



20 October 2009

### **A partnership for a fair and efficient VAT system**

CONTRIBUTION TO THE 2010 REVISION OF THE EU'S VAT STRATEGY

#### **Executive Summary**

In view of major resource and cost constraints, VAT is a huge burden for companies and tax administrations alike. The complexity of handling VAT makes it one of the most costly administrative burdens for companies, accounting for almost two thirds of the total burdens covered by the EU's better regulation agenda and a yearly cost of € 70 billion.<sup>1</sup>

Over the last years, it has become less burdensome to do business with non-EU countries than within the Single Market. Formalities, technicalities and bureaucracy have taken precedence over proportionality and ease of administration. The only ones benefiting from increased complexity are fraudsters. This situation is unacceptable for businesses, tax administrations and society at large.

#### **Companies and tax administrations share the same objectives:**

- (1) safeguarding revenues;
- (2) easing compliance – reduce bureaucracy and compliance costs;
- (3) prosecuting fraudsters and awarding compliant businesses with less frequent and better targeted controls and a fair penalty system for genuine mistakes.

We will only successfully resolve these challenges if we actively work together. A real partnership between the European Commission, Member States and businesses is required to improve this untenable situation.

Rather than venturing into a fundamental revision of the VAT system, its European dimension must be strengthened based on best practices in the administration of VAT. The business community asks for a **thorough overhaul of the administrative framework to drive efficiency and fairness** in the EU VAT system.

Efficiency and fairness need to be built on the golden principles inherent to the VAT system (neutrality, proportionality, legal certainty, ease of administration) and by focusing on the following aspects from both a business and tax administration perspective:

- (1) Trust, transparency and partnership;
- (2) Technology and risk management/assessment processes;
- (3) Tax policy based on and driven by the practical needs/challenges for both sides.

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<sup>1</sup> Opinion of the High Level Group on Priority Area Taxation (VAT), 28/05/2009



A fair and efficient VAT system would lead to a reduction of VAT-related costs, freeing funds for investments, the creation of new jobs, an increase in intra-EU trade and thus economic growth. This would be a stepping stone towards reaching the Lisbon objectives and give a boost to the competitiveness of European companies and the EU economy as a whole in difficult economic times.

At the same time it would allow a targeted and more effective fight against fraudsters, through the tax administration's ability to act quickly and accurately by freeing up human and technical resources and allocating them to those areas where fraud occurs.

This is why BUSINESSEUROPE would like to contribute to DG TAXUD's work on a new VAT strategy for 2010 with **the following proposals**:

- Create a **VAT Forum** for regular exchange between the Commission, tax administrations and business.
- Foster the **VAT partnership** between tax administrations and business through trust and transparency, as business is a crucial and integral part of collecting VAT.
- Look together into **technology options and risk management/assessment processes** which facilitate VAT management and render it more efficient.
- Create fairness - **treat VAT as a tax on consumption and not on business** and abolish interest and penalties levied in cases where no shortfall in VAT revenue occurs (nil net loss situation).
- Create the **Single European VAT Area** – enhance administrative efficiency and simplify and align regulations across the EU.

The above steps are inexpensive – trust can be built not bought – and hence should not overburden the public purse but are likely to generate significant additional revenue. European businesses advocate fundamental changes to the administration and management of VAT but not to the foundations of the VAT system itself.

As we have common objectives and common constraints, European businesses call for establishment of a partnership for a fair and efficient VAT system. There is a lot to be gained through this approach both for tax administrations and business but also for society generally.



## 1. Introduction

VAT is a main source of revenue for European governments and likely to increase in importance over the coming years.

The revenue must be safeguarded and every attempt to defraud the system punished. VAT fraud is a criminal act with destructive consequences to the functioning of our economy and modern welfare states.

