OBSTACLES TO THE EUROPEAN INTERNAL MARKET IN THE FIELD OF VALUE-ADDED TAX

Executive Summary

In the everyday experience of our member companies, the Internal Market has not reached its full potential. EU companies involved in cross-border transactions face higher advisory and compliance costs as well as risk exposure related to value-added tax (VAT) obligations than when they operate exclusively at domestic level. According to a BUSINESSEUROPE survey of 56 companies from 11 EU Member States and Switzerland, the most burdensome obstacles in this respect are:

- The fragmented implementation of the VAT Directive (2006/112/EC) into national law;
- Enhanced reporting obligations for intra-Community supplies;
- Obstructions to deduction of input VAT, in particular in cross-border situations;
- Interest and penalties levied by Member States.

Drawing upon practical examples, this report describes how the EU's VAT set-up deters business from cross-border transactions and/or forces them to organise their business structure in a non-efficient way. Proposals to remove VAT obstacles include:

- Reduction of the options for derogations granted to Member States;
- Creation of a central organ at EU level to provide guidelines for uniform application of Directive 2006/112/EC on request by taxable persons;
- Reduction of the bureaucratic cost for intra-community supplies to the indispensable minimum;
- Harmonisation and simplification of the rules as well as acceleration of the procedures for obtaining input VAT deductions or refunds;
- Removal of interest and penalties on VAT if the Member State in question has not suffered any shortfall in VAT revenue.

If these measures can be implemented, a significant step towards the Internal Market in the EU for the benefit of all stakeholders and, in particular SMEs, will have been made.

Introduction

For more than twenty years, the EU has been striving to implement the Internal Market. With the Single European Act in 1986, the EU set itself the goal of implementing a single market by 1992. Today, this aim has been achieved in several areas, from a common customs union to a common currency. Yet, in the area of VAT, the Internal Market has not reached its full potential.

The Council is obliged by Art. 93 of the Treaty Establishing the European Community to adopt provisions for the harmonisation of indirect taxes to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortions of competition. While the VAT Directive (2006/112/EC) establishes the common application of a VAT system across the EU, numerous exceptions and derogations allow Member States to deviate from the standard VAT rules as provided for in that Directive and to apply exemptions. Additional obstacles arise where Member States fail to implement the provisions of Directive 2006/112/EC correctly in their national VAT laws.

The purpose of this paper is to point out the main obstacles businesses in the EU encounter with regard to VAT in cross-border transactions. These are obstacles which increase the advisory and compliance cost as well as the VAT risk exposure of businesses, and are hence likely to deter business from cross-border transactions and/or force them to organise their business structure in a non-efficient way, thus interfering with the free movement of goods and services within the EU and the principle of tax neutrality.

Based on the feedback from a questionnaire send out to our member companies[1], the most burdensome VAT-related obstacles to the Internal Market can be divided into the following four clusters:

1. Fragmentation of national VAT laws;
2. Enhanced obligations regarding VAT for intra-Community supplies;
3. Obstructions of deduction of input VAT
4. Distortions to the principle of neutrality of VAT through interest and penalties levied by Member States.

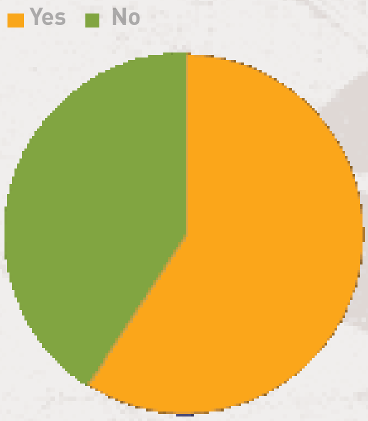
The paper will present a non-exhaustive list of examples from day-to-day business and make proposals how to improve the situation with regard to VAT for companies engaged in cross-border transactions. This should significantly enhance the implementation of the Internal Market. The underlying survey was conducted in February 2008. Thus, the paper reflects the legal status of the European VAT laws as of the last quarter of 2007.

