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Proposal for a

COUNCIL IMPLEMENTING DECISION

**authorising Czechia to apply the generalised reverse charge mechanism derogating from
Article 193 of Directive 2006/112/EC**

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

On 20 December 2018, the Council adopted Directive (EU) 2018/2057 as regards the temporary application of a generalised reverse charge mechanism ('GRCM') for transactions above a threshold of EUR 17 500¹ via an amendment to the VAT Directive².

This followed the VAT Action Plan³ in which the Commission announced its intentions regarding the introduction of a definitive VAT system for cross-border intra-Union business-to-business trade⁴. However, given the fact that it would take several years to implement such a definitive VAT system, certain Member States asked for urgent and specific measures as to combat carousel fraud⁵ in the meantime. In particular, they requested the possibility to implement a temporary GRCM that, following a Commission proposal in this respect⁶, led to Directive (EU) 2018/2057 (hereafter, the 'GRCM Directive').

Under that Directive, Member States meeting certain defined criteria have the possibility, upon their request, to be authorised to apply a temporary GRCM until 30 June 2022. Via letters registered with the Commission on 21 January 2019 and 22 March 2019, Czechia requested such an authorisation and provided information intended to demonstrate that it fulfils the criteria.

This proposal should not preclude the ongoing discussions on the definitive VAT system⁷.

• **Reasons for and objectives of the proposal**

The criteria to be met and the procedure to be followed for a GRCM authorisation are set out in the new Article 199c(1) to (4) of the VAT Directive, inserted by the GRCM Directive. Czechia provided in this respect the following information, as required in particular by Article 199c(3).

¹ Council Directive (EU) 2018/2057 of 20 December 2018 amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold (OJ L 329, 27.12.2018, p. 3-7).

² 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).

³ 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 of 7.4.2016).

⁴ In the meantime, the necessary proposals have been adopted by the Commission:
Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States (COM(2017) 569 final of 4.10.2017).
Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States (COM(2018) 329 final of 25.5.2018).

⁵ Carousel fraud (sometimes also referred to as "missing trader fraud") finds notably its roots in the current exemption for intra-Community supplies that allows for goods to be obtained VAT-free. A number of traders subsequently engage in tax fraud by not paying to the tax authorities the VAT received from their customers. Those customers, however, being in receipt of valid invoices, remain entitled to a tax deduction. The same goods can be supplied several times over by including again exempt intra-Community supplies. Similar carousel fraud can also occur when services are supplied.

⁶ COM(2016) 811 final of 21.12.2016.

⁷ COM(2018) 329 final of 25.5.2018.

1. Detailed justification of the fulfilment of the relevant criteria (Article 199c(3)(a), in connection with paragraph (1), of the VAT Directive).
- 1.1. A VAT gap of at least 5 percentage points above the Community median VAT gap in 2014 according to the VAT gap final report of 23 August 2016.

Czechia's VAT gap in 2014 was 16.14% of its overall VAT liability according to the 2016 final report dated 23 August 2016 on the VAT gap published by the Commission⁸. That report also states that the median VAT gap in the European Union (EU) was 10.4%. Czechia's VAT gap therefore exceeds the EU median VAT gap by more than 5 percentage points.

- 1.2. A carousel fraud level within the total VAT gap of more than 25% based on the impact assessment that accompanied the legislative proposal for the GRCM Directive.

According to that impact assessment⁹, 28% of Czechia's VAT gap is due to carousel fraud. Therefore, this criterion is fulfilled.

- 1.3. It is established that other control measures as well as administrative cooperation in the field of VAT are not sufficient to combat carousel fraud.

According to the information provided by Czechia, this Member State has undertaken a number of specific control measures against VAT fraud. An overview of these measures is provided hereunder together with Czechia's assessment of their functioning and effect. This is followed by Czechia's evaluation of the administrative cooperation in the field of VAT with the other Member States.

1.3.1. Application of the sectorial reverse charge mechanism

On the basis of Articles 199 and 199a of the VAT Directive, Czechia extended the application of the reverse charge mechanism to supplies in a number of sectors including: construction work, staff for construction work, immovable property where the supplier has opted for taxation, waste and scrap, goods provided as security and supplied in execution of that security, goods on which a reservation of ownership has been granted to an assignee and which are supplied in the framework of the exercise of this right by the assignee, immovable property owned by a judgment debtor and supplied in a compulsory sale procedure, greenhouse gases allowances, mobile phones, integrated circuit devices, gas and electricity and electricity certificates, certain telecommunication services, game consoles, laptops, cereals and certain crops, certain metals (including precious metals).

