

**CFE response to the Green Paper on the Future of VAT  
- Information relating to the European Commission register of interest representatives-**

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# **CFE response to the Green Paper on the Future of VAT**

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May 2011

This paper has been prepared by the members of the Fiscal Committee of the Confédération Fiscale Européenne (CFE). Coordinators were Christian Amand, Gottfried Schellmann and Jeremy Woolf. A list of the members of the CFE Fiscal Committee can be found on the [CFE website](#). The views contained in the document do not necessarily reflect the views of each contributor individually.

CFE unites 33 national professional organisations of tax advisers from 24 European countries, representing more than 180,000 tax advisers.

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## Introduction

- 1 The European Commission launched a questionnaire dealing with the future of VAT. The undoubted goal of this undertaking should be to make the VAT system simpler, more robust and efficient. Simultaneously the Commission released a comprehensive working paper which should be regarded as a well-reasoned and excellent compilation of all the problems which currently affect business operators carrying out transactions within the scope of VAT.
- 2 In recent years, the business environment has changed significantly. Because of these changes, we have sought to write this response with a slightly different approach than most other CFE Opinion Statements. In the past, the CFE has produced Opinion Statements on specific technical issues that reflect the views of its members on a subject. In this instance the CFE has sought to not only reflect the views of its members but also to take account of the views of other representative bodies in Brussels. In the process it hopes that its response is well reasoned from a technical, economic and, to a minor extent, political perspective. Given the nature of the report, we hope that this joint approach is helpful to the Commission. Many of the delegates of the CFE represent member organisations and therefore have experience about the situation in their jurisdictions. This helps to identify problems with the current system. These problems include difficulties that are caused by the large number of languages that are spoken in the Union and also problems caused by the different approaches taken by different tax administrations.
- 3 Although they are full members of the Confédération Fiscale Européenne, the Swiss delegates will submit a separate report that addresses various questions from a Swiss perspective.
- 4 In producing this response we have sought to take account of the issues that confront different industries. While the idea of creating pan-European VAT groups can be championed as an excellent idea, smaller businesses, which do not (yet) operate on a pan-European basis should also benefit from any reforms to the VAT system. One particular problem with VAT as a European tax is that Member States are using 23 languages, possibly more in the not too distant future. That means that any measures need to be translated into 22 (23) or more

languages, which is a source of misunderstanding and an obstacle for a smooth promotion of the single market. No other single market has to contend with these problems. Not only does it mean that legislation is enacted in 22(23) languages but also guidance is to be produced by the tax administrations in 22(23) languages. This clearly causes problems when trying to determine the consequences of transactions between different states. Any reforms should therefore not just focus on complicated technical issues, but also on the need to reduce compliance risks. In conducting this exercise, it may be helpful to look at the procedures that have been adopted in other areas, such as customs law, where steps have been taken to adopt a unified single return and to implement the “single window concept”, with its electronic systems for providing information to tax authorities and enabling them to access information.

- 5 The questionnaire and the working paper have divided the list of questions into 16 different sections. We have adopted a similar approach in our response.

#### **1. Justification of the current system**

- 6 Complaints about the complexity of the VAT treatment of cross border transactions have been made by both businesses and advisers throughout Europe. One of the main problems is that responsibility for administering the VAT system rests with 27 different administrations using 22 different languages. Bearing this in mind, and looking at the situation 19 years ago, the current system was probably the best that was available. . However, there is a need to improve the system. The easiest change would be to introduce the triple “Os”, One language, One legislator and One European administration. Of course, such an approach is unrealistic. Compared to the fruitless initiatives in some other common markets, like the US, Europe has not done that badly ([www.streamlinedsalestax.org](http://www.streamlinedsalestax.org)).
- 7 The current system places most of the obligations and risks on businesses. Problems are caused by the fact that they are increasingly acting internationally, while tax administrations are still looking at issues from a domestic perspective with only a few people having international experience, as a result of attending the Fiscalis network or as part of an international department. Thus, apart from any technical improvements, an enhancement of cooperation between tax administrations is essential. A second important objective must be

to seek to find ways to overcome the problems that arise from the number of languages in the Union. This problem does not just relate to legislation but also to other documents. Any documents, such as invoices and VAT returns, that are written in a foreign language become a “*non valeur*” for controlling purposes especially for tax administrations in other states. We therefore need to think about ways of harmonising the format of documents. Drawing on experience in the customs duty field, one useful step may be to have codes for different types of transactions or procedural issues. We have to think about how we can make underlying documents more understandable for businesses and tax authorities that may be based in a number of different jurisdictions and who may use a number of different languages.

- 8 The volume of the entire intra EU27 external trade is roughly € 2.5 trillion (figures represent 2007, source: Europe in Figures 2009, table 10.11) and the external trade with third countries counts for € 1.2 trillion (source: table 10.10). The entire volume of the intra EU27 trade in services amounts to EUR 600 billion (figures represents 2006; source: 10.4 table), while the extra EU27 trade in services contributes with EUR 441 billion to the GDP.

### 1.1 Concepts of systems

- 9 According to Article 113 TFEU (ex -Art. 99 of the EEC Treaty and Art. 93 of the EC Treaty) the Council shall adopt, [...] provisions for the harmonisation of legislation concerning turnover taxes, [...] 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.
- 10 Together with the abolition of customs duties on trade between European countries and the prohibition of state aids, one of the principal objectives of the European VAT directives was to eliminate artificial distortions of price that prevented an optimal allocation of production factors in a single market (see above para 9). The common rules are intended to foster an internal market and to eliminate obstacles of whatever nature to trade between businesses established in different EU Member States and consequently to allow an optimal allocation of resources. The collection of taxes is a secondary objective. Although European VAT is a consumption tax, except in the case of the final consumer, its essential characteristic is the “non- taxation of the production of goods and services”.

- 11 The efficiency of European VAT as tool to collect taxes is based on the combination of various factors: the first is the use of invoices as the primary evidence of transactions, the second is the requirement on traders to account for the tax and the third is the fractionated payment methodology to the tax. However, the fractioned payment mechanism has made the system sensitive to certain types of frauds, such as missing trader fraud.
- 12 Before the inception of the internal market some of the MS favoured the implementation of the origin system. Any attempt to implement this system was rebuffed by the majority of the MS for a number of reasons<sup>1</sup>. Objections arose particularly because of the complications that the origin system would introduce if revenue had to be transferred from the place of supply to the place of consumption. If such transfers did not occur, some Member States objected to the origin system because of the tax in balances that would arise, since a lot of the tax would benefit the tax authorities in the place of supply rather than the place of consumption. Objections also arose because of the problems that tax authorities might have in obtaining information from establishments in other states. Because of these problems we do not believe that there is much support for such a system. From a practical perspective, the question whether a taxable person has to remit the VAT to the tax authorities in the country of origin or in the country of destination is also less important than questions relating to legal certainty, the reduction of administrative compliance charges and the protection of the bona fide traders from missing trader fraud. For these reasons and because we do not believe that there is any material support for the origin system, we do not propose to discuss the merits of the origin system further.
- 13 As a result of acquisition accounting and the reverse charge on supplies of services, we currently have a system of taxing intra-Community supplies in the country of destination. Because it is left to the recipient of the goods or services to account for the tax. One problem with this system is missing trader fraud. This fraud has forced Member States to adopt measures that increase compliance costs and legal uncertainty. Problems for taxable persons have also been caused by the decision of the European Court of Justice in joined cases C-439/04 and C-440/04 (Kittel v. Belgium; Belgium v. Recolta Recycling SPRL [2006] ECR I-616).

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<sup>1</sup>Conseil, Bruxelles 5 février 1988, 4393/88, Fisc 11, Résultat des travaux du Groupe des Questions financières en date des 21 et 22 janvier 1988, mécanisme de compensation de la TVA

The objective approach adopted by the Court in that case means that innocent traders may find themselves being penalized for the defaults of other traders.

