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**SUMMARY REPORT OF
THE OUTCOME OF THE PUBLIC CONSULTATION ON THE**

**GREEN PAPER ON THE FUTURE OF VAT
TOWARDS A SIMPLER, MORE ROBUST AND EFFICIENT VAT
SYSTEM**

(1 DECEMBER 2010 – 31 MAY 2011)

1. BACKGROUND

With the adoption on 1 December 2010 of the Green Paper on the future of VAT¹, the European Commission launched a consultation process open to every stakeholder on an evaluation of all elements of the current VAT system as well as possible ways to strengthen its coherence with the single market and its capacity as a revenue raiser whilst reducing the cost of compliance.

On the basis of the 33 questions in the Green Paper, the public consultation gave stakeholders an opportunity to share their experience of the current VAT system and express their views on the future of VAT. A Staff Working Document² that accompanied the Green Paper provided a more thorough description of specific shortcomings of the current system and the different possible options and solutions.

The consultation ended on 31 May 2011. However, because of the technical problems during the last day of the consultation when a considerable number of large submissions were sent, contributions received within the first two weeks of June have also been included in this summary report. Submissions received afterwards are not included but the Commission has taken note of their content.

2. THE OUTCOME IN FIGURES

The Commission received 1726 replies in total to the public consultation.

1115 of these replies were contributions by non-profit associations (sport clubs, other social wellbeing organisations, etc.) from Sweden (968) and Finland (147) on the specific issue of non-profit organisations (notably their status as taxable persons). These contributions, stimulated by a national campaign, reflected a misunderstanding by almost all these respondents that the Green Paper process might force Sweden to change its practices towards non-profit organisations. These contributions in fact rather relate to an issue of interpretation of the current EU VAT Directive³ which arose in 2008 (see IP/08/1032⁴) and does not relate directly to the Green Paper. For that reason, they will not be taken into account in the figures below.

Out of all the 611 other contributions, 191 or 19.5% were from organisations registered in the Transparency Register of interest representatives⁵.

The *Graph 1* below presents an overview of the replies per profile of respondents. National associations (of businesses, of non-profit organisations, of charities, of religious organisations and of NGOs) accounted for the biggest share of total replies (35.8% or 219), followed by replies from individual businesses (31.9% or 195), replies from European associations of businesses, of national associations, of non-profit organisations and of NGOs (12.3% or 75) and EU citizens (9% or 55). Responses were also received

¹ COM(2010) 695 final

² SEC(2010) 1455 final

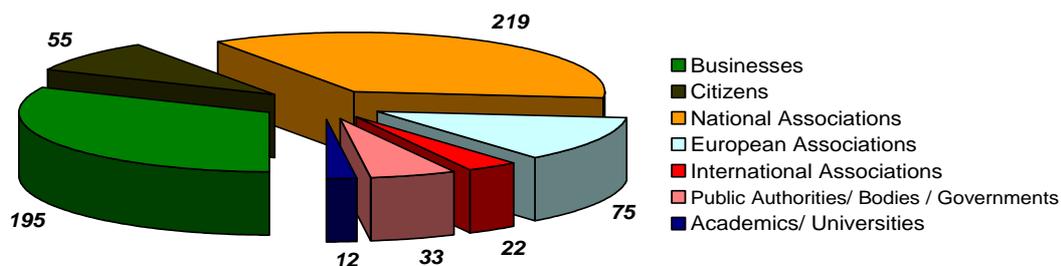
³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11.12.2006, p. 1.

⁴ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1032&format=HTML&aged=0&language=en&guiLanguage=en>

⁵ http://europa.eu/transparency-register/index_en.htm

from international associations (3.6% or 22), public authorities/bodies/governments (5.4% or 33), universities and academics (2% or 12).