[1] *56 companies have replied to the survey sent out in February 2008 (Belgium -3, Czech Republic-1, Denmark-2, France-2, Germany-14, Greece -13, Italy-1, Netherlands-8, Poland-1, Sweden-6, Switzerland-3, United Kingdom-2).*

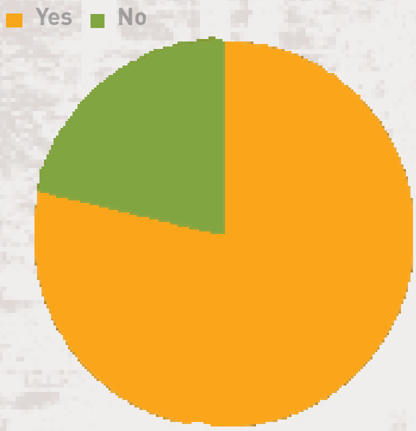
Fragmentation of national VAT laws

The major driver of VAT-related advisory and compliance cost for business involved in cross-border transactions in the EU is the fragmentation of national VAT laws. This fragmentation is due to multiple options granted to the Member States under the VAT Directive. In particular, cross-border business activity needs to comply with different regulations with regard to different invoicing requirements, the exclusion of input VAT deductions and different provisions for the application of reduced or standard VAT rates. For businesses, getting the right information concerning the different national VAT rules and formalities constitutes a high administrative burden and an important liability issue.

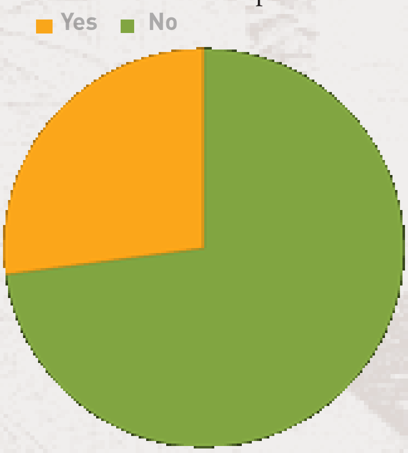
Invoicing Requirements -
manual intervention required?



Reduced VAT Rates -
manual intervention required?



Exclusion of Input-VAT Deduction -
use of external VAT advisory services for
VAT compliance?



Source: BUSINESSEUROPE Survey (2008)

Invoicing requirements

Obstacles to the Internal Market are created where Member States exercise options for derogations granted under Art. 226 ff. of Directive 2006/112/EC with regard to invoicing requirements that cannot be dealt with by standard set-ups of ERP systems.

According to the questionnaire, 50 percent of the participants encounter different invoicing requirements in other Member States. The cost of adapting to these requirements is considerable, with a majority of companies being obliged to intervene manually as the existing invoicing system is not able to deal with the issue.

Based on practical experiences of our members, the following particularly burdensome invoice requirements exist in the different Member States:

- Separate set of sequential invoice numbers: many Member States have set up the requirement to have sequential invoice numbers. That requirement seems to be particularly burdensome in Italy and Hungary, where a separate set of sequential numbers needs to be established even for foreign taxable persons.

- Language of the invoice: according to the experiences of the respondents, invoices have to be issued in the local language in Bulgaria, Poland, Romania, France and Italy.

- Signature of invoices: Bulgaria requires a signature on paper invoices, which leads by nature to manual operation in any invoicing process.

- Expression of amounts in words: Poland requires the total invoice amount due to be expressed in Polish words in invoices.

- Amounts to be expressed in local currency: the Czech Republic and Poland not only have the requirement of an invoicing in local currency; moreover there are particularly burdensome rules on the obligatory use of published exchange rates, again requiring costly manual operation in invoicing systems.

- VAT IDs of customers for domestic sales: in particular, Belgium and France require the customer's VAT ID also to be shown on invoices for mere domestic transactions, which leads to costly maintenance of additional customer data.

