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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 19 November 2018, Lithuania 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 2 April 2019 of the request made by Lithuania. By letter dated 3 April 2019, the Commission notified Lithuania that it had all the information it considered necessary for the 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 Lithuania 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 petroleum products and additives. 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

Lithuania requests, under Article 395 of the VAT Directive, that the Council, acting upon a proposal of the Commission, authorises Lithuania 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 petroleum products

(gas oil and petrol) including additives (fatty acid methyl ester (FAME) and bioethanol).

By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT, the domestic reverse charge mechanism has been found to eliminate the opportunity to engage in certain forms of tax fraud such as 'missing trader fraud'.

Lithuania submits that the introduction of the derogating measure is necessary to fight fraud occurring in the sector of petroleum products. These products are purchased from taxable persons in other Member States and before they are supplied to retailers or directly to consumers, multiple transactions are included in the chain between missing traders who do not pay VAT due to the state budget. According to Lithuania approximately 5-6% of petrol and gas oil on the Lithuanian market is traded fraudulently depriving the Lithuanian state budget of around 20 million EUR per year.

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 proportionate¹.

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 in case the reverse charge is introduced, the fraud has a tendency to move further down the supply chain (to retail level). This is due to the fact that the retailer acquires the products VAT free and after charging VAT on the subsequent supply can disappear with the amount of VAT received from the customer. Given the higher numbers of traders at the retail level this will be even more difficult to control.

In the second place, it should be noted that petrol and gas oil are consumable goods which are particularly sensitive to price changes with consumers/buyers prepared to cross the border to obtain the best price. Given this sensitivity of the market, there is a risk of fraud to move to neighbouring Member States. The introduction of the reverse charge creates an incentive for dishonest traders from neighbouring Member States to buy petrol VAT free in Lithuania which could then be resold in the other

¹ C-395/11 BLV Wohn- und Gewerbebau, ECLI:EU:C:2012:799, paragraph 40.

Member States. The neighbouring Member States will not be informed of the arrival on their territory of petrol purchased VAT free elsewhere by these dishonest traders.

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. Lithuania introduced a number of control measures and some of them appeared effective. In particular, the rules on trading of petroleum products have been tightened up and the traders need to dispose of a licence. It appears that in 2017 there were 71 companies holding such wholesale licence, so it should normally be possible for Lithuania to control such limited number of traders.

Other measures could still be envisaged, such as for instance a better control of refund claims including checks of the business premises, holding the customer of the missing trader jointly and severally liable if he knew or should have known that by his purchase he was participating in a transaction linked to VAT fraud, etc.

Finally, it should be noted that in the past the Commission communicated its intention to refuse a request for derogation by another Member State in order to apply the reverse charge mechanism to the same products. That Member State subsequently decided to withdraw its request.

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 petroleum products and additives 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 occurring in this sector.

A solution would have to be found at a wider level involving appropriate control measures, including measures for more expedite investigation and effective prosecution. The Commission remains available to provide Lithuania 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 Lithuania.