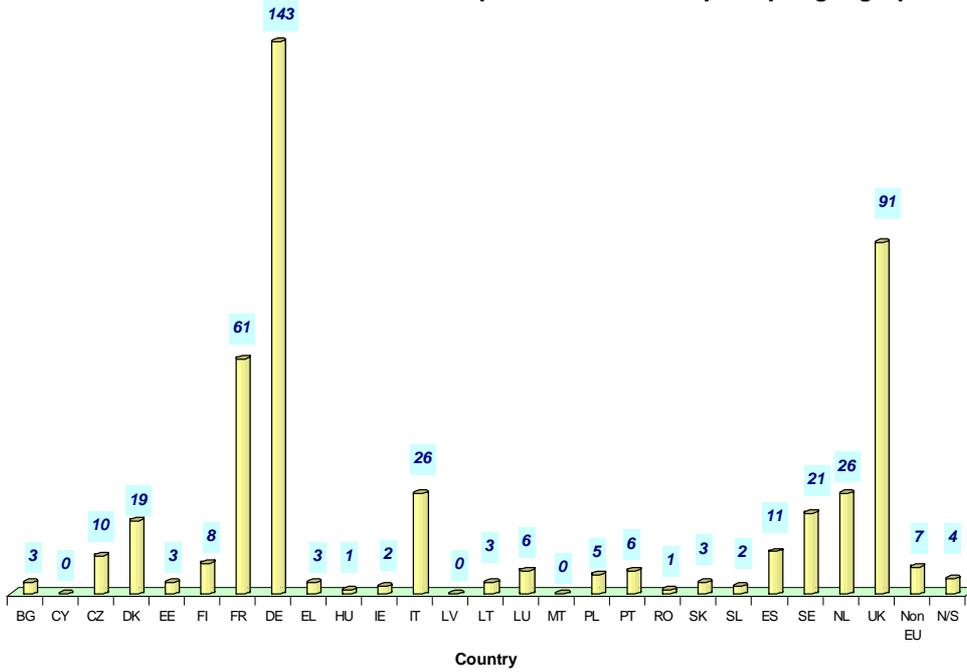
Graph 1 Overview of replies per type/ profile of respondent



The *Graph 2* below presents an overview of the replies per country. Responses were also submitted by stakeholders from outside the EU. 503 out of the total number of 611 replies originated from 24 EU Member States, 4 replies from Switzerland, 2 from USA and 1 from Japan. 4 respondents did not specify their country of origin.

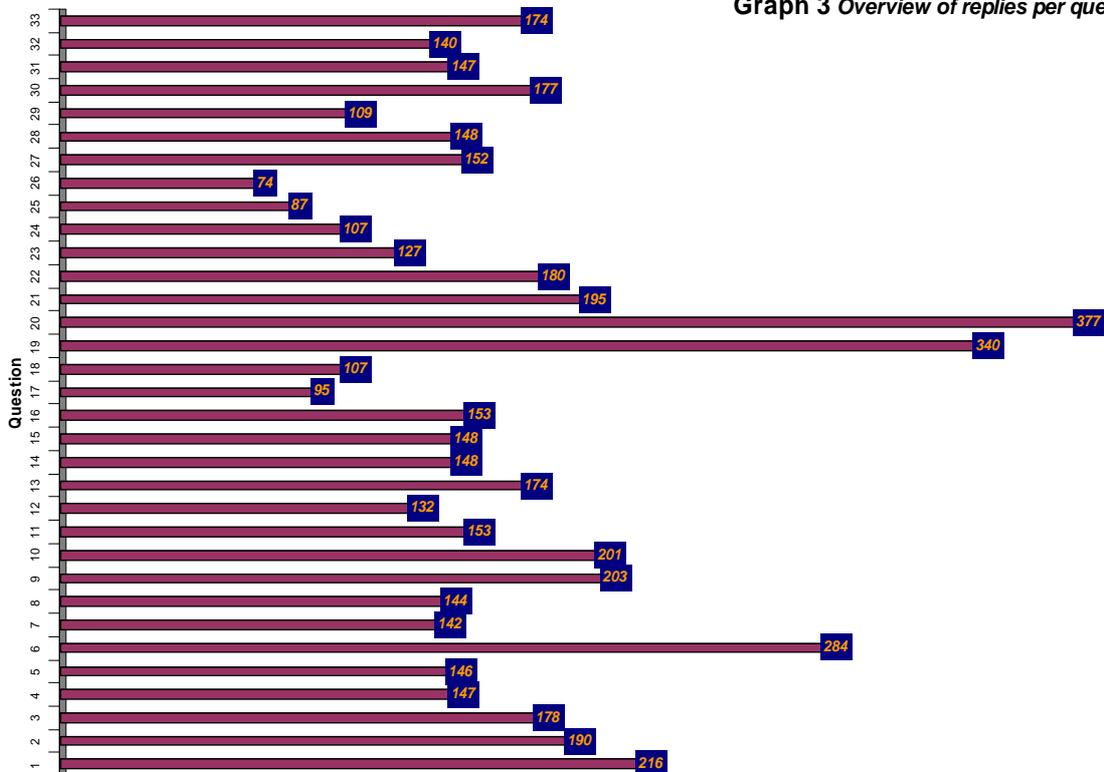
The biggest number of submissions originated from Germany (143), followed by those from the United Kingdom (91), France (61), Belgium (36) and Italy (26). A complete breakdown of responses per country is presented in the Annex as well.

