



### Questions and Answers on VAT reform in the EU

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##### Why does the EU's VAT system need reform?

The current VAT rules for cross-border trade between businesses in EU Member States date back to 1993, just after the creation of the Single Market. At the time, they were meant to be transitional. The rules do not take into account technological developments, changes in business models or the globalisation of the economy, making them outdated. Crucially, the current VAT regime exposes EU countries to an unacceptable and damaging level of VAT fraud. Revenue losses from this type of fraud are estimated at around €50 billion annually in the EU. Money which could have been used to build schools, roads and hospitals is instead spirited away by criminals to finance organised crime, and possibly terrorist organisations. Member States recently identified VAT fraud as [one of their top ten priorities](#) when it comes to the fight against organised and serious international crime (see separate section on fraud).

The VAT reform proposed today would make the system more robust, simpler and fraud resilient, a system based on increased trust and cooperation between tax administrations. The Commission wants a VAT system that helps European companies to compete in global markets. Compliance costs for all businesses should also be reduced by simplifying and modernising the VAT obligations and VAT collection process.

A definitive VAT system for the EU has been a long-standing commitment of the European Commission. Recently, the Commission's [VAT Action Plan](#) explained in detail the need to come to a EU single European VAT area that is simpler and fraud-proof. The rules also need to be rebooted so that businesses can reap all the benefits of the Single Market.

##### What is the Commission proposing today?

The Commission is today proposing a series of fundamental principles and key reforms for the EU's VAT area which will improve and modernise the system for governments and businesses alike. Once agreed, these principles or 'cornerstones' will form the backbone of a robust EU-wide system which can keep pace with today's digital and mobile economy. The new system would also be much more fraud-proof.

The cornerstones which will be sent to Member States for agreement include:

- **Tackling fraud:** VAT should be charged on cross-border trade between businesses inside the EU. Currently, this type of trade is exempt from VAT, providing an easy loophole for unscrupulous companies to collect VAT and then vanish without remitting the money to the government.
- **One Stop Shop:** It will be simpler for companies that sell cross-border to deal with their VAT obligations thanks to a 'One Stop Shop'. Traders will be able to make declarations and payments using a single online portal in their own language and according to the same rules and administrative templates as in their home country. Member States will then pay the VAT to each other directly, as is already the case for all sales of e-services.
- **Greater consistency:** A move to the principle of 'destination' whereby the final amount of VAT is always paid to the Member State of the final consumer and charged at the rate of that Member State. This has been a long-standing commitment of the European Commission, supported by Member States and the European Parliament. It is already in place for sales of e-services.
- **Less red tape:** Simplification of invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders. Companies will no longer have to prepare a list of cross-border transactions for their tax authority (the so-called "recapitulative statement").

Today's proposal also introduces the notion of a Certified Taxable Person – a category of trusted business who will benefit from much simpler and time-saving rules.

#### THE DEFINITIVE VAT REGIME

## **What is the biggest change?**

VAT is a tax levied on most goods, products and services available for purchase in the EU. In principle, everything we buy includes VAT in the price. When selling domestically (i.e. not across borders) companies also pay VAT on the goods that they buy and which they plan to sell on to another business or to consumers. VAT is not currently charged on sales between businesses in different EU Member States.

Today's proposal envisages a future VAT system where VAT will be charged on sales that are made across borders to another country in the EU. The rate applicable in the country of destination will be charged.

The VAT on cross-border sales would be collected by the tax authority of the originating country and transferred to the country where the goods or services are ultimately consumed. In order to allow a soft transition for tax administrations and businesses, the first step of the definitive VAT system will focus only on transactions in goods.

## **How does the 'One Stop Shop' portal work?**

Businesses that trade within the EU will be able to sort out their VAT far more simply and easily, via an online web portal (or 'One Stop Shop') in their home country. Otherwise, traders would have to register for VAT, file returns and make payments in every EU country where they operate. The online portal would also allow VAT to be collected by the country where the sale is made and transferred to the country where the goods are consumed. A similar system is already in place and working well for sales of cross-border e-services. The Commission [proposal to extend this system to online sales of tangible goods](#) is currently being discussed by Member States in the Council.

In order to allow for a gradual transition, trustworthy businesses ('certified taxable persons') that are certified by their tax administrations, including SMEs, could continue to purchase goods free of VAT in another Member State and pay VAT in their own country.

## **What will this mean for companies?**

The rules will become more simple and harmonised across the EU, which in turn, will make it easier for companies to do business across borders. For example, businesses will be able to make their declarations and payments for cross-border VAT via one online portal and in their own language ('One Stop Shop'). This will lighten the administrative burden and save time and money. Those companies that fulfil certain criteria will be considered eligible to become a Certified Taxable Person, which will bring further benefits (see below).

## **What will this mean for national tax authorities?**

Member States' governments will be able to collect billions in VAT revenues which would otherwise be lost. In addition, the rules will be made simpler for everyone, which means there will be easier and more harmonised procedures and less administrative burden for the authorities. The definitive regime will put in place the self-policing function of the VAT system at EU level, making VAT auditing and collection easier for tax administrations.