- Very short time limits for issuing invoices: Belgium, Bulgaria, Italy and Poland have very short deadlines for issuing invoices. If those deadlines are not met, either penalties are imposed or the deduction of VAT invoiced is denied (Poland).

- Restrictions on self-billing: there are restrictions for self-billing (like explicit acceptance of the credit note by the supplier) in Belgium, Portugal, Spain and Denmark.

There are further examples for burdensome deviations related to invoicing requirements throughout the EU. In particular, this is the case with e-invoicing, which is the subject of a separate BUSINESSEUROPE position paper.

Proposals:

-> *There should be uniform invoicing requirements throughout the EU set out in a binding Regulation, which does not grant options for deviation. Such a regulation should define the maximum extent of invoice requirements Member States may demand. However, these European requirements must not be the sum of all the existing different national requirements but must be based on the criteria of efficiency and proportionality, and be easy to handle.*

-> *Regarding the language of invoices, Member States should accept invoices in English as the common language of international business.*

-> *Whenever Member States have a local currency other than the Euro, there should be a binding obligation for Member States*
- *either to provide a monthly fixed exchange rate in advance if the Member State wishes to continue the requirement for the VAT amount to be shown in local currency;*
- *or the taxable person must be allowed to express VAT amounts in euros in the invoice and this VAT amount will be translated into local currency when the VAT declaration is completed, using a monthly fixed exchange rate for this purpose.*

Exclusion of input VAT deduction

Under Art. 176 sub-paragraph 2 of Directive 2006/112/EC, Member States can maintain their national exclusions from input VAT deduction. Thus, businesses engaged in cross-border transactions usually face a completely different situation in other Member States regarding the exclusion of input VAT deduction than in their home Member State. Since it is difficult to gain an overview of the numerous exclusions, businesses engaged in cross-border transactions in the EU have to engage VAT advisers, thus increasing the VAT advisory and compliance cost for cross-border transactions in the EU.

Another aspect is that the inhomogeneous sets of national exclusions from input VAT lead to distortions on the Internal Market, in particular as regards expenses like fuel for company cars. A great majority of respondents to the survey have faced different provisions for the exclusion of input VAT deduction (33 out of 53) and most of these companies needed to engage external advisory services to ensure VAT compliance (24 out of those 33). Companies consider that it would significantly improve their situation if Member States determined non-deductible VAT uniformly for the EU (36 out of 42).

The rules governing exercise of the right of deduction usually require the claimant inter alia to hold an invoice made out to him. Strictly this excludes invoices for employees' business expenses, such as hotel accommodation, meals, car hire etc, which bear the name of the employee rather than the claimant, although practice varies among the Member States. Provision should be made in the Directive for Member States to accept input-VAT claims supported by invoices made out to employees where the expense relates to the claimant's business.

Proposals:

The rules for input VAT deduction should be harmonised based on the principle of neutrality of VAT, meaning that all business-related input VAT shall be deductible. The existing VAT legislation (e.g. Art. 18 and 26 Directive 2006/112/EC) provides for better instruments to levy VAT upon the use of goods and services for non-taxable activities than the denial of input VAT deduction. In particular, the input VAT deduction rules for passenger transport and travel expenses should be uniform across the EU.

Different exercise of the options to apply reduced VAT

Member States have exercised the option granted by Art. 98 of the Directive 2006/112/EC to apply reduced VAT rates for the goods and services set out in Annex III of the Directive in very different manners, resulting in particular in increased VAT advisory and compliance costs for cross-border transactions, where one Member State applies the reduced VAT rate for a particular good whereas the other Member State does not. In general, 19 companies faced different provisions for the application of the reduced or standard VAT rates while 33 did not. That problem particularly arises in Member States with a wide range of transactions under reduced VAT rates (like France, UK) or newly acceded Member States (like Poland), as well as in the context of supplies of pharmaceutical, animal health and plant protection products.