Graph 2 Overview of replies per geographical region



The *Graph 3* below shows an overview of the total number of replies for each of the 33 questions.

Graph 3 Overview of replies per question



The Commission has also published on its website all submissions with the exception of those who specifically requested not to be disclosed.

3. ANALYSIS OF THE REPLIES

A number of stakeholders expressed their views on the way EU VAT should evolve in a general way, without referring to the specific questions asked. These contributions have of course been accorded equal consideration.

The present document is however, for reasons of clarity, structured on the basis of the questions asked. The more general contributions are reflected in the summary in so far as the Commission could link the comments to a specific question.

Some questions raised in the Green Paper were cross-linked and many respondents made a single reply to several questions. Certain headings have therefore been grouped in the summary below.

3.1. VAT treatment of cross-border transactions in the Single Market

Q1. Do you think that the current VAT arrangements for intra-EU trade are suitable enough for the single market or are they an obstacle to maximising its benefits?

A large majority of those replying specifically to this question indicated that the current VAT arrangements are not suitable for the single market.

Those respondents which considered them suitable indicated that they are broadly satisfied with the fundamental principles of the current regime, which ensure taxation at destination for B2B intra-EU transactions, but point out a number of improvements that should be envisaged.

A number of respondents highlighted the lack of consistency between the VAT rules applicable to intra-EU trade and domestic trade.

Different application of the EU VAT rules is clearly seen as the most serious obstacle to benefiting from the single market. These different applications stem firstly from the numerous derogations in the VAT Directive and secondly from the discretion left to Member States in its implementation and application.

This is also the main reason why respondents considered the current VAT system as extremely complex and creating high administrative burdens. As one respondent formulated it: 'EU businesses are paying the price in extra compliance costs for the lack of harmonisation'.

Differences in implementation and interpretation not only provoke an administrative burden they also impact on key issues like place of taxation, leading to potential double taxation.

Several respondents pointed out that these difficulties have an impact on commercial behaviour in that the most effective business decisions and/or transport routes are not always chosen. This implies that the economic neutrality of the tax is diluted, in that decisions on where to buy goods and services should be based only on economic reasons and not on tax factors.

They also said that they often need to seek specialised advice when embarking on cross-border activities, which brings an added expensive cost factor. It is pointed out that SMEs might not always have the resources to deal with this.

The main areas of concern with the current VAT arrangements for intra-EU trade are:

- The evidence to be provided by the supplier to support the exemption for intra-EU supplies of goods or the non charging of VAT on the invoice for intra-EU supplies of services. There are no clear and uniform rules about this, particularly for pick-up transactions.
- Cross-border chain transactions. The VAT Directive provides a simplification for triangular transactions but this is applied unevenly by Member States and does not cater for situations involving more than 3 parties.
- There are no clear rules for consignment stocks and there are large divergences in warehousing arrangements.
- Inconsistent application of reverse charge for supplies made by non-residents. This is notably an issue for services related to immovable property.
- Fraud measures taken by the Member States affecting honest traders.
- Errors, even those made unintentionally as a result of the complexity of the rules, result in substantial or disproportionate penalties.