The problem we face today is that the European VAT system - which leaves administrative aspects fully in the hands of Member States - does not fit the reality of a deeply integrated internal market. As a result, we see:

- **A lack of administrative cooperation:** A recent Commission study illustrates that Member States do not sufficiently work together collect VAT and to fight VAT fraud.<sup>2</sup>
- **Complex but ineffective administrative requirements:** Multiplying reporting requirements is not a solution against fraud<sup>3</sup>. In addition, we see great variations across EU Member States. This creates loopholes for fraudsters while imposing excessive compliance costs on companies. VAT accounts for € 70 billion or **68%** of total administrative burdens measured through the better regulation initiative.<sup>4</sup>
- **Financial sanctions for formal mistakes:** The use of disproportional penalties for formal mistakes (invoicing or reporting) increases the financial risks associated with running a business, in particular in a cross-border context. Often such financial sanctions are imposed in cases where no shortfall of VAT revenue for the Member States occurs. As a result, tax compliance is one of the key obstacles to the internationalisation and growth of SMEs in the EU.<sup>5</sup>

From a business perspective, the current VAT system is making the internal market a less attractive place to invest. Businesses report that **trade with non-EU partners is becoming increasingly more interesting than trade with EU partners** as a result of the costs and legal risks associated with VAT compliance.

VAT is the most significant bureaucratic burden in the EU. This means less money to invest in innovation and negative repercussions on European competitiveness. We consider that formalities and technicalities have taken precedence over proportionality and ease of administration. In practice, companies find it impossible to be fully compliant.

The business community is ready to pro-actively help safeguarding VAT revenues. In return, we expect tax administrations to give us the tools to effectively fulfil our obligations by enhancing administrative efficiency, simplifying and aligning legislation.

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<sup>2</sup> Report from the Commission on the use of the provisions on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures in 2005-2008, 18/08/2009

<sup>3</sup> The September 2009 Lucerne [Declaration](http://www.oecd.org/dataoecd/19/12/43669264.pdf) by senior OECD tax policy officials notes that “complexity can lead to poorer compliance”. <http://www.oecd.org/dataoecd/19/12/43669264.pdf>

<sup>4</sup> Opinion of the High Level Group on Priority Area Taxation (VAT), 28/05/2009

<sup>5</sup> BUSINESSEUROPE SME Report ‘Thinking Big’, 21/11/2007



## 2. A European approach to VAT administration/tackling fraud

VAT legislation in the EU is difficult<sup>6</sup>. Compromises in the Council often hamper or even reverse the initial intention of reducing the burden of EU legislation (e.g. VAT Package or the current Council discussions on the revision of e-invoicing rules). In addition, legislation is implemented in 27 different ways, creating legal uncertainty for cross-border trade and making compliance ever more difficult. This piecemeal approach increases bureaucracy in business life.

As a result, legal uncertainty prevails in business transactions and there is little scope for an upfront discussion with tax authorities in certain EU countries to address this problem.

The current problems go back to the 6<sup>th</sup> Directive 1977, which implemented a VAT system that is still very national and is not adapted to the needs of the Internal Market and the internationalisation of trade and services. The Common VAT System Directive (Directive 2006/112/EC) is as a mere “recast” of the 6<sup>th</sup> Directive and perpetuates the situation. Amendments made to the VAT system are piecemeal and they lack a systematic approach to reduce burden and tackle fraud.

The resulting complexity fosters VAT fraud, since complexity is always a breeding ground for fraud. The inertia of some tax authorities and time-consuming procedures give fraudsters a head start. If governments suffer a loss of VAT revenue due to fraud, they try to collect the VAT from legitimate businesses. This explains the Kafkaesque system of formalistic approaches, sanctions<sup>7</sup>, joint & several liability and other mechanisms that are currently being developed and which increase the risks associated with running a legitimate business:

Business wants to help fight fraud but cannot accept that the risk and burden of revenue loss is shifted on to legitimate businesses. Outsourcing of control obligations and financial risks to business is damaging for economic growth. Member States increasingly tend to shift VAT risks to honest taxpayers with a view to closing budget gaps. Penalties and interest are used for the purposes of raising revenue where VAT revenues cannot be raised rather than for purposes of deterrence. In our view “the punishment should fit the crime”. This means:

- no sanctions for purely formalistic errors
- sanctions should be calculated on net loss and proportional based on the gravity of a mistake.
- no sanctions in a nil net situation, e.g. no VAT revenue loss occurs to the Member States based on the whole underlying transaction (i.e. seller and buyer)

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<sup>6</sup> A recent [report](http://www.gao.gov/new.items/d08566.pdf) by the US government on VAT administration in different countries finds that even simple VAT rules creates costs and risks for businesses. This is even more pronounced in the context of the Single EU market where businesses have to comply with 27 different administrative regimes in practice <http://www.gao.gov/new.items/d08566.pdf> , April 2008.

