



11 October 2007

## **COMMENTS ON VAT FRAUD AND THE VAT PACKAGE**

RESPONSE TO ECONOMIC AND FINANCIAL AFFAIRS COUNCIL MEETING ON 5 JUNE 2007

### **Summary**

- BUSINESSEUROPE is pleased to learn that the Council agrees in principle with the place of supply rules for services in the B2B environment.
- If the B2C item is too difficult to solve in the near future, the VAT package should be split again into separate items so that the place of supply rule for B2B services can be adopted without further delay.
- BUSINESSEUROPE fully endorses the fight against VAT fraud, but insists that the principles of legal certainty, proportionality and fiscal neutrality must be respected.
- Missing-trader fraud and carousel fraud are not new types of fraud but are now committed in very sophisticated ways which results in a higher revenue loss.
- The European Union needs a well developed and coordinated strategy to fight VAT fraud. Adequate resources for tax administrations and international cooperation are indispensable to ensure efficient control of cross-border VAT fraud.
- Tax loss and tax risk should not be borne by legitimate businesses acting in good faith. Member States must interpret ECJ decisions in a uniform manner.
- BUSINESSEUROPE is strongly against reporting at invoice level because this will lead to an enormous increase of administrative burden. The added value of reporting at invoice level is very limited and may be counterproductive.
- A general reverse charge mechanism represents a fundamental change to the VAT system and should be evaluated with great care. Given the information available at this point, an optional reverse charge system does not seem likely to be an effective measure to combat VAT fraud.
- BUSINESSEUROPE insists that joint and several liability rules should be specific and targeted to combat fraudsters. If a joint and several liability scheme is deemed necessary, there have to be “safe harbour rules” for legitimate businesses. Mistakes in reporting and or invoicing must not automatically lead to a liability for legitimate businesses as this is not proportional and thus not compatible with ECJ rulings.
- To tackle fraud, tax cooperation as well as the way existing information is used have to be improved, e.g. the VIES has to be improved for business. In addition, more attention should be given to prevention of VAT fraud (e.g. through better checks on new VAT payers, destruction of old VAT numbers, etc.).
- BUSINESSEUROPE thinks that a good way forward is a reporting (and audit) system based on efficient risk management.
- Finally, uniform implementation of “lighter obligations” for “authorised companies” across the EU similar to AEO in customs could be envisaged, once this system has proved itself in practice.



## **1 Introduction**

During the 2804<sup>th</sup> Council meeting on Economic and Financial Affairs on 5 June 2007 (hereinafter ECOFIN), some very important VAT subjects were on the agenda, namely the VAT package and combating tax fraud.

BUSINESSEUROPE welcomes the progress achieved on the VAT package and supports the development of a coordinated strategy to improve the fight against tax fraud. However, BUSINESSEUROPE considers that the adoption of the VAT package should not be further slowed down by the place of supply rules for services to non-taxable persons (B2C). Also, the short timeframe provided to the Commission to analyse the impact of substantial changes to the VAT system, which could result in a significant increase of burdens for business and risk to be ineffective in the fight against tax fraud, is of concern to the business community.

BUSINESSEUROPE refers to its published position papers dated October 2006 and March 2007 on tax/VAT fraud. Tax/VAT fraud is an unacceptable society issue that should be combated with determination. Tax/VAT fraud leads to distortions of competition between legitimate businesses and those which do not pay taxes.

It should be stressed that the VAT package and combating tax fraud are two separate issues. While the VAT package is about simplifying the operation of the current system for legitimate businesses, the tax fraud element is about fighting abuses of the current VAT system. This needs to be carefully considered, as otherwise, there is a substantial risk that the purpose of the VAT package - simplification for legitimate businesses – will be tainted and its goals will not be achieved. Simplification measures for legitimate businesses need to be looked at separately from measures against TAX fraud, whose purpose it is to catch the fraudsters. Legitimate businesses should be treated as partners not as fraudsters.