In addition, certain sectors encounter specific problems with cross-border transactions which they considered an obstacle to the single market. This is the case for:

- Companies involved in distance sales, resulting in VAT registrations and subsequent VAT obligations in several Member States. It has been pointed out that because of this traders often may not offer internet or mail-order business to customers from other Member States.
- The transport sector, in particular for B2C transactions.
- Catering services supplied on board trains, to be taxed at the place of departure of the passenger transport, resulting in multiple registrations and application of different VAT rates.

Q2. If the latter, what would you consider the most suitable VAT arrangements for intra-EU supplies? In particular, do you think that taxation in the Member State of origin is still a relevant and achievable objective?

Respondents being in general not satisfied with the current rules, suggested either a change to a system of taxation at the Member State of origin, to a system of taxation at the Member State of destination or to systems where elements from both of these arrangements would be in place.

About one third of the replies to this question supported, in one way or the other, solutions with taxation in the Member State of origin. It was seen that this option best

fulfils single market principles. At the same time many recognised that, to work properly, this solution would require a high level of harmonisation of rules, notably in rates and exemptions. Some additionally stressed that in the case of taxation at origin, the purchaser should have the right to deduct all input VAT directly in his own domestic VAT return (rather than, as currently, to get it back from each Member State where the VAT has been paid).

A group of respondents stressed that SMEs preferred those arrangements as in such a system they would only have to deal with the domestic set of rules.

There was however a wide recognition that to reach satisfactory arrangements for taxation at origin, Member States, who for EU tax issues work by unanimity, would need to show political will to do so. Many considered that this is not currently the case and doubted therefore that taxation at origin was actually achievable in the foreseeable future.

At the same time slightly less than one third of the respondents explicitly opposed the origin principle. Many of them said that this is because the conditions needed will not be fulfilled in the foreseeable future and that it is therefore not achievable in practice.

A number of respondents, comparable to those supporting taxation at origin, favoured taxation at destination. The majority saw this as being far more achievable in practice. Recent developments in EU VAT legislation indicated that it is the preferred option for Member States.

A considerable group of respondents stressed that the destination principle should be applied together with One-Stop-Shop arrangements (OSS). There were a similar number of replies supporting a wide application of the reverse charge mechanism. Some however saw this as being in conflict with fractional payment – one of the key features of the current VAT system. Many shared the view that as for the place of supply, the same rules should apply for domestic and intra-EU transactions. Some added that that should also be the case for supplies of goods and services and for B2B and B2C transactions. This latter view was however not shared by all.

Some suggested that a mixed/hybrid VAT arrangement might be the best option achievable. Here, many saw a solution where for B2B transactions the destination principle should apply with the origin principle for B2C.

The common message from the large majority of respondents was that regardless of the VAT model chosen – origin or destination – there should be more harmonisation and simplification of rules. Some explicitly said that the final choice of model is less important in this context.

Many respondents described/listed the most important elements that should be present in any type of VAT system applicable in the European Union.

Together with harmonisation, the need for a simplification of the rules was largely advocated. When asking for this, many pointed to the difficulty in coping with different sets of rules and obligations across Member States, and considered that, in the first place, a limitation or even outright abolition of derogations and options available to Member States should be envisaged.

Further it was stressed that a common EU-wide understanding and application of rules is very important if the VAT arrangements are to be suited to the single market. To increase clarity and understanding of VAT rules, especially for SMEs, all the relevant VAT information should be available online.

There were suggestions that VAT incurred in other Member States should be directly deductible in the Member State where taxable persons file their tax return.

Reductions in ‘red tape’ were widely sought. Many wanted administrative requirements that were standardised and simplified. At least there should be no increase in the number of current obligations and preferably they should be reduced.

Some more detailed remarks were also put forward:

- Some stakeholders suggested that, when defining the place of supply of services, the scope of application of the ‘effective use and enjoyment rule’ should be reduced and especially Article 44 of the VAT Directive should be excluded from it.
- Some wished that the VAT number be decisive in identification of a taxable person. There was even the suggestion made that a VAT number should determine in which Member State taxation should take place.
- Some advocated that VAT grouping should be introduced at EU level.

