sup>115</sup> The VAT Expert Group (VEG) is composed of individuals with the requisite expertise in the area of VAT and organisations representing in particular businesses, consumers and tax practitioners. [https://ec.europa.eu/taxation\\_customs/business/vat/vat-expert-group\\_en](https://ec.europa.eu/taxation_customs/business/vat/vat-expert-group_en)

<sup>116</sup> GFV working paper n°37 of 2013

<sup>117</sup> VEG working paper n°20,21,25,31,39



Directive) replies were respectively received on 24 and 25 May 2016 to a questionnaire that the Commission sent on 4 May 2016.

The GFV during the 14<sup>th</sup> meeting on the 5<sup>th</sup> February 2016<sup>118</sup>, released its opinion on the project proposed by the above-mentioned Member States. Only four delegations were supportive of the generalised reverse charge, while the majority were in opposition to that idea for several reasons. The main argument was the risk for the national budget because the collection would only take place at the retail stage (i.e. at the end of the supply chain) with all the problems connected to the control of numerous businesses at this stage. On the concrete extension of the reverse charge mechanism at national level, the need for a threshold by transaction was considered problematic and easily exploited in abusive situations. On the proposal to have a pilot temporary project only in some Member States, some delegates pointed out that such measure could lead to distortion of completion or a negative impact on non-established businesses.

The VEG, during the 13<sup>th</sup> meeting on 2 May 2016, expressed its position on the request submitted by the above mentioned Member States, taking into account the academic, professional and business point of view; highlighting two main concerns: (i) collecting the VAT at the end of the chain just shifts fraud elsewhere, notably to the final last stage of the supply chain, and creates new fraud opportunities;(ii) the risk of fraud moving to Member States not applying the reverse charge.

Other institutions, such as the Committee of the Regions and the European Economic and Social Committee (EESC) have given their opinion on the Action Plan with particular reference to the reverse charge mechanism. The first institution recognised that measures, like the reverse charge, could be effective but also recommended exploring further the possibility of a so-called split payment, under which the VAT is directly paid to a separate bank account of the competent authority.<sup>119</sup> The second institution was doubtful on the capacity of the general reverse charge to achieve the objective of implementing the destination principle as a clear and consistent VAT system. The measure under analysis, although effective for certain sectors, does not seem suitable to prevent fraud at the retail sale stage<sup>120</sup>.

In addition, stakeholders explained their position in the Refit Platform, regarding the application of the reverse charge mechanism to all domestic transactions. These contributions are very important because they represent the public opinion of both the businesses (stakeholder group) and the Member States (Government group) with the aim to settle a better legislation.

The message from the stakeholders group, reported by the Danish business forum, is that it would be worth to "replace that measure with a simpler and more basic VAT regime in the EU". The rationale of that statement is the need to look for long term and sustainable solutions instead of temporary measures adopted under a situation of urgency.

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<sup>118</sup> GFV working paper n°53 of 2016

<sup>119</sup> Committee of the Regions, 119th plenary session, 10, 11 and 12 October 2016.

<sup>120</sup> Opinion of the European Economic and Social Committee ECO/406, Action plan on VAT, Brussels, 13 July 2016.

In fact, the reverse charge obliges businesses to "operate different sales and accounting systems for different business transactions"<sup>121</sup>; notably increasing the administrative burdens. In their opinion, the same results could be achieved enhancing the administrative cooperation between Member States and businesses.

The German Chambers of Commerce and industry added that the reverse charge conditions should be standardised, ensuring a uniform application at EU level for B2B transactions.

In the same context, the REFIT Government group stressed that such a measure "may continue to be necessary to combat fraud or that other measures would be required to achieve the same objective"<sup>122</sup>. The reference to other measures to tackle VAT fraud, such as the improvement of the administrative cooperation or introducing targeted measures (e.g. sound cross-check system), is a possibility that has to be taken into account besides the sectorial reverse charge.

Reference should also be made to the opinions adopted by business federations as well as to input received from academics via scientific publications.

Regarding to the business federations, the Confederation Fiscal Européenne (CFE) has delivered several opinion statements on the strengths and weaknesses of a domestic extended reverse charge. The weakness of the proposed model of VAT liability and collection is the complexity that would arise establishing a different treatment between domestic and cross border transactions<sup>123</sup>.

Regarding the sectorial reverse charge, it has been pointed out that businesses would face several difficulties, such as the complexity and the fragmentation of the procedures which, in turn, increase the compliance costs<sup>124</sup>. Costs will in particular increase for suppliers that cannot offset their input VAT against their VAT on their output to which the reverse mechanism is applied<sup>125</sup>.

However, from a tax collection point of view the application of reverse charge mechanism to certain sector is the most effective measure against the MTIC fraud. For that reason, the CFE "considers that other helpful steps might be to apply the reverse charge mechanism that is applied by at least one member state to some products on an EU wide basis to transactions above a specified value in specified products"<sup>126</sup>.

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<sup>121</sup> Refit Platform Opinion on the submission of the Danish Business Forum on the reverse charge mechanism within the VAT Directive, adopted on 27/28 of June 2016

[http://ec.europa.eu/smart-regulation/refit/refit-platform/docs/recommendations/opinion\\_taxation\\_1a.pdf](http://ec.europa.eu/smart-regulation/refit/refit-platform/docs/recommendations/opinion_taxation_1a.pdf)

<sup>122</sup> Refit Scoreboard, Opinion XVIII.1a "VAT Reverse liability charging" and Opinion XV.III.7a "Documentation for Intra-Community Trade", Towards a definitive VAT system for cross border trade, Summary, p. 335-336

<sup>123</sup> CFE Opinion Statement on the VAT Action Plan, 2016

<sup>124</sup> Opinion Statement of the CFE on persons liable for payment of VAT to the tax authorities regarding operations taking place in one Member State Submitted to the European Institutions in February 2011

<sup>125</sup> Opinion Statement of the CFE on persons liable for payment of VAT to the tax authorities regarding operations taking place in one Member State Submitted to the European Institutions in February 2011

<sup>126</sup> Opinion Statement of the CFE on the consequences of involvement in missing trader fraud Submitted to the European Institutions in February 2011

On reverse charge, the Chartered Institute of taxation (CIOT), taking into account the study launched by the Commission and provided by Pricewaterhouse Coopers in 2007, referred to the possible cash flow effects and the increased responsibility on the businesses<sup>127</sup>.

In the same context, the Austrian federal economic chamber released a paper in November 2015 where they explained in detail why a general reverse charge system would lead to a further complication of the VAT system causing legal uncertainty and large administrative costs. According to their position paper, the adoption of a reverse charge mechanism based on a threshold system will create the existence of four different VAT regimes at the same time: (i) domestic transactions under the old VAT – regime; (ii) domestic transactions under the new VAT regime; (iii) Intra EU acquisition and Intra EU supplies; (iv) export deliveries to third countries.

In that scenario, adding a new system is not a desirable measure to enhance simplification, in particular for SMEs that are the most affected category by administrative compliance costs. Another interesting remark is related to the antifraud measures that could be effective in the current system, instead of the reverse charge; like an electronic cash accounting system. The general reverse charge would shift the fraud to final consumers, at the retail stage, through the use of an invalid VAT number.

