

## INCEPTION IMPACT ASSESSMENT

<b>TITLE OF THE INITIATIVE</b>	Proposal for a more efficient VAT treatment of cross-border business-to-business (B2B) supplies of goods and a simpler, fraud-proof definitive VAT system		
<b>LEAD DG – RESPONSIBLE UNIT</b>	TAXUD UNIT C1	<b>DATE OF ROADMAP</b>	22/12/2016
<b>LIKELY TYPE OF INITIATIVE</b>	Proposal for a Council Directive		
<b>INDICATIVE PLANNING</b>	Q3/2017		
<b>ADDITIONAL INFORMATION</b>	-		

**This Inception Impact Assessment aims to inform stakeholders about the Commission's work in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options. The Inception Impact Assessment is provided for information purposes only and its content may change. This Inception Impact Assessment does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content.**

### A. Context, Problem definition and Subsidiarity Check

<b>Context</b>
<p>In the 2016 VAT Action Plan<sup>1</sup> and in the 2017 Work Programme<sup>2</sup> the Commission outlined its plans towards a single EU VAT area. Following this, four VAT-related proposals are to be adopted in 2017: the definitive VAT system, the reform of VAT rate-setting, the SME VAT package and an initiative on improved administrative cooperation. The proposal for a simpler and fraud-proof definitive VAT system is closely connected with the three other initiatives.</p> <p>When the common system of VAT was established<sup>3</sup> in 1967, Member States made the commitment to establish a definitive VAT system operating within the European Union (EU) in the same way as it would within a single Member State. Since the political and technical conditions<sup>4</sup> were not ripe for such a system when the physical borders between Member States were abolished by the end of 1992, transitional VAT arrangements were adopted.</p> <p>The existing VAT legislation<sup>5</sup> provides that these temporary rules which are still in force have to be replaced by definitive arrangements. As agreed by the European Parliament<sup>6</sup> and the Council<sup>7</sup>, the definitive VAT system should be based on the principle of taxation at destination.</p> <p>This initiative will also take into account recent Council conclusions and the European Parliament resolution on the way to improve the VAT treatment of cross-border transactions<sup>8</sup>.</p>

<sup>1</sup> See 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.

<sup>2</sup> See Commission Work programme 2017: Delivering a Europe that protects, empowers and defends, COM(2016) 710 final.

<sup>3</sup> First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes — Structure and procedures for application of the common system of value added tax.

<sup>4</sup> The desired system required clearing mechanisms to reattribute VAT receipts to the Member State of consumption. It implied a high degree of confidence between Member States and a high level of harmonisation of rates and exemptions, in order to avoid distortions of competition.

<sup>5</sup> See Article 402 of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>6</sup> See Resolution on <http://eur-lex.europa.eu/procedure/EN/199945>

<sup>7</sup> See in particular point B, 4) of Council conclusions on the future of VAT adopted on 15 May 2012 on [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/130268.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130268.pdf)

## Problem the initiative aims to tackle

The current transitional VAT arrangements for cross-border transactions lead to a complex and fragmented VAT system. This results in high compliance costs for businesses trading across the EU and significant administrative burden for companies and tax administrations. It has also generated a significant level of cross-border fraud in the trade of goods and hampers the functioning of the single market.

Problem 1 – High administrative burden and compliance costs: a retrospective economic evaluation of the EU VAT system<sup>9</sup> was carried out in 2011 in parallel with the public consultation launched by the Green Paper on the future of VAT. A recent study<sup>10</sup> confirmed the findings of the evaluation: the costs associated with complying with cross-border VAT obligations are substantially higher (11% higher) than the VAT compliance costs associated with domestic trade.

Problem 2 - VAT fraud undermining tax revenues: the evaluation also confirmed the major revenue loss for Member States due to high levels of VAT fraud. The VAT gap between expected revenue and revenue actually collected is estimated at EUR 170 billion<sup>11</sup>, while cross-border fraud alone is estimated to have been generating a VAT revenue loss of EUR 50 billion annually.