According to Czechia's assessment these measures have been highly effective but they have not prevented fraud shifting to other sectors; e.g. from mobile phones to other electronics, from gold to other metals (silver, platinum).

1.3.2. Joint and several liability

Based on Article 205 of the VAT Directive Czechia has introduced, for supplies between taxable persons, the joint and several liability for VAT purposes in a number of cases. Thus, joint and several liability is applicable in relation to certain supplies of mineral oils and other products subject to excise duties.

⁸ Center for Social and Economic Research (CASE), Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report ([TAXUD/2015/CC/131](#)), 2016, p.19.

⁹ SWD(2016) 457 final of 21.12.2016, p.39.

Further, customers have also been held jointly and severally liable for payment of VAT in relation to any other supply of goods or services where a customer has been found not to be in good faith, in particular when the ‘knowledge test’ is fulfilled, i.e. when the customer knew or should have known that the VAT would deliberately not be paid by the supplier to the tax administration. In addition, there are a number of particular situations under which the joint and several liability of the customer is systematically applied like, for instance, when the price, without any apparent justification, clearly deviates from the normal market price; when virtual currency is used, or when the supplier is an unreliable taxable person (see further, point 1.3.4).

According to Czechia’s assessment, this measure has had a preventive character but it is difficult to apply in complex situations within supply chains, notably where the customer of a missing trader is an entity without any assets. Further, the ‘knowledge test’ has also created considerable problems for the tax authorities, as national courts have ruled that it is for the tax administration to prove that the customer ‘knew or should have known’ that the VAT would not be paid by the supplier.

1.3.3. Split payment mechanism

Czechia has introduced an optional split payment mechanism. Via the split payment mechanism, the customer pays the VAT directly to the tax administration and no longer to the supplier. This eliminates the customer’s VAT liability in respect of the whole VAT due in a transaction, in cases where the customer is held jointly and severally liable on the basis of the conditions set out in point 1.3.2.

According to Czechia, the measure is effective but has disadvantages owing to its optional character. Making the split payment obligatory would, in the view of Czechia, be administratively and financially too demanding in terms of increased administration for payments, personnel and IT costs, both for traders and for the tax authorities. In addition, in case the customer does not make use of the split payment mechanism, it cannot be assumed that the ‘knowledge test conditions’ have been fulfilled. National courts have held that, even in that case, the tax administration has to demonstrate that the customer knew, or should have known, to be involved in a fraud situation. Moreover, the VAT can only be recovered from the customer who has not used the split payment mechanism under the joint and several liability scheme, insofar the recovery from the supplier has proven unsuccessful; effective recovery can therefore only take place after a certain period.

1.3.4. Identification of unreliable taxable persons (for registered persons)

Where a serious breach of tax obligations has occurred, the tax administration can identify a taxable person as unreliable based on certain criteria, notably the following: cumulative VAT arrears for at least three consecutive calendar months of at least CZK 500 000, breach of tax obligations leading to tax adjustments by the tax administration in at least two out of six consecutive tax periods, rejection by the tax administration owing to tax infractions of claimed input VAT deduction of at least CZK 500 000, failure to respond to the tax administration’s requests, failure to file a VAT return at least twice during a period of twelve consecutive calendar months, provision of false or incomplete information for VAT registration purposes, or establishment by the tax administration that an amount of at least CZK 500 000 output VAT has not been declared. Information on unreliable taxable persons is published on the website of the tax administration and an appeal procedure is foreseen.

According to Czechia, the measure has a preventive effect but requires an effective decision from the tax administration, before which fraudsters can already commit fraud. Further, the measure is not really effective in cross-border situations as an unreliable taxable person in Czechia can still use a (valid) VAT number for intra-Community fraud schemes.

1.3.5. Identification of unreliable persons (for non-registered persons)

The measure, similar to the previous one, is intended to identify unreliable persons. In this case, however, the target are those persons which are not (yet) registered but which have already breached certain VAT obligations. The list of unreliable persons is published on the website of the tax administration.

If such an unreliable person becomes VAT registered, that person automatically obtains the status of an unreliable taxable person within the meaning of the measure outlined in point 1.3.4. Furthermore, when an unreliable taxable person is de-registered, the status as unreliable person is preserved. An appeal procedure to withdraw such status is foreseen on the basis of similar conditions as those existing for unreliable taxable persons.

According to Czechia, the measure has a preventive effect and ensures a continuity between the status of unreliable person and unreliable taxable person. However, similar to the pitfalls identified in point 1.3.4 above, fraudsters are able to effectively circumvent the measure prior to registration and in cross-border scenarios.