3.2. The scope of VAT

Q3. Do you think that the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality, and if not, why not?

The responses relating to public authorities and to holding companies have been separated because different issues are at stake.

Public bodies

Reactions to this question varied with two clear clusters of opinions emerging.

Opinion 1: Current system not appropriate

One group – including the overwhelming number of contributions from private entities – stressed that the current rules need to be amended because they are neither harmonised nor neutral. Given that private entrepreneurs are more and more active in areas that were previously reserved to the public sector and the existence of more and more complex arrangements between public and private bodies (e. g. public-private partnerships), it was considered that the different VAT treatment for private and public bodies cannot be justified and could lead to distortions of competition on both inputs and outputs.

On the input side, many saw the non-deductibility of input VAT as preventing public bodies from outsourcing support services given that such services might be performed by specialized (private) providers more efficiently and at lower costs (excluding VAT), even if VAT is often not the only factor for an outsourcing decision. Several feared that the

motivation of public bodies to avoid paying non-deductible VAT could favour outsourcing to non-VAT registered companies (some of which could be operating in the ‘shadow economy’).

On the output side, most private respondents argued that the different VAT treatment of the same or very similar activities depending on the status of the supplier could lead to distortions of competition to the detriment of private competitors.

Although the anti-distortion clause of the second subparagraph of Article 13(1) of the VAT Directive should help, several respondents were concerned that a private entrepreneur who is experiencing unfair competition from a public sector body would have no readily accessible legal mechanism to formally raise this issue with the tax authorities or the courts.

One particular area of unfair competition indicated by some respondents was, inter alia, the sewage and refuse disposal sectors where private service providers – e.g. in Germany – operate under contract with the public-law entities responsible for disposal pursuant to public law. It was reported that because of their VAT benefits public entities responsible for guaranteeing disposal would increasingly take the provision of disposal services which they previously outsourced to private disposal companies back into their own hands (‘remunicipalisation’).

Furthermore, many respondents shared the view that the current VAT regime for the public sector is too complex as public bodies’ activities could be outside the scope of VAT, or if they are within the scope of VAT they could be liable to tax or be tax exempt. This also complicates the determination of the deductible VAT which, as a few respondents reported, would sometimes discourage public authorities from deducting input VAT.

Many respondents complained that the lack of harmonisation is a significant problem in practice e. g. for intra EU-trade. It was mentioned that key terms such as ‘public authorities’ or ‘significant distortion of competition’ were not clearly defined by the VAT Directive or were inconsistently interpreted by the different Member States. Some saw the option available to the Member States to regard certain tax exempt activities as out of scope (Article 13(2) of the VAT Directive) or to make the granting of certain exemptions dependent on additional conditions if bodies other than those governed by public law are concerned (Article 133 of the VAT Directive) could lead to significant and damaging differences between the VAT rules in Member States. In any case, complexity and lack of harmonisation of the VAT rules for the public sector are considered as entailing high compliance and administration costs and offer too much room for tax planning and avoidance.

Opinion 2: Current system appropriate

According to another group of respondents – including the majority of the contributions by representatives of public bodies – the current rules are sensible and need no amendment.

A few were of the opinion that a modernization of Articles 13 and 132 of the VAT Directive could be considered.

Many believed that the equality of treatment between the private and the public sector where the two sectors are operating under comparable conditions would be ensured by the competition clause in the second subparagraph of Article 13(1) of the VAT Directive.

The criterion of '(potential) significant distortion of competition' has already proven its worth in relation to the enforcement of the neutrality principle. The objective of simplification could not be achieved through a system in which the first step would be to include all the economic activities of public bodies in the scope of VAT, and then possibly to exclude many of these activities again by bringing in a list of tax-exempt or out-of-scope activities. According to these respondents, it would not be sensible to replace the criterion 'significant distortion of competition' whose structure has by now been largely defined through the case law of the Court of Justice of the European Union and the respective national courts, with the criterion 'economic activity' which would likewise require a great deal of interpretation and whose structure would need to be clarified afresh by the courts.