- 14 An alternative way in which it may be possible to remove any differences between domestic and intra-Community supplies would be to introduce a reverse charge procedure for all supplies. This concept was thoroughly examined by Germany and Austria five years ago and it is still supported by some members of the Fiscal Committee of the CFE. But such a system will only work well if the retail sector is dominated by large supermarket chains. The latter are likely to account for any VAT due and therefore should not result in any leakage from the system. However, greater concerns of VAT leakage arise in economies with more small retailers. Because of the dominance of big chains in the retail industry, Austria is the only economy where this approach is likely to be attractive (Recommendations of the Council, OJ L 195, August 23rd 2003, 43).
- 15 Another alternative system that led to lively discussions within the Fiscal Committee of the CFE would be for suppliers to charge VAT on intra-Community transactions at the rate and under the rules of the Member State of destination. This would indeed restore the principle of fractionated payment for cross-border transactions and, in relation to intra-Community transactions, subject to the important points made in paragraph 18 below, would deal with the current system's endemic vulnerability to fraud on goods (with the exception of "tradable services"). However, it would cause difficulties for traders who would have to discover about how transactions are taxed in other states. These problems would be compounded if a business in one Member State was required to register and account for tax in another state where the business has no presence at all and therefore is unaware of the accounting procedures in that state.
- 16 A variant of the above would be taxation of intra-community supplies of goods and services at the rate of the country of the acquirer (or its establishment) without regard to the physical movement of the goods i.e. following the invoices so liability would be determined by the seat or fixed establishment that the goods and services were invoiced to. The VAT would be immediately remitted to the tax authorities of the country where the customers had his seat or fixed establishment. These authorities would be immediately informed of the supply by the recapitulative statement of the intra-community supplies of goods and services and possibly the intra-community recapitulative statement of the acquisitions. The

supporters of this system admit that the current absence of harmonisation of some VAT concepts could be a source of difficulties, but these difficulties would be limited to certain type of operations and not to the great majority of the intra-community exchanges. This has the benefit over the system outlined above that it would be unnecessary for traders to register in other Member States or to submit separate tax returns to each tax authority. Such a system would also build on existing concepts of establishment and identification and could be introduced without major structural changes. Such a system may not require major changes from either the tax authorities' or businesses' perspective but would require improvements in administrative cooperation procedures (e.g. on how to catch a fraudster established in another Member State who fails to account for VAT to the tax authority in a different state on supplies made to customers in that state?). It would also require improvements to the current IT systems relating to the verification of the VAT ID numbers of foreign taxable persons (e.g. by permanently updating the database and by adding further information, such as the address and bank account details of traders etc). In the light of recent experience of claiming refunds of the VAT, such an IT system should be managed at European level. In addition, as is currently the position, non EU acquirers/ suppliers should register in a EU Member State. The position may be more complex for services rendered to non – business customers, but the one stop shop provisions applicable from 2015 would probably solve most of the problems. This system could be easily monitored by the existing recapitulative statement and would not require additional VAT identification procedures. It would significantly simplify the compliance procedures for businesses that are active in global markets and which require global sourcing and make global supplies. This system would not require any approximation of tax rates. Subject to the points made in paragraph 18, the taxation of intra-community supplies may reduce the risks of the bona fide trader becoming involved in missing trader frauds (even if taxation of intra-community supplies is not an appropriate tool in order to limit fraud in some particular sectors such as tradable services, precious metal, etc where it should be envisaged to create new legal concepts).

- 17 Other members of the CFE Fiscal Committee consider that such a concept could fit, possibly after advanced technology is in place and a one stop shop or if a single window feature is established like for customs duties. However, the burden that such a system would impose on small business would clearly need to be considered.

18 Some members of the Fiscal Committee fear that the proposals outlined in paragraph 16 would impose undue burden on businesses. Unless substantive VAT law is completely harmonised, such procedures will require business to know what the rules are in other Member States. This extra burden may in turn discourage intra-community trade. They also argue that it is questionable whether such changes will reduce fraud, since it will always be possible to commit an MTIC type of fraud by acquiring the goods or services from a third country (even the supporters of the taxation of all intra-community operations admit this). The Green Paper is based on the assumption that MTIC type fraud is generally caused by customers' immediate suppliers. In the UK, in virtually all the cases the fraudster is many transactions away. Indeed he is often many chains of transactions away. It is argued that unless procedures can be put in place that ensure that VAT is accounted for when goods or services enter the EU, any such changes are unlikely to have the effect of removing concerns about fraud in the system.

### **1.2 Technical mismatches which currently are at stake**

19 Many technical obstacles are hampering the efficient management of businesses in the single market. A major reason for these obstacles is the lack of harmonisation, which in part results from different perceptions caused by the different languages, administrative practices, historical traditions, and the general legal and economic environment in different Member States. Problems are also caused by the failure to adapt procedures that would be most suitable for an internal market (for example, does a physical follow up of goods make sense when such movement is registered in the accounts?). The following list, which is not complete, highlights some main areas where improvements should be considered.

- Determination of the person liable for the payment of tax (This is an issue considered in the [CFE Opinion Statement on persons liable for payment of VAT to the tax authorities regarding operations taking place in one Member State](#), February 2011).
- VAT registration formalities in another Member State.
- Prefinancing costs when buying local advice in another Member State, these can often be so significant that they constitute a trade barrier.

- Dangers of missing trader fraud and the exposure for honest market participants (This is an issues considered in the [CFE Opinion Statement on the consequences of involvement in missing trader fraud](#), February 2011).
- Uncertainty about the scope of VAT exemptions.
- Administrative costs in order to prove zero rating on intra – community supplies and exports.
- Different treatments of the requirements for the deduction of input VAT.

### 1.3 Question 1

20 The current system is in need of improvement, so as to make the system safer and more reliable. Consideration needs to be given to not only the structure of the system as a whole but also to steps that can be taken to standardise procedures and reduce linguistic barriers, for example by introducing standardised returns and to a certain extent introducing codes which may assist in reducing language barriers. In addition, harmonised legislation and harmonised interpretation is required, particularly with regard to exemptions which vary in the different Member States, either by interpretation or by derogation.

### 1.4 Question 2

- 21 Taxation in the MS of destination may be a solution. At first glance, it might be implemented together with a European VAT portal, similar to that proposed for customs duty purposes. Consideration could be given to introducing similar systems for VAT. It has however been noted that in practice problems could arise, particularly in identifying the place of establishment of the customer and the responsibilities of the supplier in this regard.
- 22 Some members of the Fiscal Committee have concerns that the suggested harmonisation of customs and VAT procedures will impose extra burdens on businesses, in particular small business that would be required to make investments in technology. They fear that imposing such burdens will discourage rather than encourage intra-community trade. Inter-state trade within the Community is twice the level of trade with third countries. Procedures that may be appropriate in one context may not be appropriate in the different context. While they see no problem in saying that there may be opportunities to adopt or adapt customs

procedures, this needs to be done on a basis that does not impose significant extra burden on small businesses.

- 23 It has also been observed that small business would probably like a system where all cross-border B2B supplies are zero-rated and all B2C supplies are taxed in the county of establishment. As a simplification measure, thresholds might be imposed so that there is only a need to register in a different state if supplies in that state exceed a threshold and below those thresholds tax should be payable in the country of establishment (if the company exceeds the registration threshold of that state). The system would have similarities to the systems that already applies to distance sales of goods but would be extending it more generally. In its survey of members the CIOT (UK Chartered Institute of Taxation) has found that small businesses like the idea of only having to deal with their own tax authority if possible. It is much simpler to deal with the VAT authorities of one's Member State than with those of other Member States. This is in part, but not solely because of language problems.

## **2. Neutrality, public entities, holding companies and charities**

### **2.1 General reasoning**

- 24 Neutrality in the supply chain is a characteristic of the VAT system, but this has nothing to do with the entities listed above. The vast majority of these organisations act always on the edge between being engaged in business activities and “non-business activities”. The current system reflects the consequences of the scope of their activities. Holding companies are in a slightly different position, since the Court's decisions do not give totally clear guidance (Polysar C-60/90, ECR (1991) I-2187; Sofitam C – 333/91; ECR (1993) I-3513; BLP C-4/94 ECR (1995) I-0983; Welcome Trust C- 155/94 (1996) ECR I-3013; FloridienneBerginvest C – 142/99, ECR (2000) I-9567; Cibo Participations C-16/00, ECR (2001) I-6663; KapHag C-422/01, ECR (2003) I-6851; Kretztechnik C-465/03, ECR (2005) I-4357; Securenta C-437/06, ECR (2008) I-1597).
- 25 There should be no objection to holding companies being members of an Article 11 grouping. If the holding company is not carrying on any economic activity the amount of input tax that it is incurring should be small. There should also be no objections to the input

tax being recoverable if it would be recoverable if all the activities of the group were being undertaken by a single company. Allowing the holding company to join the group is just putting the group in the same position as it would be in if all the activities were undertaken by a single company. Given those considerations, it should be open to the grouping to allocate activities between different members in the grouping in the manner that it considers most desirable. The grouping as a whole (including the passive holding company) is then placed in the same position as if it were one taxable person, which is the objective of the grouping.