1.3.6. Additional VAT reporting

Data from additional VAT reporting submitted by taxable persons for each calendar month is cross-checked in order to identify possible tax fraud scenarios. This has helped the tax administration improving the method for selecting taxable persons that will be subject to control.

Although useful for detecting fraudsters in a quicker way, Czechia is of the opinion that this conventional tool has reached its limits, taking into account the overall control capacity of the tax administration.

1.3.7. Seizure

In individual cases, seizure orders can be issued by the tax administration in order to guarantee payment of the VAT.

According to Czechia, the measure is very effective but since it is only applicable in individual situations, it does not provide a general protection to the common VAT system.

1.3.8. Automatic VAT deregistration

This measure consists in cancelling the VAT number of a taxable person in case of serious breaches of VAT obligations. The measure is applicable in relation to VAT groups and to taxable persons that had a turnover that did not exceed CZK 1 million during the previous twelve calendar months.

Czechia describes the measure as very efficient both domestically and for cross-border supplies. However, as the measure can only be applied after infractions have taken place, the measure is not able to entirely prevent the risk of fraud.

1.3.9. Refusal of the right of deduction (or of the exemption for intra-Community supplies), based on the knowledge test

The measure is applied to refuse the right of deduction, or the right to apply an exemption, in case the acquirer (in the first case) or the supplier (in the second) knew or should have known (knowledge test) that they were participating in a transaction connected with fraudulent VAT evasion. This reflects the case-law of the Court of Justice of the European Union ('CJEU'), as set out in *Kittel*¹⁰. The Czech administration makes use of 'knowledge letters' informing businesses that they might be involved in a fraud scheme. These letters are either recipient specific (they can mention the suspected business partner or not) or general (notification to the general public about the existence of a specific risk situation of fraud in Czechia or the European Union).

However, according to Czechia, it is difficult for the tax administration in case of organised fraud to demonstrate in practice that a business knew or should have known to be involved in fraud.

1.3.10. Screening of applicants before VAT registration

Systematic pre-registration verification takes place in order to target, inter alia, potential missing traders; e.g. on-site investigation is used to demonstrate that no effective economic activity is carried out or prepared in order to refuse registration.

Czechia considers the measure to be highly effective in preventing fraudsters from entering the VAT system (and committing intra-Community fraud) but finds it difficult to demonstrate, on the basis of objective factors, that there is sound evidence leading to the suspicion that a VAT identification number will be used fraudulently, taking into account the criteria of the CJEU laid down in *Ablissio*¹¹.

1.3.11. Administrative cooperation in the field of VAT (Council Regulation (EU) No 904/2010)¹²

According to Czechia, much attention is given to the cooperation and the exchange of information with the other Member States. In addition to the cooperation provided for in Regulation (EU) No 904/2010, cooperation agreements have been established with Slovakia and Poland, and another one with Germany is under preparation.

Czechia also regularly participates in the so-called simultaneous multilateral controls with other Member States. Further, Czechia is involved in all work conducted under the Eurofisc network (missing trader intra-Community (MTIC) fraud, means of transport, customs procedures, observatory, e-commerce and Transaction Network Analysis (TNA)). Eurofisc data is actively used to detect suspicious transactions.

Administrative cooperation in the field of VAT, according to Czechia, has an undeniable importance but does not entirely prevent the occurrence of fraud. Moreover, it is not useful for purely domestic fraud.

1.3.12. Conclusion

¹⁰ Judgment of 6 July 2006, *Kittel*, C-439/04, EU:C:2006:446.

¹¹ Judgment of 14 March 2013, *Ablissio*, C-527/11, EU:C:2013:168.

¹² Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (recast) (OJ L 268, 12.10.2010, p. 1).

The overall conclusion of Czechia with regards to the above-mentioned measures is that, while they have significantly contributed to the reduction of fraud, they have not been able to entirely eliminate missing trader fraud in the current VAT system.

Given the considerable and real attempts that have been made to fight (carousel) fraud and the fact that these attempts have not been wholly successful, the condition in Article 199c(1)(c) of the VAT Directive can be considered as being fulfilled.

1.4. The expected estimated gains in tax compliance and collection outweigh the expected overall additional burden on business and tax authorities by at least 25%.

According to the Czech authorities, the introduction of the GRCM will not require, as far as the tax administration is concerned, any increase of staff, only a relocation of human resources. The cost of adapting the organisation of the Czech tax administration (including training and modification of the IT systems) is estimated at CZK 4 million.

