



Reverse Charge Mechanism - the future of EU VAT?



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Agenda




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- Status quo: VAT as a fractionated tax with exceptions
- Reverse Charge as Solution?
- Proposal for a General Reverse Charge Mechanism
- Evaluation: Pros and Cons
- Outlook



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Status quo



- **EU VAT is levied on each stage of the supply chain (fractionated payment) ≠ sales tax**

- **Art 1 VAT Directive:**

“The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged.

On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.”



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Status quo

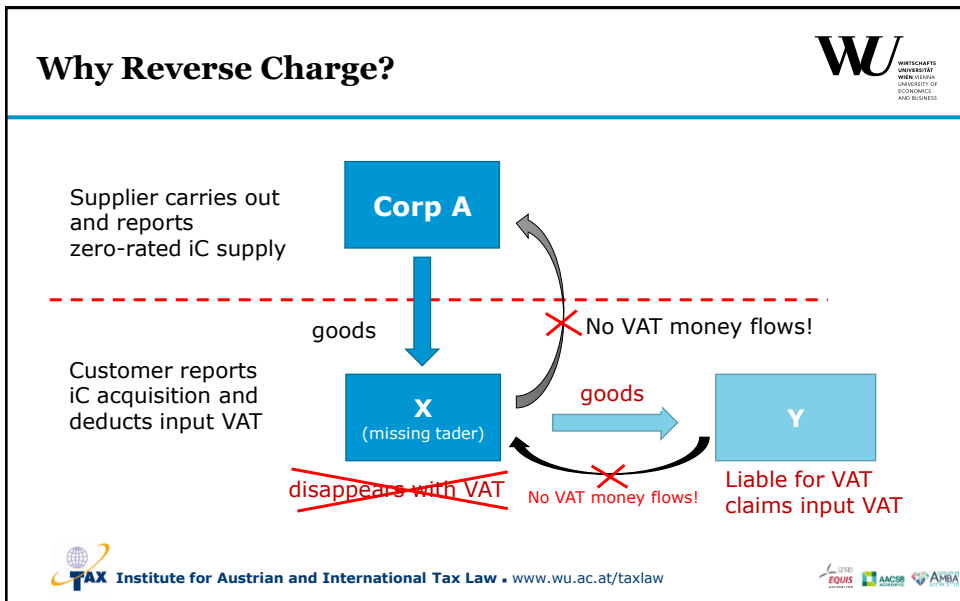
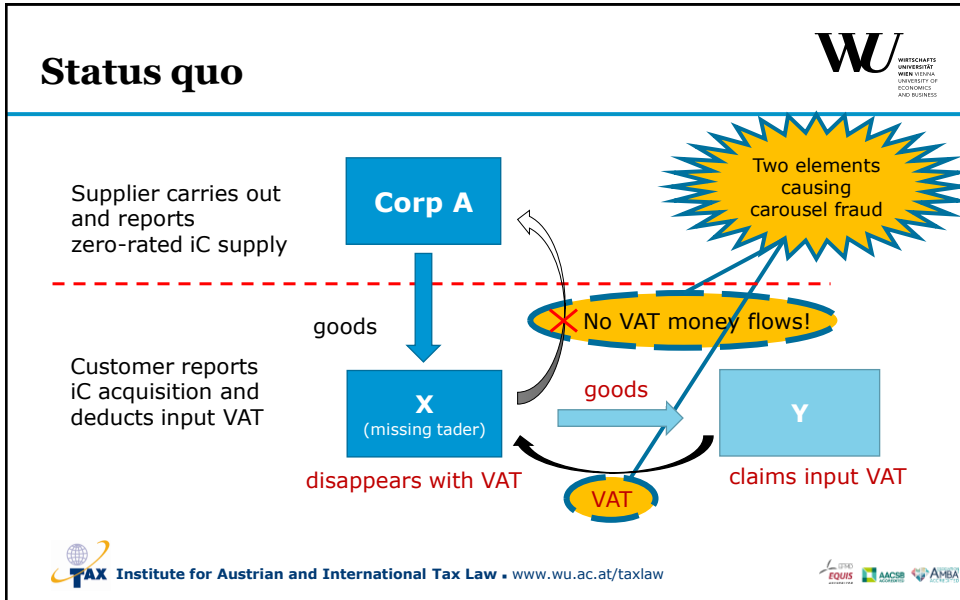


- However, the EU VAT Directive provides several **exceptions**:
 - Exemptions (financial services, health care, ...) for different reasons
 - For cross-border supplies: with the aim of avoiding disproportional administrative burdens for businesses
 - Zero-rated intra-Community supplies (Art 138)
 - Reverse Charge for cross-border supplies of B2B services (Art 196)
 - For domestic supplies: further optional exceptions with the aim to avoid fraud (Arts 199, 199a, 199b)