However, a majority of the participants in our survey see an easy to achieve yet significant release for businesses, if the goods set forth in the list of Annex III were exactly defined by Combined Nomenclature (CN)-codes. Currently the Member States might have different understandings of e.g. the pharmaceutical goods referred to in No. 3 of Annex III or of the goods intended for the use in agricultural production referred to in No. 11 of Annex III.

A strong need is seen for full harmonisation regarding the goods and services for which a reduced rate can be applied. The Member State may only define the reduced rates to be applied. Overall, the cases in which the reduced rate is to be applied should be restricted to a reasonable minimum. VAT is there for financing public needs and not a steering instrument. Hence, VAT should not be used as an instrument to foster political aims fostered by one or some Member States.

Proposals:

-> *In a first step the goods eligible for reduced VAT rates should be shown by CN codes in Annex III of the Directive 2006/112/EC.*

-> *In the long run it would be strongly advisable to have a uniform and binding legislation at EU level setting out the goods and services for which Member States apply a reduced VAT rate. The definitions of the goods and services eligible for reduced tax rates in such legislation should be definitive, i.e. non-optional.*

Further example for a lack of harmonisation of national VAT laws

Further practical examples of non-uniform application of VAT rules with significantly enhanced VAT compliance costs for cross-border transactions are:

- Different national rules to obtain a VAT registration (particularly burdensome in most of the Central and Eastern European Countries);
- Different reporting/record and storage requirements;
- Application of a general reverse-charge-mechanism for domestic transactions of non-resident taxable persons (e.g. France) in deviation from the VAT laws of most Member States;
- Different rules for the application of the reverse-charge mechanism for domestic transactions involving the supply of construction work (Germany);
- Different application of the triangulation simplification regime depending on VAT registrations of the involved suppliers either in the Member State of departure or arrival of the goods;
- Different treatment regarding the taxability of supply of goods not entered into free circulation (T1);
- Different rules for the application and interpretation of exemptions in some sectors (e.g. financial).

Proposals:

To reduce the VAT risks and costs related to cross-border transactions in the EU with a view to lowering the threshold for entering the Internal Market, in particular for SMEs, BUSINESSEUROPE proposes the following general measures besides the particular measures already mentioned:

-> *In order to implement a harmonised VAT system in the EU, the numbers of options for deviations granted to the Member States under the Directive 2006/112/EC have to be significantly reduced. Any exercise of the remaining options for deviations by the Member States should be subject to binding rules in order to ensure that such options are exercised uniformly throughout the EU.*

-> *A central organ shall be created at EU-level (preferably in the framework of DG TAXUD) for issuing guidelines on a uniform interpretation of the Directive 2006/112/EC in case of different interpretations of that Directive by Member States. Taxable persons shall have the opportunity to ask for the issuance of such guidelines.*

Enhanced obligations for intra-Community supplies

Additional cost for VAT compliance for intra-Community supplies

Unlike for exports into non-EU countries, there is a requirement for intra-community supplies to submit recapitulative statements pursuant to Art. 262 Directive 2006/112/EC. This requirement results in additional cost for business engaged in cross-border supplies of goods within the EU, in particular when delivering to business doing mere domestic supplies.

While only few estimates of VAT compliance costs exist, these seem to be substantial. The German Federal Government has published a bulletin, which includes a summary of the 100 most costly reporting requirements. Four reporting requirements in the field of VAT are ranked among the top 10 of the most costly reporting requirements in Germany. Alone the requirement to submit recapitulative statements for German business engaged in cross-border supplies of goods within the EU adds up to 854 million euros compliance cost per year. Furthermore, German business engaged in cross-border supplies of goods within the EU have to spend additional 98 million euros a year to fulfil the INTRASTAT reporting requirements.

It is thus not surprising that almost 20% (9 out of 49) of companies surveyed have already refrained from intra-community supplies due to increased VAT compliance costs or know businesses that have done so. Among a smaller subset of respondents, 50% (11 out of 23) would be engaged to a larger extent into intra-community supplies if additional VAT compliance costs would be reimbursed or if the INTRASTAT returns would be abolished (13 out of 27).