## **2 The VAT package**

The VAT package contains a set of measures with the aim of simplifying the VAT system for business with no establishment in the Member State where they are carrying out the activity through six concrete measures:

- introduction of the one-stop scheme (mini OSS) for non-established taxable persons;
- introduction of a OSS to modernise the eighth directive refund procedure;
- harmonisation of the scope of the goods and services for which Member States may apply restrictions on the right to deduct;
- extension of the use of the reverse charge mechanism for certain business-to-business (B2B) transactions carried out by non-established taxable persons;
- review of the special scheme for small traders;
- simplification of the distance selling arrangements.

The ECOFIN reached political agreement on the VAT package elements related to:

- place of supply rules for services, for B2B as well as B2C;
- mini OSS;
- directive on refund;
- administrative cooperation elements.



BUSINESSEUROPE is pleased to learn that the Council in principle agrees upon the place of supply rules for services in the B2B environment. The proposed mechanism is a very good instrument to decrease the administrative burden for business, to decrease the costs of foreign VAT and to facilitate growth within the European Union.

BUSINESSEUROPE is of the opinion that a listing of services is not necessary. The past has shown that there is no point in listing the services as mentioned under article 56 of the VAT directive (old art 9-2-e of the sixth directive). Also, implementing a sales listing for services would be against the objective of simplification, as the creation of an additional burden leads to the fair question of whether any real simplification has been achieved.

However, the ECOFIN concludes that for the place of supply rules for services in the B2C environment further discussion is necessary. The result of this is that the VAT package as such could not be adopted.

It is known that the European VAT system is in dire need of simplification. BUSINESSEUROPE would like to stress that, as mentioned above, the proposed place of supply rules for services in the B2B environment is a very good system. We therefore ask Member States to try to solve the issues in the B2C area as soon as possible so that the VAT package can be adopted. If the B2C item is too difficult to solve in the near future, we consider that the VAT package should be split again into separate items. This would imply that B2B would be separated from B2C and the OSS and the refund directive for a Council decision. As a consequence, the place of supply rule for B2B services could be adopted without further delay and the European Union would make some useful progress in the area of VAT.

### **3 Tax/VAT fraud**

During the last ECOFIN meeting, it was agreed that the European Commission would be invited to come forward with the necessary legislative proposals (including an impact assessment) by the end of 2007 regarding the following subjects:

- change from a quarterly listing obligation to a monthly listing obligation;
- increase the speed of sharing the gathered information;
- examine joint and several liability;
- improve confirmation messages and information to operators (improve the VIES).

Furthermore, the European Commission was invited to examine all measures to combat fraud proposals by Member States and to submit a report in the second half of 2007.

Besides this, the European Commission was invited to analyse the effects of an optional general reverse charge and to submit a report in the second half of 2007. The analysis has to address effects on the budgets of Member States, the coherence and harmonisation of VAT law in the EU, the cost for taxpayers and authorities, the possible migration of VAT fraud, the risk of new tax/VAT fraud and the possibility of running a pilot.



Some of these subjects, e.g. the reverse charge mechanism and reporting on invoice level, link into the fundamentals of the VAT system. BUSINESSEUROPE wants to stress that the next steps and any further decisions should be based upon a thorough study that has looked at all related issues. Furthermore, next steps and decisions should be well balanced and take possible future developments into account.

### **3.1 Tax fraud in general**

BUSINESSEUROPE acknowledges that there is revenue loss. However not all loss of revenue is a consequence of VAT/tax fraud. Insolvencies often lead to loss of revenue but are in most cases not caused by fraud but by an unfortunate setback in the business. BUSINESSEUROPE is of the opinion that the Commission should focus on “real fraud“ like missing trader fraud, black economy and carousel fraud.

