



Council of the
European Union

Brussels, 29 May 2018
(OR. en)

9461/18

Interinstitutional File:
2018/0150 (CNS)

FISC 231
ECOFIN 502

PROPOSAL

From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 25 May 2018

To: Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of
the European Union

No. Cion doc.: COM(2018) 298 final

Subject: Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on
the common system of value added tax as regards the period of application
of the optional reverse charge mechanism in relation to supplies of certain
goods and services susceptible to fraud and of the Quick Reaction
Mechanism against VAT fraud

Delegations will find attached document COM(2018) 298 final.

Encl.: COM(2018) 298 final



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Proposal for a

COUNCIL DIRECTIVE

amending Directive 2006/112/EC on the common system of value added tax as regards the period of application of the optional reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud and of the Quick Reaction Mechanism against VAT fraud

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

The purpose of the current proposal for a Directive amending Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ (hereafter the VAT Directive) is to prolong: 1) the possibility for Member States to apply the reverse charge mechanism² to combat existing fraud in supplies of goods and services included in Article 199a(1) of the VAT Directive and 2) the possibility to use the Quick Reaction Mechanism (QRM) to combat fraud.

Article 199a³ of the VAT Directive allows Member States to optionally use the reverse charge mechanism for payment of VAT on supplies of pre-defined goods and services, which are susceptible to fraud, and in particular, to Missing Trader Intra-Community (MTIC) fraud.

If a Member State would like to apply the reverse charge mechanism to other supplies than those listed in Article 199a of the VAT Directive, a derogation can be granted based on Article 395 of the VAT Directive in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion and avoidance. However, the adoption of the derogation based on this article requires a proposal from the Commission and unanimous adoption by the Council, a process which takes up several months (up to a maximum of 8 months according to Article 395 of the VAT Directive). In cases whereby a Member State is suddenly confronted with massive fraud, the duration of the procedure for obtaining a derogation based on Article 395 could result in important losses of VAT receipts. The QRM included in Article 199b⁴ of the VAT Directive contains a faster procedure for allowing Member States, under certain strict conditions, to introduce the reverse charge mechanism, thereby providing Member States with a more adequate and effective response to sudden and massive fraud.

The purpose of the measures foreseen in Articles 199a and 199b is to allow Member States to quickly tackle problems of the MTIC fraud: Article 199a by an option of applying the reverse charge mechanism for listed supplies and Article 199b by offering a faster procedure for the introduction of the reverse charge mechanism in case of sudden and massive fraud. Both Articles expire on 31 December 2018⁵.

The MTIC fraud occurs when a trader acquires goods, transported or dispatched from another Member State, by means of a supply exempt from VAT and sells them on including VAT on the invoice to the customer. After having received the VAT amount from the customer such trader disappears before paying the VAT due to the tax authorities. At the same time the customer, acting in good faith or not, can deduct the VAT he paid to the supplier through his

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p.1.).

² As a general rule, Article 193 of the VAT Directive stipulates that the taxable person supplying goods or services is liable to pay VAT. As a derogation from this system of fractioned payment, the reverse charge mechanism allows to designate the recipient (taxable person) of the supply as the person liable for the payment of VAT.

³ Introduced by Council Directive 2013/43/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud (OJ L 201, 26.7.2013, p.4).

⁴ Introduced by Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a quick Reaction Mechanism against VAT fraud (OJ L 201, 26.7.2013, p.1).

⁵ As regards the QRM, see Article 2 of Council Directive 2013/42/EU.

VAT return. The optional reverse charge mechanism based on Article 199a of the VAT Directive appears to be a useful and precautionary tool for Member States to fight this type of fraud in the pre-defined sensitive areas when it occurs on their territory. Once the trader is obliged to use the reverse charge mechanism for such domestic supplies, he cannot charge VAT on its invoice. He will subsequently not receive the VAT amount from his customer and as a result he cannot disappear with the amount of VAT received. The QRM of Article 199b is an exceptional measure allowing Member States to quickly introduce a temporary reverse charge mechanism for supplies of goods and services in sectors where sudden and massive fraud occurred and which are not listed in Article 199a of the VAT Directive. Using this mechanism Member States can bridge the period required for obtaining the normal derogation under Article 395 of the VAT Directive.