The group of professionals specialised in tax matters (represented by TAJ, a Paris law firm) expressed their view both regarding sectorial reverse charge and generalised reverse charge<sup>128</sup>.

In their opinion on the generalised reverse charge, they stated that the measure at domestic level would not be effective because it would just shift the fraud to the retail stage as it would transform the VAT into a sale tax. The consequence would be that the control activity of the tax administration on the retailers would become more difficult without the collaboration of compliant taxable persons collecting the tax via the fractionated system.

Another French group of professionals (APTE) delivered his position to the commission, stressing the importance of keeping the fractionated payment of the tax in order to ensure the respect of the neutrality principle.

Regarding to the scientific publications on VAT, in particular in the VAT Monitor, there was a lively discussion between academics on the effectiveness and the need of a generalised reverse charge<sup>129</sup>.

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<sup>127</sup> Possible introduction of an optional reverse charge mechanism for VAT. Response by The Chartered Institute of Taxation to the European Commission, 18 October 2007

<sup>128</sup> M. Guichard and M. Manuelli "La généralisation de l'autoliquidation de la TVA aux transactions internes entre assujettis est-elle une mesure efficace pour lutter contre la fraude ?" in TAJ-STRATEGIE.FR

<sup>129</sup> Robert F. van Brederode and Sebastian Pfeiffer, "VAT' s Superiority: Is the Emperor Dressed like Adam?", IBFD, IVM, 04/2015, p.226

Gorka Echevarría Zubeldia "Turning VAT Inside Out", IBFD, IVM, 04/2015, p.204

Robert F. van Brederode and Sebastian Pfeiffer, "Debate on general reverse charge", IBFD, IVM, 05/2015, p.288

The debate mainly focused on the elimination of the fractioned payment introducing the general reverse charge. Two authors explained that the general reverse charge could be implemented under the condition that the requesting country has a well-functioning tax administration. The general reverse charge, according to their view, is the most effective remedy to combat VAT fraud<sup>130</sup>. These authors defined the fractioned collection as an "illusion" as far as the recipient of the transaction has the right of full deduction of the input VAT<sup>131</sup>. On the other side, the other author, argued that abandoning the fractioned collection of VAT would not comply with the general principle governing VAT (i.e. neutrality and proportionality). Regarding to the practical aspects it would create a "much wider base of taxable persons to audit" and transform the actual EU VAT system in a retail sales tax system<sup>132</sup>. In such scenario, the cash flow would disappear for the taxable persons but, in the same way, the tax authorities would not collect the tax unless the chain transaction ends with the final consumption.

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<sup>130</sup> Robert F. van Brederode and Sebastian Pfeiffer, "Combatting Carousel Fraud: The general reverse charge", IBFD, IVM, 03/2015

<sup>131</sup> Robert F. van Brederode and Sebastian Pfeiffer, "Debate on general reverse charge", IBFD, IVM, 05/2015, p.288

<sup>132</sup> Gorika Echevarría Zubeldia "Turning VAT Inside Out", IBFD, IVM, 04/2015, p.204

### **Annex 3: Who is affected by the initiative and how?**

In Member States applying the generalised reverse charge mechanism, (normal) VAT taxable persons (businesses) and tax administrations are affected by these new rules. Businesses on the way the VAT is accounted for on supplies of goods and services and tax administrations that have to audit the application of these new rules by the taxable persons concerned. The general public should not be affected by these changes. Goods and services will be purchased domestically with payment of VAT in exactly the same way as is currently the case. Consumer prices are therefore not expected to be substantially impacted by the initiative.

In this context, it is important to underline that SMEs, which benefit from the VAT exemption scheme for small enterprises (see Chapter I of Title XII of the VAT Directive which encompasses Articles 284 to 294 of the VAT Directive) are not affected by the measure at all. As today, these SMEs will continue not charging VAT to their customers on their supplies and will, as a consequence, also not be able to deduct their input VAT. In this respect, they are not different from private individuals who would sell personal goods. To note that the current exemption thresholds varies amongst Member States, which is, inter alia, linked to their date of accession (see Articles 285 to 287 of the VAT Directive) and to derogations granted to individual Member States (on the basis of Article 395 of the VAT Directive). Therefore, the Commission is planning to come forward with a proposal in the form of a comprehensive VAT simplification package for small enterprises by the end of 2017. As the reverse charge mechanism is only applicable in those situations where VAT is actually due, these SMEs are, as mentioned, entirely unaffected and will remain unaffected even in case such a new proposal would be adopted.

As regard the 'normal' taxable persons; i.e. taxable persons who are obliged to charge VAT on their supplies and who are filing regular VAT returns, a distinction should be made between those who are established within a Member State, which applies the generalised reverse charge mechanism, and those who are not established in such a Member State but who conduct operations in that Member State for which, under normal circumstances, they would be liable for the payment of the VAT. For those, who are not established, a further distinction is to be made according the situation under which the Member State, applying the generalised reverse charge mechanism, has made use (or not) of Article 194 of the VAT Directive that stipulates that Member States may provide that, in case a taxable supply of goods or services is carried out by a taxable person who is not established in the Member State where the VAT is due, the person liable for payment is the person to whom the goods or services are supplied. In cases where use has been made of this possibility, the situation remains unchanged in practice for those non-established taxable persons although the legal basis regarding the person liable for payment of VAT might change. In fact, in case the threshold for the generalised reverse charge mechanism would be exceeded, the new rules would be applicable and the reverse charge mechanism would be applied. In case the threshold would not be exceeded, the reverse charge mechanism would still be applied but then on the basis of the above mentioned Article 194 of the VAT Directive. Under the situation that a Member State is not making use of this Article 194, the situation remains also unchanged as the supplier, in the same way as today, would also, as a rule, have to be identified for VAT purposes in the Member State where the supplies take place.

Other Member States than those, having introduced the generalised reverse charge mechanism, might be impacted as fraud might shift to their territory because of the

possibility for taxable persons to obtain goods 'VAT free' (above the threshold) and to bring them across the border in order to be sold on the black market. These Member States might therefore adapt or reinforce their tax control measures or be forced to introduce a generalised reverse charge mechanism as well. This might imply increased administrative costs to these tax administrations as well as new compliance cost to their businesses. In order to intercept these untaxed goods fleeing into the country, Member States might be inclined to increase physical controls on e.g. foreign trucks which could gradually evolve into the equivalent of border controls.

Finally, it is to note that VAT fraud does not impact the overall level of the EU budget. Although VAT fraud reduces the Member States' VAT contribution to the EU (one of the EU own resources is based on VAT), since the EU budget must be in balance, expenditure not covered by amounts yielded from other revenues must be offset by contributions based on the Gross National Income (GNI) of each EU Member State. Therefore, the introduction of the generalised reverse charge mechanism is not expected to influence the EU budget. However, while VAT-fraud (and the measures adopted by the Member States to fight against it) does not impact the overall level of the EU budget (because remedied by another resource in view of the principle of budgetary balance), a loss to one own resource is still a loss, which is particularly unacceptable in terms of fairness of EU taxation systems.