Nearly one billion euros additional annual reporting costs in Germany alone is indicative of the obstacles business face when considering cross-border activity in the Internal Market. BUSINESSEUROPE acknowledges the need for reporting requirements in order to prevent and fight cross-border VAT fraud. However, Member States must unburden business from the cost of the additional reporting requirements for the cross-border supplies of goods within the EU to release the growth potential of the Internal Market.

The problems pointed out here will be enhanced once the new directive regarding the place of supply of services has come into effect in 2010, in particular in the context of the additional reporting requirements for services in the recapitulative statements (new Art. 262 (c) of Directive 2006/112/EC).

Proposal:

In order to further the Lisbon Strategy, the bureaucracy cost for the intra-Community supplies have to be reduced to the indispensable requirements. However, where such bureaucracy cost for intra-community supplies cannot be reduced, e.g. in order to tackle VAT fraud, there shall be a reimbursement of enterprises making cross-border supplies of goods within the EU for the cost of submitting recapitulative statements and INTRASTAT reports.

Enhanced obligations of evidence for the zero-rating (VAT exemption) of intra-Community supplies

Pursuant to Art. 131 of Directive 2006/112/EC, Member States may lay down conditions for the purpose of ensuring correct and straightforward application of the exemption for intra-Community supplies and of preventing any possible evasion, avoidance or abuse. As, according to Art. 138 paragraph 1 of Directive 2006/112/EC, the exemption for intra-Community supply of goods is only granted for the supply to another taxable person, Member States require an analysis of the nature of the customer by the supplier. Whereas some Member States are satisfied with a simple check of the VAT ID provided by the customer in the VIES-Database, other Member States require more qualified checks on the nature of the customer.

The VIES database itself is not completely accessible, not updated on a regular basis, can contain wrong information (e.g. in some cases, fraudsters are not eliminated from the database) and is thus unreliable:

In some Member States it takes a significant amount of time between the application of a business for a VAT ID and the entering of such VAT ID in the VIES-system by the tax authorities of the respective Member State. In Belgium, Spain and Germany it takes on average 2 months.

There are examples where a VAT ID is shown as incorrect in the VIES-system although the affected company has obtained a document from its competent tax authorities confirming the validity of the respective VAT ID. In Spain, some companies only have a “NIF-Number” used for domestic operations. This number is not mentioned in the VIES database. If this company, for its intra-community transactions only communicates its NIF number, it is impossible to check the accuracy of the number in the VIES-system. Another example is Poland, where companies not only require a VAT number but also a “EURONIP document “.

Given the fact that most Member States still link the VAT exemption of intra-Community supplies to the VAT ID of the customer shown in the VIES database, the supplier either runs into a risk of being charged with VAT on the intra-Community supplies and not being able to pass the VAT so charged to the customer or the customer runs into difficulties sourcing via VAT-exempt intra-Community supplies during the first phase of its business.

Under such circumstances, intra-Community supplies are discriminated against exports into non-EU countries, as the latter (with usually the same requirements for evidence of a physical dispatch of the goods to the customer) requires no evidence about the nature of the customer.

In this case, it is less risky for business to export into non-EU countries than to effect intra-Community supplies. This is confirmed by 50% of the respondents, while 45% consider the VAT compliance costs higher for securing a VAT exemption for supplies of goods within the EU than for exports to third countries.

