

INCEPTION IMPACT ASSESSMENT

TITLE OF THE INITIATIVE	Review of the special scheme for small enterprises under the VAT Directive 2006/112/EC		
LEAD DG – RESPONSIBLE UNIT	TAXUD – C1	DATE OF ROADMAP	22/12/2016
LIKELY TYPE OF INITIATIVE	Legislative package. It might be complemented by soft-law instruments such as guidelines.		
INDICATIVE PLANNING	Q4/2017		
ADDITIONAL INFORMATION	-		

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

Context
<p>In the 2016 VAT Action Plan¹ and the 2017 Work Programme² the Commission outlined its plans towards a single EU VAT area. Following this, four VAT-related proposals will be adopted in 2017: definitive VAT system, the reform of VAT rate-setting, a simplification package for small and medium sized companies³ (SME VAT package), and an initiative on improved administrative cooperation.</p> <p>The review of the SME scheme, that is also part of the Single Market Strategy⁴, is particularly linked with the initiative on the definitive VAT regime because the current provisions of the SME scheme are temporary in character and apply only until the definitive arrangements for cross-border trade enter into force⁵. Similarly to the e-commerce proposal⁶, the review aims at simplifying VAT rules for small businesses, including startups, but its scope is much larger. It covers exemption, simplification and burden reduction measures and is not limited to businesses selling online, but covers broadly all the sectors of economic activity.</p>
Problems the initiative aims to tackle
<p>Problem 1: Higher compliance costs for SMEs. Current VAT rules are burdensome for small enterprises, which bear proportionally higher VAT compliance costs than large enterprises. This problem has two aspects. The first one is linked to the complexity of domestic rules on VAT obligations and the resulting costs of complying with them. The second relates to the need for cross-border trading companies to comply with different sets of rules in place in different Member States. The first aspect calls for simplification and a reduction of unnecessary burden, the second for harmonisation or at least some degree of alignment of the rules relating to VAT obligations.</p>

¹ 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.

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

³ SMEs are generally defined at EU level according to the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (OJ L 124, 20.05.2003, p. 36). With its rules for small enterprises, the VAT Directive however targets businesses operating on a much smaller scale. Only the businesses qualifying as microenterprises according to the EU definition are in VAT terms generally referred to as SMEs.

⁴ See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Upgrading the Single Market: more opportunities for people and business, COM(2015) 550 final.

⁵ Article 292 of the VAT Directive - Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

⁶ Proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods.

Problem 2: Too strict territorial limitations for SMEs. The strict territorial limitation of the VAT exemption provided for under the SME scheme, leaving only small enterprises established within the Member State of taxation to benefit, also raises issues. This has a negative impact on the competitive situation of suppliers established in other Member States compared to that of domestic suppliers of goods and services. Those issues are set to increase with the shift towards taxation at destination that will be completed with the proposal on the definitive VAT regime. One such example is linked to the rules by which telecommunications, broadcasting and electronically supplied services provided to final consumers have been taxed at destination since 1 January 2015. These rules meant that small enterprises having had no VAT obligations in their own Member State (because they were able to make use of the domestic SME exemption) now have to charge VAT in the Member State of their customer, without having access to an exemption from which their competitors established in that Member State may benefit.

Problem 3: Particular problems relating to the threshold effect of the VAT exemption which may prohibit young enterprises from scaling up⁷, and the treatment of those who only make supplies on an occasional basis. Information on the scale and impact of these possible problems is being collected.

Therefore, the regulatory framework of the SME scheme needs to be reviewed. The current legislative initiative will propose, within the Regulatory Fitness and Performance Programme (REFIT), a comprehensive simplification and burden reduction package for SMEs.

Subsidiarity check (and legal basis)

Domestic businesses whose turnover is below a certain threshold can benefit from VAT exemption and linked to that, be released of some or all VAT obligations whilst cross-border trading enterprises have no access to such exemption. This creates distortions in the Internal Market and national measures alone are insufficient to alleviate administrative burden and reduce compliance costs. These are problems triggered by the rules of the existing VAT Directive which cannot be tackled at national level alone. Member States are currently (apart from specific derogations to be granted by the Council on the basis of a Commission proposal) generally not allowed setting different rules by themselves. Therefore, any initiative to modernise the VAT scheme for small enterprises requires a proposal by the Commission to amend the VAT Directive. Hence, it is appropriate for the Commission to propose legislative action to improve the situation, possibly accompanied by soft-law instruments.

The legal basis is Article 113 of the TFEU which states that "*The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*".

B. Objectives and Policy options

The most important policy objective is to reduce the VAT compliance costs for small enterprises. The tools to achieve this objective are the simplification, reduction of unnecessary burden and alignment of VAT obligations and the granting of exemption from VAT. Other policy objectives, closely linked to the one above and interlinked between themselves, are to provide a level playing field for EU businesses and in this way to contribute to the smooth functioning of the single market, to contribute to the creation of an environment favourable to SMEs' growth and, in general, to contribute to the wider review of the VAT system with the aim of making it more robust and efficient.