As regards taxable persons, the introduction of the GRCM will mean one-off costs in order to modify the IT systems. According to estimates, the GRCM should apply to a total of 97 000 taxable persons. From this group, more than 60% already have experience with sectorial reverse charge. Their IT structures and invoicing systems are prepared for the GRCM, so that they would only need partial modifications of existing structures. For the other 37 500 taxable persons, they may need to purchase new IT structures or extend the existing ones; however, based on queries from the largest tax and accounting software providers, it seems that such changes are part of regular updates and are not charged separately.

Other costs are linked to employee training; however, such costs are required essentially with any legislative change. Since reverse charge is not a measure that would be completely new, it is not expected that these costs would be significant.

Other costs for taxable persons arise from the need to monitor for each transaction whether the threshold of EUR 17 500, above which the GRCM would apply, is met. However, taking into account that in most cases this is done through accounting software, these costs will not be very significant. Moreover, in the GRCM the differentiation of transactions in terms of their amount is significantly easier than the differentiation in the case of a sectorial approach.

Further in some cases, suppliers of goods and services may need to verify whether the customer is a taxable person and therefore whether reverse charge applies. However, in those cases the register of taxable persons can be used, which is made available by the tax administration (connection with the taxable person's software).

Czechia further explained that, when additional VAT reporting was introduced in 2016, costs for taxable persons were estimated at EUR 370 for small businesses and from EUR 740 to EUR 3 000 for other companies, resulting in a total of around CZK 6 billion for businesses. The Czech authorities estimate that the total costs for taxable persons arising from the implementation of the GRCM would approximately represent a 10% of that amount, namely CZK 0.6 billion.

As regards the benefits of the system, reference is made to the experiences in the sectorial reverse charge which have led to a decrease of 98% of the fraud amount and to a decrease of 89% in the number of fraud cases. On this basis, it is expected that fraud will be reduced by CZK 5 billion per year. If applied for 2 years, the gain would be CZK 10 billion. On the other hand, as stated above, the costs incurred by the tax authorities would only amount to CZK 0.004 billion and the costs for taxable persons are expected at CZK 0.6 billion. In conclusion, the estimated costs represent 6.04% of the estimated benefits.

Given that the estimated gains (CZK 10 billion) largely exceed the overall costs (CZK 0.604 billion) by more than 25%, this condition can be considered as fulfilled.

1.5. The introduction of the GRCM will not result in higher costs for businesses and tax authorities than those arising from other control measures.

On the basis of the above-mentioned calculations, it would appear that the expected costs for both businesses and tax administrations are not significant, although Czechia acknowledges that it is difficult to provide a precise comparison with other control measures.

Czechia has no intention to change the overall organisation of its tax controls after the introduction of the GRCM. Therefore, no additional costs (apart from the costs mentioned above) will arise for the tax administration or the controlled businesses.

This condition can therefore be considered as fulfilled.

2. Foreseen starting date of application of the GRCM and period to be covered (Article 199c(3)(b) of the VAT Directive).

Czechia has requested to be authorised to start the application of the GRCM from 1 January 2020 and until 30 June 2022.

3. Actions to inform taxable persons (Article 199c(3)(c) of the VAT Directive).

Taxable persons will be electronically informed about the introduction of the GRCM as well as the starting date of its application. Moreover, contacts will be established and discussions will take place with business associations and tax advisors. Promotional material will be distributed via public media (e.g. leaflets, information on the website of the tax administration).

4. Detailed description of the accompanying measures (Article 199c(3)(d), in connection with paragraph (2), of the VAT Directive).

This provision requires the introduction of appropriate and effective electronic reporting obligations for all taxable persons and, in particular, for taxable persons who supply or receive goods or services to which the GRCM applies to ensure the effective functioning and monitoring of the application of the GRCM.

Czechia considers that the tax control mechanisms which are already in place suffice in order to ensure the correct functioning of the GRCM and that no additional control measures are needed. Such measures already include the additional VAT reporting tools referred to in section 1.3.6. above. In particular, data obtained from such reporting obligations already established at national level will be used as an analytical tool for detecting suspicious supply chains. According to this reporting system, which entails the submission of a VAT statement (listing in addition to the VAT return) that can be filed electronically, supplies under the GRCM will have to be reported in the same way as it is already done for domestic supplies under reverse charge (but with the addition of a special GRCM code).

- **Consistency with existing policy provisions in the policy area**

The purpose of this authorisation is limited in scope and in time and is without prejudice to the development of the definitive VAT system for intra-Union business-to-business cross-border trade.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

Article 199c of the VAT Directive.

- **Subsidiarity (for non-exclusive competence)**

Considering the provision of the VAT Directive on which the proposal is based, the subsidiarity principle does not apply.

- **Proportionality**

The Decision concerns an authorisation granted to a Member State upon its own request and does not constitute any obligation.

