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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
No. Cion doc.:	15817/16 FISC 241 IA 145
Subject:	Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold – Orientation debate

I. INTRODUCTION

1. At the ECOFIN meeting of 17 June 2016, the Commission made the following statement to be inserted in the minutes: *"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."*
2. On 21 December 2016, the Commission therefore adopted a Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism (GRCM) in relation to supplies of goods and services above a certain threshold (doc. 15817/16 FISC 241).

3. This Proposal was discussed under the Maltese Presidency at the meeting of the Working Party on Tax Questions (WPTQ) of 26 January 2017. A first compromise text was prepared by the Presidency and discussed at the WPTQ of 22 February 2017. A second compromise text was presented and discussed at the WPTQ of 8 March 2017. It was then updated with a view to Coreper meeting on 15 March 2017 and Council meeting on 21 March 2017 (doc. 7118/17 FISC 61).

II. STATE OF PLAY

4. During the first discussions, some Member States supported the principle of a GRCM while others showed scepticism, but were open for further discussions. Another group of Member States had general and/or political scrutiny reservations.
5. The main reason for concerns mentioned by Member States not supporting the Proposal in general is that with a GRCM, VAT fraud could shift to other Member States. They also expressed concerns relating to the controls, the increased costs and burdens for businesses and the existence of two parallel systems of VAT. Finally, they raised the fact that Member States which apply GRCM would not be able to return back to their original system easily and that GRCM could become, in the future, the Definitive Regime for VAT.
6. In its compromise texts, the Presidency has addressed certain concerns mentioned by Member States both in favour and against the proposal. The latest Presidency compromise text provides legal certainty for those in favour of the GRCM, mainly by clarifying the VAT Gap criterion and the provision of information on serious risk of shift of fraud.
7. To address the concerns regarding the shifting of fraud, the Presidency has proposed an obligation for a Member State applying GRCM to provide information to the other Member States regarding persons who have been subject to proceedings, whether criminal or administrative, for VAT fraud and persons who deregister or fail to submit consecutive VAT returns, which could potentially intend to shift their activities to other Member States (new Article 199 c, paragraph 7).

8. The compromise texts presented by the Presidency addressed the issues set out in paragraphs 5 to 8. However, the Presidency considers that there are four political issues for which orientations would be required for future work:

(1) Scope of the future directive

9. Some Member States question the scope of the proposal which would be applicable to all services and goods. Other Member States supported the scope as it stands in the Proposal from the Commission.
10. The Presidency would like to assess **if Member States could support the scope of a GRCM for a temporary period, on all goods and services above 10 000 euros, based along the lines proposed by the Presidency.**

(2) Clear criteria for obtaining a derogation

11. The discussion showed that some Member States were in favour of restrictive criteria in the Directive while others wanted more flexibility or even no criteria at all.
12. Furthermore, some Member States were of the opinion that criteria foreseen in the future directive should be clearer in order to determine whether or not a Member State qualifies for this derogation. Concerning Article 199 c, paragraph 1, letter (a), the Presidency proposed clarifications on the way of calculating the VAT gap but the compromise could not be supported by all Member States. Regarding Article 199 c, paragraph 1, letter (b), the level of carousel fraud was discussed by the group but some Member States contested the figure of 25% of carousel fraud within the total VAT gap.
13. The Presidency would like to receive an orientation on **whether the criteria suggested in the compromise text could serve as a basis for the application of a GRCM.**

(3) Repealing of the derogation: role of the Council and the Commission

14. The proposal of the Commission provides that, in case of considerable negative impact on the internal market, the Commission can repeal all the derogations previously granted. Giving this possibility to the Commission raised concerns in some Member States. The question of the involvement of the Council instead of the Commission in the process of repealing the derogation was therefore discussed. A majority of Member States was of the opinion that the powers to adopt and to repeal the derogations should remain with the Council.
15. If the Council would be deciding on the repealing of the derogation in the usual manner, in conformity with the principle of unanimity, all Member States, including the Member States applying the derogation, would have to support the repealing. This could result in a situation where it would be very difficult to obtain, in practice, the consent of the Member States benefiting from the derogation.
16. In order to make the system workable, a reverse unanimity procedure has been proposed by the Presidency. This procedure would entail that, if a set of criteria are met, the Commission would present a proposal aiming at repealing a derogation given to one Member State. This proposal would be adopted – and thus the derogation repealed – unless the Council unanimously agrees to reject the Commission's proposal of repeal within 30 days ("reversed unanimity").
17. Unanimous support could not be reached on this issue at the Working Party as Member States which are in favour of a GRCM argued that the repealing procedure might lead to shortening the five year duration period of the derogation. Against this background, they do not support the repealing procedure, in particular if the possibility to repeal the derogation would be given to the Commission.
18. The Presidency is seeking an orientation from Member States on **whether the solution proposed by the Presidency in its compromise (namely that a repeal mechanism should be put in place and that the repeal of the derogation should be submitted to the reversed unanimity, as set out in paragraph 16) should be further examined.**

(4) Duration of the derogation of five years

19. The proposal provides that the duration of the derogation shall be of five years. Some Member States voiced concerns that, due to the administrative changes to be introduced in the national legislations and the burden on businesses to implement the system, this period of time is too limited. Other Delegations thought that, due to its experimental nature, the derogation should be limited to two or three years or, at least, not last more than five years.
20. The open question on which an orientation is sought is, therefore, **whether delegations are in a position to support as a compromise the duration of five years proposed in the Presidency compromise.**

III. WAY FORWARD

21. Against this background, the Committee of Permanent Representatives is invited to suggest that the Council, on the basis of this note, at its forthcoming meeting:
- exchange views on the issues set out in Part II of this note and give orientations on whether the approach suggested by the Presidency in doc. 7118/17 FISC 61 forms a good basis for further technical work;
 - invite the Working Party on Tax Questions to continue its technical work in the light of the discussion at the ECOFIN Council on 21 March 2017 with a view to reaching political agreement at a future Council meeting.