Missing trader fraud and carousel fraud have already existed for several decennia. Missing trader fraud happens quite a lot in the construction and clothing industry. VAT is charged and collected but not paid to the authorities. This is an old type of fraud. The same applies for carousel fraud. In the past (before 1993) goods were in theory exported but in real life sold on the EU market. Neither type of fraud is new. What is new is that these types of fraud are now committed in a very structured and professional way. The structured and sophisticated approach results in the increase of revenue loss.

It should also be noted that when VAT fraud occurs it is often linked to other types of fraud (e.g. social security fraud, customs fraud, direct tax fraud, food safety rules violations, money laundering, etc.). It would therefore be advisable to put in place a general combat plan to tackle fraud.

Finally, BUSINESSEUROPE emphasises that the existence of cross-border VAT fraud is due in first instance to deficient cooperation between EU tax administrations. Before any thought is given to changing the system or increasing compliance obligations and costs, the working methods of tax administrations should be improved:

- by dedicating sufficient human as well as technical resources;
- by allowing Member States which collect other Member States' VAT in cross-border fraud situations to retain a proportion of the amount collected;
- by making efficient use of administrative cooperation and of information exchange;
- by setting up a pan-European team of VAT fraud investigators with cross-border competence (to enable them to take quick action against fraudsters throughout the EU).

### **3.2 Combat VAT/tax fraud by introducing a monthly listing?**

The change from quarterly to monthly reporting of intra-Community supplies constitutes an increase in the administrative burden. However, as the information and the reporting format is already available within companies, the increase in administrative burden for collecting the information is slight. The real additional burden is monthly instead of quarterly reporting. It is of course important that Member States actually match (and use) the numbers after they have been reported, which is often not the case in practice. BUSINESSEUROPE is of the opinion that with the current model of quarterly reporting (and the possible future model of monthly reporting) a fair amount of unnecessary data



are reported. For instance, it has no added value to report all inter-company invoicing of a legitimate business. Reporting based upon an efficient risk management approach gives fewer data but has more added value for governments.

### 3.3 Combat fraud by introducing report obligations at invoice level?

There is the idea put forward by some Member States that transactions should be reported at invoice level. The European Commission has to report at the end of this year regarding the impact of such a reporting obligation.

BUSINESSEUROPE is strongly against reporting at invoice level because:

- Reporting at invoice level will imply an enormous increase in administrative burden. Systems have to be changed; data and or reporting must be merged into returns etc. Bearing in mind that a company in practice makes use of different (ERP) systems, the introduction of such a reporting obligation will be very costly.
- It has to be stressed that increasing reporting requirements by no means leads to an automatic decrease in VAT fraud. The value added of this massive reporting is very limited because:
  - The majority of the information is from legitimate business. A very small part of the information is linked to VAT fraud. In addition, past experiences have shown that fraudsters have in fact been fulfilling their reporting requirements very conscientiously.
  - Governments will need more time and resources to check all the data. However, to catch the fraudsters, governments have to speed up the audit process. The massive reporting will lead to more audit time so less time to respond to fraudsters. Furthermore it is no secret that even now resources are a matter for concern in quite a few Member States. Our opinion is that an overload of data can have a negative effect in the fight against fraud.
- It could represent a serious security issue. This kind of data is very confidential to the company and includes customer-specific business information. Even though the data are available to tax inspectors during control visits, sending it out requires additional security measures generating additional costs. Also, companies and tax authorities would have to ensure that the data are stored in a secure environment with the tax authorities, e.g. to satisfy US regulations.

BUSINESSEUROPE has serious doubts as to whether the Commission can report properly on such a fundamental issue with such a possible impact within the given timeframe. We think it will be almost impossible to report on all the possible side-effects, the problems, the costs for business as well for government, the possibilities for audit, and the added value of this kind of reporting. As said before, our opinion is that an excessive amount of data can slow down the reaction time of fiscal authorities and thus have a negative effect in the fight against fraud.

BUSINESSEUROPE thinks that the best way forward is a reporting (and audit) system based upon efficient risk management.



