

28<sup>th</sup> March 2017

## Generalised Reverse Charge Mechanism

### KEY MESSAGES

- 1** BusinessEurope fully endorses the fight against VAT-fraud. VAT fraud has a negative impact on government revenues, is a threat to the internal market, and harms legitimate business. BusinessEurope continues to be of the opinion that the best way to reduce VAT fraud is through enhancing administrative cooperation, collectively improving the performance of European tax administrations, ultimately within the framework of the definite regime.
- 2** A reverse charge should be explored as one of the options in designing the definite regime, but BusinessEurope does not support a fragmented approach. The Generalised Reverse Charge Mechanism (GRCM) proposal would be a significant departure from the fundamental principle of fractional payment and has the potential to create internal market distortions without ensuring that the GRCM can deliver a genuine absolute reduction in VAT fraud in the EU at an acceptable cost, rather than merely an expensive redistribution of fraud through the supply chain or across multiple Member States increasing administrative burden and cost for both legitimate businesses and tax authorities. If the proposal is adopted, it is of vital importance that the European Commission operates pro-actively and withdraws the GRCM the moment significant negative effects to the Single Market arise.
- 3** It is of particular importance that neither this GRCM nor any other similar temporary measure should impose disproportionate compliance costs on affected taxable persons. The significant increase in administrative burden, as discussed in the Commission's own impact assessment, is alarming. Not only will the proposed reporting scheme in itself constitute an administrative burden, but also the relatively short lifespan of the GRCM and the issue of running parallel systems will further add to this. Therefore, further clarity on the likely reporting and compliance requirements is needed and the Commission should make sure that Member States implement this proposal in a consistent and harmonised way.



## WHAT DOES BUSINESSEUROPE AIM FOR?

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- BusinessEurope supports the on-going battle against VAT-fraud.
- BusinessEurope believes more harmonisation of VAT-rules are needed to ensure certainty and consistency for businesses across the EU but the introduction of the proposed GRCM would further fragment VAT-obligations in the Single Market and may create internal market distortions.



## **A generalised reverse charge mechanism (GRCM)**

VAT fraud was an area identified in the Action Plan for VAT as requiring urgent measures pending the implementation of the definitive VAT system. BusinessEurope supports the European Commission in its fight against VAT-fraud, as this has a negative impact on government revenues, is a threat to the internal market and harms legitimate businesses who do pay their VAT in full. In response to a request from certain Member States seeking a way to tackle significant carousel fraud, the Commission agreed to consider a proposal for a Generalised Reverse Charge Mechanism (GRCM). The proposal permits a Member State to apply for GRCM as a derogation from Article 193, subject to the Member State meeting qualifying criteria regarding the size and nature of the VAT Gap, and establishing that other control measures are “insufficient”. It allows a neighbouring country of a GRCM country to apply a GRCM as well on the grounds that it is at serious risk of VAT fraud as a result of the neighbouring GRCM regime. Countries that want to use the GRCM should establish suitable electronic reporting obligations, and should report on the GRCM’s effectiveness to the Commission. In addition, countries who do not operate GRCM, should report on the impact as well. The proposal also consists of a ‘sunset clause’ which makes clear that all derogations will cease at 30/9/2022.