Proposal:

The VIES system is an internal control mechanism for Member States to reconcile intra-Community deliveries with the respective acquisitions. It should not be used to deny VAT exemption for intra-Community supplies, provided that the supplier can demonstrate by other evidence that the goods have been dispatched to another Member State to a taxable person.
The following short term measures would significantly improve the situation for businesses engaged in intra-Community supplies:

-> *Full name and address(es) of the tax payer, whose VAT ID is checked, to be shown in the VIES database,*

-> *Standardisation binding all Member States of the required evidence for intra-Community supplies,*

-> *Cross-border VAT grouping of intra-Community supplies within a group of companies.*

Obstruction of deduction of input VAT

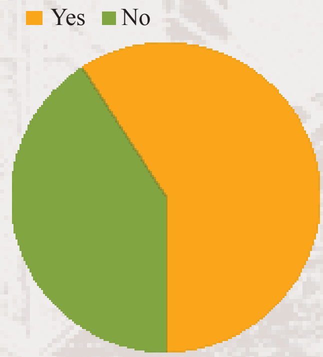
Businesses acting cross-border in the EU often face situations in which they either have an excess of input VAT over output VAT or in which the have to apply for VAT-refund under the 8th Directive (Directive 79/1072/EC) in a Member State where they are not registered for VAT purposes.

Domestic reimbursement of VAT

According to the survey, 40% of companies have faced a situation during the two last years in which a Member State in which their business is registered for VAT purposes has postponed a reimbursement of VAT by more than two taxable periods. This has occurred above all in Italy and Belgium but also in most other EU countries, particularly in Central and Eastern Europe.

Discrimination against local resident business with regard to the reimbursement of input VAT is less frequent though with only 9 out of 52 companies having faced such a situation in different countries (Belgium, Germany, France, Hungary, the Netherlands, Poland, Spain, UK). In practice, it seems however that tax inspectors are more relaxed on formalistic invoicing requirements when addressing resident business. In the Netherlands, overviews with details of sales and purchase invoices have to be sent with the VAT return for non-resident business and in the UK, a company faced difficulties obtaining an authorisation for electronic submission.

Delays of more than two taxable periods with regard to domestic reimbursement of input VAT in excess of output VAT during the last two years

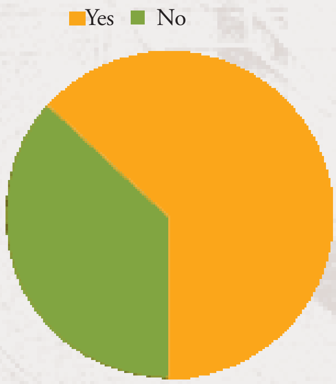


Reimbursement of VAT under the 8th Directive

This is an issue of particular concern which might be only partly addressed by the new Directive 2008/9/EC adopted on 12 February in the ECOFIN Council.

Indeed, 34 out of 54 companies face problems with the reimbursement of VAT (under the 8th Directive) in Member States where their business is not registered for VAT purposes. Many complaints relate to new Member States and in particular Poland, Hungary and the Czech Republic. But 'old' Member States also impose additional hurdles for foreign VAT refund, notably Italy, Spain, France and Germany. A still considerable 25% of respondents has already decided not to file a refund application and instead take the VAT as a cost. Indicative of the revenue loss is the answer by 15 companies that decide frequently not to file a refund application with an estimated resulting annual VAT cost of 42'100 euros on average (ranging between zero and 200'000 euros).

Problems with regard to **foreign** VAT refund
(e.g. in Member State where business is not VAT registered)



Excessive formal and procedural requirements create bureaucracy hurdles that are exploited to reject the refund. By way of example, it takes between 18 and 24 months to obtain a reimbursement of foreign VAT in some new Member States (in particular Poland) and in Spain. Other countries, such as Germany and the UK, reject all requests of reimbursement in case one single document is missing, not correctly filled out or submitted as duplicate when the original is required.

Among the main difficulties, companies face in this respect, are:

- The short deadline for remedies,
- The signature of a person who is officially assigned to represent the company for VAT purposes is often not accepted. In Germany, the signature of the CEO of the company is required.
- The requirement to send the original paper invoices and to store them afterwards.
- Additional documentation would have been required (e.g. contracts, sales orders).
- Some countries require proof of remittances/payment.
- Translation requirements both in terms of submission of claims and supporting documents.
- Refund forms are not easily accessible and/or only available against a fee.
- Discrepancies between requests by local and federal tax authorities.