Generally, the differentiation between public bodies and private law entities was regarded as justified since the respective activities and, in particular, the respective legal framework for these activities are in no way comparable. The public sector is characterized by the obligation of the public body to offer certain services and supplies to the customer, as well as by the strict requirement that costs are covered and no profit is realized. In this context many contributions concerned the area of waste and waste water treatment. The respondents referred to the fact that in many Member States (e. g. Germany) waste and waste water treatment are statutory duties of the municipality which cannot be transferred to private third parties. Even if a municipality entrusts the carrying out of such duties to third parties, this would not alter the fact that it is the municipality which has the obligation towards the citizens to fulfil these duties. Any private enterprise engaged in such an activity would therefore only be acting as an agent of the municipality. The principle of neutrality could not apply in such a situation because public and private operators would operate under conditions that are not comparable. A public body fulfilling its duties itself, and hence acting in compliance with the law, could not be a source of competition. Furthermore there would be no unequal treatment from the viewpoint of the final consumer (the citizen) because it is ensured that he has to pay no VAT in either case.

Some respondents suggested that an obligation to tax public services which are only performed by public bodies (in relation to the final consumer; e.g. waste water treatment) would be a major interference in the Member States' powers protected by Article 4(2) of the Treaty on European Union. In cases where, in line with European and national law, no competition should exist between public-sector and private-sector entities, the EU would have no powers to enact regulations forcing Member States to make public-sector services taxable.

Finally, some respondents stressed that a simplification of the system could not be accepted if services and supplies became more expensive for the citizen. Especially for those citizens who do not have strong economic power, the introduction of adequate exemptions or the treatment of public interest activities as non taxable would be required not only for public bodies but also for private entities carrying out such activities (e. g. charities).

Proposals concerning the future VAT treatment of public bodies

Respondents who regarded the current system as not optimal made a variety of proposals to overcome the problems they mentioned.

The majority of these respondents were of the opinion that public bodies should be taxed to a larger extent, although only a few respondents took the view that every activity of public bodies should be taxed (possibly partly at reduced rates or with a limited list of exemptions).

A large number were of the opinion that all activities undertaken by public authorities in competition with the private sector should be taxed in the same way. To this end, every economic activity should fall within the scope of VAT regardless of whether it is performed by a private or public entity. This would lead to the abolition of Article 13 of the VAT Directive.

Some respondents stated that every activity performed against consideration which at least covers its costs should qualify as economic activity. Many thought that public bodies should be treated as non-taxable only where they carry out their core activities on the basis of their 'regalian prerogatives' for which they cannot be in competition with private operators, or which cannot, by their very nature, be carried out by these private operators. The determination of this criterion should, as a few respondents stated, be carried out under the national legislation of the Member State governing these activities. In contrast many saw a need for harmonised EU-wide definitions. This could be supported by adding a non-exhaustive list of activities to Article 9(1) of the VAT Directive that cannot, by their very nature, be carried out by economic operators.

Many suggested that the range of exemptions should be – if not abolished completely – very limited. The widening of the VAT base could be used to lower the (reduced) VAT rate. Where the imposition of VAT on services provided by public authorities would be undesirable (e.g. education, medical services, etc.), possible negative consequences for the final consumer could be mitigated by clearly defined zero, reduced or super-reduced rates, which would be open to all taxable persons, both public and private. However, several respondents regarded the pursuit of social policy objectives through VAT law as problematic in general. The preferable solution would be to grant direct state benefits through additional payments to the persons concerned.

As far as the current rules creating a disincentive to outsource is concerned, many respondents (from the private but especially from the public sector) saw that VAT compensation funds are an appropriate means to mitigate this negative effect. Some respondents were however concerned that refund systems are not harmonised within the EU and stressed that they should either be made compulsory or abolished so as to achieve a level playing field within the EU. Some respondents stressed that the UK's Section 33 VAT refund mechanism would provide a model that could be incorporated EU-wide. Finally, some respondents stated that where such compensation funds are implemented only for public bodies, they should also be opened to private entities carrying out the same (tax exempt) activity (e.g. charities).