## **Annex 4: Methodology**

The initiative is the result of a political agreement made on the ECOFIN of 17 June 2016 to present a proposal on a generalised reverse charge mechanism for certain Member States before the end of 2016.

Given this timing, no specific tool or methodology was developed for the assessment of the options. Due to timing constraints, no independent study could either be launched. However, a number of studies in the field of fraud and reverse charge already existed of which the results were used in the impact assessment. In addition, the replies received by the Commission to the questionnaire sent by it to the two requesting Member States also served the analysis (see Annex 6). These results were complemented by a qualitative analysis on which this impact assessment mainly relies.

### **Overview of studies**

- CASE, 2016, Study and Reports on the VAT Gap in the EU-28 Member States

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/2016-09\\_vat-gap-report\\_final.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09_vat-gap-report_final.pdf)

- EY, 2015, Implementing the ‘destination principle’ to intra-EU B2B supplies of goods

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/ey\\_study\\_destination\\_principle.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ey_study_destination_principle.pdf)

- CASE, 2015, Study to quantify and analyse the VAT Gap in the EU Member States

[http://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/common/publications/studies/vat\\_gap2013.pdf](http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/studies/vat_gap2013.pdf)

- EY, 2014, Assessment of the application and impact of the optional ‘Reverse Charge Mechanism’ within the EU VAT system

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/kp\\_07\\_14\\_060\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/kp_07_14_060_en.pdf)

- IFS et al., 2011, A retrospective evaluation of elements of the EU VAT system

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/report\\_evaluation\\_vat.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/report_evaluation_vat.pdf)

- Pricewaterhousecoopers, 2007 (A), Study in respect of introducing an optional reverse charge mechanism in the EU VAT Directive

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/4209\\_study\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/4209_study_en.pdf)

- Pricewaterhousecoopers, 2007 (B), Study on new risks of fraud generated by the introduction of a generalised reverse charge system on an optional basis and the taxation of intra-Community supplies

## **Annex 5: Short term measures to enhance tax compliance and strengthen the fight against VAT fraud**

In its VAT Action Plan - adopted on 7 April 2016<sup>1</sup> - the Commission noted that fraud was not affecting all Member States to the same extent and that shorter term measures might be needed in order to achieve better administrative cooperation, improve voluntary compliance and collectively improve the performance of European tax administrations. In this context, the Commission stated that it stands ready, via the organisation of technical assistance, to help the Member States concerned to improve their tax collection and inspection capacity.

The present paper summarises how such a technical assistance could be organised and what it should aim at.

The following actions could be considered:

1. **Carrying out a TADAT assessment.** An assessment of a tax administration's strengths and weaknesses helps in identifying measures for improving tax compliance. A Tax Administration Diagnostic Assessment Tool (TADAT) is available for tax administrations to assess the key performance areas (registration, risk analysis, voluntary compliance, timely filing and payment, audit, appeals, efficient revenue management, accountability and transparency). The Commission and Member States have certified assessors for carrying out a TADAT assessment.
2. **Making better use of IT tools.** More and more tax administrations are using electronic means to collect data from taxpayers and other institutions. This allows for cross-checking and better risk analysis. In the area of the cash economy, new techniques (e.g. electronic cash registers) are used to limit the possibilities of committing fraud. Sharing experiences and practices with these measures could be an advantage when a Member State is considering introducing them. The Commission is willing to organise targeted workshops in this area.
3. **Providing targeted technical assistance on request.** For those Member States willing to improve their national situation, the Commission offers hands-on assistance, either directly or via experts from other Member States. For this purpose a Fiscalis budget is available.
4. **In-depth analysis of VAT fraud schemes.** Not all non-compliance is fraud. The nature, number and size of VAT fraud schemes vary between Member States. VAT fraud schemes can flourish depending on the weaknesses in VAT legislation and tax administration practices (e.g. lacking auditing, limited exchange of information, corruption, restricted cooperation)..

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<sup>1</sup> Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT (COM(2016) 148 final 7.4.2016)



5. **In-depth analysis of the VAT Gap.** The VAT Gap study only provides for a general estimation of the VAT Gap. Member States are encouraged to further analyse the components of the VAT Gap and quantify the VAT fraud part therein by identifying economic sectors and/or activities that are responsible for causing VAT losses. The Commission published a report with an overview of methodologies currently used by several Member States to measure the VAT Gap. The Commission will also try to develop a methodology for estimating VAT fraud. A workshop can be organised to discuss methodologies and experiences.
6. **Improving accessibility of information at national and international level.** A lot of information is available among law enforcement bodies, police, customs and market regulators, but access is fragmentary. This situation is even worse when it comes to cross-border transactions. National limitations in making the information available to other Member States for their domestic risk analysis are limiting the efficiency of the risk analysis and tax collection.
7. **Piloting an EU-wide risk analysis by a dedicated team under Eurofisc.** A team composed of auditors/analysts from Member States could analyse information available at EU level within the Eurofisc network and on VIES<sup>2</sup>. This should be completed by a) closer cooperation with law enforcement agencies (e.g. police, Europol, Eurojust) and customs, b) joint audit teams conducting audits in Member States based on the results of the joint risk analysis. The Commission could play a coordinating role.
8. **Sharing good practices for improving tax compliance and combating VAT fraud.** Some Member States managed to significantly reduce their percentage of the VAT Gap. Sharing their practices could help tackling fraud and improving tax compliance. The Commission is willing to organise targeted workshops in this area.
9. **Reviewing the penalty system.** Penalties are often considered as an effective means to enforce compliance with tax obligations. However, a penalty system can also become ineffective and counterproductive. The Commission is launching a study to identify the impact of a penalty system on compliance.
10. **Influencing taxpayer behaviour.** The willingness of taxpayers to pay their taxes often relates to a cultural background. Knowing and trying to change this background requires that a government and tax administration is trustworthy and transparent. Experiences in this field should be shared.

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<sup>2</sup> Value Added Tax information exchange system, containing the listings of all cross-border supplies.

## Annex 6

### Replies of Austria

#### 1. Background and general policy

*Have any specific studies, analyses or simulation exercises been carried out to assess the impact of reverse charge on fraud and if so, what were the results?*

The most in depth study - PPS Schönberger Study - highlighted the effectiveness of such a system. Missing trader fraud would be eliminated entirely; the only disadvantage would be micro fraud. But this new risk was assessed as negligible compared to the benefits from such a new system.

The study further highlighted the very positive impacts of introduction of reverse charge in case of bankruptcy within the business chain.

Currently the supplier of an insolvent customer is entitled to adjust his VAT debt with regard to the tax administration if he cannot recover the VAT from this customer. Reverse charge will eliminate this kind of budgetary losses. Revenue shortfalls resulting from bankruptcy will be enormously reduced.