### **The risk of B2B fraud shifting within the internal market**

- We support to further explore the generalised nature of the proposals. This would make the GRCM not limited to specific sectors or products, which removes the option of VAT fraud simply switching to a different business sector in that Member State. In addition, the possibility of fraudsters moving their operations to other Member States is provided for by allowing physically adjacent Member States to adopt a GRCM themselves if they establish a “serious risk” of contamination from their GRCM neighbour. There are, however, elements of these control measures that are insufficient. According to the proposal, a Member State which wishes to introduce the GRCM must establish to the Commission’s satisfaction “that other control measures are not sufficient to combat carousel fraud on its territory”. It is unclear to what ‘other control measures’ refers to and whether each Member State is expected to have exhausted all these measures, given the differences in technical capability and control resources across the Member States. All of this has to be further explored in detail and considered carefully in order to prevent VAT fraud moving across to other Member States.
- Under Article 199c.2, a Member State sharing a common border with a Member State operating the GRCM may itself apply to introduce the GRCM. In addition to the “other control measures” insufficiency test referred to above, such a Member State is only required to establish “that a serious risk of shift of fraud towards its territory exists because of the authorisation of the GRCM” to its neighbour. It is not clear what constitutes such a “serious risk”, or what is required to establish its existence. Contemporary VAT fraud is becoming more and more international and sophisticated. Therefore, it does not seem logical to restrict the measure under Article 199c.2 only to Member States sharing a common border. We



propose to extend it to all Member States regardless of physical proximity. Such an approach would also be fairer to island Member States, or those with only one EU neighbour. For example, under the current wording, Malta or Cyprus would have no opportunity to apply for GRCM under 199c.2. This does not seem logical or fair.

- BusinessEurope supports the principles in the proposed Article 199c (6) that ensures the possibility to repeal all implementing decisions in case of considerable negative impact on the internal market. BusinessEurope finds it important that a measure is built in that ensures that a single member state cannot hinder a repeal in case of considerable negative impact on the internal market

### **Risk of B2C fraud increasing**

- It is clear that the Commission's proposal for a GRCM is a significant departure from the fundamental principle of fractional payment, with potentially problematic consequences. One key consequence is the transfer of fractional risk from a B2B supply chain to a concentrated risk in B2C. The Impact Assessment concluded that whilst there was likely to be an increase in retail fraud activity as a consequence of the GRCM, it would only develop over a longer period, probably coincidental with the ultimate implementation of the definitive system. This conclusion seems to be somewhat optimistic, given the operational agility of the fraudsters concerned based on previous experience with specific sector and product based reverse charge mechanisms.

### **Risk of VAT number hijacking will increase**

- A GRCM objectively multiplies the transactions where VAT number hijacking is a fraud opportunity. It will take more effort for bona fide suppliers, especially SMEs, to check and document whether a business client is really owner of the VAT number he gives. It can be questioned if VIES does not need upgrading to help bona fide suppliers defending themselves against fraudsters under a GRCM. Optional connection of VAT numbers with bank accounts might have to be considered again.

### **Risk of increased compliance costs**

- It is essential that any measure to fight VAT-fraud should not place any more compliance burden on taxable persons than is strictly necessary to ensure its effective operation. Given the planned relatively short life span of this measure, businesses should not have to incur significant costs (systems and otherwise) to comply with reporting on evidential requirements. This is particularly so given the possibility for the derogations to be withdrawn rapidly in the event that "considerable negative impact" on the internal market is established. The Commission should require any Member States wishing to operate the GRCM to adopt a harmonised approach to reporting formats and evidential requirements and the Commission should assess whether the implementation by each Member State is identical. These standard reporting requirements should also be kept to



a minimum and could be set out in an implementing regulation in order to drive consistency.

