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NOTE

From:	Presidency
To:	Council
No. Cion doc.:	15817/16 FISC 241 IA 145 - COM(2016) 811 final
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 – General approach

I. INTRODUCTION

1. On 21 December 2016, the Commission presented 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 threshold¹.
2. The objective of this proposal is that Member States, if they meet a number of very strict conditions, could apply GRCM in relation to non-cross border supplies of goods and services above a certain threshold. As stated by the Commission, "this measure is intended to help Member States particularly affected by fraud to fight against carousel fraud, while a comprehensive and EU-wide solution is put in place".²

¹ Doc. 15817/16 FISC 241.

² Doc. 12617/17 FISC 202 ECOFIN 785, page 6 (COM(2017) 566 final).

3. The opinion of the European Economic and Social Committee on this dossier was issued on 31 May 2017³. The opinion of the European Parliament is pending.
4. As early as January 2016, the ECOFIN Council held an exchange of views on a possibility for some MS to apply a reverse charge mechanism for domestic transactions. The Commission was "invited, in its upcoming Action Plan on the Future of VAT [...] to, inter alia, analyse whether a well-designed pilot project for specific Member States, wishing to practically apply VAT reverse charge mechanism in a broader scale, would be feasible and permissible, taking into consideration the risks and possible implications of such a pilot project, including the related legal aspects."⁴
5. The Council in its May 2016 conclusions "On the Commission 2016 Action Plan on VAT"⁵ stated that the Council:

- "10. *RECOGNISES that some Member States are more heavily affected by VAT fraud than others and the need to find practical and short-term solutions rapidly, and TAKES NOTE of the position of the Commission regarding a possible temporary derogation for certain Member States to apply the reverse charge mechanism in a wider scope and that the implementation of such derogation would require legislative measures;*
11. *CONFIRMS that such derogations should not disproportionately hamper the proper functioning of the internal market;*
12. *UNDERLINES, without prejudice to a definitive VAT system, that the information obtained from a temporary derogation could be useful to decide on the most efficient way of fighting VAT fraud [...]*"

³ OJ C 288, 31.8.2017, p. 52.

⁴ Doc. 5302/16 PV/CONS 1 ECOFIN 28, point 8 (January 2016 ECOFIN minutes).

⁵ Doc. 14257/16 FISC 190 ECOFIN 1023.

6. Following the exchange of views in June 2016 ECOFIN, the Commission made a statement, whereby it 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.*"⁶

II. STATE OF PLAY

7. This dossier was discussed in the ECOFIN Council meetings in June 2017⁷, May 2018 and July 2018⁸, where the Presidency suggested that following further technical work, the compromise text should be ready in time for the 2 October 2018 ECOFIN meeting.
8. Following the meeting of Fiscal Attachés on 17 September, and the meeting of the Committee of Permanent Representatives on 26 September 2018, only one delegation maintained its reserve on the compromise text set out in the Annex to this note. The open issue is explained with more detail in Part III of this note. All other delegations, including those which maintained reserves in July meeting of the ECOFIN Council, could support the Presidency compromise text set out in the Annex to this note.

⁶ Doc. 10451/16 PV/CONS 35 ECOFIN 633, point 10 and Annex (June 2016 ECOFIN minutes).

⁷ Doc. 10041/17 FISC 128 ECOFIN 502 + COR 1 and doc. 10042/17 FIC 129 ECOFIN 503 + COR 1.

⁸ Doc. 8770/1/18 FISC 207 ECOFIN 402 REV 1 + COR 1.

III. KEY ISSUE (VAT gap as conditions to apply VAT GRCM - *draft Article 199c(1) point (b) of the VAT Directive*)

9. Application of the optional VAT GRCM is subject to a number of very strict conditions set out in the draft Article 199c of the VAT Directive, that a Member State, wishing to exercise that option, has to satisfy, before it submits an application to European Commission. Once the Commission has sufficient information to determine that all required conditions are met by that Member State, it submits a proposal to the Council for a decision to authorise the requesting Member States to apply the GRCM. Where these conditions are not met, the Commission would not make a proposal for a Council implementing decision.
10. The conditions that a Member State requesting to apply GRCM has to fulfil cover a wide range of aspects set out in Article 199c(1) and (2). For example, it has to have a **certain proportion of carousel fraud within its VAT gap⁹ (25%, as required by point b of Article 199c(1))** and, in accordance with Article 199c(2), the Member State concerned has to **establish appropriate and effective electronic reporting obligations on all taxable persons. In particular the reporting should cover taxable persons who supply or receive the goods or services to which this mechanism applies to ensure the effective functioning and monitoring of the application of the GRCM.**

⁹ VAT gap is generally understood as the overall difference between the expected VAT revenue and the amount actually collected. 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 (in absolute and relative terms) between the VAT revenue expected (the VAT Total Tax Liability or VTTL) and the VAT actually collected by national authorities.