26 As far as public entities are concerned the Member States do not adopt a uniform approach. The bodies treated as a “public entity” vary, according to objective circumstances, political priorities or national constitutional requirements. However, there are clear grounds for treating some supplies by “public entities” differently from other supplies because they are producing goods and services that cannot be produced in an efficient way in a market context (i.e. the “public goods”), because:

1. the goods or services are not fitted to be supplied individually against payment (such as a lighthouse);
2. because of the danger of monopolies or the inability of market mechanisms to produce goods and services at a price suitable in the light of long-term social and economical objectives and therefore should be subject to an appropriate VAT treatment.

So as to avoid distortions in competition, the VAT system needs to ensure that activities that can essentially be provided by ordinary business operators are taxable. However, where to draw the borderline should be left as a domestic issue rather than becoming a European one. The list in annex I embraces all activities which are mandatorily taxable. But there are some activities missing like the disposal of sewage and waste disposal. Consequently, these services are in some Member States outside of the scope of VAT while in other Member States they are taxable.

## **2.2 MS have different systems in place on how public entities have to be compensated for VAT suffered.**

- 27 In the UK, Scandinavian countries, the Netherlands and France, public entities are directly reimbursed the VAT they incur (see e.g. s 33 of the VATA in the UK). In some federal states, for example Austria and Germany, in which Länder and communities get their share from the VAT proceeds, no further compensation is in place. Other systems like Australia compensate public entities in general or parts of them like schools and other institutions providing education by a system of zero rating (registration under the goods and service tax act 1999, Chap. 4 Div. 149).
- 28 The observations and the suggestions of the Copenhagen Economics Study “VAT in the public sector and exemptions in the public interest” deserve particular attention. It would be worth considering whether its observations equally apply to other sectors such as immovable property, public transport and the banking and insurance services sectors. Non-taxation and exemption can impact on whether it is cost-effective to outsource services and may therefore result in services being provided on a less efficient basis than would otherwise be the position. It may also require complex apportionments to be undertaken when determining the right to recover input tax between activities which are outside the scope of taxation, tax-exempt and taxable. These pro-rata calculations can make it difficult to prepare budgets because of the retrospective adjustments that these calculations may require. Extending the scope of taxation, even at reduced rates, may minimise these problems. However, especially if supplies are just taxed at a low rate, it can also have the disadvantage of imposing administrative burden on businesses and tax authorities for very little revenue gain. Whether changes are desirable may therefore vary depending on the precise activities being considered.

### 2.3 Question 3

- 29 The principle of neutrality is only violated to a minor extent, since those entities do not normally perform business activities. Many Member States pursue different concepts which in the essence do not substantially create distortions of competition. Any alternative concept will interfere with Member States' existing systems of revenue sharing which are supposed to be an exclusive responsibility of the latter. Where public entities are operating in distortion of competition with the private sector, their activities should be taxed.
- 30 Many bodies governed by private law are performing activities that are not of a commercial nature and which are beneficial for the community as a whole and which therefore should be encouraged (such as assistance for small businesses or workers or disabled persons) and for this reason are receiving financial support from the public authorities and other organisations. This leads to the complex issue of whether "subsidies" should be regarded as consideration for supplies. Some members suggest that if such activities are not of a commercial nature they should be treated as outside the scope of VAT.

### 2.4 Question 4

- 31 Many public entities are outsourcing services which they are statutorily obliged to provide for reasons outside of the scope of tax law, mainly to escape from the rigid regulations related to public service labour law. In some situations the outsourcing can be exempted by Art 132 f RVD. However, problems are caused by the limitations on this exemption, including the requirements that there must be a group of persons that the entity is rendering services to. This limits opportunities to form outsourcing vehicles, despite the fact that this mechanism is extremely important in many sectors such as the health sector, social security, education, insurance and trade unions. In addition, it creates substantial compliance costs, limits the adoption of new methods of organisation or technologies and also makes such entities difficult to set-up on a cross-border basis.

## 2.5 Question 5

- 32 Consideration should be given to amending Art 132f so as to make it easier for exempt and non-tax businesses to use it (on a national and cross-border basis) as a way of conducting exempt outsourcing. This will help to mitigate one of the problems with the current system where such outsourcing becomes impossible because of the VAT costs. This prevents such activities being conducted on the most efficient basis.

## 3. Exemptions

### 3.1 General Reasoning

- 33 Neutrality is one of the main principles of the VAT system, and is often used as an argument for changing the rules. In an ideal single market exemptions should not exist. However, there are social and political reasons why not all supplies should be taxed at the standard rate. Other jurisdictions that have introduced VAT systems have also introduced exemptions or reduced rates. The only difference is that exclusions on the right to deduct input VAT and the reduced rates, if in place, are fully harmonised (e.g. China has a tax rate for small businesses of 3% instead of 17% (after the tax reform act 2008) and a long list of exemptions; see also Australia Goods and Service Tax Act 1999, Chap. 3). The reason for this is that VAT impacts on consumers regressively and results in a disproportionate burden on individuals with low incomes. Extending the scope of taxation, even at reduced rates, may have the benefit over exemptions in that it may reduce any tax disincentives to outsourcing and simplify the process for recovering input tax by reducing the need to undertake complex apportionment exercises. However, especially if supplies are just taxed at a low rate, it can also have the disadvantage of imposing administrative burdens on businesses and tax authorities for very little revenue gain. Whether changes are desirable may therefore vary depending on the precise activities being considered.
- 34 Additionally, the vast majority of European states impose enormous charges on wages and salaries compared to other single markets, which have to be taken into account when determining what charges should be made for goods and services. If VAT at the standard rate is charged as well, the accumulated tax burden becomes excessive. Labour costs are a particularly significant cost in the health care industry as well in the sectors providing

treatment for the elderly and personal services including tourism. Only Denmark does not levy any payroll taxes. The imposition of such charges is a major reason why consumers cannot afford to also have to pay VAT at the standard rates.

- 35 In order to demonstrate the composition of taxes rates as well as revenues in specific countries of Europe compared to Australia and China the following table gives an overview (Source: Eurostat, Taxation Trends 2010, ESA Codes, D211 VAT, D29C Payroll taxes, D6111 Employers Social security charges, statistics refer to 2008; in billion, currencies not converted).

<b>MS</b>	<b>Soc. Sec.%</b>	<b>Payrolltax %</b>	<b>Soc. Leys</b>	<b>Payroll tax</b>	<b>VAT</b>	<b>Total Rev.</b>
Austria	21.83 %	9.43%	19.020	7.127	21.957	120.923
Belgium	33.97 %	minor	28.970	0.007	24.126	138.682
Czech Rep.	34.00 %	0	380.108	0	260.366	1.334.170
Denmark	0	local	0.771	8.874	175.472	837.653
France	up to 42 %	local	214.001	24.448	136.838	834.349
Germany	19.325%	0	162.350	0	175.870	968.320
Italy	up to 45 %		143.695	0	92.811	672.408
Poland	17.59 %	0	60.497		102.214	437.150
Spain	29.9 %	0	96.370	0	57.298	380.316
Sweden	31.42 %	0	262.365	139.651	297.512	1.486.617
UK	12.8 %	0	64.825	0	91.954	555.784
Australia	0 up to 6.85 %					
China	22%	up to 12 %				

Note: the UK social security figure of 12.8% just reflects employer contributions. There are also employee contributions that are deducted from employees' pay. In the year to 5 April 2011, the employee's contribution was 11% for employees earning up to £ 817 per week with any excess being subjected to a 1% contribution. Each of these rates have been increased by 1% as of 5 April 2011.

- 36 The table illustrates the significant taxes levied on wages and salaries in Europe which, especially in the service sector, have to be borne by customers and consumers. The existence of these charges reduces the possibility of eliminating exemptions or reduced rates without any countermeasures to compensate those whose cannot afford increases in prices for essential goods or services.

- 37 Another issue is that MS which became members at the right time got the best options as far as reduced rates are concerned as well as exemptions. The question then is, does Article 4 TEU require an equal treatment of all MS in the same way? Does the Treaty require a concept like the most favoured nation clause? If this were the position, every deviation from the standard as well as any zero rating or reduced rate in one MS should be eligible for any comparable transaction in another MS. But Art 4 (2) TEU does not contain a provision granting equal treatment as far as secondary law is concerned and of course accession treaties form part of the primary law. The wording “The Union shall respect the equality of MS before the Treaty” means only that all of the MS shall be granted participation in the institutions. It is not directed at differences in treatment that result from the VAT Directive and the accession treaties which were all subject to unanimous agreement by all the MS. Provided they have been properly approved, any differences in treatment are valid, irrespective of whether they may create distortions of competition.
- 38 Deviations also result in distortions in the funding of the Union. Art 322 (2) TFEU sets out the rules which have to be applied for the calculation of the funds entrusted to the institutions. Even though Reg. (EEC) 1553/89 determines how to calculate contributions, any reduced rates or exemptions have an impact on the volume of the payments. So the payments that the MS are required to make are not the same as they would be if the rules were totally harmonised.

