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COVER NOTE

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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 395 of Council Directive 2006/112/EC

1. BACKGROUND

Pursuant to Article 395 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the VAT Directive), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. As this procedure provides for derogations from the general principles of VAT, in accordance with the consistent rulings of the Court of Justice of the European Union, such derogations should be proportionate and limited in scope.

By letter registered with the Commission on 18 September 2017, Latvia requested an authorisation to apply a measure derogating from Article 193 of the VAT Directive. In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 27 October 2017 of the request made by Latvia. By letter dated 31 October 2017, the Commission notified Latvia that it had all the information it considered necessary for appraisal of the request.

As a general rule, the person liable for the payment of VAT to the tax authorities under Article 193 of the VAT Directive is the taxable person supplying the goods. The purpose of the derogation requested by Latvia is to place that liability on the taxable person to whom the supplies are made (the so-called reverse charge mechanism), in the case of particular products, notably as regards consumer electronics and electrical household appliances. The aim of the requested derogation is the fight against fraud.

2. REVERSE CHARGE

The person liable for the payment of VAT pursuant to Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the reverse charge mechanism is to shift that liability onto the taxable person to whom the supplies are made.

Missing trader fraud occurs when traders sell goods or provide services, collect the VAT from their customers and subsequently disappear without remitting the VAT they collected from their customers to the tax authorities. In the most aggressive cases of such tax evasion, the same goods or services are, via a "carousel" scheme (which involves the goods or services being traded between Member States), supplied several times without payment of VAT to the tax authorities, whereas at the same time the customer will deduct the VAT it paid to its supplier. By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT in such cases, the domestic reverse charge mechanism has been found to eliminate the opportunity to engage in that form of tax evasion.

3. THE REQUEST

Latvia requests, under Article 395 of the VAT Directive, that the Council, acting upon a proposal of the Commission, authorises Latvia to apply a special measure derogating from Article 193 of the VAT Directive as regards the application of the

reverse charge mechanism in relation to domestic supplies of consumer electronics and electrical household appliances.

In light of occurring fraud, Latvia introduced the reverse charge mechanism in the sector of mobile phones, integrated circuit devices, tablets and laptops. As a consequence according to Latvia, the VAT fraud reduced in these sectors, but at the same time it shifted to the supplies of consumer electronics and electrical household appliances. Latvia submits that the fraud risks are high owing to the nature of the goods, which are generally small and of high value.

The fraud in question consists of taxable persons registered for VAT declaring bogus transactions on which VAT is payable into the state budget. These traders then disappear without paying the VAT due to the state budget.

By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT, Latvia would like to combat the above fraud which occurred in the sector of consumer electronics and electrical household appliances. It appears from the request and is confirmed by a letter sent to the Commission on 12 October 2017 that Latvia envisages the application of the reverse charge mechanism to supplies of these goods as from 1 January 2018.

4. THE COMMISSION'S VIEW

When the Commission receives requests in accordance with Article 395, these are examined to ensure that the basic conditions for their granting are fulfilled i.e. whether the proposed specific measure simplifies procedures for taxable persons and/or the tax administration or whether the proposal prevents certain types of tax evasion or avoidance. In this context, the Commission has always taken a restrictive, cautious approach to ensure that derogations do not undermine the operation of the general VAT system, are limited in scope, necessary and proportionate.

Any derogation from the system of fractionated payment can, therefore, not be more than a last resort and an emergency measure and must offer guarantees as to the necessity and exceptional nature of the derogation granted.

Against this background, it should be recalled that it has been the Commission's policy to consider derogations on the reverse charge mechanism only when, at the same time, the goods at stake cannot reach the final consumption, a weak taxpayer is replaced by a more reliable one and there is no risk of fraud to the retail level or to other Member States that do not use the mechanism.

In the first place, it should be noted that the products concerned can be intended for private consumption entailing thus the risk that the fraud is shifted further down the supply chain which could become even more difficult to control. Transferring the whole VAT liability to the last link of the chain would, therefore, increase the risks. There is also a risk of fraud shift to other Member States or to other sectors. Latvia submits namely that the fraud in the sector concerned occurred due to the introduction of the reverse charge mechanism in neighbouring sectors of mobile phones, integrated circuit device, tablets and laptops.

Furthermore, a derogation is in any case not a long-term solution, nor does it replace adequate control measures for the sector and for taxable persons. Although Latvia indicated in its request that a comprehensive range of control measures is currently in

place to tackle VAT fraudsters, it did not demonstrate why such control measures would not be sufficient to fight fraud in consumer electronics and electrical household appliances. Nor did Latvia indicate concretely which measures have been taken or will be taken to fight fraud in the sector of consumer electronics and electrical household appliances.

Finally, the Commission refused a number of requests for derogation to apply the reverse charge mechanism based on the above elements. In this respect reference is made to Commission's communications concerning pig-farming and animal fodder industry (COM(2013)148 of 19.3.2013 - in response to a request from Hungary), sugar sector (COM(2014)229 of 22.4.2014 – in response to the request by Hungary), precious stones (COM(2014) 623 of 10.10.2014 - request by Estonia), meat sector (COM(2017) 24 final of 19.1.2017 – request by Slovakia).

Taking into account the above, the Commission has come to the conclusion that a derogation allowing the reverse charge mechanism to be applied in the sector of consumer electronics and electrical household appliances could have adverse impacts on fraud at the retail level and on other Member States. Therefore, it is not considered an appropriate solution to tackle the fraud situation in this sector.

A solution would have to be found at a wider level involving appropriate control measures. The Commission remains available to provide Latvia with necessary assistance to counter the problems of VAT fraud.

5. CONCLUSION

On the basis of the above-mentioned elements, the Commission objects to the request made by Latvia.