11. The delegation, which still cannot support the Presidency compromise text set out in the Annex to this note, wishes that the conditions to apply VAT GRCM are modified to the extent that this delegation becomes eligible for VAT GRCM. In the view of this delegation, this objective could be attained by an amendment of point (b) of Article 199c(1) of the VAT Directive. To be noted that the current wording of Article 199c(1) point (b) precludes this Member State from applying the optional VAT GRCM (the condition requires that, **based on the impact assessment that accompanied the legislative proposal for this Article, a Member State has to have a carousel fraud level within its total VAT gap of more than 25%**).
12. Following the meeting of Fiscal Attaches of 17 September, this delegation requested that, as an alternative to the condition set out in point (b) of Article 199c(1), **a Member State would also be eligible for VAT GRCM, if it has a difference between VAT Total Tax Liability (VTTL) and VAT gap not exceeding 63% of VTTL**, based on the 2014 data (this data can be found in the 2016 final report of 23rd August 2016 on the VAT gap published by the Commission, on which the VAT gap would be determined for the purposes of this legislative act). However the difference between VTTL and the VAT gap includes not only the amounts of VAT fraud, evasion, avoidance but also bankruptcies, financial insolvencies and miscalculation of VAT. While these numbers result in a loss of VAT, they are not indicators for the level of a VAT fraud in a Member State.
13. Following the meeting of the Committee of Permanent Representatives, this delegation indicated that its objective to become eligible for VAT GRCM could be attained in a number of other ways, by modifying point (b) of Article 199c(1), for example, by extending the scope of that point by referring to the fraud levels in 2016 or by permitting a possibility that the fraud levels can be proven by relevant and updated data validated by the Commission.
14. Nevertheless, a number of other delegations do not support any further extension of the eligibility conditions to apply VAT GRCM.

IV. WAY FORWARD

15. The Presidency hopes that the compromise on this dossier can be found in the Council and the remaining reserve will be lifted.
 16. The Council is therefore invited to:
 - resolve the open issue set out in Part III of this note; and
 - reach a general approach on the draft Directive, on the basis of the compromise text set out in Annex to this note, with a view to adopting the Directive, subject to receiving the opinion of the European Parliament and legal-linguistic revision.
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DRAFT

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

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 Parliament,

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

Acting in accordance with a special legislative procedure,

Whereas:

- (1) In its VAT Action Plan¹⁰, the Commission announced its intentions to come forward with a proposal for a definitive value added tax (VAT) regime for cross-border business-to-business trade between Member States on the basis of the taxation of cross-border supplies of goods and services.
- (2) Given the current level of VAT fraud and the fact that not all Member States are equally affected by this fraud, and given the fact that it will take several years for the definitive VAT regime to be implemented, some urgent and specific measures may be necessary.
- (3) In this context, certain Member States have asked to be allowed to implement a temporary generalised reverse charge mechanism (hereinafter 'GRCM') with a certain threshold per transaction which would derogate from one of the general principles of the current VAT system, as regards the fractionated payment system, in order to address endemic carousel fraud. Carousel fraud finds notably its root in the current exemption for intra-community supplies that allows for goods to be obtained VAT-free. A number of traders engage subsequently in tax fraud by not paying to the tax authorities the VAT received from their customers. Those customers, however, being in receipt of valid invoices, remain entitled to a tax deduction. The same goods can be supplied several times by including again exempt intra-community supplies. Similar carousel fraud can also occur when services are supplied. By designating the taxable person to whom the goods or services are supplied as the person liable for the VAT, the derogation would remove the opportunity to engage in that form of tax fraud.
- (4) Member States showing differences in the development of the capacities of their tax administrations sustain a special effort, in terms of higher levels of VAT fraud and revenue losses, in the implementation of the VAT regime, within the meaning of the first paragraph of Article 27 TFEU.