- Article 199c.3 states only that “Member States that apply the GRCM shall establish appropriate and effective electronic reporting obligations on all taxable persons and, in particular, on taxable persons who supply or receive the goods or services to which this mechanism applies”. What might be considered “appropriate and effective” is not defined. Similarly, paragraph 7 of the preamble to the proposed Directive states only that “Member States choosing to apply the GRCM should introduce specific electronic reporting obligations on taxable persons so as to ensure the effective functioning and monitoring of the application of the GRCM. They should detect and prevent all new forms of tax fraud.” The Directive should be amended to stress the objective of minimising additional compliance costs.
- The proposal is silent on the important issue regarding the responsibility to pay the tax. Given the anticipated – and very burdensome - reporting framework, BusinessEurope strongly believes that the responsibility to pay the tax clearly is with the customer, if the customer provides a valid VAT-number. It is fair to expect that Member States applying a GRMC and asking for increased reporting also have to make use of this reporting in order to monitor the risks and perform adequate risk-based audits. Any other conclusion will further increase the administrative burdens and the risks for businesses.
- In this regard the section 6.2 (“Impact on compliance costs to business”) of the Impact Assessment is troubling. “The same impacts as those pointed out under option 2b are expected, i.e. new reporting obligations leading to set-up costs (and costs to revert back to the normal VAT system), increase in compliance costs to businesses. Since the GRCM might be implemented in more than two Member States, the probability that a business will be active in these additional Member States would be higher. This would mean complying with more numerous specific (and probably different) obligations in the Member States.”
- In a best-case scenario, in the same way as under option 2b, the smallest businesses may not be impacted by the changes in the short term, and increase in compliance costs to businesses may also be limited in Member States having already requested to apply the GRCM). However, in the medium term, an increase in compliance costs (approaching 43%) to businesses active in other Member States (those that would have introduced the GRCM because of fraud shifting to their Member State) is more than likely. Indeed, these other Member States could be forced to apply the GRCM although no such specific reporting obligations as those already implemented in the initial Member States exist. However, large set up costs would in any case be incurred twice by all businesses of all Member States applying the GRCM or been active in such Member States. These businesses would also need to manage two parallel systems (above and under the threshold). In a worst-case scenario, the increase in compliance costs in the other Member States (others than those having "initially" implemented the GRCM) happens already in the short term leading to a possible more chaotic and therefore costly implementation.



- The proposal does not address the appropriate lead-time to implement the changes. Introducing a GRMC-system will require businesses to change their systems. This is not only costly, but requires adequate time. BusinessEurope therefore believes that a minimum lead time (6 months) to accommodate for the change in systems for businesses needs to be part of the proposal.

### **SME considerations**

- The Impact Assessment states that the cost to businesses of complying with VAT obligations is substantial according to most studies and varies substantially across countries. Because much of the cost of complying with VAT is fixed (i.e. incurred regardless of the level of sales), compliance costs are relatively more burdensome for small businesses: compliance costs could represent 3.9% of turnover for unincorporated businesses but only 1.5% of turnover for firms with more than six employees. Compliance costs are also particularly high for cross-border trade. VAT obligations are 11% higher than the VAT compliance costs associated with domestic trade. BusinessEurope believes this warrants concerns, especially since the proposal will increase the fixed compliance costs.
- BusinessEurope is also concerned about the impact on the average SME cash flow. According to the Impact Assessment, businesses in the Member States applying the GRMC will have a different cash-flow situation compared to businesses in the other Member States. The cash flow impact will however depend on the business-model of the enterprise and will be influenced by the import/export situation of the company as well as payment lead times toward both suppliers and customers. Based on case-studies in the Impact Assessment, the average cash flow impact for SMEs is expected to be negative.

### **Other considerations**

- In addition to addressing the immediate fraud issue, the GRMC could also effectively provide a pilot opportunity to study the impact of reverse charging on a wider scale than previously, across all business sectors rather than a few selected sectors or products. This would enable a better-informed assessment of the merits of reverse charging as a component of the definitive VAT system.
- BusinessEurope reminds the Commission that article 167 of the Directive, imposes that the timing when VAT becomes due and when it can be deducted, are synchronized. Corrections with reverse charge invoices should therefore not lead to interest bearing tax arrears if VAT is fully deductible.
- In view of the fight against fraud, BusinessEurope is looking forward to the proposals for a Transaction Network Analysis (TNA) as agreed upon in the Ecofin Council on 25<sup>th</sup> May 2016. BusinessEurope strongly supports this IT fraud analysis instrument which creates the possibility to use information on transactions available in the Member States in a more effective way. By using the tool international fraud networks can be identified faster and more complete. BusinessEurope supports the goal oriented approach of the TNA. An EU-wide



implementation of this IT-tool could reduce the increasing number of different national anti-fraud measures, which often cause needless substantial extra costs for legitimate businesses.