### **3.2 Exemptions for certain activities in the public interest**

- 39 The list of exemptions for activities in the public interest more or less reflects those services which were historically provided by the public sector. Postal services today are often no longer provided by public sector operators. Additionally, strong private competitors may exist in the market. For these reasons there are arguments for considering that the exemption for such services is no longer justified (see case TNT Post C-357/07, ECR (2009) I-3025).
- 40 Many members of the CFE Fiscal Committee see force in the argument that the judgment in the TNT case has achieved a proper balance. Organisations like Royal Mail have obligations to provide a universal service and they can see some force in arguments that the exemption

can be justified as a quid pro quo for those obligations that other private competitors do not assume.

- 41 Healthcare services are generally provided by the public sector (eg. NHS in UK). Even though in Europe private providers are increasingly providing such services, especially in Germany, where private operators of hospitals have a roughly 25% market share, the public sector still dominates the market. Some private companies are also obliged to provide publicly funded healthcare treatments in order to be eligible for the tax exemption (Para 4 (1)(14) of the German VAT code). However, independents in Germany do not have to comply with the strict rules for charitable institutions and can pursue profitable activities. Other MS require even private operators to comply with rules for charitable entities in order to be eligible for exemption (e.g. Austria). Refunds are provided to compensate for any VAT incurred (Art. 33 VATA). Germany does not grant extra compensation payments for input VAT. Costs deriving from procurement are instead based on a general tariff system.
- 42 The provisions regulating exemptions have to be interpreted strictly (Pflegetdienst Kügler, C-141/00, ECR (2002), I 6833), ancillary services which are not medical care are vat-able (Diagnostiko & Therapeftiko Kentro Athinon-Ygeia, C-394 and 395/04, ECR (2005) I- 10373): This distinction is difficult to implement in practice and is not compatible with sound business management. In practice tax authorities frequently do not require traders to tax such ancillary supplies.
- 43 Definitions that define the services that are eligible for exemption pursuant Art 132 RVD are also rather vague. This is especially true of the term “social wellbeing”, which is a term to be determined by the national courts in the light of the MS’s law (Kingscrest C-498/03, ECR (2005) I-4427). Real distortions of competition arise in the area of services linked to sport or physical education by non – profit making organisations. For example, after waiting normally five years, so they can recover any input VAT on acquiring equipment, Gyms reorganise themselves into non-profit organisations in order to benefit from the exemption.
- 44 Services listed in Art 132 RVD, except postal services, are not so easily convertible into taxable ones. Maybe some of them, like medical care, education welfare and social security work, as well as museums should be eligible for zero rating, since in most of the MS

procedures for reimbursing input tax exist and it does not matter to the treasury departments on what basis the payments are made.

### 3.3 Exemption for other activities

- 45 The main exemptions relate to financial services, immovable property and gambling. The absence of any public information about the historical justification for these exemptions is unhelpful and can cause confusion (see [CFE Opinion Statement on the case C-455/05, Velvet & Steel regarding the definition of financial services](#), November 2009).
- 46 As a rule, exemptions should be limited and clearly defined. When distortions of competition still exist, there should be a formal procedure to resolve these issues. Distortions in competition can be of two types. The first relates to differences in the tax treatment of similar supplies, which can place some businesses at an economic disadvantage. Another distortion is caused by the fact that exemptions may generate a tax barrier to outsourcing, since VAT may be due on the outsourced service that cannot be recovered by the exempt business.
- 47 The treatment of financial services could be changed so that they are taxed at a low rate. The rate would effectively compensate for the input taxation that becomes recoverable, like under the farmers' scheme. If the rate is sufficiently low it should not place any extra burdens on the customer because the charge will be matched by the input tax that is recoverable (see [CFE Opinion Statement on the Proposals VAT Directive and Regulations regarding financial services](#), 2008).
- However, in some cases, charging VAT on financial services may require businesses to disclose their margins (because VAT is a proportion of the margin or remuneration of the service) and this would reduce the negotiation position of the supplier of such services: therefore, in B2C cases, it would be desirable if the services could be taxed on a margin basis, but without any obligation on the supplier to disclose the margin. In B2B cases, the services could be zero rated with a full right of deduction of input VAT, since this would not impact on the tax paid by the final consumer. One clear concern that should be highlighted is that any changes should be structured in a manner that does not impact on the competitiveness of the EU financial services sector.

- 48 As far as the general insurance industry is concerned, a premium tax is in place in most of the MS. The merits of altering the VAT treatment of such transactions will clearly have an impact on whether such transactions should be subjected to a Financial Activities Tax (FAT) or a Financial Transfer Tax (FTT), as the Commission has proposed. If it is proposed to adopt a FTT we do not consider that it would be appropriate to make any changes to the insurance exemption, which results in insurers effectively paying VAT on their inputs. If a FAT is introduced we consider that consideration should be given to imposing VAT at a low rate with a full rate of recovery.
- 49 As noted at paragraph 32 above we consider that there would be merit in amending Art 132(f) so as to enable it to be more easily utilised.
- 50 Leasing and letting of immovable property embraces the exemption for renting out premises either to private or business tenants. The concept of “relative passive involvement” which the ECJ has relied upon to define the concept of leasing of immovable property has neither a rational, a scientific nor historical base and it is a source of legal uncertainty and disputes (see [Opinion Statement of the CFE on the distinction between taxable and VAT exempt letting of immovable property](#), November 2009 ). If VAT is charged, for social reasons there may be a justification for lower rates for residential accommodation. Imposing a charge will also increase the burdens on the charitable sector and upon businesses that are not required to register and lower rates may also be justified in such cases. Another area of potential unfairness relates to the sale of land that has been owned for a long time and where there has been no right to recover input tax on its acquisition. If any charge is to be imposed, there is clearly a need for a transitional relief. These are issues touched on in paragraphs 53-54 below.

### 3.4 Question 6

- 51 The current list of the VAT exemptions derives from the activities that were not within the scope of VAT under the Second VAT Directive<sup>2</sup> i.e. activities that had at that time little or no

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<sup>2</sup> The Sixth VAT Directive and its explanatory documents just mention the list of the exemptions that most commonly existed in the Member States under the Second VAT Directive. There is no historical evidence

impact on intra-community trade, mainly at retail level and some operations for which the free circulation was limited by regulatory or physical constraints (banking and insurance services, as well immovable property services were initially excluded from the list of the VAT exempt/outside of the scope activities).

- 52 As a general rule, VAT exemptions without right of deduction of input VAT should be restricted to small business activities (with a high threshold) and be optional. Activities that should be encouraged from a social or political perspective should be entitled to a reduced VAT rate. However, when making an assessment on these issues, it is legitimate to take account of the compliance obligations that taxing supplies would impose on businesses and tax administrations.
- 53 The macroeconomic consequences of immovable property exemptions should be carefully examined. In particular, the immediate taxation of the long-term private use of buildings forces households, public authorities and other organisation who become subject to taxation on these costs (mainly in social sensitive areas such as education, health, culture, etc) to increase the borrowings that they need to fund projects. This in turn has the consequence that future income or public support will be used to refund credits obtained from banks that have been used to pay taxes that have sometimes been paid twenty years earlier. In practice, since such institutions are frequently funded by subsidies paid by public authorities and thus by taxes, such charges will result in the funding of past taxes by future taxes and borrowings. This situation has important macroeconomic consequences, for example on interest rates that need to be considered.
- 54 Maurice Lauré has observed that VAT is not fitted to tax long term consumption and VAT on the private use of buildings should be replaced by a yearly tax on consumption. This is in line with the views of members of the CFE Fiscal Committee who are not in favour of significantly altering the exemptions for land transactions. These exemptions are unlikely to give rise to cross-border issues. Land transactions are also often already subject to transaction taxes. With older buildings, there will also be no corresponding significant rights of input tax recovery because the major works have already occurred. Imposing a VAT charge will also

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that the Council adopted some exemptions according to their intrinsic nature: this approach seems to have been adopted much later by the Court of Justice on the basis of submissions by the Commission.

represent an additional cost for not only the residential sector but also any exempt businesses (this may be less significant if most exemptions are removed) and the charitable sector. If a low rate of VAT is to be introduced, it should be for residential sales generally. This would mitigate the suggested undesired effect. Imposing a very high tax on all residential sales will discourage people from moving homes, which will increase inflexibility in the labour market. Similar problems may arise for the exempt and charitable sectors. It also seems very harsh that people who have made investments in properties expecting the investments to be free from VAT should find those investments subject to VAT. Especially if a reduced rate is not applied or if there is no form of transitional relief, the impact on the value of investments could be significant.