*Has the effect on the budget of possible cash-flow losses during the year of introduction been assessed, and if so, what were the results?*

In Austria VAT deduction is generally possible in the same period in which the VAT is chargeable. Concerning cash flow there is no difference between the current system and reverse charge. With regard to the state budget negative effects are therefore not expected.

*How many taxable persons, as a percentage of all taxable persons, account for e.g. 80% of the VAT paid? What would this percentage be after the introduction of the generalized Reverse charge?*

VAT Revenue (2013)	VAT taxpayers	80 % of revenue	Number of taxpayers (80 % of revenue)
21.127.658.544,95	698.978	16.902.126.835,96	2.265
			0,3%

It is not possible to analyse details about the impact of the reverse charge system to this percentage.

Nevertheless it can be stated that the Austrian retail sector is to a large extent marked by a few big companies. Therefore we do not expect a significant increase of the percentage of the taxpayers who account for a large part of the revenue. We expect only a shift within this group of the most important VAT payers.

## **2. Main features of the system**

*What are, apart from the EURO 10 000 threshold, the main features of the system?*

B2B transactions are within the scope of reverse charge if the following conditions are met:

- recipient is a taxable person or a public body using its VAT ID
- recipient is liable for VAT
- reporting obligations via a recapitulative statement (see below part 3)
- payments exceeding 10.000 Euro have to be made via bank transfer and so the identity of the purchaser can be tracked.

*Would the reverse charge be applicable to all types of taxable persons (partial taxable persons, mixed taxable persons, exempt taxable persons, SMEs who benefit from an exemption, a graduated tax relief or a flat-rate scheme, farmers under the common flat rate scheme, occasional taxable persons,..).*

AT approach: In general reverse charge is applied to taxable persons or public bodies using their VAT ID when receiving supplies exceeding 10.000 Euro. Fully VAT exempt businesses as recipients are generally not covered by the reverse charge mechanism, except they use their VAT ID. Flat rate farmers as suppliers are not covered by reverse charge.

If a business carries out tax exempt as well as taxed transactions it is obliged to use its VAT ID number and reverse charge has to be applied.

*Would it be envisaged to extend the system to non-taxable persons such as public authorities?*

Public authorities without taxable activities using their VAT ID are subject to reverse charge.

*Does the system have any impact on other elements (place of supply, right and adjustment of deduction, special regimes...)*

The main features of the VAT system remain unchanged. In general reverse charge will not affect any of the mentioned elements. In line with the ECJ case law input VAT deduction would be possible without invoice (in case reverse charge is applied).

### 3. Obligations

*Which specific obligations on taxable persons would be needed to control such a proposed scheme? Would these obligations be applicable to all (types of) taxable persons? (see also further under 'control and fraud')*

The control system contains:

- Identification of the status of the recipient (VAT ID) similar to the check of VAT ID for intra community transactions.
- A recapitulative statement of supplier and purchaser on a monthly basis (similar to the EU recapitulative statements) is foreseen. In these statements taxable persons have to indicate both, the monthly sum of all supplies and the monthly sum of all purchases under reverse charge with respect to all business partners. This system enables an automatic reconciliation of the data. This automatic check is more comprehensive than the checks in the current system. In the current system tax authorities can only check the transfer of goods by tax audits of all pre-suppliers in the entrepreneurial chain, i.e. only a minor part of the overall transactions is checked.
- In the proposed system discrepancies can be detected by means of an automatic reconciliation of the recapitulative statement with the preliminary VAT declaration. Discrepancies will be examined by the tax office.
- Payments exceeding 10.000 Euro have to be made via bank transfer and so the identity of the purchaser can be tracked.

*How would non established taxable persons be treated when supplying or receiving goods or services?*

Non established taxable persons have to register via an electronic portal when supplying or receiving goods or services. They will have the same rights and obligations as established taxable persons.

*Has the cost and the administrative burden for taxable persons in relation to these new obligations been estimated?  
What would be the specific cost on non-established taxable persons?*

Given the high threshold small companies are generally not affected. Nearly all medium and large sized companies apply electronic bookkeeping systems where the basic data of customer and supplier are already recorded. Therefore the change of the system is more or less limited to a simple adaptation of the IT bookkeeping system.

#### Invoicing and check of VAT number:

The reverse charge system does not significantly raise the administrative burden for taxpayers. Under the current VAT legislation all businesses which are carrying out B2B- transactions with a consideration exceeding 10.000 Euro are obliged to indicate the VAT number of the purchaser on the invoice. An invoice without indication of the client's VAT ID is insufficient and could be penalized. Also in the current situation businesses have to indicate the VAT ID of their purchaser in the electronic bookkeeping systems and also have to check the validity of the VAT ID.

#### Recapitulative statement:

Electronic bookkeeping systems already contain all necessary information which is required for a recapitulative statement. Thus, this statement can be generated automatically. Also the current generation of recapitulative statements and VAT statements is generally carried out completely automatically according to the bookkeeping data. Implementation costs are inherent (e.g. deployment of new tools, additional staff training, etc.).

#### Non-established taxable persons

The same applies for non-established taxable persons. If non-established businesses are either suppliers or recipients of transactions covered by the reverse charge principle (e.g. in cases of chain transactions) the administrative costs will be negligible (or reduced).

Currently non-established taxable persons in Austria have to register with the tax office "Graz Stadt".

Under the reverse charge system they can use the Austrian "FinanzOnline" system. FinanzOnline is a protected electronic portal by which every Austrian taxpayer can directly communicate with the tax administration. This system will be adapted for the reverse charge.

Although the official language in Austria is German, English operating elements could be added to ease the application.

*What would be the different steps for a taxable person to complete before deciding that the reverse charge mechanism has to be applied? What, in particular, would be the possibilities for a supplier to check whether his customer is a taxable person to whom supplies under reverse charge can take place? What would be the liability of a supplier who, in good faith, applied the reverse charge, only to discover subsequently that his customer was not entitled to receive the goods under reverse charge?*

As already mentioned there is no substantial change in the procedure. The check of the VAT ID of the recipient has to be done even under the current system in order to fulfil the invoicing obligations.

Payments exceeding 10.000 Euro have to be made via bank transfer and so the identity of the purchaser can be tracked.

*What would happen if at the time of supply, the conditions for applying the reverse charge were fulfilled but these conditions are changed later? E.g. (in case a threshold is applied) a credit note is issued whereby the threshold is no longer exceeded.*

The criterion of the threshold has to be met when the transaction takes place. In case the amount of the invoice falls later below the threshold the transaction remains under the reverse charge regime.

#### **4. Control and fraud**

*What steps should be taken to stop new forms of fraud in relation to the threshold? Fraudsters could obtain goods 'VAT free' (under RC), sell them on with VAT (possibly via artificial splitting of supplies to remain below the threshold) and then disappear before paying the tax over to the treasury; potentially developing this into national carousel fraud schemes.*

As to the reporting obligations please see our responses under point 3.

The system of recapitulative statements with cross checks ensures that fraudsters splitting off supplies will be detected easily, because all acquisitions with reverse charge will be reported to the tax administration. If purchases are not matched by an adequate amount of sales, additional checks will be carried out.

