

FUTURE CHANGES TO THE 6th VAT DIRECTIVE PLANNED BY THE EUROPEAN COMMISSION

THE NEW VAT STRATEGY

In June 2000 the European Commission presented a communication to the Council and the European Parliament in which it set out its strategic programme for improving the operation of the VAT system in the short term.¹ This was the launch of the “New Strategy for VAT”. The communication acknowledged that the “transitional” common VAT system, which has been applicable in the Member States of the European Community since 1 January 1993, is likely to remain in force for the foreseeable future. The Commission therefore announced its intention to focus its efforts, not on replacing the existing system, but on improving the way it works. The Communication set out a pragmatic programme with four main objectives, namely the simplification, modernisation and more uniform application of the current rules and closer administrative cooperation. The intention was to give new momentum to work in the Council and encourage it to adopt as quickly as possible certain specific, much needed improvements to the existing VAT system. At the same time, however, the concept of a definitive system of taxation in the Member State of origin was retained as a long-term Community objective.

On 20 October 2003 the Commission presented a further communication entitled “Review and update of VAT strategy priorities”² which contained an interim report on the progress made under the new strategy. This showed that between June 2000 and October 2003 the Council had adopted nine proposals on VAT-related matters. The Council has subsequently adopted two further directives making a total of eleven since the launch of the new Strategy. Although not all the measures are equally important it has to be recognised that in an area where a unanimous Council decision is still required, the new strategy has been relatively successful. A list of the directives that have been adopted is annexed.

¹ COM (2000) 348 final of 7.6.2000.

² COM (2003) 614 final of 20.10.2003.

THE NEXT STEPS

In its communication "Review and update of VAT strategy priorities", the Commission has presented the new initiatives it envisages in the short term. These are, to a large extent, guided by two general objectives, i.e. the reaffirmation of the principle of taxation at the place of consumption and the simplification of traders' obligations.

Taxation at the place of consumption

VAT is a general tax on consumption, under which the revenue should go to the Member State where actual consumption takes place. One of the major objectives of the common VAT system therefore is to assign the tax to the Member State where final consumption of goods or services occurs via the rules governing the place of taxable transactions.

However, the rules on the place of taxation for services, which were first drawn up in the nineteen seventies, serve less and less well to ensure that the objective of assigning revenue is achieved. In practice, in the case of remotely provided services (such as telecommunication or digital supplies), firms are increasingly choosing their place of establishment mainly for tax-planning reasons. The rules on the place of taxation need to be reviewed therefore in order to ensure that, as far as possible, the place of taxation and the place of actual consumption are the same, subject to ensuring that the new rules do not impose excessive tax obligations on traders.

Simplifying tax obligations

For cross-border B2B (business to business) transactions between taxable persons, using the reverse charge mechanism (whereby the business customer becomes the taxable person) means taxation occurs at the place of consumption and tax obligations are not imposed on the supplier in the Member State of consumption. Thus both correct revenue allocation and simplification of obligations are achieved. A broader application of this mechanism to cover all cases where the person carrying out the transaction is not established in the Member State of taxation is therefore desirable.

For business to consumer (B2C) transactions, where the customer is generally a private individual, taxation at the place of consumption cannot be achieved by making the customer liable. Instead, if tax is to be collected with any certainty, the supplier has to remain liable and thus be identified, and make tax returns and payments, in every Member State where he carries out taxable transactions. It is therefore necessary to try to find a means of simplifying tax collection in the B2C area without jeopardising the principle of taxation in the country of consumption.

The "one stop shop" mechanism

In this context, the special mechanism which has been introduced for electronically provided services represents an important step in the operation of the common VAT system. For the first time, the Council has accepted the principle that the Member State where a transaction is taxed need not necessarily be the Member State in which the VAT obligations relating to the transaction have to be fulfilled. In the interests of simplifying those obligations, the Council has agreed that a trader not established in the EU can be identified, lodge his tax returns and pay VAT on all services provided electronically to non-taxable persons established in the EU in one single place (the one-stop shop). There is no reason why Community traders in a comparable position (liable for tax in one or more Member States where they are not established) should not benefit from a similar simplification. The 2003 communication therefore identifies wider use of the idea of a one-stop shop mechanism (although not necessarily identical to that introduced for electronically supplied services) as a key to simplifying the obligations of Community traders.