Given its scope and limitation in time, the special measure is proportionate to the aim pursued, i.e. combating carousel fraud while, in the meantime, the definitive VAT system is being negotiated.

- **Choice of the instrument**

Proposed instrument: Council Implementing Decision.

Under Article 199c of the VAT Directive, the GRM can only be applied upon authorisation of the Council acting unanimously on a proposal from the Commission. A Council Implementing Decision is the most suitable instrument since it can be addressed to an individual Member State.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Stakeholder consultations**

This proposal is based on a request made by Czechia and concerns only this Member State.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The insertion of Article 199c in the VAT Directive, on which this authorisation is based, was subject to an impact assessment on which the Regulatory Scrutiny Board gave a positive opinion with recommendations on 28 November 2016¹³.

4. BUDGETARY IMPLICATIONS

The proposal will have no negative implications for the European Union budget.

5. OTHER ELEMENTS

The proposal is limited in time.

¹³ See: http://ec.europa.eu/smart-regulation/impact/ia_carried_out/cia_2016_en.htm

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹, and in particular Article 199c(4) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Article 199c of Directive 2006/112/EC permits Member States, by way of derogation from Article 193 of that Directive and under certain strict conditions, to introduce a generalised reverse charge mechanism ('GRCM') on non-cross-border supplies of goods and services, providing that the person liable for payment of VAT is the taxable person to whom all supplies of goods or services are made above a threshold of EUR 17 500 per transaction.
- (2) By letters registered with the Commission on 21 January 2019 and 22 March 2019, Czechia requested authorisation to apply the GRCM.
- (3) The VAT gap in Czechia in 2014 was 16.14% of the VAT total tax liability, according to the method and figures set out in the Commission's 2016 final report of 23 August 2016 on the VAT gap². Czechia's VAT gap therefore exceeded the Community median VAT gap (10.4%) by more than 5 percentage points.
- (4) The carousel fraud level within Czechia's total VAT gap was more than 25% according to the impact assessment³ that accompanied the proposal for Council Directive (EU) 2018/2057⁴, which introduced the GRCM.
- (5) Czechia provided details to the Commission showing that, although several control measures had been implemented in Czechia with positive results, the measures had not been sufficient to combat carousel fraud. Administrative co-operation in the field of VAT had also not proved sufficient to combat carousel fraud.
- (6) Czechia provided details to the Commission showing that the estimated gains as a result of the introduction of the GRCM are expected to be CZK 10 billion. Czechia

¹ OJ L 347, 11.12.2006, p. 1.

² Center for Social and Economic Research (CASE), Study and Reports on the VAT Gap in the EU-28 Member States: 2016 Final Report ([TAXUD/2015/CC/131](#)), 2016, p.19.

³ SWD(2016) 457 final of 21.12.2016, p.39.

⁴ Council Directive (EU) 2018/2057 of 20 December 2018 amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold (OJ L 329 of 27.12.2018, p. 3).

also showed that the overall additional burden on business and tax authorities is expected to be CZK 0.604 billion. The estimated gains therefore outweigh the expected overall additional burden by more than 25%.

- (7) Given that Czechia does not expect the overall additional burden resulting from the introduction of the GRCM to be significant, it will not result in businesses and tax authorities incurring costs that are higher than those incurred as a result of the application of other control measures.
- (8) Czechia has asked to be authorised to apply the GRCM from 1 January 2020 to 30 June 2022.
- (9) Czechia has confirmed to the Commission that actions will be taken to inform taxable persons of the introduction of the application of the GRCM via e-mail, public lectures, discussions with business associations, the website of the administration and printed or electronic promotional material.
- (10) Czechia has provided the Commission with a detailed description of its existing VAT control mechanisms and confirmed that, with the addition of a special GRCM code, the existing measures will be sufficient to ensure the effective functioning and monitoring of the GRCM.
- (11) Based on the information provided by Czechia to the Commission, it is considered that Czechia fulfils the conditions referred to in paragraph 1 of Article 199c of Directive 2006/112/EC and that the request submitted by Czechia complies with the other requirements of paragraph 3 of that Article. It is therefore appropriate to authorise Czechia to apply the GRCM for the period requested by Czechia.
- (12) The derogation will have no adverse impact on the Union's own resources accruing from VAT,

HAS ADOPTED THIS DECISION:

Article 1

Czechia is authorised to apply the generalised reverse charge mechanism in accordance with Article 199c of Directive 2006/112/EC for the period from 1 January 2020 to 30 June 2022.

Article 2

This Decision is addressed to Czechia.

Done at Brussels,

*For the Council
The President*