For more than 20 years, the existing transitional VAT arrangements have been inappropriate to address the obstacles to the proper functioning of the single market. The current cross-border VAT rules offer the possibility to buy goods free of VAT and create opportunities for committing fraud in the next stages of the commercial chain. They also cause liability risks to any businesses which unknowingly became involved in a fraudulent supply chain<sup>12</sup>. This undermines public finances, has negative repercussions on a very large number of actors of the European economy and affects equally private economic operators and national tax administrations. Indirectly it also affects EU citizens who, as tax payers and final consumers, compensate for the loss of VAT revenue in their national budgets through higher VAT rates and other taxes, and suffer higher prices due to the significant VAT compliance costs of their suppliers.

Therefore, the regulatory framework of cross-border transactions subject to VAT needs to be reformed. The current legislative initiative will propose, within the Regulatory Fitness and Performance Programme (REFIT), to replace the transitional VAT rules by a simpler, more efficient and fraud-proof definitive VAT system.

## Subsidiarity check (and legal basis)

National instruments have shown to be inefficient in fighting cross border fraud, and in particular the so-called “missing-trader fraud” - inherent to the transitional VAT arrangements. The EU cross-border fraud can be fought efficiently and effectively only at EU level.

In the absence of EU action amending the VAT Directive, the losses of public revenue due to fraud would persist. Some Member States could take individual measures to tackle fraud, but without a common EU policy this would make the system even more fragmented and complex. It would also increase compliance costs for businesses and administrative costs for national tax administrations, and result in efficiency and competitiveness losses.

Also, enabling businesses to operate in the single market as freely as in a domestic market can only be achieved by replacing the current transitional VAT rules by a more efficient definitive VAT system for intra-EU trade.

Article 113 of TFEU gives the EU right to act and adopt provisions for the harmonisation of legislation concerning Value Added Tax. As the problems at stake which hamper the functioning of the Single Market concern intra-EU sales of goods and cover purely cross-border matters, a common European solution is needed to reduce the level of cross-border VAT fraud and overcome the high level of burden experienced by businesses operating in different Member States.

## B. Objectives and Policy options

<sup>8</sup> See Council conclusions of 25 May 2016 on the Commission's VAT Action plan, Council conclusions of 8 November 2016 on Improvements to the current EU VAT rules for cross-border transactions and European Parliament resolution of 24 November 2016 on towards a definitive VAT system and fighting VAT fraud.

<sup>9</sup> [http://ec.europa.eu/taxation\\_customs/resources/documents/common/publications/studies/report\\_evaluation\\_vat.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/report_evaluation_vat.pdf)

<sup>10</sup> Implementing the ‘destination principle’ to intra-EU B2B supplies of goods (2015) ([http://ec.europa.eu/taxation\\_customs/resources/documents/common/publications/studies/ey\\_study\\_destination\\_principle.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/ey_study_destination_principle.pdf))

<sup>11</sup> The VAT gap provides an estimate of revenue lost due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies and miscalculations (CASE, *Study to quantify and analyse the VAT Gap in the EU Member States*, 2015).

<sup>12</sup> The growing number of litigation cases examined by the European Court of Justice in the area of VAT during the last years demonstrates that the existing legal framework is insufficient to address the endemic fraud in this area.

The current initiative aims to implement the destination principle, simplify the rules for intra-EU business-to-business transactions so as to reduce the burden and costs related to doing business in more than one Member State, and to reduce the level of cross-border VAT fraud.

### **Baseline – no EU policy change on the intra-EU trade VAT rules**

Under the current transitional VAT arrangements, goods sold between businesses established in different Member States cross borders before VAT is paid to the competent authorities. These sales are exempt from VAT in the Member State of departure of the goods and the buyer has to self-assess and pay the VAT due in the Member State of arrival. This offers opportunities for fraud. In addition, the system is complex and can discourage cross-border trade, in particular for SMEs. In the absence of a common EU definitive VAT system for intra-EU trade, additional and uncoordinated measures to fight against fraud could be imposed on businesses by individual Member States, leading to new layers of complexity. A new derogation could further fragment the existing system by allowing individual Member States to apply under certain conditions a generalised reverse charge mechanism<sup>13</sup> to domestic supplies. This could additionally increase the costs and burden of businesses.