¹⁰ Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT - Towards a single EU VAT area - Time to decide (COM(2016)148 final of 7.4.2016).

- (5) In order to limit the risk of fraud shifting between Member States, all Member States that fulfil certain criteria as regards their fraud level, in particular in relation to carousel fraud, and who are able to establish that other control measures are not sufficient to combat that fraud, should be allowed to use a GRCM. In addition, they should establish that estimated gains in tax compliance and collection expected as a result of the introduction of the GRCM outweigh the estimated overall additional burdens on businesses and tax administrations and that businesses and tax administrations will not incur costs that are higher than those incurred as a result of the application of other control measures.
- (6) If Member States choose to apply the GRCM, they should apply it to all non-cross-border supplies of goods and services above a defined threshold per transaction. The GRCM should not be restricted to any specific sector.
- (7) Member States choosing to apply the GRCM should introduce specific electronic reporting obligations on taxable persons so as to ensure the effective functioning and monitoring of the application of the GRCM. They should detect and prevent all new forms of tax fraud, **such as artificial splitting of the taxable amount of transactions.** ~~including split payments.~~
- (8) In order to be able to assess whether the introduction of the GRCM in one Member State does not result in fraud shifting towards other Member States and to be able to assess the degree of possible disturbances to the functioning of the internal market, it is appropriate to provide a specific obligation to exchange information between Member States that apply the GRCM and the other Member States. All exchanges of information are subject to applicable personal data protection and confidentiality provisions. Those provisions provide exemptions and restrictions for safeguarding the interests of the Member States or of the Union in the area of taxation.
- (9) 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 those Member States as to enable an assessment of the level of fraud before and after the application of the GRCM.

- (10) The decisions authorising the application of the GRCM would have a budgetary impact which for one or more Member States could be significant. Accordingly, the power to adopt the individual decision authorising the application of the GRCM should be conferred on the Council.
- (11) Member States choosing to apply the GRCM should request the Commission to propose the application of the GRCM and provide relevant information in order to enable the Commission to assess that request. Where necessary, the Commission should be able to request additional information.
- (12) Given the unexpected effects that such a GRCM might have on the functioning of the internal market because of the possible shift of fraud to other Member States that do not apply it, the Council should be able, as a safeguard measure, to repeal all implementing decisions approving the application of the GRCM. In view of the need to react quickly in a situation where considerable negative impact on the internal market is established, reversed unanimity voting should be used.
- (13) In view of the uncertain effects that such a mechanism might have, it should be limited in time.
- (14) To closely monitor the impact on the internal market, all Member States should, in case the GRCM is used at least in one Member State, present reports to the Commission as to enable an assessment of the impact on the fraud, the compliance costs for businesses and a shift in fraudulent activities due to the application of the GRCM.
- (15) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

The following Article 199c is inserted in Directive 2006/112/EC:

"Article 199c

1. Until 30 June 2022 a Member State may, as a Generalised Reverse Charge Mechanism (GRCM) on non-cross-border supplies, provide that the person liable for payment of VAT is the taxable person to whom all supplies of goods and services are made above a threshold of EUR ~~{15 000}~~ **17500** per transaction, by derogation from Article 193.

A Member State wishing to introduce the GRCM shall comply with the following conditions:

- (a) it had, according to the method and figures in the 2016 final report dated 23rd August 2016 on the VAT gap published by the Commission, a VAT gap in 2014, expressed as a percentage of the VAT Total Tax Liability, of at least 5 percentage points above the Community median VAT gap; and
- (b) it has, **based on the impact assessment that accompanied the legislative proposal for this Article,** ~~in the year covered by the report referred to in point (a)~~ a carousel fraud level within its total VAT gap of more than 25%; and
- (c) it establishes that other control measures are not sufficient to combat carousel fraud on its territory, in particular by specifying the control measures applied and the particular reasons for their lack of effectiveness, as well as the reasons why VAT administrative cooperation has proven insufficient; and
- (d) it establishes that the estimated gains in tax compliance and collection expected as a result of the introduction of the GRCM outweigh the expected overall additional burdens on businesses and tax administrations by at least 25%; and

- (e) it establishes that businesses and tax administrations will not incur, as a result of the introduction of the GRCM, costs that are higher than those incurred as a result of the application of other control measures.

The Member State shall attach to the request referred to in paragraph 4 the calculation of the VAT gap according to the method and figures available in the report on the VAT gap published by the Commission, as referred to in (a) above.