## **What will this mean for consumers?**

The new proposal only applies to transactions between businesses (B2B), so EU consumers will not be directly affected. However, solving the problem of tax fraud is beneficial for society as a whole. The vast sums of money which are lost now because of fraud could be better invested in public projects and services such as schools, hospitals and roads. In addition, cutting back on tax fraud will close down a cash cow for criminal organisations and possibly even terrorist groups.

Finally, by removing obstacles to selling goods and services across borders, the definitive regime can boost competition between firms from different countries, resulting in lower prices for the consumers.

## **What is a 'Certified Taxable Person'?**

The concept of a Certified Taxable Person is a new initiative being proposed today to facilitate trade and make life easier for companies operating cross-border in the EU. Provided that companies, small or big, meet a set of criteria, they can get a certificate allowing them to be considered throughout the EU to be a reliable VAT taxpayer. A business can become a Certified Taxable Person by applying to their national tax authorities and proving compliance with a set of sufficiently harmonised and standardised pre-defined criteria including: regular payment of taxes, reliable internal control systems and proof of solvency.

Once certified, both they and the companies that do business with them will enjoy a number of simplified procedures for the declaration and payment of cross-border VAT. The status of Certified Taxable Person will be mutually recognised by all EU Member States.

## **VAT FRAUD**

### **Who commits VAT fraud?**

VAT fraud is a major EU-wide problem. It is carried out by criminals and organised crime networks. VAT fraud can occur in many sectors including electronics, cars and carbon permits.

While VAT carousel fraud is set up by individuals sometimes involved in other criminal activities, fraudulent VAT schemes generate financial profits which are then subject to money laundering in the same way as profits from other criminal activities.

### **Which products or sectors are most prone to VAT fraud?**

The most attractive goods for fraudsters have been those of high value and low volume such as mobile phones or computer chips, which generate huge amounts of VAT in the lowest number of transactions and in the shortest possible time.

In recent years, by taking advantage of the shortcomings inherent in the current VAT regime, VAT carousel fraud has rapidly moved from one product or economic sector to another with criminals quickly adapting to any counter actions taken by enforcement bodies.

VAT fraud also tends to move from traditional to new sectors where buying and selling can happen extremely quickly due to the intangible nature of the products. For example, pollution rights exchanged on the carbon-trading market have given rise to huge fraudulent schemes in the past years. One of these networks was dismantled in France between 2008 and 2009 and amounted to a loss of more than €1.6 billion for the French budget.

It is also now possible for VAT fraud to take place without any tangible goods being moved at all: carousel fraud circuits have recently moved from real economic flows to entirely virtual operations supported by fake invoices.

### **What are the links between VAT fraud and organised crime, including terrorism?**

Several cases of VAT fraud investigated in recent years have repeatedly highlighted the link between VAT carousel fraud and money laundering:

- In 2016, an EU-wide VAT fraud and money laundering network operating in Spain and Portugal was dismantled. It [had been committing VAT fraud with fuel oil and precious metals and laundering the proceeds](#).
- A [2015 case](#) involved the dismantling of an organised crime network operating in Czech Republic, Netherlands, Germany and Poland.

In addition, investigations are ongoing at Member States level which could potentially reveal links to the financing of terrorist activities.

A [recent study](#) by the European Parliament's PANA Committee revealed that, according to EUROPOL, 388 out of the 3,469 entries appearing in the so-called Panama papers were connected to VAT fraud operations. Fighting large-scale VAT fraud implies tackling the money laundering processes of fraudsters as well.

According to another [EU study](#), 21 cases of EU VAT fraud between 2004 and 2010 involved organised crime, with the proceeds potentially being used to finance other types of crime, such as drug trafficking, trafficking in human beings, identity fraud, alcohol smuggling and counterfeiting.

### **What is missing trader fraud (MTIC) and VAT carousel fraud?**

VAT fraud can occur when a company that has collected VAT from its buyer and should pay this amount to the tax authority does not pay but instead disappears. The business owner simply vanishes with the money. Most fraud takes place when the company buys goods from another Member State, because purchasing the goods is VAT-free. When selling the goods on domestically, the company receives the entire amount of VAT, which it pockets. Because the company disappears, this type of fraud is called missing trader fraud.

Carousel fraud goes even further. In this case the same goods are bought and resold by the fraudster several times via middlemen. Each time the amount of collected VAT increases and the company either disappears or becomes insolvent before the tax authority can collect the accumulated VAT. With carousel fraud, the same product goes around several times before the fraudsters disappear.

### **Why are the current rules prone to fraud?**

The nature of VAT collection, whereby the money is collected step-by-step all along the production chain, helps incentivise companies to follow closely their VAT obligations. In this way, they can claim back the VAT they pay when buying and the full amount of VAT is finally paid only by the final consumer. But goods sold across borders in the EU are today exempt from VAT. At the same time, the

company buying the goods must charge VAT when selling on to another business or to a final consumer in the same Member State. This gives unscrupulous businesses the opportunity to simply pocket the full amount of VAT and disappear. There are no adequate cross-border control systems that can operate quickly enough and this problem forms the root of a significant amount of fraud. For example, significant MTIC fraud or carousel fraud can occur within a single month, which is too short for the tax authority to detect the fraud and to react.