<sup>7</sup> The Lucerne Declaration (see footnote 2) asks policy-makers to “encourage tax administrations to ensure that penalties for genuine mistakes made by business have regard to the net amount of revenue lost”.



We believe that business and tax administrations share common objectives. The current system is tough to operate for both as it is complex and does not give certainty to either party. This complexity and insufficient harmonisation makes the VAT system prone to fraud. But the situation can be improved and this improvement will lead to economic growth and more tax income for governments.

To effectively address loopholes that can be used by fraudsters, we need:

- (1) an easy and efficient system which reflects the fact that
- (2) VAT is a consumption tax and not a tax on business, and therefore we need
- (3) a real partnership between EU, Member States and European business
- (4) which reduces the exceptional attractiveness of the EU VAT system for fraudsters and reduces bureaucracy for legitimate businesses which want to be fully VAT-compliant.

### 3. What should be done?

A compliance-friendly and efficient VAT system is the only way to reduce bureaucratic burden for both business and government. This cannot wait, albeit some measures will take more time to be implemented. Therefore, we ask for a two-step approach combining shorter-term objectives with longer-term target.

The following non-exhaustive list of proposals should enter into effect **no later than 2013**:

1. **VAT Forum:** Structured EU-level dialogue between business, Commission and Member States. The aim is to foster dialogue between business and tax administrations about the tax system, differences in the set-up across the EU and practical impact on commercial transactions. Moreover, this could be used to improve the understanding by tax authorities of business processes and needs.
2. **Partnership:** between tax administrations and business community to ensure that new legislation hits the fraudsters and not honest businesses and to reduce the compliance burden on honest business (targeted audits, better risk management, etc.). We would like to see an EU-wide partnership develop. Good examples are the Dutch and UK approach.
3. **Risk assessment:** make use of modern technology to develop VAT risk profiles. Business considered at low risk should receive less administrative obligations. This could also be linked to the level of business-internal control/risk assessment mechanisms – build external controls on internal controls.
4. **Better regulation:** the proposals for reducing red tape in the area of VAT by the High-Level Group should be implemented rapidly and not be diluted in the legislative process. Fast-track approach is of key importance here, also as a recovery measure to exit the current crisis. Examples here are deregulation of e-invoicing, reporting, evidence/documentation, VAT refunds, efficient audits, etc.



5. **Notification of national transposition of VAT law to European Commission and ex-ante evaluation** based on criteria of efficiency/simplification.
6. **Set incentives to governments:** Defining a conceptually efficient VAT system as benchmark for VAT burden to be borne by business – business to be reimbursed for additional complexity – “**simplify or reimburse**”. Moreover, the introduction of a “VAT performance index” would peer-pressure governments in streamlining and simplifying VAT similar to Customs where an international “logistics performance index” measures the logistics friendliness of countries.
7. **“Break the chain”:** Provide business with the right tools to help detect fraudulent transactions involving legitimate business: Make VIES more up-to-date and extend VIES with more information such as name, address, start and end date of a VAT number and even an indication for the risk assessment of this taxable person by the tax authorities of its home Member State - if business “should have known”, member states must provide the tools to be able to know.
8. **Real-time online information system:** giving VAT rates and exemptions for all Member States which business can rely on without checking or getting advice would reduce risk of penalty. Member States would be responsible for updating the system and compliance would be solely assessed vis-à-vis information contained therein.
9. **Simplify Intrastat reporting:** by reporting the intra-Community supply of goods and services for VAT purposes (EC sales listing) and with the dispatching Member State passing on the data collected to the receiving Member State, the question arises about the need and use of Intrastat reporting in practice. While not technically a VAT matter, Intrastat reporting is usually an integral part of indirect tax functions and represents a major compliance burden.
10. **Stakeholder consultation:** The e-commerce Directive is a good example for efficient VAT legislation as stakeholders were consulted **throughout** the legislation process. The implementation of the VAT Package is an example of how not to proceed, as stakeholder opinions have not or insufficiently been taken into account. Here, Member States have missed a major opportunity for simplification of cross-border VAT. We ask for consistent and timely interaction with stakeholders.
11. **Documentation/Evidence:** Invoices are only one document in a set of documents that prove that a transaction has taken place. Formally incorrect invoices should entitle to VAT deduction if alternative evidence that the transaction took place is available, e.g. transport documents, purchase order, contract, etc<sup>8</sup>. Tax payers should be entitled to exercise the right to deduct input VAT in the tax period associated with the underlying transaction also when they are not in possession of a correct invoice and receive a corrected invoice only at a later point of time.