In this connection it is interesting to note that a very similar system, the "Streamlined Sales Tax Project" (SSTP),³ is under way in the United States. Although the "sales and use taxes" charged in the United States are very different from the value added tax system of the European Union, similar problems arise in both in connection with cross-border sales and the proposed solutions are comparable.

For instance, in the United States – mainly thanks to the possibilities opened up by the Internet – there has been a big expansion in the distance selling of goods to private consumers. In the United States these transactions cause considerable tax collection problems since a vendor not established in a given State (i.e. without "physical nexus") cannot be designated as liable for the tax in that State. The party liable for the tax is therefore the end consumer, who cannot be relied upon to pay the tax.

In 1967, and again in 1992, the Supreme Court decided that States may not require tax to be collected from a mail order vendor not physically present in that State and has indicated that this would not be possible unless the States simplified and standardised their tax system. The SSTP is currently attempting to achieve this, the aim being to ensure that taxation takes place at the point of consumption and is collected from the taxable vendor. To fulfil the criteria laid down by the Court, consideration is being given to the possibility of setting up an electronic system that will enable a vendor to pay the taxes due in the various States where his customers are established. The features of this system are very similar to those of the one-stop shop (e.g. a single place for identification and for lodging tax returns).

³ See <http://www.streamlinedsalestax.org>

THE GUIDELINES APPLIED IN PRACTICE

There are basically four different types of cross-frontier transactions which can be identified in the common VAT system and which can be tested against the two guidelines described above.

B2B supplies of goods

The current system of exempting intra-Community supplies and taxing the intra-Community acquisition in the Member State of destination, where the tax is paid by the recipient in his normal VAT return, gives the right result both in terms of revenue allocation and in the simplification of obligations. It does, however, give rise to a serious potential for fraud given that the self-policing aspect of the VAT system (the fractionated payment of VAT at various stages) is no longer present at the intra-Community stage. Thus the well-documented phenomenon of carousel or missing trader fraud has grown somewhat alarmingly. To counter this, the Commission and the Member States have sought to enhance administrative co-operation and to develop a system of "Best Practice" in control methods⁴.

B2C supplies of goods

Since 1 January 1993, special arrangements have been incorporated into the common VAT system to provide for taxing, at destination, intra-Community sales of new means of transport, intra-Community sales to exempt taxable persons or non-taxable legal persons and distance sales to private consumers.

The main reason for introducing these special arrangements was the risk that insufficiently harmonised tax rates would lead to distortion of competition and incorrect allocation of tax revenue on a significant scale. This situation still applies and the special arrangements will therefore need to be maintained for the foreseeable future in order to ensure correct revenue allocation. However, in order to simplify the tax obligations of suppliers of such goods, the introduction of the one-stop shop could bring substantial simplifications for traders established in the Community.

B2B supplies of services

On 23 December 2003 the Commission presented a proposal for a directive on the place of supply of services.⁵ The key element of this proposal, which covers B2B transactions only, is an amendment of the general rule for establishing the place of taxation, which is currently the place where the supplier is established, so that it would become the place where the customer is established or has a fixed establishment. However, to avoid placing a disproportionate administrative burden on some traders, there would be exceptions to this general rule for some services for which there are currently specific rules (e.g. services related to immovable property and transport services). This would

⁴ See the Commission report on the use of administrative cooperation arrangements in the fight against fraud COM (2004) 260 final, 16.04.2004

⁵ COM (2003)822 final of 23.12.2003.

reinforce (in cases where the customer does not have a full right of deduction) the principle of taxation in the Member State of consumption. On the other hand, the amendment does not impose any additional tax obligations since the customer would pay the VAT by means of the reverse charge mechanism.