### **Envisaged policy options**

In its 2016 VAT action plan<sup>14</sup>, the Commission sets out the way forward towards a single EU VAT area. In this context, and following discussions with stakeholders (in the [VAT Expert Group](#)) and with representatives of the Member States (in the [Group on the Future of VAT](#)) to address the endemic weakness of the VAT treatment of intra-EU B2B supplies of goods (in addition to maintaining the current system as described in the baseline scenario), five options have been identified:

- **Option 1** – Improving the current rules without modifying them fundamentally;
- **Option 2** – Adapting current rules whilst still following the flow of the goods with the supplier charging the VAT of the Member State of destination;
- **Option 3** – Adapting current rules whilst still following the flow of goods with the reverse charge mechanism;
- **Option 4** – Aligning with the rules governing the place of supply of services with the reverse charge mechanism; and
- **Option 5** – Aligning with the contractual flow with the supplier charging the VAT of the Member State of destination.

They have been analysed in depth in an expert study published in 2015 "*Implementation the destination principle to intra-EU B2B supplies of goods*"<sup>15</sup>.

All options (except baseline) require legislative amendments of the current rules: a Proposal for a Directive is needed to amend the existing VAT Directive<sup>16</sup>. It could be complemented by other legal instruments such as an Implementing Regulation.

The design of the future system will consider using a digital and internet ready electronic platform (a "One-Stop-Shop") for the payment of the VAT. This way, businesses would only need to register for VAT purposes in the Member State where they have been established. This technology could lower burdens for all businesses, including SMEs.

## **C. Preliminary Assessment of Expected Impacts**

### **Likely economic impacts**

The creation of a simpler and more fraud-proof EU VAT system would support a deeper and fairer single market.

This initiative would also have a positive impact on VAT revenues in Member States as it would address the inherent weakness of the existing transitional arrangements as regards the risk for cross-border VAT fraud. This could in turn allow for more balanced and fairer distribution of the tax burden across all groups of tax payers.

The definitive EU VAT system would also help boosting growth, investment and competitiveness. Trade between

<sup>13</sup> See Commission proposal: [https://ec.europa.eu/taxation\\_customs/business/vat/vat-legislation-proposed\\_en](https://ec.europa.eu/taxation_customs/business/vat/vat-legislation-proposed_en). Under a generalised reverse charge mechanism, VAT is 'suspended' along the whole economic chain and is charged only to consumers. This means that total VAT collection is shifted to the retail stage.

<sup>14</sup> COM(2016) 148 final

<sup>15</sup> For detailed description of these options, see EY study 2015 ([http://ec.europa.eu/taxation\\_customs/resources/documents/common/publications/studies/ey\\_study\\_destination\\_principle.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/ey_study_destination_principle.pdf)) p.45 and 46.

<sup>16</sup> Council Directive 2006/112/EC of 28 November 2006 – as amended.