2. Member States that apply the GRCM shall establish appropriate and effective electronic reporting obligations on all taxable persons and, in particular, on taxable persons who supply or receive the goods or services to which this mechanism applies to ensure the effective functioning and monitoring of the application of the GRCM.
3. Member States wishing to apply the GRCM shall submit a request to the Commission and provide the following information:
 - (a) a detailed justification that the conditions referred to in paragraph 1 are fulfilled; and
 - (b) the starting date of the application of the GRCM and the period to be covered by it; and
 - (c) actions to be taken to inform taxable persons of the introduction of the application of the GRCM; and
 - (d) a detailed description of the accompanying measures referred to in paragraph 2.

If the Commission considers it does not have all the necessary information, it shall request additional information, including underlying methods, assumptions, studies and other supporting documents, within one month of receipt of the request. The requesting Member State shall submit the required information within a month of receipt of the notification.

4. Where the Commission considers that the request complies with the requirements referred to in paragraph 3, it shall, no later than three months after it has received all the necessary information, submit a proposal to the Council. The Council, acting unanimously on such proposal from the Commission, may authorise the requesting Member State to apply the GRCM. Where the Commission considers that the request does not comply with such requirements, it shall, within the same deadline, communicate its reasons to the requesting Member State and to the Council.
5. In case of considerable negative impact on the internal market, the Commission shall, no later than three months after it has received all the necessary information, propose the repeal of all the implementing decisions referred to in paragraph 4, at the earliest six months after the entry into force of the first implementing decision authorising a Member State to apply the GRCM. Such repeal shall be deemed to be adopted by the Council unless the Council decides by unanimity to reject the Commission's proposal within 30 days of the Commission's adoption thereof.

Considerable negative impact shall be considered established, where the following conditions are fulfilled:

- (a) at least one Member State, not applying the GRCM referred to in paragraph 1, informs the Commission of an increase of VAT fraud on its territory due to the GRCM; and
 - (b) the Commission establishes, including on the basis of the information provided by the Member States referred to in point (a), that such increase is related to the application of such a mechanism in one or several Member States.
6. Member States applying the GRCM shall submit in electronic format to all Member States:
 - (a) the names of the persons who, in the twelve months preceding the date of application of the GRCM, have been subject to proceedings, whether criminal or administrative, for VAT fraud; and

- (b) the names of the persons, including in the case of legal persons the names of their directors, whose VAT registration in that Member State is terminated after the introduction of the GRCM; and
- (c) the names of the persons, including in the case of legal persons the names of their directors, who have failed to submit a VAT return for two consecutive tax periods after the introduction of the GRCM.

The information in (a) and (b) above shall be submitted no later than 3 months after the introduction of GRCM and shall be updated every three months thereafter. The information in (c) shall be submitted no later than nine months from the introduction of GRCM and shall be updated every three months thereafter.

Member States applying the GRCM shall submit an interim report to the Commission no later than one year after the start of application of the GRCM. This report shall provide a detailed assessment of the effectiveness of the GRCM. Three months after the end of the application of the GRCM, Member States applying the mechanism shall submit a final report on its overall impact.

7. Member States not applying the mechanism shall submit an interim report to the Commission as regards the impact in its territory of other Member States applying the GRCM . Such report shall be submitted to the Commission within three months after the GRCM will have been applied for at least one year in one Member State ~~by that date~~.

If at least one Member State applies the GRCM, Member States not applying the mechanism shall submit a final report to the Commission as regards the impact in its territory of other Member States having applied the GRCM no later than {30 September 2022}.

8. In the reports referred to in paragraph 6, Member States shall assess the impact of the application of the GRCM on the basis of the following evaluation criteria:
- (a) the evolution of the VAT gap;
 - (b) the evolution of the VAT fraud, notably carousel fraud and fraud at the retail level;
 - (c) the evolution of the administrative burdens on taxable persons;
 - (d) the evolution of administrative costs for the tax administration.
9. In the reports referred to in paragraph 7, Member States shall assess the impact of the application of the GRCM on the basis of the following evaluation criteria:
- (a) the evolution of the VAT fraud, notably carousel fraud and fraud at the retail level;
 - (b) shift of fraud from Member States applying or having applied the GRCM."

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*.

It shall apply until 30 June 2022.

Article 3

This Directive is addressed to the Member States.

Done at Brussels,

For the Council

The President