As required by the VAT Directive, the Commission presented a Report on the effects of the mechanisms included in Articles 199a and 199b of the VAT Directive⁶. For the preparation of this Report, Member States were invited to provide their experience and assessment of the measures. To ensure that the feedback from business is taken into account, business stakeholders were requested, via the VAT Expert Group⁷, to provide their views. Member States and consulted stakeholders generally consider the reverse charge mechanism included in Article 199a of the VAT Directive an effective and efficient, temporary tool in fighting VAT fraud. Regarding the QRM included in Article 199b of the VAT Directive, although it was never effectively applied, most Member States consider that it remains a useful tool and a precautionary measure for exceptional cases of VAT fraud.

The Commission presented lately two legislative proposals which aim at tackling VAT fraud more fundamentally. The first is a proposal for administrative cooperation and fighting fraud in the field of VAT⁸, which would strengthen cooperation between Member States to efficiently combat cross-border fraud.

The second is the proposal outlining the cornerstones for a simpler and fraud-proof definitive VAT system for intra-Union trade⁹. A two-step approach will be followed for the implementation of these cornerstones. As a first step, the Commission will present in the first semester of 2018 a proposal containing the detailed provisions for the operation of the definitive arrangements for intra-Union Business-to-Business (B2B) supplies of goods.

These arrangements, which should enter into force on 1 July 2022, provide a fundamental response to MTIC fraud. Since VAT would be effectively charged on intra-Union supplies, a trader can no longer acquire goods, transported or dispatched from another Member State, exempt from VAT which is at the root of the MTIC fraud. Only trustworthy taxable persons that obtained the status of certified taxable person will be able to obtain goods transported or dispatched from another Member State without the VAT having been charged by the supplier.

⁶ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118/2.

⁷ The VAT Expert Group assists and advises the European Commission on VAT matters. The group is composed of individuals appointed in a personal capacity with the requisite expertise in the area of VAT and organisations representing in particular businesses and tax practitioners which can assist in the development and implementation of VAT policies.

⁸ Towards a single EU VAT area - Time to act. Amended proposal for a Council Regulation amending Regulation (EU) No 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, COM(2017) 706 final.

⁹ Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final.

It appears from the above that the measures included in Articles 199a and 199b of the VAT Directive have been useful as temporary and targeted measures. Their expiration on 31 December 2018 would deprive Member States of an efficient tool to fight fraud.

It is therefore appropriate to prolong the measures included in Articles 199a and 199b until 30 June 2022, the date on which the definitive regime for intra-Union B2B supplies of goods should enter into force.

According to Article 199a(1) of the VAT Directive, Member States may apply the reverse charge mechanism for a minimum period of two years. The requirement of a minimum of two years for the application of the measure proved to be an impediment to a few Member States wishing to introduce the reverse charge mechanism in the course of 2017 to fight newly discovered cases of VAT fraud in the supplies of goods and/or services included in the list of Article 199a. The Member States concerned ultimately had to file the request for a derogation based on Article 395 of the VAT Directive and according to the procedure included in this Article resulting in delaying the reaction of the Member States to the fraud problem. Consequently, it is proposed to remove the requirement of minimum period of two years from the provision.

- **Consistency with existing policy provisions in the policy area**

The current proposal is without prejudice to the Commission's proposal as regards the temporary application of a generalised reverse charge mechanism¹⁰ which would provide Member States that are particularly affected by fraud with the possibility to introduce a general (and not sector specific) reverse charge mechanism for domestic supplies of goods and services provided strict conditions are met. The scope and conditions proposed for the application of the general reverse charge mechanism are different from the conditions of Articles 199a and 199b of the VAT Directive.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The Directive amends the VAT Directive on the basis of Article 113 of the Treaty on the Functioning of the European Union.

As the proposal prolongs the application of certain provisions of the Directive, an amendment of the VAT Directive is necessary.

- **Subsidiarity (for non-exclusive competence)**

According to the principle of subsidiarity, as set out in Article 5(3) of the Treaty on European Union, action at Union 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 Union.

The objective of fighting fraud via the application of the reverse charge mechanism and the possibility to use the Quick Reaction Mechanism to fight sudden and massive fraud is best achieved at Union level and finds its specific legal basis in the VAT Directive. Therefore, the prolongation of these measures requires an amendment to the VAT Directive.

