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COMMISSION STAFF WORKING DOCUMENT

on the implementation of the definitive VAT regime for intra-EU trade

1. INTRODUCTION

In international taxation, indirect taxes on consumption are governed by a fundamental principle: that of taxation in the country of destination. In other words, taxes are charged in the country in which the goods and services are consumed. This principle is in particular implemented by allowing goods to be exported exempt from tax but taxed instead when they are imported.

Value-added tax (VAT) is Europe's longest-standing consumption tax. In 1967 the commitment was made to establish a definitive VAT system operating within the European Union (EU) in the same way as it would within a single country¹. 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, 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 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. These rules were regarded as temporary and are not without drawbacks: for instance, allowing goods to be bought free of VAT increases the opportunity for fraud, while the inherent complexity of the system is not conducive to cross-border trade. However, these 'transitional arrangements' are still in operation more than 20 years after their adoption.

After a broad public debate launched with a consultation on the *Green Paper on the future of VAT*,² on 6 December 2011 the Commission adopted the communication *On the future of VAT — Towards a simpler, more robust and efficient VAT system tailored to the single market*.³

The consultation confirmed that many businesses consider that the complexity, additional compliance costs and legal uncertainty of the VAT system often prevent them from engaging in cross-border activities and reaping the benefits of the single market. It also provided an opportunity to examine whether the commitment made in 1967 was still relevant.

Discussions with Member States confirmed that the objective was still politically unachievable, and this was confirmed by the Council in May 2012.⁴ The European Parliament⁵ and other stakeholders such as business, tax practitioners and academics, also recognised the deadlock and therefore favoured a new system based on taxation at destination as a realistic solution.

After the adoption of the Communication, the Commission services therefore entered into a broad-based and transparent dialogue with Member States and with other stakeholders to examine in detail the different possible ways of implementing the destination principle. The

¹ 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.

² COM(2010) 695, Commission Staff Working Document, SEC(2010) 1455, 1.12.2010.

³ COM(2011) 851, 6.12.2011.

⁴ http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130257.pdf.

⁵ Resolution of 13 October 2011, P7_TA(2011)0436.

guiding principle was that doing business across the EU must be as simple and as secure as engaging in purely domestic activities.

Intense and in-depth analytical work has been conducted since then: 12 options were identified as possible solutions and have now been narrowed down to five. Each of these options has merits and shortcomings that deserve careful assessment.

The Commission's initial intention was to put forward a legislative proposal establishing the definitive regime of taxation of intra-EU trade in the first half of 2014. In view of the extensive analysis undertaken and the strong involvement of stakeholders already at an early stage, further work is however needed. Therefore this document sets out the state of play and the next steps.

2. STATE OF PLAY

Main issues at stake

After over 20 years of the current transitional arrangements, the objective is to reach a conclusion on establishing the definitive VAT regime. The need to move towards a definitive regime has grown and thus it has been decided that efforts should be directed towards this end. The most recent figures released in October 2014 on the 'VAT gap'⁶ (i.e. the difference between the expected VAT revenue and VAT actually collected by national authorities) demonstrate that the VAT losses incurred by Member States are very significant (EUR 177 billion in VAT revenues) and that the situation is not getting better.

Furthermore, simplifying the VAT system could make a major contribution to reducing compliance costs and administrative burdens on business, particularly smaller businesses. The present transitional VAT system is out of step with the new economic, digital and international environment.

The initial focus of the Commission services work on the destination principle was to identify possible options and their likely advantages and disadvantages. After extensive analysis and discussion with stakeholders, a limited number of options were selected by the Commission services as a basis for in-depth work for the impact assessment.

All stakeholders (Member States, business, tax practitioners and academics) agreed with the methodology proposed by the Commission to work first on possible options for implementing the principle of destination for business-to-business (B2B) supplies of goods. Once significant progress was made in this area, the rules applicable to other intra-EU supplies, such as the VAT treatment of services and business-to-consumer (B2C) supplies, could be reviewed to arrive at a more consistent and simpler VAT regime for all intra-EU transactions.

As set out in the 2011 Communication, two fundamental issues in particular need to be addressed:

- (1) **The definition of the place of taxation:** the place of taxation determines the Member State to which the VAT on a given transaction is due. Taxation at destination could mean the Member State to which the goods are transported, but it could also mean the Member State in which the customer is established or any other plausible criterion.

⁶ http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf.