### **How will the switch to a definitive VAT regime help to fight VAT fraud in the EU?**

The proposed cornerstones of a definitive regime scrap the exemption of VAT that is currently in place for cross-border trade within the EU, which is the main case of large-scale, cross-border VAT fraud today. In future, VAT should be collected and paid in the same way as for domestic transactions. This would dramatically decrease the risk of non-payment of VAT to governments and eliminate the main weakness of today's cross-border VAT calculation (see diagram).

In short, the proposed rules would simplify the EU VAT area and make it more difficult to commit fraud. A robust single European VAT area would treat cross-border transactions in the same way as domestic transactions (i.e. cross-border trade will no longer be exempt from VAT), putting an end to the inbuilt weaknesses of the system.

### **How does this proposal fit into the EU's fight against organised crime?**

Member States have identified missing trader intra-community fraud (MTIC fraud or "carousel fraud" if it is repeated over and over again with the participation of the same companies) [as one of ten EU priorities](#) in the fight against organised and serious international crime for the period 2018-2021. VAT fraud needs to be tackled with the same vigour as other international crimes such as cybercrime, drugs and money laundering.

Member States can only fight VAT carousel fraud efficiently through close cooperation at both national and EU level. At national level, competent actors including tax authorities, financial intelligence units, law enforcement bodies and judicial authorities need to work together. At EU level, we believe that close cooperation and action between Member States and all competent EU bodies including the EUROFISC network, EUROPOL, EUROJUST, OLAF and the upcoming European Public Prosecutor Office is needed.

### **SHORT-TERM 'QUICK FIXES'**

#### **Why is the Commission proposing 'Quick Fixes' to improve the VAT system?**

The Commission is also proposing today a number of short-term measures to improve the functioning of the VAT system until the definitive regime has been fully agreed and implemented. These quick fixes address issues explicitly requested by both businesses and Member States, and cover:

- Simplification of VAT rules for companies in one Member State storing goods in another Member State to be sold directly to customers there. This simplification is limited to Certified Taxable Persons who will no longer need to register and pay VAT in another Member State when they store goods there.
- Simplification for those elements of a chain transaction which do not involve the physical movement of goods, for example when goods are sold via several traders, but physically the goods move directly from the original seller to the final buyer. This simplification is limited to Certified Taxable Persons.
- New harmonised and uniform rules so that traders can more easily provide proof that goods have been transported from one EU country to another. This simplification is limited to Certified Taxable Persons.
- Clarification that, in addition to proof of transport, the VAT number of the commercial partners recorded in the electronic EU VAT-number verification system (VIES) is required for the cross-border VAT exemption to be applied under the current rules.

### **NEXT STEPS**

#### **What are the next steps for this proposal?**

The proposal will be forwarded to the European Parliament for consultation and to the Council of Ministers for their agreement. It will require unanimous agreement from all Member States in the Council before it can enter into force.

A second directive overhauling the whole VAT Directive will be proposed in which the cornerstones will be implemented and the current transitional articles will be replaced or deleted.

Further changes regarding the administrative cooperation rules and substantial IT developments will be needed in order to ensure the proper operation of the system.

The adoption of this second proposal is currently scheduled for 2018 and the definitive regime should enter into application in 2022.

**Will these new rules affect trade with suppliers outside of the EU?**

No, the new proposal only applies to commercial transactions within the EU.

**Who have you consulted ahead of this proposal and what was the outcome?**

Throughout the process of drafting the proposals, interest groups and stakeholders were consulted regularly through conferences, working groups with representatives of Member States (Group on the Future of VAT) and business (VAT Expert Group).

A public consultation also ran for three months until March 2017, resulting in 121 contributions.

**What other VAT reforms are planned?**

This proposal is part of the Commission's VAT action plan and there are several other initiatives to change the EU's VAT area planned before the end of the year.

<b>By end of 2017</b>	<b>Proposal to reinforce administrative cooperation between Member States</b> The aim of this proposal will be to strengthen the capacity of Member States to conduct faster joint risk analysis of available information, launch follow-up actions and share VAT intelligence with law enforcement bodies at EU level, such as with Europol and OLAF.
	<b>Proposal for a modernised system of setting VAT rates</b> The current rules have not been updated to reflect new developments and the growth of new sectors such as digital products. Updating VAT rates for specific sectors is difficult because all decisions in this area have to be taken unanimously. The Commission intends to modernise the rules, removing outdated legal restrictions for Member States, while preventing the erosion of VAT revenues and a shrinking of the tax base.
	<b>Proposal to simplify VAT for SMEs</b> SMEs proportionally bear higher VAT compliance costs than large businesses due to complexity and fragmentation of the EU VAT system. In an effort to alleviate those compliance costs, the Commission will propose a comprehensive simplification package for SMEs with a view to create an environment that is conducive to their growth and favourable to cross-border trade.
<b>Spring 2018</b>	<b>Full technical adaptation of the VAT directive</b> to reflect the changes needed to practically implement the VAT definitive regime as proposed by the Commission.

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