¹⁰ 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, COM(2016) 811 final.

- **Proportionality**

Because of the optional and temporary character of the prolonged measures, the proposal is proportionate to the aim pursued which is to combat fraud in certain supplies of goods and services and help Member States to tackle cases of sudden and massive VAT fraud.

- **Choice of the instrument**

A Directive is proposed in view of amending the VAT Directive.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Stakeholder consultations**

The feedback from Member States and stakeholders was presented in the Commission's Report on the effects of Articles 199a and 199b of the VAT Directive on combatting fraud.

As set out in the Report, Member States generally consider the reverse charge mechanism included in Article 199a of the VAT Directive an effective and efficient tool in fighting VAT fraud. Due to the introduction of the reverse charge mechanism the fraud decreased significantly or disappeared in the defined sectors. This view is also shared in the replies received from the consulted business stakeholders who consider the reverse charge mechanism as an efficient, temporary measure for combatting fraud.

Regarding the Quick Reaction Mechanism in Article 199b of the VAT Directive, although it has never been used, most Member States consider that it remains a useful tool and a precautionary measure against exceptional cases of sudden VAT fraud.

- **Collection and use of expertise**

The VAT Expert Group was consulted regarding the effects of the measure included in Article 199a of the VAT Directive. The feedback indicates that the reverse charge mechanism for given supplies is considered an efficient, temporary tool for fighting fraud.

In general, the optional reverse charge mechanism has been assessed in earlier studies. According to a recent study on the assessment of the optional reverse charge mechanism¹¹, the reverse charge mechanism implies an increase by 43% of compliance costs to businesses. An assessment of a general reverse charge mechanism (also comparing to the sectorial reverse charge) on the internal market has been carried out in the impact assessment accompanying the proposal on the temporary application of a generalised reverse charge mechanism¹². Given its limitation in scope and time, the targeted reverse charge mechanism does not appear to have major detrimental consequences.

- **Impact assessment**

The initiative prolongs the measures included in Articles 199a and 199b to support Member States in tackling VAT fraud until a more in-depth reform of the VAT system will be in place.

Given the Commission's on-going work on the definitive VAT regime and its expected impact on the fight against fraud, it would not be useful for the moment to evaluate beyond the recent

¹¹ EY, 2014.

¹² Impact assessment for the proposal as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold, SWD(2016) 457.

Report or revise the measures as any conclusions would be transitional and would need to be reassessed once the definitive regime enters into force.

4. BUDGETARY IMPLICATIONS

The proposal will have no negative implications for the Union's budget.

5. OTHER ELEMENTS

The proposal is limited in time.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 113 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Parliament¹,

Having regard to the opinion of the European Economic and Social Committee²,

Acting in accordance with a special legislative procedure,

Whereas:

- (1) Tax fraud in the field of value added tax (VAT) leads to considerable budget losses and has an impact on the operation of the internal market.
- (2) Article 199a of Council Directive 2006/112/EC³ allows Member States to provide that the person liable for payment of VAT on supplies listed in that Article is the taxable person to whom the supply is made (the reverse charge mechanism) in order to quickly tackle the problem of the missing trader fraud in intra-Community trade (MTIC). The Member States may apply this mechanism until 31 December 2018 and for a minimum period of two years.
- (3) The Quick Reaction Mechanism (QRM) special measure set out in Article 199b of Directive 2006/112/EC offers Member States a faster procedure allowing the introduction of the reverse charge mechanism as regards specific supplies of goods and services in order to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses. In accordance with Article 3 of Council Directive 2013/42/EU⁴ Member States may apply the QRM special measure until 31 December 2018.

¹ OJ C , , p. .

² OJ C , , p. .

³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

⁴ Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a quick Reaction Mechanism against VAT fraud (OJ L 201, 26.7.2013, p. 1).