- 55 VAT exemption with a right of deduction on purely national transactions (national reverse charge) should be maintained or extended as long it is strictly necessary in order to fight against fraud or to deal with specific types of business (such as for example, financial services).
- 56 It is open to question whether the continued exemption for postal services is justified. This exemption might be scrapped provided it does not create higher costs for private consumers. With other services covered by these exemptions, since in most MS compensation schemes exists to compensate publicly provided services for the input tax that they incur, it may not matter in practice whether such services are subject to zero-rating or exemption. The taxation of financial services should be reconsidered in the light of other proposals for the taxation of financial services.
- 57 As general remark, VAT charged on in the course of tax audits are not recharged to customers. This also has an impact on the neutrality of the system.

### **3.5 Question 7**

- 58 The tax treatment of passenger transport is not consistent and produces unfair competition from a VAT perspective. Ground transport, especially domestic transport, is generally subject to a number of charges, and in particular excise taxes, insurance premium taxes, registration taxes and VAT; air transport is not subject to similar taxes although it may be subject to specific air passenger duties. Additionally, many countries provide exemptions for

international passenger transport (e.g. Accession Treaty OJ 236, 23rd September 2003, list pursuant to Art 24, annex V – XIV). Since taxation of international passenger transport cannot be solved by the MS themselves, it is a European issue which offers the opportunity to impose a European tax, which can be divided by the MS and the institutions. Some members observe that care must be taken with regard to the financial difficulties which most airlines are facing, to avoid further problems.

- 59 However, some members of the CFE Fiscal Committee see merit in zero-rating transport. It avoids the complications of apportionment that otherwise arise. Public transport/transport of goods should also be encouraged for ecological reasons and also because it assists the objectives of creating a single market.

### **3.6 Question 8**

- 60 The observations and the suggestions of Copenhagen Economics made in the study “VAT in the public sector and exemptions in the public interest” deserve considerable attention. But attention should also be paid to the fact that some VAT-exempt activities are not profit oriented, that they are partly or totally funded by taxes, since this could impact on the merits of any change.
- 61 Since changes to the exemptions will interfere significantly with scope of VAT and also national measure to compensate for input tax incurred by public bodies, any reforms are likely to be politically contentious. If reforms to Art 132 are really intended, the promoters will have to take into account the views of national parliaments given the principles of subsidiarity and proportionality (Protocol 2 TFEU).

## **4. Deductions**

### **4.1 General remarks**

- 62 One of the deficiencies of the VAT system is that a purchaser can claim a deduction in any case<sup>3</sup> even if he has not paid the supplier. Art. 167 RVD provides that the deduction is due at the time when the deductible tax becomes chargeable. Chargeability refers to a neutral coherent event for the purpose of the right of deduction and does not require any payment by the purchaser. From a theoretical perspective there is much force in this approach, since it accords with principles of neutrality. The loss of rights to deduct input VAT or delays in repayments can lead to substantial distortions of competition.
- 63 However, this mechanism may be abused by purchasers who immediately deduct VAT while at the same time systematically delaying paying their suppliers. This is unfair to the supplier who has to account for VAT to the tax authorities, even though he has not been paid by the purchaser. This feature of the system effectively enables a purchaser to obtain interest free credit from his suppliers. It has been observed that this mechanism for obtaining “free credit” has been systematically used by large purchasers who have a strong market position against smaller suppliers. Currently there is no solution in the pipeline. A similar problem occurs when the purchaser does not pay and the supplier has to perform complex formalities in order to recover VAT on unpaid receivables. This is another example of how the current VAT system supports dishonest traders against bona fide traders.
- 64 Another issue is the mixed use of items for private and business purposes. As far as the deduction of construction costs of buildings are concerned, the negative consequences of the ECJ’s judgements in Lennartz (C-97/90, ECR (1991) I-3795; Armbrecht C-291/92 ECR (1995) ECR I-2775; Bakcsi C-415/98, ECR (2001) I-1831; Seeling C-269/00 ECR (2003) I-4101; Wolny C-72/05 ECR (2006) I-8297) have been solved by implementation of Directive 2009/162/EU (OJ (2010) L 10) in the beginning of 2011. The determination of the private use of business assets such as computers, telephones or cars, as it is authorized by the Directive and implemented at least by one Member State, is bureaucratic and inquisitorial.
- 65 Further uncertainties are caused by the different restrictions that Member States have imposed on the right to deduct input VAT. These restrictions mainly relate to input VAT on the cost of cars, entertainment, accommodation and restaurant services.. The lack of

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<sup>3</sup>Some members of the CFE Fiscal Committee are not happy with the suggestion that it is a deficiency of the VAT system that the right of deduction can arise irrespective of whether the supplier has paid the VAT. If the customer has paid the VAT it can hardly be right that he should be subject to double jeopardy.

harmonisation on these issues causes difficulties for resident business operators, but also, more importantly, for non-residents when they apply to recover input VAT that they have incurred in another MS. The VAT-package was more a boost than a bust to mitigate compliance costs. However, mostly the requests for information which are released by the country liable for a repayment are done in the language of the country in which the tax authority is established.

- 66 It may also be worth noting that problems may be caused by the decision in Case C-97/09 *Schmelz v. Finanzamt Waldviertel*. This is because a business may have to account for VAT on supplies in another Member State even though it is not registered in the country where it is established because it is a small enterprise. The fact that it is not registered in the country where it is established may impact on its ability to recover input tax in the country where it is established that relate to the supplies that are taxed in the other Member State. To avoid this problem, there may be merit in having an EU wide exemption for small enterprises.
- 67 It would also be desirable if reforms could be made to the system for reclaiming VAT incurred in Member States where there is no establishment. At present, in the light of the 2010 reforms, individual requests have to be made to each national authority and each authority generally requests a scanned copy of the relevant invoices. This makes it more difficult for businesses and groups to centralise their VAT accounting functions.
- 68 The limitations on the right of deduction of input VAT on cars when combined with the taxation of supplies of second hand cars by business leads to an accumulation of non deductible VAT and is inconsistent with principles of neutrality.
- 69 The harmful consequence of these restrictions can be seen in the car insurance sector where one may observe a combination of high insurance premium taxes, non deductible VAT on cars and non deductible VAT on health services. Detailed studies could possibly demonstrate that victims of car accidents are as highly taxed as smokers of cigarettes!
- 70 Another issue requiring clarification is the treatment of subsidies when calculating pro rata. This issue received some consideration from the Court in *Commission v. Spain* (C-204/03, ECR (2005) I-8389) and *Commission v. France* (C-243/03, ECR (2005) I-8411)).

#### 4.1 Question 9

71 The main problems with the right of deduction are:

1. An absence of harmonisation of VAT exemptions combined with the total freedom that Member States and to some extent businesses have to select rules for determining how to attribute input tax to supplies. The combination of these factors results in a lack of neutrality. Some members of the CFE Fiscal Committee consider that the freedom to select rules for determining how to attribute input tax to supplies should be regarded as a state aid.
2. Limitations on the right of deduction should be strictly limited to private consumption;
3. Irrecoverable VAT input tax is a tax on production and is inconsistent with the principle that tax should be paid by the final consumer in the country of consumption;
4. There are two methods for limiting the right of deduction, i.e. the self-supply at the time of acquisition of goods and services and the limitation of deduction. These two methods are overlapping or combined.

72 There remain significant problems in recovering VAT that is paid in another EU Member State. In particular:

1. A trader who just has a partial right to deduct input VAT can have difficulties in exercising that right in another Member State or in a third country;
2. It has been observed that the current electronic refund procedure does not function properly and that the tax authorities systematically require a copy of invoices;
3. Businesses that make supplies in another Member State where they do not have a fixed establishment and where the supplies are subject to a national reverse charge, so the customer accounts for the VAT, are faced with having to recover substantial amounts of VAT input tax using the 8th Directive procedure.

73 One of the more surprising features of the current VAT system is the significance placed on the invoice as the document that needs to be produced in a totally correct form with an endless list of items to put on it before the customer can exercise its right to deduct VAT. No other evidence is accepted and the requirements have been tightened. In other parts of the

Community law, e.g. customs or export refund, the Court has been more willing to accept other evidence: see for example *Huygen* (C-12/92, ECR (1993) I-6381). This strict requirement does more harm than good especially for small businesses.