B2C supplies of services

The current general rule for B2C transactions, i.e. that the service is taxed at the place where the supplier is established, is very simple for traders. However, when services can be provided remotely, this rule no longer guarantees that tax receipts will go to the Member State in which the service is consumed and, increasingly, results in distortion of competition.

The rules on the place of taxation of services provided to end consumers therefore need to be re-examined. Any revision should guarantee that the principle of taxation at the place of consumption is applied more strictly. However this must not result in traders bearing a significantly increased administrative burden, and the solution therefore is to apply the one-stop shop mechanism to remotely provided B2C services. Thus in the case of (B2C) services, the two guidelines on simplifying tax obligations (via the one-stop shop) and on taxation at the place of consumption are inextricably linked. The Commission plans to present a proposal on the place of taxation of B2C services in 2005.

OTHER TOPICS COVERED BY THE NEW STRATEGY

With a view to modernisation, simplification and more uniform application of the system several other proposals have already been presented to the Council and several more are planned for 2004. The most significant of these are the following:

Proposals before the Council

VAT rates

This proposal⁶ on the application of reduced VAT rates aims to give Member States equal opportunities to apply reduced VAT rates in certain areas where there is little or no danger of cross-border distortions (such as restaurants, housing, gas and electricity supplies and home care services). It also aims to rationalise the numerous derogations currently applicable in some Member States. The intention is to make Annex H the only reference for any derogation from the standard rate of VAT.

Special rules for travel agencies

The proposal aims to amend the VAT rules applicable to travel agencies that sell package tours to destinations in the European Union. The current special arrangement allows travel agents to apply VAT to their profit margins rather than to the full value of their sales. The proposal aims to change the rules to eliminate problems of double taxation which currently arise when one travel agency deals with another. It will also create a level playing field between EU travel agents and non-EU operators who do not currently have to charge VAT on the package tours they sell to EU residents.

Arrangement for the postal sector

The Commission has also presented a proposal to apply VAT to all services provided in the postal sector⁷. This is designed to take into account the considerable changes, notably the growth of liberalisation and privatisation, which have occurred since the Sixth Directive was adopted. The aim of the proposal is to eliminate the distortions of competition currently causing difficulties for both conventional national providers of postal services, who are currently exempt from VAT, and for their competitors, who are required to apply VAT. Market liberalisation is likely to increase these distortions.

The proposed changes would not have a big impact on the cost of postal services to the general public since national operators will be able to deduct the VAT they themselves are required to pay on their costs - which they currently recover from their customers in the form of a hidden VAT charge. Also, to prevent any rise in the prices charged to the general public, Member States will be able to apply a reduced VAT rate to ordinary postal services. As far as business customers are concerned, applying VAT to postal services provided by national operators will bring the benefit that the business customer will be able to deduct the tax from his expenditure on postal services. This will reduce business costs marginally.

⁶ COM (2003)397 final of 23.7.2003.

⁷ COM (2003)234 final of 5.5.2003.

Recast of the Sixth VAT Directive

The Sixth Directive has undergone 20 legislative amendments since it first entered into force and the result is a legal instrument that is complicated and difficult to consult. This is particularly the case since the "transitional" arrangements were introduced into the Directive in 1992.

The Commission has therefore prepared a reworked version of the Directive in order to clearly set out the legislation actually in force. The proposal, which does not contain substantive amendments, was presented to the Council in April 2004⁸

Proposals planned for 2004

Simplifying VAT obligations

The Commission envisages the introduction of a proposal simplifying traders' obligations, of which be the most important component will be the one-stop shop. However, the Commission is also considering including other simplifications for the application of the reverse-charge mechanism, the 8th Directive refund procedure and the arrangement for distance sales. A public consultation on this matter is currently being held.

Sales promotions using vouchers and payment cards

The tax treatment of vouchers, mainly used as part of sales promotion campaigns, has been the subject of a number of Court of Justice rulings in recent years. A number of principles can be derived from these rulings relating to specific cases, but their application to the multiplicity of forms that promotion systems can take continues to pose considerable problems. In addition, changes in the way certain goods and services are paid for, such as payments by telephone cards, raises issues regarding the point in time at which the tax becomes chargeable and the nature of the taxable amount for transactions conducted through intermediaries. A proposal to ensure more uniform treatment of all these matters at Community level is envisaged.