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Status quo



- **Optional Reverse Charge to combat carousel fraud**
 - **for specific categories of services** (Arts 199 and 199a)
 - Art 199: construction work, supply of staff, etc
 - Art 199a: mobile phones, game consoles, laptops, etc
 - MS need to inform VAT Committee (authorization Art 27 Sixth Directive)
 - **Quick Reaction Mechanism** (QRM, Art 199b), since 2013
 - imperative urgency and irreparable financial losses, limited to 9 months
 - Authorization by Commission necessary
- **Special measures for derogation in order to prevent evasion (Art 395)**
 - Authorization by Commission/Council necessary
 - never granted so far (5 applications)



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Proposal for a Temporary General Reverse Charge Mechanism



- Proposal published on 21 December 2016 (COM(2016) 811)
 - Preparing and implementing the definitive system as proposed in the VAT Action Plan is „likely to take some time“
 - „upon request of certain Member States“
 - **„temporary generalised reverse charge mechanism (GRCM)“**
- New Article 199c(1):

*“**Until 30 June 2022** a Member State **may**, as a Generalised Reverse Charge Mechanism (GRCM), provide that the person liable for payment of VAT is the taxable person to whom **supplies of goods and services** are made above a **threshold of EUR 10 000 per invoice**, by derogation from Article 193.”*



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Eligible Member States



- Which Member States could use the option?
 - Substantial requirement: only MS with a comparable high level of VAT fraud or their neighbouring countries
 - Formal requirement: request to and authorization by Commission
- **Requirement on VAT fraud: three cumulative criteria**
 - (a) VAT gap, expressed as a percentage of the VAT Total Tax Liability, of **at least 5 percentage points above the Community median VAT gap**;
 - (b) **carousel fraud level within its total VAT gap of more than 25%**;
 - (c) *other control measures are not sufficient to combat carousel fraud*
- Presidency compromise (June 2017):
 - VAT gap according to Final Report 2016
 - two additional tests on efficiency/necessity



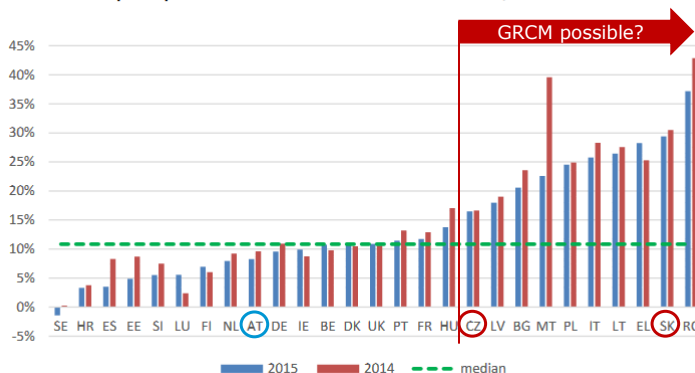
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Eligible Member States



Figure 2.1. VAT Gap as a percent of the VTTL in EU-27 Member States, 2015 and 2014