#### **4.3 Question 10**

- 74 Steps to remedy the issues outlined above. A second issue is the fact that the vast majority of MS restrict the right of deduct input tax on the cost of cars. This is claimed to be a simplification measure. However, such exclusions undermine the principle of neutrality.
- 75 We would like to see the neutrality and fairness of the rules on deduction of input VAT improved by the introduction of the following changes:
1. In so far as possible limiting the VAT exemptions, since these restrict the right to deduct and can require complex pro-rata calculations. Although the administrative consequence of any change need to be taken into account (for example additional obligations to register and submit returns), in many instances it would be better to replace exemptions with a super reduced rate of 2/4 %. This would minimize the need to undertake complex pro-rate calculations. If these rates correspond to the input tax that would otherwise be irrecoverable it should result in no additional tax of the final consumer;
  2. Where exemptions are retained, the capital goods scheme for determining the entitlement to deduct input tax on investments should be compulsory in order to avoid distortions of investment decisions and distortions in competition;
  3. An one-stop-shop mechanism whereby business could offset the input VAT incurred in a Member State against the VAT due in another Member State should be combined with a harmonisation of the procedures relating to the VAT returns.

## **5. International services**

### **5.1 General remarks**

- 76 The OECD has opened a consultation about international services. To some extent payments for royalties may result in double taxation in cases where they are taxed by the country where the licensee is located and the royalties are also subject to importation VAT due to the rules of customs valuation. This can be particularly onerous in cases where the recipient cannot recover the VAT or importation VAT. One example is the medical industry which is particularly adversely affected by these rules.
- 77 The issue of tradable services (CO<sup>2</sup> certificates, vouchers, positions on precious metal, etc.) in relation with third countries also deserves further consideration because of the dangers of fraud in this sector.

### 5.2 Question 11

- 78 The issue comes up more in cases where one VAT/GST concept pursues a legal approach for branches while others follow the economic approach (Switzerland, Australia, New Zealand and South Africa). Normally this does not matter except in cases of bank services or services within other exempt industries like gambling.

### 5.3 Question 12

- 79 The OECD initiative is valuable, since it is desirable to have a more coordinated system of indirect taxation.
- 80 The main problems with the current VAT rules for international services relate to issues of competition and tax neutrality:

Danger of double taxation: This is increased by the fact that there are different limitation periods for the tax authorities and taxpayers making claims and different limitation periods in different countries. In addition to harmonising the rules on time limits, consideration should be given to the following issues:

1. Non taxation of branch – head office supplies combined with “input taxation” (or VAT exemption) depending on the country and the way the business is structured (see on this issue: [CFE Opinion Statement on the case C-210/04, FCE Bank](#), April 2008). The CIOT (UK

Chartered Institute of Taxation) disagrees with the comments that tax should be imposed on cross-border branch to branch supplies.

2. There would be merit in harmonising the place of supply and classification of supply rules, for example by removing or limiting the current derogations. This may have the benefit of reducing the dangers of double taxation and non-taxation (note for example case C-277/09 HMRC v. RBS Deutschland).

## 6. Degree of harmonisation

### 6.1 General remarks

- 81 It is clearly desirable that there should be as much harmonisation as possible. However, regulations will not totally solve the problems, since these are partly caused by the different languages used in the Union and the fact that provisions are interpreted differently because of the different legal and cultural traditions. As we have learned from customs duties, MS tend to fix the most of the necessary explanations in the implementation code which contains now more than 1,000 articles. This is evidence that MS tend to exaggerate and are not behaving carefully with their capacity to have the power of a legislator. They produce too much then and not always comfortable for readers, including mistakes (e.g. transport facilities). It is evident that current means of comitology cannot be used due to lacking rules in a regulation. And there are doubts whether MS will champion such a step fearing an evasion of their last resort of sovereignty, taxes and budget.
- 82 Business operates in a single market and after a problem emerges, it is not possible to wait for ten to twenty years to obtain legal certainty. There a clear need for an European interpretation body where both business and Member States can get binding answers without having to go through the Court system where fundamental decisions for the European economy can be influence by factual circumstances, short term political or budgetary constraints of some Member States or the Commission, or simply because the judges do not fully understand the impact of their interpretation.
- 83 One solution could be to establish an administrative authority, but not a court, in which all MS are entitled to appoint a minimum of one expert. The decision of the authority must be

binding for the parties and in cases of interpretation for all MS. Any decision should be accessible for the public. Business operators should be entitled to bring questions to the authority to solve intra-community problems. Any MS should also have the right to raise questions. Decisions made by the authority should be open to challenge in the ECJ. The authority should also be treated as a tribunal that is able to refer questions to the ECJ (Art 267 TFEU). The most important requirement is that the authority must produce a decision in an appropriate time frame (three months). The implementation can be done on a contractual basis pursuant to international law and does not require any amendment of the Treaty. Such a forum may encourage MS to be more cooperative and to learn from each other. Since there will be a need for a comparable administrative authority for the purposes of the CCCTB, it should be regarded as an opportunity to improve cooperation as well as trust.

#### **6.2 Question 13**

- 84 The entire VAT law can be eligible to be set out in a regulation. But this will not solve the problems for the reasons outlined in paragraph 81 above.
- 85 However, members of the CFE Fiscal Committee consider that regulations may assist in a resolution. For that reason, they consider that there must be some benefits in measures being implemented by regulation even if this does not completely solve all the problems that arise. Due to the high costs of the administrative changes and the necessity of uniform implementation and interpretation across the EU, the following provisions of EU VAT law should be laid down in a Council regulation instead of a directive: the requirements for VAT registration, VAT returns, recapitulative statements, and accounting for VAT liabilities. This will provide greater legal certainty.

#### **6.3 Question 14**

- 86 Decisions in which the representatives of the MS are not involved will not have the effect the business community would expect.

#### **6.4 Question 15**

- 87 Soft law concepts are very common in the Community law. The guidelines for the AEO (authorized economic operators) are also soft law as, to a more important extent, are the frameworks released by the DG Competition in the area of state aid law. It could be helpful.
- 88 Authorities derogating from the guidance would probably feel obliged to justify their position. If such guidance strictly pursues the objectives of simplicity, clarity and coherence, in line with the general principles of European VAT and the Treaties, the guidance may reduce the need for national Courts to refer preliminary rulings to the ECJ. Such guidance would be very useful for new Member States that have not yet had the opportunity nor the means to develop their own guidance.
- 89 It would be extremely important to create a permanent forum where business can bring forward issues of significance and contribute with essential practical information.

## **6.5 Question 16**

- 90 As long as an initiative is in hands of the Commission the process is transparent enough. If the proposal starts to be processed by the Council, then the business community loses track of progress and the final result contains provisions that are sometimes unexpected, obscure and therefore are not understood by business and sometimes not even by Member States. The current legislative process at Council level does not allow for discussion of major economic issues that can only be clarified in an open and face-to-face debate.

## **7. Derogations and the ability of the EU to react quickly**

### **7.1 General remarks**

- 91 Currently, the decision making process takes too long. For this, MS can not to be blamed since learning processes and coordination with the national parliaments take time. However, urgent measures cannot be enacted in the same manner. Derogations are part of the concept as long as many of them originate from the historical legislators continuing with their zero rating, super reduced rates, and additional needs to combat tax fraud or to grant simplification measures.

## **7.2 Question 17**

- 92 Knowledge about derogations is no longer a problem, since the Commission provides good quality documentation about them.
- 93 However, derogations cause problems when they affect the accounting and IT procedures of businesses that operate in a number of Member States. Unless there is some compelling reason for not doing so, there should be consultation before agreeing on derogations. Derogations are undermining the VAT system and create disharmonisation and complexities by allowing Member States to apply their own national approaches.

## **7.3 Question 18**

- 94 It takes too long to obtain specific derogations to fight fraud. Necessary derogations to combat tax fraud should be authorized by a small Committee consisting of the experts of the Commission the applying MS and representatives of the current Council presidency, the previous and the next presidency. So as to ensure no long term prejudice to the principle of unanimity, such measures should be authorized for no more than one year.

# **8. Rates**

## **8.1 General remarks**

- 95 For reasons which have been elaborated above in relation to exemptions, members of the Fiscal Committee of the CFE believe that reduced rates are a proper means to limit the impact of the regressive effects of VAT. Reduced rates can also have a negative impact on competition if they result in similar products being taxed at different rates or the same products being taxed at different rates in different countries, since it may then impact on where customers buy their goods. For example groups of consumers will look where they can buy goods at the lowest price. So for example farmers eligible for the special schemes buy fertilizers at the place where a reduced rate makes a significant price difference. They organize purchases in countries where a reduced rate is applied like in Italy (4%) and purchase amounts that ensure that they will not exceed the threshold for the acquisition

VAT. These issues may be slightly less of a concern with services. It has also been noted that reduced rates do not necessarily reduce prices.