Rationalising existing derogations

The Commission plans a certain degree of rationalisation of some of the many simplification and anti-avoidance derogations which Member States have been granted under Article 27 of the Sixth VAT Directive. In certain cases this could mean extending to all Member States the right to apply certain derogations that have proved particularly effective. Many existing derogations have certain features in common. For instance, there are similarities between the derogations several Member States apply in the gold and waste sectors. On the other hand, it is clear that some measures are designed to remedy a particular situation in a single Member State. The rationalisation exercise does not intend to generalize nor call this type of authorisation into question.

⁸ COM (2004) 246 of 15.04.2004

Mechanism for eliminating double taxation in individual cases

Finally, the Commission intends to introduce a mechanism to resolve the problem of individual cases of double taxation. This will not deal with differing interpretations of the Sixth Directive, since this is a matter to be resolved either in the VAT Committee or ultimately by the Court. It is instead aimed at cases where different national administrations interpret the nature of a supply differently which then leads to divergent and sometimes conflicting tax treatment. Experience has shown that bilateral double taxation agreements, which provide for a procedure to eliminate double taxation in the direct tax field simply by getting the national authorities of the States concerned to discuss a case, very often result in a settlement. Accordingly, the Commission would like to see similar arrangements introduced in the Sixth VAT Directive.

6. CONCLUSION

Developments to date have shown that the new VAT strategy has created a new climate in discussions on VAT harmonisation. This process will benefit both taxpayers and tax administrations alike particularly by harnessing the use of new technologies to ease the burden of compliance on taxpayers and facilitate the task of control by tax administration. This should give rise to much needed improvements in Community legislation, so that the oldest VAT system in the world can meet the demands of the 21st century.

Proposals adopted since the new strategy was launched in June 2000

Subject of the proposal	Stage reached in Council
Determination of the person liable for payment of value added tax [COM(1998) 660]	Adopted by Council Directive 2000/65/EC of 17.10.2000 (OJ L 269 of 21.10.2000)
Greater mutual assistance for the recovery of claims [COM(1998) 364]	Adopted by Council Directive 2001/44/EC of 15.6.2001 (OJ L 175 of 28.6.2001)
Fixing the minimum standard VAT rate [COM(2000) 537]	Adopted by Council Directive 2001/41/EC of 19.1.2001 (OJ L 22 of 24.1.2001)
Invoicing [COM(2000) 650]	Adopted by Council Directive 2001/115/EC of 20.12.2001 (OJ L 15 of 17.1.2002)
Extending the Fiscalis programme [COM(2002) 10]	Adopted by Decision No 2235/2002/EC of the European Parliament and of the Council of 3.12.2002 (OJ L 341 of 17.12.2002)
Electronically supplied services [COM(2000) 349]	Adopted by Council Directive 2002/38/EC and Council Regulation (EC) No 792/2002 of 7.5.2002 (OJ L 128 of 15.5.2002)
administrative cooperation in the field of value added tax [COM(2001) 294]	Adopted by Council Regulation (EC) No 1798/2003 of 7.10.2003 (OJ L 264 of 15.10.2003)
Extending the facility allowing Member States to apply reduced rates of VAT to certain labour-intensive services [COM(2002) 525]	Adopted by Council Directive 2002/92/EC of 3.12.2002 (OJ L 331 of 7.12.2002), the corrigendum of 23.1.2003 (OJ L 18 of 23.1.2003) and Council Directive 2004/15/EC of 10.2.2004 (OJ L 52 of 21.2.2004)
Place of supply of gas and electricity [COM(2002) 688]	Adopted by Council Directive 2003/92/EC of 7.10.2003 (OJ L 260 of 11.10.2003)
Conferment of implementing powers and the procedure for adopting derogations [COM(2003) 335]	Adopted by Council Directive 2004/7/EC of 20.1.2004 (OJ L 27 of 30.1.2004)