*Would joint and several liability of the supplier be introduced?*

Joint and several liability currently is implemented in the Austrian VAT Act 1994. It is foreseen that the supplier can escape the liability if he provides the data necessary to identify the real recipient.

*Could you explain in more detail the electronic control tools to which you refer in your letter and specify how they would be more useful within the generalised reverse charge mechanism than within the current system?*

See point 3

*Have you, in addition, considered other specific control measures to be deployed within the generalised reverse charge system and, if so, could you provide a detailed explanation on their functioning?*

Currently cross checks of invoices are carried out only within the frame of chain audits.

After the implementation of the reporting system far more information will be available. This reporting system enables an automatic reconciliation of the data. This automatic check is more comprehensive than the checks in the current system. In the current system tax authorities can only check the transfer of goods by tax audits of all pre-suppliers in the entrepreneurial chain, i.e. only a minor part of the overall transactions is checked.

In the proposed system discrepancies can be detected through reconciliation of the recapitulative statement with the preliminary VAT declaration. If purchases are not matched by an adequate amount of sales, further checks will be carried out.

*Which control policy will be established to audit the more numerous taxable persons at the end of the chain who account for an increased amount of VAT in comparison to the current situation?*

To the assumption that there are more numerous taxable persons, see 1.

The reporting system should provide vital information for an effective risk analysis.

*Is it the intention, to that end, to re-allocate control resources to end of the chain? How far could this be stretched without creating the risk that an increased amount of non taxed goods would reach the retail stage (or stage where VAT has to be applied)?*

Yes, there is an intention to significantly increase control resources for the end of the chain. Within the business chain, the reporting system provides an important tool to significantly increase the efficiency of the control. As mentioned above all purchases above the threshold will be reported to the tax office and if purchases are not matched by an adequate amount of sales, additional checks will be carried out.

The significant reduction of the budgetary risk connected to bankruptcy within the business chain should also free up control resources that can be used to monitor the end of the chain. The Austrian control measures are flexible and resources are always allocated to occurring fraud fields. Therefore risk management and permanent alignment of audit and control plans are and will be in place.

*In the same way, are measures foreseen to monitor and subsequently prevent the possible shift of fraud to other Member States?*

The reporting system and risk analysis will prevent a shift of fraud to other Member States.

*Which steps should be taken to control non-taxable persons claiming to be taxable persons (via "hijacking" of VAT identification numbers) to avoid that VAT would be charged?*

Payments exceeding 10.000 Euro have to be made via bank transfer and so the identity of the purchaser can be tracked.

## **5. Other**

*Has the business community been consulted on the idea of a generalised reverse charge? If so, what were the reactions?*

We are in close contact with the business community.

*Apart from the recurrent costs, has the cost of transition, both for tax administrations and taxable persons been estimated and, if so, what are the results?*

As already mentioned due to the fact of the high threshold and the currently used IT progress in bookkeeping systems, the reverse charge application should not significantly affect costs of



regular bookkeeping operations. We expect one-off costs incurred in the course of the implementation period and in training of staff.

## **6. Statistical document to be filled in**

Years 2013 to 2015

AUSTRIA

### Tax fraud investigation and audit

- Number of cases of missing trader fraud evidenced

Year	Number of cases carousel fraud evidenced	Number of cases resulting in additional VAT revenue	Additional VAT revenue x)
2013	6	6	58.687.528
2014	6	6	13.595.906
2015	8	8	36.582.852

x) Additional revenue means all statements of an audit and is not limited to carousel fraud.

- Estimation of carousel fraud as part of the VAT gap (in%)

Information on such traders and fraudulent transactions is collected, but there are no real data available on how much VAT is evaded by these traders. Therefore recently the European Commission has initiated a Fiscalis project group on "Tax Gap Measurement".

### Administrative cooperation

- Early warnings

A rather limited number of early warnings as Austrian businesses are involved in their role as suppliers but fraud happens in other Member States.

- Multilateral Controls During the period 2013 to 2015 Austria joined 21 Multilateral Controls. 14 out of these 21 MLCs were initiated by Austria. 7 out of the 21 have been finalized in the meantime. The result for Austria was 9.050.000€. In one case the carry forward losses were reduced which will have impacts in the future. In another case the right of taxation was shifted to another state. For the future this might change. Two MLCs are to be finished in the near future.

#### Other measures

Year of limited validity of VAT ID	Number of VAT-ID with limited validity
2013	33.916
2014	34.993
2015	36.732

### Replies of the Czech Republic

## Generalised reverse charge

### Background and general policy

Have any specific studies, analyses or simulation exercises been carried out to assess the impact of generalised reverse charge on fraud and if so, what were the results?

*Preliminary analysis on impact on tax revenue and cash flow has been carried out by Ministry of Finance. Our estimations are based on the suggestion that carousel frauds account for 2/3 of total VAT Gap, i. e. roughly 60 bln. CZK. The rest of VAT Gap creates frauds stemming from other VAT frauds.*

*According to this analysis the impact on the tax revenue is negative in the first year of introduction. However, in the further years the positive impact is expected hence significant elimination of the carousel frauds. In the first year of introduction the decrease in tax revenue 33,6 bln CZK hence change in cash flow is expected. On the other hand a rise in tax revenue by 30,7 bln CZK hence an elimination of carousel frauds is estimated in the first year of introduction as well.*

*Analysis regarding already introduced reverse charge mechanism has been carried out by the Czech Financial Administration. This analysis has proven that introduction of reverse charge mechanism has significantly reduced carousel frauds. As in 2015 reverse charge mechanism was significantly broadened, the volume of carousel frauds, where reverse charge mechanism newly applied, significantly dropped. According to his analysis total volume declined by 98 %, number of detected carousel frauds went down by 89 %. Such result gives convincing result about efficiency of reverse charge mechanism.*

Has the effect on the budget of possible cash-flow losses during the year of introduction been assessed, and if so, what were the results?

*In the first year of introduction decrease in tax revenue by 33,6 bln. CZK is estimated.*

- How many taxable persons, as a percentage of all taxable persons, account for e.g. 80% of the VAT paid? What would this percentage be after the introduction of the generalised reverse charge?

*Currently 309 VAT tax payers account for 80 % of total VAT tax revenue. The share of these VAT payers on the total number of VAT payers was 0,1 %.*

### **Main features of the system**

- What are, apart from the EURO 10 000 threshold, the main features of the system?

*The system is based on the assumption that all great features of VAT (neutrality, predictability, relative simplicity, etc.) can be maintained while its biggest problem (huge fraud) can be solved if the collection (rather than the economic principles) of the tax designed 60 years ago is adopted to the current technological tools (like internet and wireless data connections).*

- Would the reverse charge be applicable to all types of taxable persons (partial taxable persons, mixed taxable persons, exempt taxable persons, SMEs who benefit from an exemption, a graduated tax relief or a flat-rate scheme, farmers under the common flat rate scheme, occasional taxable persons,...). Would it be envisaged to extend the system to supplies made to non-taxable persons such as public authorities?