### **3.4 Combat fraud by introducing an optional general reverse charge mechanism**

As already stated, the European Commission has to report at the end of this year regarding the impact of an optional reverse charge mechanism. For this, the European Commission has published a consultation paper in August 2007. The response date for the consultation paper is 15 October 2007.

BUSINESSEUROPE remarks that an optional reverse charge mechanism creates IT and system issues and an enormous additional administrative burden. Retail businesses in the UK face considerable difficulties with implementation of the new reverse charge rules for certain goods. Furthermore, an optional reverse charge mechanism does not create harmonisation and simplification in the European Union.

BUSINESSEUROPE considers that the concept of a general reverse charge mechanism represents a fundamental change of the VAT system. Any decision taken regarding the fundamentals of the VAT system should therefore:

- be based upon a thorough study that has looked at all related issues;
- be balanced and take into account possible future developments;
- take into account new technological opportunities (e.g. electronic payments, e-cards, e-signatures, ERP systems)

It has to be pointed out that at this stage it is not apparent that an optional reverse charge system is an appropriate and effective tool to combat VAT fraud.

The decision to report on invoice level is a fundamental decision about the VAT system. This decision can only be taken on the basis of very thorough analyses of all facts and all possible consequences. BUSINESSEUROPE again has serious doubts as to whether it is possible to report on such a fundamental issue with such a possible impact in the given time frame. E.g. the impact on cash flow can differ per company per country and per situation. Certain companies, e.g. in the retail sector, will face an enormous positive cash flow effect because their purchases are subject to reverse charge and their sales are subject to local VAT. On the other hand, within the business chain other companies will face severe cash flow problems as there is less output VAT and certain governments actually refund the VAT after a period of six to nine months.

### **3.5 Combat VAT fraud by joint and several liability?**

BUSINESSEUROPE acknowledges that in situations where legal persons actively are involved in fraud, a liability should exist. However, BUSINESSEUROPE wants to stress that tax losses and tax risks must not be borne by legitimate businesses acting in good faith. This implies that in the case of joint and several liability, the joint and several liabilities rules should be specific and targeted to combat fraudsters and should be uniformly applied across the EU. If the introduction of a joint and several liability scheme is unavoidable, it has to be ensured that “safe harbour rules” for legitimate business are put in place. This implies also that mistakes in reporting and or invoicing must not by default lead to a liability. Such a liability would not be proportional and thus would not align on ECJ rulings regarding joint and several liability cases.



### **3.6 Combat VAT fraud by prevention?**

BUSINESSEUROPE stresses that more attention should be given in the current debate to the necessary measures which could help to prevent VAT fraud (better check of new VAT payers, destruction of old VAT numbers, etc.).

Tax authorities should also inform legitimate businesses more proactively about risks of fraud or suspicious traders, in order to prevent new fraud opportunities.

Also, as stated repeatedly by BUSINESSEUROPE, VIES could in principle be a suitable system to check whether a customer is a taxable person, but this means that a trader has to be able to rely on VIES (system as well as content), which is not the case at present. In order to rely on VIES verification data, the current data in VIES have to be improved (updating and search functions). Changes in data have to be adjusted in time, including reference to the situation in the past (e.g. when did a taxable person start and end his taxable activities, what is the nature of the taxable activity?). Furthermore we are of the opinion that the system should be adjusted in such way that the name, all addresses and the VAT id are shown in the VIES system to taxable persons who want to verify a customer/taxable person.

## **4 Conclusion**

BUSINESSEUROPE considers that the current VAT system can function well, provided governments work together more closely, enhance risk management systems and increase the resources dedicated to an early detection of fraudsters. In the context of the Lisbon Strategy's objective of decreasing red tape by 25% until 2012, an increase of compliance costs and administrative burden for legitimate business seems to be the wrong approach. Finally, every change to the VAT system should be evaluated against its impact on the legal certainty for business decisions, as this is crucial for a prosperous business environment.

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