Proposal:

Harmonise the rules and reduce red tape for obtaining a VAT refund, in particular with regard to application for reimbursement under the 8th VAT Directive. The new Directive 2008/9/EC deals sufficiently with some of the difficulties shown above. Yet unfortunately new bureaucratic hurdles for VAT refunds were set up in this Directive, which should be revised.

Distortions of the principle of neutrality of VAT by interests and penalties

Although interest and penalties levied on VAT might be an appropriate measure by the Member States to cope with VAT fraud, such levies do harm the principle of neutrality of VAT if they are applied on transactions between VAT persons, where no shortfall in VAT revenue has occurred to the respective Member State.

In businesses' day-to-day practice the following examples illustrate this:

- Invoicing of the standard instead of the reduced tax rate, although the receiver of the invoice was entitled to full input-VAT deduction and the supplier has paid the full amount of the VAT invoices to the tax authorities: Germany, Belgium, France, UK, Italy, Spain, Czech Republic.

- Invoicing of VAT on the transfer of a business is an ongoing concern, although the Member State has exercised the option under Art. 19 of Directive 2006/112/EC to treat this transaction as not taxable. However, the receiver of the invoice was entitled to full input-VAT deduction and the supplier has paid the full amount of the VAT invoices to the tax authorities: Germany.

- The invoice raised by the supplier did not fulfil all invoice requirements. However, the supplier issued a corrected invoice containing all requirements later. The receiver of the invoice was entitled to full input VAT deduction and the supplier has paid the full amount of the VAT invoices to the tax authorities: all Member States, particularly Germany, France.

- The invoice raised by the receiver under a self-billing arrangement did not fulfil all invoice requirements. However, the receiver later issued a corrected invoice containing all requirements under the self-billing arrangement. The receiver of the invoice was entitled to full input VAT deduction and the supplier has paid the full amount of the VAT invoices to the tax authorities: Germany, Italy.

- The receiver of goods or services reported VAT under the reverse-charge mechanism incorrectly. However, the receiver was entitled to full input VAT deduction; hence no shortfall of VAT revenue could ever occur: Belgium, Italy, France, Poland, with particular disproportionate penalties in Belgium and Italy.

Practical experience shows a tendency in most Member State to increase their revenue by imposing interests or penalties on VAT particularly in situations, where formal mistakes in invoicing occurred in transactions between VAT payers, yet no VAT revenue shortfall.

According to the survey, the most disproportionate penalties on formal mistakes without leading to a shortfall of VAT revenue of the respective Member State are imposed in Belgium, France, Italy and Poland. Belgium has introduced disproportionate and excessive joint and several liability rules up and down the supply chain based on a "you could/should have known".

The legal remedies provided for in the EU against such disproportionate penalties and interests on VAT have proven not to be sufficient in practice, in particular as it would take a very long time to get a respective judgement by a competent court.

Proposal:

There shall be a binding EU-wide legislation that Member States may only charge interest or penalties on VAT arisen from formal mistakes made by the taxable persons if the respective Member States proves that he has suffered a shortfall in VAT revenue.

Conclusion

Based on a survey of 56 EU companies from 12 European countries, this report described how the EU's VAT set-up deters business from cross-border transactions and/or forces them to organise their business structure in a non-efficient way. To remove VAT obstacles, BUSINESSEUROPE asks the Commission and Member States to consider the following proposals:

- Reduction of the options for derogations granted to Member States;
- Creation of a central organ at EU level to provide guidelines for uniform application of Directive 2006/112/EC on request by taxable persons;
- Reduction of the bureaucratic cost for intra-community supplies to the indispensable minimum;
- Harmonisation and simplification of the rules as well as acceleration of the procedures for obtaining input VAT deductions or refunds;
- Removal of interest and penalties on VAT if the Member State in question has not suffered any shortfall in VAT revenue.

If these measures can be implemented, a significant step towards the Internal, or better the Single Market in the EU for the benefit of all stakeholders and, in particular SMEs, will have been made.