*We suggest to apply the domestic RCM applies in situations where the taxable person is registered for VAT; otherwise it stays beyond the RCM scheme. Concerning different types of taxable persons we would like to stress that we work with them just now when applying the sectorial reverse charge. No unsolved problems are expected then.*

- Does the system have any impact on other elements (place of supply, right and adjustment of deduction, special regimes, ...)

*We do not see any reason why any other element of VAT should change.*

### **Obligations**

- Which specific obligations on taxable persons would be needed to control such a proposed scheme? Would these obligations be applicable to all (types of) taxable persons? (see also further under 'control and fraud')

*No new obligations on taxable persons would be needed. Obligations that already exist should be used within the reverse charge system as well.*

- *electronic VAT listings "VAT control statement" (to crosscheck invoices)- already in force in CZ not only for the RCM transactions (it contains data about each individual invoice)*
  - *in the case the temporary measure is implemented, the current structure can be used*
  - *VAT returns and "VAT control statements" are already submitted exclusively by electronic means in CZ (there is no new burden for taxpayers)*
  - *it is obligatory for all persons registered as VAT payers (since 1.1.2016 regardless they make RCM operations or not)-> no new obligation for taxable persons (no special new listing to be submitted to the tax administration)*
- *electronic filling of sales (control of the end of the distribution chain)- is to be introduced soon regardless the temporary measure will be implemented or not*

- How would non established taxable persons be treated when supplying or receiving goods or services?

*There is a simplifying measure in the legislative process just now where according to the Art. 194 of the VAT directive. In case a non-established taxable person not registered for VAT in CZ supplies goods to the taxable person registered for VAT in CZ with the place of supply in CZ, the reverse charge is applied and the non-established taxable person is not touched by the domestic reverse charge.*

- Has the cost and the administrative burden for taxable persons in relation to these new obligations been estimated?

*In the Czech Republic VAT control statement has been introduced since January 2016. All VAT payers have been obliged to complete list of all received supplies from other VAT payers and all provided supplies to other VAT payers. Such obligation is similar to the one that is already required within the reverse charge mechanism.*

*It is suggested that all VAT payers have already adjusted their tax and accounting systems because of the VAT control statement. Hence, no substantial additional costs are expected if the general reverse charge mechanism is introduced.*

*In general, current information duty stemming from VAT control statement is very similar to the one that would be required within reverse charge mechanism.*

*Setting of threshold for application of the reverse charge mechanism in tax and accounting systems could cause a slight increase in costs for VAT payers. No other increase in costs for VAT payers is expected.*

- What would be the specific cost on non-established taxable persons?

*No specific cost are expected (see the answer above).*

- What would be the different steps for a taxable person to complete before deciding that the reverse charge mechanism has to be applied? What, in particular, would be the possibilities for a supplier to check whether his customer is a taxable person to whom supplies under reverse charge can take place?

*The check of the validity of the VAT number and of the registration has to be done (the public online database of VAT payers exists) when the amount of the transaction exceeds the threshold.*

*If the VAT number is checked and the taxable person does not use RCM because there is not a valid VAT registration, the RCM is not applied (we have introduced the provision for the strengthening of the legal certainty).*

*The risk of the misuse of the VAT number is not higher than in the case of IC transactions.*

- What would be the liability of a supplier who, in good faith, applied the reverse charge, only to discover subsequently that his customer was not entitled to receive the goods under reverse charge?

*Such cases are to be individually examined according to the case-law. As the quality of the data in the VAT database is not problematic, we do not suppose that the situation described could occur frequently.*

- What would happen if at the time of supply, the conditions for applying the reverse charge were fulfilled but these conditions are changed later. E.g. a credit note is issued whereby the threshold is no longer exceeded.

*If a credit note is issued and the threshold is no longer exceeded, the RCM is still applied. If the threshold is exceeded by a correction, RCM is applied to this correction. CZ has already implemented a RCM with a threshold; the practical experience of the tax administration and of taxpayers already exists concerning this issue.*

### **Control and fraud**

*We can imply from questions posed in this section that some doubts arise concerning the complexity of the conception of the implementation of the reverse charge applied to big transactions especially in the relation with the existing VAT system, its administration and tackling tax fraud. One of doubts concerns the possible transformation of fraud schemes once the reverse charge is introduced. The basic idea of this is that VAT fraud would split to shorter chains and then it would shift from the beginning of the transaction chain to its end. Thus B2C sales would stay out of the system.*

*The example of the scheme is for example: MT - Buf 1 - Buf 2 - Buf 3 - Buf 4 - Broker - Customer / export*

*In case where transactions in the chain are under the reverse charge scheme and the goods at the end of the transaction chain leave the CZ (from the point of view of the place of the supply), the problem with fraudulent schemes based on fictive transactions or the problem with carousel frauds can be solved by the reverse charge mechanism.*

*In case the supply at the beginning of the distribution chain is not under the reverse charge or the final consumption is in CZ, the risk of the fraud exists. But those risks are significantly smaller and the solution of potential frauds is much easier than within the current VAT system.*

*The risk of the fraud at the end of the distribution chain is in CZ solved by the electronic filling of sales that is planned to be implemented for the risky segment at the beginning of 2017. At the same time the VAT control statement system reduces the risk of the shift of the trade to the "grey zone". This system is significantly more effective than the simple procedure where the taxpayer just declares the value to be allowed to apply the right to deduct the VAT. Individual invoices are matched in the system of VAT control statements and the potential problems are detected with the sensibility set at the level of the invoice.*

*It is also important to say that the risk of this fraudulent shift is dramatically lower under the reverse charge than within the current system even if above mentioned control tools are not applied. This is because the possibility to make a fraud at the beginning of the chain is practically limited by the logistic and property limits of the group performing the fraud. It is possible to resale the goods in the value of CZK 100 bil. plus CZK 21 bil. VAT by the sole invoice and steal this big volume of the VAT by one turn only. When the tax is shortened at the end of the chain, the mass of the fraud is limited also because fraudsters need to place huge volumes or values of goods to the final consumer or they need to find the requested number of those final consumers. This fact represents a serious obstacle for the fraudulent behaviour.*

*It is possible to solve the risk of the fraud at the beginning of the distribution chain, which is performed by reduction of the transaction value under the threshold, more effectively under the reverse charge than in the current VAT system. The possibility that the organiser of the fraud will use higher number of missing traders and buffers to reach the same fraudulent effect exists but the risk then will be diversified. It is easier to tackle smaller or shorter chains than it is for current huge and complicated structures. No risk would exist at the level of current big brokers. It would shift "lower" within the distribution chain, closer to missing traders. It would be logistically and economically more complicated to organize the fraud than it is at present. Such chains are possible to be detected using the VAT control statement and could be easily eliminated. These assumptions are further supported by other steps of tax administration - the detailed control during the VAT registration process with the aim to reduce the number of potential fraudsters within the VAT system, use of the status of unreliable VAT payer by which we can indicate*

*high- risk companies for other traders, securing orders supported by joint and several liability and the cooperation in the prosecution area and AML as well.*

*All the mentioned tools with the exception of the electronic filling of sales has been already implemented in CZ and conditions for the effective implementation of the reverse charge applied to big volume transactions are met. The common denominator of the chain (carousel) frauds is the big volume of transactions and the requested temporary derogation is targeted to this common attribute.*

□ □ What steps should be taken to stop new forms of fraud in relation to the threshold? Fraudsters could obtain goods 'VAT free' (under RC), sell them on with VAT (possibly via artificial splitting of supplies to remain below the threshold) and then disappear before paying the tax over to the treasury; potentially developing this into national carousel fraud schemes.