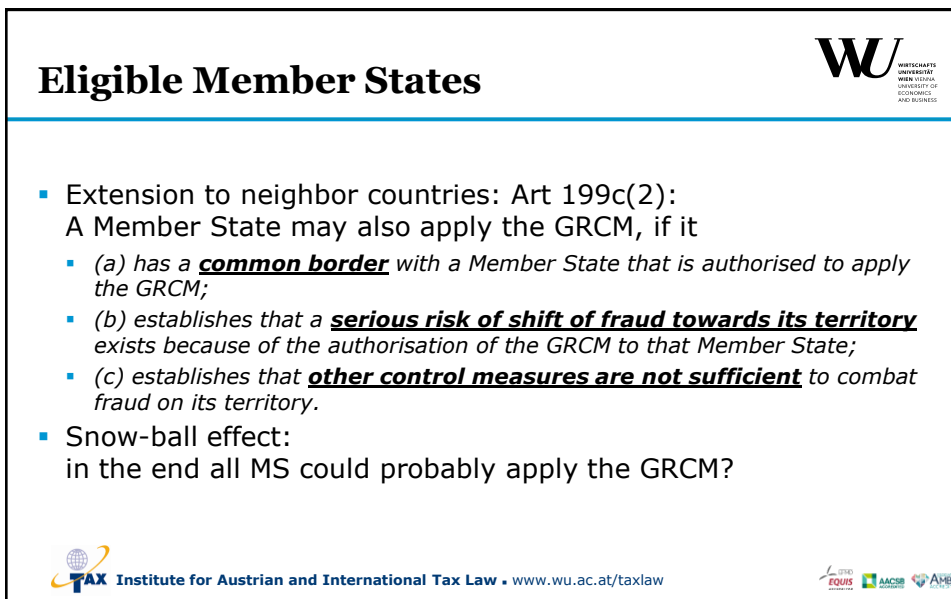
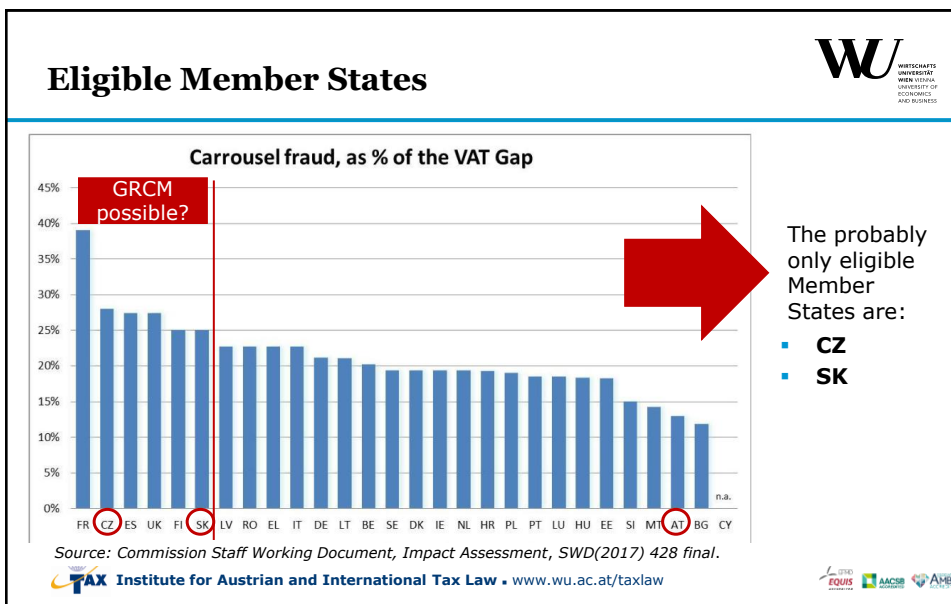


Source: Study and Reports on the VAT Gap in the EU 28 Member States: 2017 Final Report, TAXUD/2015/CC/131



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Substantial Scope



- Very broad scope: “**supplies of goods and services**”
 - No restriction to any specific industry, no cross-border requirement
 - All or nothing approach: if option is exercised, MS have to apply GRM to “all supplies of goods and services” above threshold (preamble)
- But: invoice threshold: “**EUR 10.000 per invoice**”
 - Typcasting approach to distinguish between B2B and B2C
 - Aim of excluding abuse by private persons faking business status and of avoiding disproportional administrative burden (e.g. supermarket)



hybrid system



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Risks of the proposal (COM(2016) 811)



- Uncertainty as regards scope
 - VAT gap criteria? Temporary only? Repeal of authorization by Commission?
- Uncertainty as regards economic effects
 - shift of fraud to other countries, ...
- Uncertainty as regards legal/policy effects:

Would EU VAT in fact become a Retail Sales Tax?

 - Yes, EU VAT would get closer to a Sales Tax
 - But: still differences to a traditional sales tax:
 - Hybrid: still invoice with VAT for low-value B2B supplies (< 10.000)
 - Reporting obligations for businesses in B2B transactions



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Would Reverse Charge solve the problems?



■ Pro Arguments

- Member States:
 - **NO missing-trader fraud**
 - Compared to definitive system: Application/auditing based on own domestic VAT system only, less need for mutual trust between authorities
- Businesses:
 - Invoice is no requirement for input VAT deduction?
 - Customer: no need to pay VAT to supplier (may include cash-flow advantage)
 - Compared to definitive system: Supplier: no need to get familiar with a different VAT system (in particular for SME)



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Would Reverse Charge solve the problems?



■ Contra Arguments

- Original character of EU VAT as a fractionated tax undermined
- Member States: still risk of abuse:
 - Total amount of VAT levied at one stage only (B2C, black market)
 - Risk of „fake“ businesses
- Businesses:
 - administrative burden: reporting for all transactions, change of IT systems
 - Supplier: hybrid system: verification of each customer (status) and verification of invoice turnover important
 - Customer: liability risk and verification of exemption, rate



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Outlook



- Reverse Charge might have some advantages as regards combating carousel fraud, but it might include other risks
- 16 June 2017: discussion in ECOFIN:
 - “no agreement could be reached due to diverging views of Member States” (opposed by France)
- “Definitive system” (One-Stop-Shop) has strong support by the Commission and, hence, seems to be the way forward?



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Thank you



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