95a Many members of the CFE Fiscal Committee consider that especially if exemptions are to be removed, reduced rates are to be welcomed for social reasons and because of the dangers that EU traders may be placed at a competitive disadvantage if for example financial services were taxed at the standard rate.

### **8.2 Question 19**

96 There are some areas in which distortive effects can be identified. As explained above, fertilizers and farmers are one example; another is provided by e-books and audio files which can be downloaded from the internet. The application of reduced rates particularly in neighbouring Member States may create distortive effects.

97 It has been observed that differences in VAT and excise duty rates can have a substantial impact on where people will choose to buy goods up to a distance of about 50 km from the border or even more, depending on the products.

98 Similar issues arise in relation to e-services, but this should end in 2015.

### **8.3 Question 20**

99 A pan-European strategy would be more appropriate. But the issue also needs to be considered on a more local basis. Uniform reduced rates may not always be appropriate.

## 9. Reducing red tape

### 9.1 Preliminary remarks

100 The lack of harmonisation of administrative procedures causes significant costs for businesses that operate in a number of Member States. Major concerns include the differences in the forms used, the different on-line filing systems, the different IT requirements and the general absence of harmonised standards. More efforts should be put into the harmonisation of compliance procedures, especially from an IT perspective.

101 Practically speaking, the outcomes of the High Level Group are rather overdrawn than helpful. Once an electronic accounting system is in place, it does not an undue hardship to press the button one, two or three times. The issuing of annual returns can be helpful, especially in parts of businesses which have complicated VAT driven record requirements in place, for example for the construction industry or smaller tour operators. Having concepts in place in which accountants have to watch closely whether a contract creates more than 10 invoices on advanced payments and in the final invoice have to reflect all of them, mistakes are inherent, especially if the business is established in a jurisdiction in which it is required to take care of a reverse charge mechanism for the construction industry depending on whether the customer is a principal constructor or a final consumer (Art 199 (a) e.g.: The Netherlands).

102 An annual report helps to reconcile the figures used for VAT return with the results of the financial statements. The listing is as well not an issue since it is an incomplete controlling instrument as long as no corresponding records are in place for acquisition VAT purposes, as set out in the administrative regulations to VAT in the Czech Republic. However, differences exist as far as the intrastate statement is concerned. Some of the transactions have to be recorded in the listing other than in the intrastate return and vice versa.

103 More important are the requirements to provide evidence to justify zero rating transactions, either intra-community supplies or exports. In case an ex-work clause (Incoterms 2010) is stipulated, the buyer has the obligation to arrange the transport as well as to apply for the export customs clearance. However, many MS require traders to provide the original customs or transport documents which will never come into the hands of the seller and will

be needed by the buyer for its own records (Twoh International BV, C-184/05, ECR (2007) I-7897). The same happens in the case where a DAP clause (Delivered at place, replaces DDU, delivered duty unpaid) is stipulated. DAP clauses result in cases where, if more than two parties are involved and the last two are established in the country of destination, importation VAT and regular VAT will become due simultaneously. Some countries do not allow a deduction for both of these amounts.

104 Smaller businesses have to pay disproportionately more fees to comply with the rules since special international VAT networks are not affordable and most local accountants or tax advisers are seldom part of a transeuropean tax network with the appropriate access to the correct solution. The mandatory application of standardised returns may be of considerable assistance to them. For many small businesses, there is also no non-VAT reason to produce monthly or quarterly accounts.

## 9.2 Question 21

105 The annual return is more helpful than a mess since it is used as a controlling tool to reconcile VAT numbers with the numbers of the financial statements. More important is that the power of attorney once accepted in one MS will also be valid for any other interventions on behalf of the client. In cases of exports an automatic information of the responsible customs authority (customs office of export) shall be forwarded to the responsible tax office of the seller, if the latter can be identified by his VAT-ID, irrespective of what kind of Incoterms are stipulated (Art 792 (1) Customs Implementation Code).

106 One of the easiest amendments could be to standardise VAT returns, as has already occurred for customs duty purposes. This would be helpful to overcome language differences, as well to improve controlling routines.

107 Any change in formalities implies huge costs in adaptation of computer programmes. Differences in formalities are not compatible with the current way of doing business.

### 9.3 Question 22

108 Cooperation between tax authorities, customs, Eurostat (intrastate) and business operators is highly desirable since this may be a way of streamlining the information that has to be provided.

109 Major attention should be given to the harmonisation of formalities. It would be very helpful if maximum requirements could be set at EU level, since this would assist the introduction of IT systems that are designed to handle a predefined range of information and which could operate on a cross-border basis.

### 9.4 Question 23

110 The list of the High Level Group is too much driven by desk top publishers rather than experts having done the work in question. Since, at least with larger businesses, any monthly return is normally based on monthly accounting work, which is required to be done by other legal or commercial constraints, like the obligation to prepare proper accounting for the purpose of controlling. Different considerations may apply to smaller businesses. The same is the case with annual returns.

111 Recommendation 8 is correct in relation to the different requirements to prove exports. Recommendation 9 is simply not useful, since the intra-EU supplies listing deviates significantly in many cases, like triangular case, assembly and installation, cross-border multi-processing. Recommendation 10 is not completely correct, since the vast majority of MS do not require monthly returns when notifiable transactions do not occur. The Directive also does not impose such an obligation. The other recommendations are either implemented (e-government) or in the process of being implemented.

## 10. Small businesses

### 10.1 General remarks

112 VAT can be particularly burdensome for small businesses. Cost constraints mean that they are less likely to engage professionals who have the experience about how to deal with

issues relating to the single market. They are also less likely to know about the appropriate solutions to problems and to have computerized records with software packages that can simplify the process of making returns.

113 Micro-businesses with less than EURO 100,000 revenue should be eligible for an option for total exemption (although they will be paying some tax because of their inability to recover input tax). Some businesses in the range between EURO 100,000 and 1,000,000 could be offered an opportunity, which will not be compulsory, to join a flat rate scheme comparable to that offered to farmers, so as to reduce their compliance burdens. There could also be merit in having an EU wide threshold below which an individual does not need to register in any EU jurisdiction. Any steps that reduce the need for small businesses to have to register in a number of jurisdictions would be welcomed.

114 The flat rate scheme should be calculated by reference to the average input VAT that could otherwise be expected to be recovered. The scheme should only be available to traders if more than 95 percent of their supplies are B2B transactions.

115 In general the Commission and DG Budget, rather than DG TaxUD, should be responsible for conducting tests for determining the basis upon which the flat rate scheme should operate. This exercise will need to be kept under periodic review, so as to ensure that governments and businesses do not obtain excessive benefits from the system. Farmer schemes do not have a ceiling (Title XII, Chap. 2), however, comparable generosity cannot be applied to small businesses.

116 Small businesses operating in the single market need better access to correct and solid solutions. They may find the establishment of the administrative authority (see paragraph 83 above) an especially helpful measure provided it has to make decisions within strict time frames.

## **10.2 Question 24**

117 A review of the exemption concept is essential when programming a more generous exemption concept, along the lines of that in the UK (BP 73.000, 2011/2012). Simultaneously, the Commission should consider whether substantial improvements can be

made to the flat rate system, in order to reduce compliance costs, bearing in mind that such a simplification can only apply to businesses that predominately make B2B supplies.

### **10.3 Question 25**

118 Other simplification measures could include reducing the frequency for filing returns for traders with a turnover of up to EUR 500,000 per annum and allowing simplified invoices for transactions below EUR 2,000. However, one must take into account that what is considered small in large Member States may be considered as medium to large in small Member States.

### **10.4 Question 26**

119 Farmers are treated favourably by the Directive. The merits of having a flat rate scheme without any ceilings should be reconsidered. It is also unsatisfactory that farmers' sales to non-taxable persons are totally untaxed.

## **11. One stop shop**

### **11.1 General remarks**

120 The use of electronic data systems is far more advanced in the customs duties field than it is in VAT. A one stop shop could be part of the single window concept which is currently in place in some of the MS. This portal could be used to electronically follow any intra-community transactions. Any export and import would be immediately recorded and controlled by the system. This would make such transactions easier to monitor. It is ridiculous to talk about the necessity of a listing without putting in place a direct control mark in the country of destination. Once in place, it does not matter how the VAT will be charged, either in the country of destination with an automatic imposition of the right rate, or in the country of origin. If taking into consideration that instead of sending the money into a circle with spinning wheels a matching between input and output can be done electronically without any cash transfers. Having such a system in place all goals can be accomplished easily.