*Using the threshold in the combination with the data from the "VAT control statements" will allow to find out that the supply was split into several smaller supplies for one purchaser (see the reply above).*

□ Would joint and several liability of the supplier be introduced?

*We have already implemented the joint and several liability in some predefined cases and we do not intend to make further extension of this tool at the moment.*

□ Could you explain in more detail the electronic control tools to which you refer in your letter and specify how they would be more useful within the generalised reverse charge mechanism than within the current system?

*See the reply above.*

□ Have you, in addition, considered other specific control measures to be deployed within the generalised reverse charge system and, if so, could you provide a detailed explanation on their functioning?

*See the reply above.*

□ Which control policy will be established to audit the more numerous taxable persons at the end of the chain who account for an increased amount of VAT in comparison to the current situation?

*The generalized reverse charge will not have any impact on the number of taxable persons at the end of the transaction chain. The structure of control activities will probably change - it will be aimed mainly at two risky issues: control of the threshold and the control of the end of the transaction chain. It will be possible to strengthen the control of these risky issues because the rest of the transaction chain would not need such intensive control as it is now. The information from the "VAT control statement" together with the electronic filling of sales (primarily oriented on "cash" transactions) will help the tax administrator to check the end of the transaction chain.*

□ Is it the intention, to that end, to re-allocate control resources to end of the chain? How far could this be stretched without creating the risk that an increased amount of non-taxed goods would reach the retail stage (or stage where VAT has to be applied)?

*The transfer of control resources to the end of the chain will be important but not absolute. The assumption is that the reason for the creation of long and complicated fraudulent chains will not persist and there will be a positive impact on control resources of the tax administration.*

□ In the same way, are measures foreseen to monitor and subsequently prevent the possible shift of fraud to other Member States?

*Based on the data from the VAT control statements and electronic filling of sales and using mechanisms of administrative cooperation we can provide other member states with the information and data they*

*could use when applying their own anti-fraud measures. All effective anti-fraud measures have in principle the effect of the shifting of fraud to another destination (or commodity) disregarding the fact whether this measure is the reverse charge or any conventional measure with the same degree of the efficacy.*

Which steps should be taken to control non-taxable persons claiming to be taxable persons (via "hijacking" of VAT identification numbers) to avoid that VAT would be charged?

*There is no general measure to avoid the misuse of the VAT identification number irrespective of the system but this problem is not bigger than in IC transactions. Measures that can improve the potential risks are for example pre-registration audits of taxpayers, risk analysis, institution of unreliable taxpayer etc.*

### **Other**

Has the business community been consulted on the idea of a generalised reverse charge? If so, what were the reactions?

*The Ministry of finance has organized an international conference in Prague (4.12.2015) with the participation of the representative of the business, academic field and the Commission.*

*The business is generally in favour of the reverse charge, they want the most simple and compact system as it is possible.*

*However as we are targeting the carousel fraud we have to introduce the threshold to eliminate the impact on small traders and to keep this goal.*

Apart from the recurrent costs, has the cost of transition, both for tax administrations and taxable persons been estimated and, if so, what are the results?

*No additional costs for tax administration are estimated and only some small improvement of IT systems could be needed on the side of taxable persons (relates to the setting of the threshold).*

\*

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Statistical document to be filled in  
Years 2013 to 2015

**o Tax fraud investigation and audit**

Number of cases of missing trader fraud evidenced

- Domestic carousel fraud
- MTIC fraud

**o Number of taxpayers involved in missing trader fraud**

- National taxpayers
- Foreign taxpayer

*The data are analysed and it will be provided as soon as possible.*

**o Number and amount of VAT assessments made as a result of the relevant audits or investigations in the context of Carousel fraud**

*The data from Annual reports of the Tax Administration - The total number of audits and assessments (the estimation is that the carousel fraud represents 80% of this number)*

Tax audits - number and results

year	Number of tax audits	The amount assessed (in thousands of CZK)
2015	10 130	13 660 791
2014	11 565	8 259 054
2013	10 228	7 033 203

Other investigations - number and results

year	Number of investigations	Number of investigations closed with a	The change as a result of the investigation (in thousands of CZK)	
			tax	Excess of the deduction
2015	17 672	10 011	7 459 754	-3 105 244
2014	16 522	8 312	4 755 414	-1 526 874
2013	12 213	5 484	2 876 534	-1 713 981

**o Number of criminal prosecutions initiated in this context**

The data of the Tax administration (the data concerns all the taxes, not only VAT):

Criminal offence shortening of the tax	Number of cases					Amount (in bil. of CZK)				
	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
	1 325	1 555	1 164	1 294	1 512	6 452	9 367	4 886	7 034	10 603



The data of the Home Office - opening of the prosecution (the data concerns all the taxes, not only VAT)

year	Number of cases	Damage (in CZK)
2013	703	3 478 352 100
2014	435	6 333 325 300
2015	473	5 691 709 100

Number of convicted persons following these prosecutions (data of the Home Office)

2013: 818 persons convicted

2014: 725 persons convicted

2015: 716 persons convicted

### **Estimation of Carousel fraud as part of VAT fraud and as part of the VAT gap (in %)**

According to the latest estimation of VAT Gap we assume that 2/3 accounts for carousel frauds and 1/3 of VAT Gap accounts for other VAT frauds (unreported sales, fictitious invoices). This estimation is based on the data of Czech Statistical Office about unreported sales in the Czech Republic.

### **Administrative cooperation**

Number of early warnings received from Eurofisc and results: number and amount of tax assessments, number of cancellation of VIES numbers, etc.