The options outlined below do not preclude the possibility that alternative approaches may emerge through further public and stakeholder consultations.

Option 1: Status quo plus the legislative changes stemming from the proposal on Modernising VAT obligations for cross-border e-commerce; The current exemption system is optional both for Member States and for enterprises, covers only enterprises established in the Member State in which the VAT is due, enterprises using the scheme cannot deduct input VAT, neither can they indicate VAT on invoices. The e-commerce proposal would introduce a common EU threshold below which enterprises making supplies in other Member States would be able to opt for treating these supplies as domestic transactions.

Option 2: SME exemption scheme extended to supplies from other Member States and including streamlined simplification and burden reduction measures.

Option 3: Option 2 plus mandatory treatment of occasional traders as non-taxable persons.

Option 4: Option 3 plus measures reducing the negative impact of the 'threshold effect', i.e. addressing the issue

⁷ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Europe's next leaders: the Start-up and Scale-up Initiative, COM(2016) 733 final.

<u>of transition for enterprises when upon increase in their turnover are going from exemption to taxation.</u>
C. Preliminary Assessment of Expected Impacts
The following preliminary assessments do not preclude the findings of the Impact Assessment the Commission will undertake.
Likely economic impacts
Most likely positive. The measures proposed will assist in strengthening the single market. Tax compliance should be made easier, which may have a positive impact on VAT revenues and a reduction of administrative burden and compliance costs for businesses, in particular small enterprises. The proposal should contribute to creation of a more level playing field for small enterprises. Existing distortions linked to unequal treatment of domestic suppliers and suppliers from other Member States should be reduced/ minimised. A possible increase in cross-border commerce may provide greater choice for consumers and possibly reduce prices.
Likely social impacts
No direct impacts expected. Indirect impacts would be positive. The simplification, transparency, burden reduction, clarification, enhancement of legal certainty and facilitation of trade to be expected from these reforms are expected to stimulate growth and entrepreneurship, particularly at the level of the smallest enterprises (micro-enterprises). This could in turn have a positive impact on job creation.
Likely environmental impacts
No impacts expected.
Likely impacts on fundamental rights
Most likely broadly positive. The proposal brings about more equal treatment of small enterprises by opening the exemption which currently applies only to domestic enterprises, also to suppliers from other Member States.
Likely impacts on simplification and/or administrative burden
Most likely positive. The main objective of the review is simplification and reduction of unnecessary administrative burden and compliance costs borne by small enterprises. The relevant quantitative data is being collected through a study which is currently being carried out by an external contractor.
D. Data Collection and Better Regulation Instruments
Impact assessment
The Evaluation and Impact Assessment work has already commenced through the data collection and analysis of options through the ongoing study on the special scheme for small enterprises (micro-enterprises) under the VAT Directive 2006/112/EC – Options for review. The broad problem and the options for review were considered by the Inter-Service Steering Group (ISSG) on the VAT Action Plan.
Data collection
A study is underway to assist with the collection of the most comprehensive knowledge base possible, including available statistics and survey results and carrying out new surveys where possible and useful. The study will, amongst other things, produce an overview of the measures applied by the 28 Member States based on the provisions on the special scheme for small enterprises. It will undertake an analysis of different categories of enterprises in relation to their activities and annual turnover and of the VAT revenues at stake in 28 Member States. It will also undertake an analysis of taxed and exempted (under the SME scheme) transactions carried out by small enterprises in the EU as a whole and for each Member State in a sample of eight Member States chosen for the study. The Final Report of the study is due in January 2017. In parallel to the study, the Commission has consulted SMEs via the Enterprise Europe Network survey and is gathering feedback from several EU stakeholder associations through bilateral meetings.
Consultation strategy
An open public consultation has been launched. Its purpose is to gather the views of stakeholders on the current VAT provisions for SMEs and their application as well as on possible changes as regards these provisions. Its

results will feed into the review of the SME scheme. The consultation is available on the DG TAXUD website https://ec.europa.eu/taxation_customs/consultations-get-involved/tax-consultations/public-consultation-special-scheme-small-enterprises-under-vat-directive_en. The Commission will inform stakeholders of the public consultation through EU business representative organisations (especially SME organisations), the SME panel and by advising Member States. In addition, public consultations on the related VAT initiatives have also been launched.

A targeted consultation of stakeholders took place as part of the ongoing study on the scheme and the options for the review. This involved in-depth interviews with business (SMEs) and Member States. In addition, an SME panel consultation was carried out with the use of Enterprise Europe Network.

Will an Implementation plan be established?

While dependent on what is adopted, it is expected that the implementation plan will include guidelines for business/tax administrations and an extensive communication plan. As with other VAT measures, stakeholders and Member States will be consulted on the implementation through seminars, workshops, the VAT Expert Group and the VAT Committee.