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<sup>8</sup> See latest developments in Switzerland.



12. **EU rules on proportional penalties:** Ensure proportionality of penalties/interest through EU-wide regulation, including the empowerment of the ECJ for judicial control.
13. **Online advance ruling system on place of supply** for intra-EU supplies to prevent double or non-taxation or to ensure legal certainty. In this respect: In France, for instance, there is a procedure by which businesses can notify its uncertainty about a VAT treatment applied to the authorities in its VAT return. Then the French authorities cannot impose penalties anymore if the VAT treatment applied was wrong. Moreover, they have only a couple of months to comment on or even reject the VAT treatment applied. Very effective for important or recurring transactions that cannot wait on the tax authorities' final opinion.

The following inter-dependent proposals should enter into effect **no later than 2020**:

14. **One-stop shop: a unique form for reporting of EU-wide VAT (“one form for all”):** a unique VAT number, a common VAT return form with same boxes in which all countries can be reported at once, one listing for all sales.
15. **Reduce the risk of fraud by reducing vulnerability of VAT system to certain forms of fraud.** The margin of the VAT fraudsters stem from a system, in which they can buy free of VAT and sell with VAT. Instead of impeding the input VAT deduction – the core element of a VAT system – the European policy-maker should focus on implementing a system less vulnerable to VAT fraud.
16. **Single European VAT Area:** Enhance administrative efficiency and further simplify and align the VAT rules across the EU, both the material and the formal ones. This implies the reconsideration of the subsidiarity principle in VAT. This also implies the further elimination of options for Member States. Ultimately, this leads to the introduction of a common VAT regulation like in the area of customs, as well as one VAT single area.

#### 4. Who should do what?

**The European Commission should:**

- come up with a new VAT strategy which fosters a partnership approach for a fair and efficient VAT system, striking the right balance between safeguarding the VAT revenues on the one side and making it proportionate and more simple for businesses to comply with the VAT regulations in practice and for Member States to efficiently execute their control function in practice.
- facilitate the establishment of a standing VAT Forum at EU level composed of representatives from national tax authorities, VAT experts from smaller and larger business and European Commission representatives, which should work on making the current EU VAT system fairer and more efficient for businesses and tax administrations.



- propose in the short term a revision of the VAT directive with a view to simplifying administrative obligations, to achieve uniform application of VAT rules and to restrict options for national law to deviate from the standard rules. The report of the High Level Group has highlighted areas of simplification (e.g. e-invoicing, reporting, documentation/evidence, VAT refunds, efficient audits, etc.).
- enhance the VAT directive by a VAT regulation with a view to increase legal certainty and reduce the scope for differentiated implementation of VAT rules across the EU.

**National tax authorities should:**

- adopt this partnership approach and actively work on making the current EU VAT system fairer and more efficient through an appropriate allocation of human and technical resources.
- respect the fundamental idea that VAT is a tax on final consumption and must be neutral for business. Penalties and interests must be proportional and business-related input VAT must be deductible. Businesses need to be treated as partners in practice.
- consider and speedily implement the simplification aspects highlighted in the High Level Group report (e.g. e-invoicing, reporting, documentation/evidence, VAT refunds, efficient audits, etc.)
- act in a spirit of mutual trust and cooperation with other Member States in administrating and recovering VAT, instead of shifting the administrative burden and risk of revenue loss on to legitimate economic operators.

**Businesses in Europe should:**

- be a pro-active partner of tax authorities in the administration and collection of VAT (“VAT partnership”) based on the common objective to safeguard revenues. This would be based on an internal risk management process which allows both sides a more efficient use of their human and technical resources.
- be a reliable partner in the work that needs to be undertaken to make the current EU VAT system fairer and more efficient.