- (2) **The person liable for payment of VAT to the tax authorities:** the supplier could charge and pay to the competent tax authority the VAT of the Member State of destination, as is done for domestic supplies.⁷ Alternatively, the customer could account for VAT, in what is called a ‘reverse charge’ mechanism.

Options selected

Two options maintaining and improving the current system and three additional options were selected for further examination. They covered the range of achievable combinations of possible ways of addressing the two fundamental issues (the place of taxation and the person liable for tax). They reflected the different views of stakeholders and the need to concentrate on the more ambitious and promising options.

The options can be outlined as follows⁸:

- **Option 1:⁹ Taxation of intra-EU supplies where the goods are delivered**

Under this option, the supplier would charge and pay the VAT of the Member State to which the goods are delivered by declaring them in its own Member State. This option would require a one-stop-shop to make it easier for suppliers in their Member State of establishment to comply with their obligations in other Member States.

- **Option 2:¹⁰ Taxation of intra-EU supplies where the customer is established regardless of the place of delivery of the goods**

As in option 1, the supplier would charge and pay the tax by declaring them in its own Member State, but it would be the VAT of the country in which the customer is established, regardless of the country to which the goods are delivered.

- **Option 3:¹¹ Reverse charge where the customer is established**

Under this option, the goods would be taxed in the Member State of establishment of the customer, with the customer being liable to pay the VAT. This reflects the rules already in place for B2B supplies of services.

- **Option 4:¹² Reverse charge where the goods are delivered**

In this case, a possible variant suggested by Member States, as in option 3 the recipient would be liable to pay the tax, but the place of taxation would be the place to which the goods are delivered, as in option 1. There is no significant difference between this system and the current treatment of cross-border supplies of goods. In both situations, the place of taxation is where the goods are delivered and it is the customer that pays the VAT.

- **Option 5:¹³ Status quo with some simplification of the procedures**

⁷ Such an option would require a tool such as a one-stop-shop to make it easier for suppliers in their Member State of establishment to comply with their obligations in other Member States.

⁸ More details on the twelve options are available in a series of working documents discussed with the members of the VAT Expert Group: <https://circabc.europa.eu/w/browse/6764319c-9bd9-43d8-bf8a-49c37884ca85>

⁹ Option 2a in the working documents discussed with stakeholders.

¹⁰ Option 5a in the working documents discussed with stakeholders.

¹¹ Option 4b in the working documents discussed with stakeholders.

¹² Option 2b in the working documents discussed with stakeholders.

A final option is to improve the current rules without amending them fundamentally. This solution would keep the system as it is, while addressing some of its weaknesses. Simpler procedures could be devised for consignment stocks, for chain transactions and for providing proof that the goods have moved from one Member State to another.

3. NEXT STEPS

Based on this identification of options, Commission staff launched a study to quantify the problems related to intra-EU supplies in comparison with domestic supplies and assess the impacts of each of the options in comparison with the current situation. This assessment will consider the effects on taxable persons and on Member States. The final report should be available by spring 2015.

The Commission services will continue working with all stakeholders, notably to set the major principles and features of the future EU VAT system to tax intra-EU supplies at destination and to prepare the impact assessment.

The members of the VAT Expert Group¹⁴ and the business community generally have shown that they are highly committed to this work. Through a unanimously adopted opinion, the members of the VAT Expert Group reiterated this commitment¹⁵ at the end of its first term, together with their willingness to continue to actively contribute.

The following qualitative criteria, which were agreed by stakeholders, will continue to guide the work:

- **Equality and simplicity** — Domestic and intra-EU transactions should be treated the same, so that doing business across the EU becomes as simple and as secure as doing business within a Member State, in particular for SMEs. VAT rules should not be an obstacle to the proper functioning of the single market.
- **Budgetary impact** — VAT revenues should be allocated to the Member State of final consumption of the goods in accordance with its conditions and in particular its VAT rates. The impact on the cash flow of business should be similar to that for domestic transactions to ensure a genuine level playing field.
- **Ease of administration and cost of collection** — The administrative burden for tax administrations and business should be as low as that for domestic transactions whereas the capacity of the tax administrations to carry out cross-borders controls should be ensured.
- **Prevention of fraud and abuse** — Breaks in the VAT chain within the single market should be avoided as far as possible to ensure that the VAT system remains robust and fraud-proof.

¹³ Option 1b in the working documents discussed with stakeholders.

¹⁴ http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/expert_group/index_en.htm.

¹⁵ http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/expert_group/opinion_vat_2014.pdf