<p>businesses across Europe would become easier and the costs for businesses willing to sell goods in other Member States would be reduced. As tax compliance would be easier, existing VAT-related obstacles to engage in intra-EU trade would be removed. An increase in cross-border sales may provide greater choice for consumers, increase competition and possibly reduce prices.</p> <p>This initiative would benefit businesses, including SMEs, established in all European Member States. It would have a positive impact mainly on the sectors dealing with trade in goods and could increase the volume of goods sold cross-border in Europe.</p>
<p><b>Likely social impacts</b></p>
<p>By simplifying the VAT system and reducing the costs and burden for businesses (including SMEs) running a cross-border activity, this initiative could have positive impacts on the competitiveness of the European enterprises resulting in job creation and positive effect on employment in Europe. It should also contribute to creating fairer tax systems.</p>
<p><b>Likely environmental impacts</b></p>
<p>No impacts expected.</p>
<p><b>Likely impacts on fundamental rights</b></p>
<p>No impacts expected.</p>
<p><b>Likely impacts on simplification and/or administrative burden</b></p>
<p>This initiative is part of the Commission's Regulatory Fitness and Performance Programme (REFIT). All the options (except baseline) of this initiative will likely have significant impacts on simplification and will reduce administrative burden and compliance costs. These benefits for businesses (including SMEs), would have a positive impact on economic growth and competitiveness.</p> <p>During the implementation period, additional costs can be expected for tax administrations for training of staff and adapting IT systems but the national public authorities would ultimately benefit from an increase in VAT revenue. Also, simpler VAT legislation with clearer rules should ensure that the compliance challenges are reduced for tax administrations and litigation costs are decreased.</p>
<p style="text-align: center;"><b>D. Data Collection and Better Regulation Instruments</b></p>
<p><b>Impact assessment</b></p>
<p>An evaluation and an impact assessment are being prepared to support the preparation of this initiative and to inform the Commission's decision.</p>
<p><b>Data collection</b></p>
<p>A significant amount of data is available to be used for the evaluation and impact assessment of this initiative.</p> <p>With regard to the current VAT system <a href="#">a retrospective evaluation</a> has already been conducted in 2011 and its findings are still valid.</p> <p>Regarding the options for a definitive VAT system, the following studies provide detailed analysis of the problems at stake and the possible ways forward :</p> <ol style="list-style-type: none"> <li>1) <a href="#">Study on applying the current principle for the place of supply of B2B services to B2B supplies of goods, PWC, 2012;</a></li> <li>2) <a href="#">Economic study on charging VAT on intra-EU supplies of goods and services, CBP, 2013</a></li> <li>3) <a href="#">Implementing the 'destination principle' to intra-EU B2B supplies of goods, EY, 2015</a></li> <li>4) <a href="#">Study to quantify and analyse the VAT Gap in the EU Member States, CASE, 2016</a></li> </ol> <p>Additional evidence will be gathered by an open public consultation and where needed, by targeted consultations of stakeholders and using existing statistical and economic databases.</p>

## Consultation strategy

### Public consultation

A new open public stakeholder consultation<sup>17</sup> related to this initiative has been launched. In addition, public consultations on other related VAT initiatives will also be conducted.

In 2010, an open public consultation on the 'Green Paper on the future of VAT' - Towards a simpler, more robust and efficient VAT system<sup>18</sup> resulted in 1726 contributions and was followed by a conference in 2011 which brought together policy makers, experts, businesses, other stakeholders and the general public.

### Targeted consultations

The 2017 legislative proposal for a definitive VAT system will focus on intra-EU sales of goods between businesses. It will mainly affect tax administrations and businesses operating cross-border in Europe. Thus, business and Member States Representatives have been continuously involved and consulted over the past six years on each policy step leading towards the current initiative on the definitive VAT system.

Technical debates were organised during the regular meetings of the Group on the Future of VAT (tax administrations) and in the VAT Expert Group (businesses and academics). SME communities' positions have been taken into account through their representatives' attendance of the latter meetings. In addition, a joint seminar for tax administrations and businesses has been organised in 2015 in order to allow detailed discussions on the different policy options for the definitive VAT system and gather expert opinion from all affected stakeholders.

Consultation with the Group on the Future of VAT and the VAT Expert Group will continue during the ongoing process.

## Will an Implementation plan be established?

An Implementation plan will be prepared after the end of the negotiations on the legislative proposal for a definitive VAT system. This implementation plan will take into account the outcome of the negotiations and build upon the best practices developed with the 2008 VAT package including, if appropriate, implementing regulations and publication of Explanatory notes encouraging a consistent implementation of the new rules across Europe.

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<sup>17</sup> [https://ec.europa.eu/taxation\\_customs/consultations-get-involved/tax-consultations/public-consultation-definitive-vat-system-business-business-b2b-intra-eu-transactions-goods\\_en](https://ec.europa.eu/taxation_customs/consultations-get-involved/tax-consultations/public-consultation-definitive-vat-system-business-business-b2b-intra-eu-transactions-goods_en)

<sup>18</sup> [http://ec.europa.eu/taxation\\_customs/taxation/vat/future\\_vat/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/future_vat/index_en.htm)