Data from the annual reports for Eurofisc:

WF 1 (MTI/C)						
Year	Number of lines received -	Missing Traders detected	Conduit Companies detected	Deregistrations	Unreliable VAT payers	VAT audits
2013	560	114	28	9		10
2014	773	199	92	5	20	24
2015	574	99	51	23	4	36
In total	1907	412	171	37	24	70

Year	Number of Lines received	Missing Traders detected	Conduit Companies detected	Deregistrations	Unreliable VAT payers	VAT audits	Additional VAT return submitted
2013	495	55	9	23		36	14
2014	510	64	8	22	43	41	21
2015	435	78	16	15		43	37

## WF 3 (Customs Procedures)

In total 1440 197 33 60 43 120 172

Year	Number of lines received	Number of VAT payers	Missing Traders detected	Deregistrations	Unreliable VAT	VAT audits	Additional VAT return submitted
2013	992	91	6	6	3	2	2
2014	886	88	5	4	2	4	2
2015	2242	87	3	1	4	4	3
In total	4120	266	14	11	9	10	7

**Number of Multilateral Controls initiated or joined, and results thereof**

Results of multilateral controls with CZ participation opened in the period 2013-2015

MLC code	Initiating MS	Start year	End year	Additional assessment in CZ (EUR)	Commodity
020	UK	2013	2014	0	Mobile phones
022	CZ	2014	2016	1.4 mil	Concrete steel
035	AT	2014	2016	0	Sugar
042	SI	2014	ongoing		Precious metals
049	CZ	2014	2016	28.6 mil	Mobile phones
052	SK	2014	2016	0	IT components
053	AT	2014	2016	8.2 mil	Rape
076	CZ	2014	2016	1.6 mil	Car tyres
037	IT	2015	2016	0	Electricity
094	NL	2015	2016	0	Used cars
100	RO	2015	ongoing	10 mil (up to now )	Electronics
011	LT	2015	ongoing	12.8 mil	Mobile phones
133	DE	2015	2016	21.8 mil	Gas
Total				<b>84.4 mil EUR</b>	

**Other measures**

Number of administrative de-registrations

**Number of deregistrations**

Year of deregistration (decisions)	2013	2014	2015
total	20 788	32 362	41 757
from that made ex offo	4 167	10 338	16 168

**Unreliable VAT payers**

Number of persons qualified as unreliable VAT payers

	2013	2014	2015
Decisions coming into force	44	159	4104

Number of unreliable VAT payers that has been made public

	31.12.2013	31.12.2014	31.12.2015
Number of published unreliable VAT payers	31	143	3486

Total number of persons registered for VAT purposes

	10.1.2014	29.12.2014	11.1.2016
Number of VAT registrations	508 733	508 538	496 841

**Number of cancellations of the VIES number**

See above - there is no special registration for the VIES system in CZ.

**Number and amount of cases where joint and several liability has been applied**

No relevant data at the disposal.

**Number and amount of estimated assessments of non-filers**

The total number of the non-submitted VAT returns during 2013-2015 is more than 310 000 (313 137).

The estimation of the assessment from those VAT returns is CZK 60 bil.

## Annex 7



The following table summarises the current forms of fraud which are likely to increase with the proposed reverse charge system and those which can be considered as new forms of fraud.

<b>Forms of fraud likely to increase</b>	<b>New forms of fraud</b>
Concentration of fraud on a retail level	Direct or disguised artificial splitting of the taxable amount of a transaction in order to circumvent the threshold
Hijacking of VAT ID numbers (by Pure Holdings, Sham Companies, Non-Established Taxable Persons, End Consumers)	Migration of artificial splitting to other Member States that have implemented the reverse charge system and that apply a high VAT rate
Abuse by Pure Holdings of their own valid VAT ID number	
Migration of missing-trader fraud to Member States not implementing the reverse charge and having a high VAT rate	
Creation of fake invoices to lower payment position	
Replication of carousel patterns in a purely domestic scenario	
Access of goods to national and cross-border black markets will be made more easy and at a more attractive price	

The study also evidenced that some specific aspects of the reverse charge system such as the existence of a threshold to apply this system, would be the causing factor of specific schemes such as the artificial splitting the taxable amount of a transaction in order to circumvent this threshold and to collect VAT from the customer without remitting it to the Treasury.



EUROPEAN COMMISSION  
SECRETARIAT-GENERAL  
Directorate D - Policy Co-ordination I  
SG-D-2 Internal market and competitiveness  
Head of Unit

Brussels, 16 September SG.D2 TB/ik

## MEETING REPORT

**SUBJECT: ISSG on a temporary application of the VAT reverse charge mechanism**

ISSG members discussed the draft impact assessment and the draft legal text.

### 1. Political context and timing

SG pointed to the political commitment of the Commission to deliver this proposal by the end of 2016 and to the challenge not to ignore the risks coming with such proposal and at the same time establishing an impact assessment underpinning the proposal. TAXUD recalled the need to distinguish this proposal from the general reform of the VAT system planned for 2017 and gave an overview over the draft impact assessment and the draft proposal.

Comments by ISSG members:

### 2. Criteria for a temporary application

Main element discussed at the meeting were the criteria for the temporary application of the reverse charge as the current draft impact assessment and proposal would require a high VAT gap and a deficiencies in tax collection capacity for all Member States except AT and CZ that would not have to meet these requirements. SG, ENV and SJ stressed the need to ascertain whether the fact that CZ and AT have already made a request for a reverse charge derogation at the moment of the proposal is sufficient to place them in a different situation than other Member States whose conditions would be more restrictive, or whether other aspects would need to be considered. SJ and BUDG also wondered whether the criteria are sufficiently precise. OLAF recalled that the criterion on VAT fraud would be difficult to apply since the Commission did not regularly receive data from the Member States as criticised by the CoA in its recent report. SJ wondered whether it should be for the Commission to assess whether the criteria would be met for a Member State. TAXUD argued that safeguarding the Internal Market should first and foremost be a Commission task.

### 3. Safeguarding the Internal Market

SJ and SG suggested that the proposal should contain a safeguard clause or recital if even before the interim report severe distortions of the internal market are detected. To this end, TAXUD should explore further with SJ how this could best be achieved, taking into account precedents such as the Quick Reaction Mechanism (QRM). TAXUD showed openness to a safeguard clause or recital.

### 4. Other aspects of the draft impact assessment

JUST asked to elaborate further on the impacts on consumers, in particular regarding compliance costs were passed on to consumers. OLAF raised that increased liquidity resulting from reverse

charge could counter this effect. TAXUD warned that such impacts were difficult to predict as only limited data had been available. OLAF also suggested replacing the explanatory graphs for carousel fraud with material used in other documents. CNECT and SG suggested putting more emphasis on the potential double administrative burden when changing to reverse charge and back again. CNECT suggested looking at specific sectors more prone to VAT fraud but TAXUD and SG confirmed that this was reflected by current VAT legislation such as the Quick Reaction Mechanism (QRM). SG suggested beefing up the monitoring, in particular by adding indicators.

## **5. Other aspects of the draft proposal**

SJ suggested underpinning the proposal not only with political but also legal arguments. SG asked to rephrase the justification for skipping an open public consultation in case the request for exemption was granted (a decision is still outstanding). The fact that "only" businesses were concerned would not be an acceptable justification.

## **6. Conclusions and next steps**

SG summarised that the draft impact assessment was a good basis. SG welcomed that SJ had generally found a solution to legally underpin the proposal as such but asked them to collaborate closely with TAXUD to solve the remaining issues. More specifically, they should explore options regarding the criteria for application to allow AT and CZ participation while ensuring equal treatment of Member States; further reflect on the decision-making mechanism on whether the application criteria are fulfilled; and look at feasible options for safeguards in case of severe distortions in the Single Market, possibly taking inspiration from the QRM.

SG recalled the timing with RSB submission by 28 September, RSB meeting on 26 October, and an adoption in November/December, possibly with other VAT proposals on 30 November. Written comments should be sent to TAXUD, cc SG, by 21 September.

*[e-Signed]*  
Michael Wimmer

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### Participants:

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