- (4) On 8 March 2018 the Commission presented a Report on the effects of the mechanisms on combatting fraud referred to in Articles 199a and 199b of Directive 2006/112/EC to the European Parliament and to the Council⁵.
- (5) According to the Report, Member States and stakeholders generally consider the reverse charge mechanism set out in Article 199a of Directive 2006/112/EC as an effective and efficient temporary tool in fighting VAT fraud in the given sectors or in preventing the fraud from taking place. The requirement of a minimum of two years for the application of the measure included in Article 199a(1) proved to be an impediment to a few Member States wishing to introduce the reverse charge mechanism and not fulfilling this condition. Consequently, the requirement of minimum period of two years is removed from the provision.
- (6) Regarding the QRM special measure referred to in Article 199b of Directive 2006/112/EC, although it has never been effectively used, Member States consider that it should remain as a useful tool and a precautionary measure against exceptional cases of VAT fraud.
- (7) Given the findings and the conclusion of the Report it appears that the measures referred to in Articles 199a and 199b of Directive 2006/112/EC have proved to be useful temporary and targeted measures to fight VAT fraud. Those measures are to expire on 31 December 2018 and that would deprive Member States of an efficient tool to fight VAT fraud. It is therefore appropriate to prolong the application of those measures for a limited period of time, until the envisaged entry into force of the definitive VAT regime.
- (8) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 2006/112/EC is amended as follows:

- (1) in Article 199a(1), the introductory words are replaced by the following:

'Member States may, until 30 June 2022, provide that the person liable for the payment of VAT is the taxable person to whom any of the following supplies are made:';

- (2) Article 199b is replaced by the following:

"Article 199b

1. A Member State may, in cases of imperative urgency and in accordance with paragraphs 2 and 3, designate the recipient as the person liable to pay VAT on specific supplies of goods and services by derogation from Article 193 as a Quick Reaction Mechanism ("QRM") special measure to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses.

⁵ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118 of 8 March 2018..

The QRM special measure shall be subject to appropriate control measures by the Member State with respect to taxable persons who supply the goods or services to which that measure applies, and shall be for a period not exceeding nine months.

2. A Member State wishing to introduce a QRM special measure as provided for in paragraph 1 shall send a notification to the Commission using the standardised form established in accordance with paragraph 4 and at the same time send it to the other Member States. The Member State shall provide the Commission with the information indicating the sector concerned, the type and the features of the fraud, the existence of imperative grounds of urgency, the sudden and massive character of the fraud and its consequences in terms of considerable and irreparable financial losses. If the Commission considers it does not have all the necessary information, it shall contact the Member State concerned within two weeks of receipt of the notification and specify what additional information is required. Any additional information provided by the Member State concerned to the Commission shall at the same time be sent to the other Member States. If the additional information provided is not sufficient, the Commission shall inform the Member State concerned thereof within one week.

The Member State wishing to introduce a QRM special measure as provided for in paragraph 1 of this Article shall at the same time also make an application to the Commission in accordance with the procedure laid down in Article 395(2) and (3).

In cases of imperative urgency as set out in paragraph 1 of this Article the procedure laid down in Article 395(2) and (3) shall be completed within six months of receipt of the application by the Commission.

3. Once the Commission has all the information it considers necessary for appraisal of the notification referred to in the first subparagraph of paragraph 2, it shall notify the Member States thereof. Where it objects to the QRM special measure, it shall produce a negative opinion within one month of that notification, and shall inform the Member State concerned and the VAT Committee thereof. Where the Commission does not object, it shall confirm this in writing to the Member State concerned and to the VAT Committee within the same time period. The Member State may adopt the QRM special measure from the date of receipt of that confirmation. In appraising the notification, the Commission shall take into account the views of any other Member State sent to it in writing.

4. The Commission shall adopt an implementing act establishing a standardised form for the submission of the notification for the QRM special measure referred to in paragraph 2 and of the information referred to in the first subparagraph of paragraph 2. That implementing act shall be adopted in accordance with the examination procedure referred to in paragraph 5.

5. Where reference is made to this paragraph, Article 5 of Regulation (EU) No 182/2011 of the European Parliament and of the Council(*) shall apply and for this purpose the committee shall be the committee established by Article 58 of Council Regulation (EU) No 904/2010(**).

6. The QRM special measure as provided for in paragraph 1 shall apply until 30 June 2022.;

(*) Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13).

(**) Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (OJ L 268, 12.10.2010, p. 1).";

- (3) in Article 395, paragraph 5 is deleted.

Article 2

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Article 3

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council
The President*