121 It is affordable for small businesses as well, since it will be offered by the public and currently any small freight forwarder and customs agent has the same access.

### **11.2 Question 27**

122 The one stop shop is a solution that is starting to be implemented for the administration of customs duties and this should help to increase tax administrations' confidence in such systems.

123 Some members of the CFE Fiscal Committee believe that a one stop shop should be optional. They are particularly concerned that any system will impose undue demands on small businesses or on businesses that only occasionally undertake transactions with customers in other Member States. However, all agree that it should be based on a standardised EU IT platform, using standardised forms that can be completed by an individual using a single set of IT procedures from a central point, even if the data being inputted relates to a number of countries.

## **12. Pan – European businesses**

### **12.1 General remarks**

124 The creation of Pan-European groups is to be welcomed as a way to reduce unnecessary administrative burdens. All the bigger groups will have risk management tools in place that apply on a cross-border basis. Responsibility for the group could possibly be placed in a cross-border AEO (authorized economic operator). Unfortunately, customs administrations have so far limited themselves to certifying business operators on a country by country basis rather than on a group by group basis. Here again, the limited will to cooperate results in unnecessary administrative burden. A cross-border grouping may also have the benefit of increasing the cooperation between tax authorities in the Member States.

### **12.2 Question 28**

125 One of the major problems with the current system is the lack of harmonisation of administrative procedures. Currently problems are caused by the lack of harmonisation of rules relating to invoices and returns and other administrative procedures. Harmonisation may enable these issues to be dealt on a pan-European basis with greater efficiency. However, it is also important that smaller businesses benefit from any reforms. Therefore group simplification measures should be implemented hand in hand with a single window concept for VAT which is affordable and can also be designed to mitigate compliance constraints.

126 The current VAT rules create difficulties for intra-company or intra-group cross-border transactions that are VAT exempt. This in particular applies to the financial sector. These difficulties would disappear if financial services were taxed in a way that was appropriate to that sector.

## **13. Synergies with other legislation**

### **13.1 Question 29**

127 As mentioned above, a single window concept with one portal for VAT, customs, import and export licences as well as export refunds and additionally for excise tax purposes would be helpful.

128 Some members of the CFE Fiscal Committee also consider that it would be desirable if information that has already been collected by tax authorities was exchanged between them, possibly with a central IT system at European level.

## **14. VAT collection**

### **14.1 Question 30**

129 Superficially there may be some attraction in a split payment system. However, the split payment model is dependent on the rapid exchange of information and this will be particularly problematic in the EU if each Member State has one or even more systems. The

promoters of this system have probably underestimated the major practical difficulties that will arise. For example, some businesses have EU wide group treasury centers so the introduction of a number of different systems would cause serious problems for them. Problems may also be caused by the fact that many transactions within a group of companies do not result in any payments. The split payment model in the EU context still has many unanswered concerns and questions, such as:

- How to deal with the exchange risk?
- How will non-EU suppliers and purchasers be informed and convinced to step into this split payment system with its added complexity?
- How will it apply to barter trades or other transactions where there is no monetary payment?
- What is the liability of the supplier if the client doesn't pay into the blocked bank account (in time)?
- Can the authorities seize amounts in the blocked accounts?
- How does the split payment method work in practice with credit notes?
- How will split payment method deal with in-house banking of multinationals, where bulk payment are made (i.e. one payment for multiple invoice) and where netting is a daily practice?
- Who will pay the implementation costs?
- What will be the effect on turnover?
- Are the credits on the blocked account interest bearing?
- Does split payment entail that everybody has to VAT report on a cash accounting basis?

130 The scepticism about the merits of a split payment methodology is widely shared by the members of the CFE Fiscal Committee. Instructions will have to be given to the bank on a payment by payment basis, given exemptions, different rates and the fact that some payments do not relate to taxable supplies. If suppliers remain liable for VAT, they are also

likely to require safeguards (for example notification by the tax authority that it has been paid) before they feel safe about the idea of making the supply. We are also sceptical about it having any impact on fraud for the reasons outlined above. We also have concerns about the cost implications especially for small businesses where it faces the problem that a lot of supplies may still be paid for with cash.

131 However, another method could be the direct accounting of inputs in the system of the tax administration which are collected to credits for the recipients of a supply of service or goods which have to be matched with the VAT due of the supplier. Cash transaction shall contain the net value of the invoice.

132 Another proposal is that there should be a central VAT monitoring database or a data warehouse with an IT gateway for the tax authorities to be able to access the system. The problem with these proposals is that they will potentially enable highly sensitive information to be accessed such as invoices that contain names of suppliers, prices, timing etc. There is clearly a danger that hackers may obtain access to these systems. This will be more difficult if there is a decentralized storage of data for individual business. The intrinsic dangers of these proposals mean that they require very careful consideration.

133 The certified taxable person model is a model where a taxable person's VAT compliance process and internal controls are certified. However, it is questionable whether this provides any real protection against fraudulent suppliers and fraudulent clients.

134 Particular problems arise for small businesses, where payments are frequently made in cash. However, consideration can obviously be given to simplifying procedures for them.

## **15. Protecting bona fide traders**

### **15.1 Question 31**

135 An optional split system does exist in some MS. It has been suggested that this may help to reduce the risk of traders having problems because of the fraudulent actions of suppliers and customers. In practice the benefits of such a system are likely to be limited because in many missing trader cases the defaulting trader is not the immediate supplier but someone much

further up the chain of supply or in a completely different chain. It also has many of the practical problems noted at paragraphs 138 and 139 above. In particular, suppliers may want confirmation that payment has been made before being prepared to render supplies. This may in turn impose additional obligations on tax administrations. Smaller businesses would be required to take a strong stance against their suppliers on which they may depend and which could therefore prejudice their business. However, there may be limited occasions when it may be helpful.

136 Some members of the CFE Fiscal Committee believe it would be helpful if there was a European database that traders could consult which would in addition to the VAT number also indicate whether

1. the trader has filled all its VAT returns;
2. the trader has nil returns;
3. the trader has fully paid his VAT liabilities;
4. the trader's total intra-Community acquisitions.

This information would help traders identify whether their supplier is a potential missing trader. This information could also be used by Eurofisc for basic data mining and to enable speedier decisions to be taken by the tax authorities.

137 The following steps could also assist the fight against fraud:

1. the synchronization of VIES database with national databases;
2. updating the VIES database with more information such as the name, address, period of validity;
3. upgrading the VIES database so that it contains warnings of there have been "payment delays", "late filing" and/or "consistent nil filing". This would help taxpayers to become aware of business partners that were not fully compliant long before their VAT numbers are cancelled;
4. significant mismatches between sales listings and purchase listings of suppliers and clients are communicated to both parties. According to our information (subject to further verification), such data can be exchanged via an external platform without

- enabling the host of the platform to read the information exchanged, using encryption keys that only the sender and receiving party have;
5. updating VIES database with information about whether a given taxpayer is “certified” and the date of certification data available on VIES.

## **16. An efficient and modern administration of the VAT system**

### **16.1 Question 32**

138 Any efforts to foster a climate of trust and cooperation between tax authorities and businesses will contribute to a better system. One problem that needs to be addressed is that while international operators are equipped to cope with problems that arise from conducting business on a global basis, tax administrations do not have the opportunity to obtain the same level of expertise. This creates distrust. Cooperation has to be designed in a way that helps to sort out the honest from the fraudster and to make the system understandable to both sides.

## **17. Other issues**

### **17.1 Question 33**

139 As we hope that the answers to the previous questions make clear, greater efforts have to be made to increase cooperation between tax administrations, the Commission and businesses. The best way to do this is to establish an administrative body (authority) in which every MS will be represented and which is specializing in two areas, one is VAT and cross border transactions and the other is the enactment and implementation of the CCCTB. Businesses need quicker access to solutions. One of the main problems with the European Union is the lack of harmonisation and the lack of any procedures for obtaining speedy cross-border rulings and avoiding risks of double taxation. Uncertainty is a powerful disincentive to doing business on a cross-border basis. It is also important that even if a penalty system is left to each Member State, such a system should comply with the principle of proportionality and effectiveness. In certain Member States, VAT penalties are applied even in absence of

any VAT fraud (and sometimes, in absence of any loss of VAT revenue). This can again be a powerful disincentive to doing business on a cross-border basis.