A clarification of terms like 'public authorities' or 'significant distortion of competition' by providing a clear definition and interpretation valid for every Member State, or the implementation of a formal procedure under which tax authorities and/or courts have to make a legally binding decision on the tax status of a body governed by public law in

cases where a private sector company is experiencing unfair competition by a public body were named as examples of single measures which could be taken.

Holding companies

Almost all respondents were of the opinion that the current legislation or the jurisdiction with respect to the VAT treatment of holding companies is not appropriate. The question of whether a holding company is operating inside or outside the scope of VAT is so complex that it has become extremely difficult for companies, tax administrations and courts to deal with it.

Most respondents stressed that it is not justified to treat holdings as out of scope in cases where taxable activities are not carried out by themselves (passive holdings). Many respondents pointed out that there are a lot of commercial and managerial reasons for setting up a holding company, e.g. to coordinate and direct the activities of subsidiary companies. Against that background, holding companies carry out economic activities through their subsidiaries and a treatment as out of scope, with the consequence that holding companies cannot deduct input VAT, violates the principle of neutrality (of the legal form). Holding structures are unduly disadvantaged in relation to companies which carry out their business through dependent branches.

Additionally, some respondents referred to the fact that the VAT treatment of holding companies as regards VAT grouping is inconsistent within the EU because some Member States allow passive holding companies to be part of a VAT group and others do not.

As a consequence, almost all respondents stated that the activities of holdings should be treated as taxable. A few stated that this should be generally the case; a large group of respondents stressed that holdings should only fall within the scope of VAT if they hold a significant share capital in another company and thus have a significant influence in that subsidiary company. Many respondents regarded Switzerland and its 10% threshold as best practice in this context. Some individual respondents were of the opinion that holdings should at least be granted an option to tax. Others said that passive holding companies should generally be allowed to be part of a VAT group.

As far as holding companies would then qualify as taxable persons they should, as many respondents stated, have the right to deduct input VAT to the extent that the underlying companies benefit from the right of deduction.

If no taxation of holding companies is envisaged some respondents stated that at least a legal clarification of the definition of (passive and active) holding companies and which requirements have to be met in order to qualify as a taxable person, is needed.

Q4. What other problems have you encountered in relation to the scope of VAT?

Q5. What should be done to overcome these problems?

With questions 4 and 5, the Commission wished to verify whether, besides the issues related to public authorities and holdings, other problems existed in relation to the scope of VAT and what could be the potential solutions to them.

Certain respondents however interpreted these questions in a much broader way and took the opportunity to express general views on topics (VAT obligations, rates, etc.) covered by other questions. Those comments will not be mentioned here but have been taken on board in the analysis of the specific questions to which they relate.

Extension of the scope of VAT

Many respondents regarded the scope of VAT as too narrow due to tax exemptions which, additionally, contribute to the complexity of the system because they create a lot of boundary issues (e. g. the determination of the boundary between supplies that are liable to tax, tax exempt and out-of-scope) and are regulated differently among the Member States.

With respect to the potential abolition of VAT exemptions for activities carried out in the public interest, several respondents stated that tax legislation should not be used as an instrument of social policy because this could lead to illogical tax legislation. Targeted benefit schemes/immediate subsidies would be a more efficient solution. In contrast to this position some respondents considered it necessary to have adequate exemptions with regard to public interest activities of public bodies or private entities (e.g. charities) in order to ensure the support of socially disadvantaged people.

Some respondents considered that VAT exemptions could be kept for services that are financed in redistribution systems organised by the State, such as social security and health services, since, ultimately, charging VAT on such services would only boost public resources derived from tax revenue while reducing public resources available for health, for example.

Several contributors also complained about VAT benefits (tax exemptions or reduced rates) granted to the so called social economy, defined as employment created for people who are distant from the employment market. Since social economy is integrating increasingly with the regular economy it should be subject to the same VAT rules because otherwise VAT legislation could lead to unfair competition between 'social' and 'regular' economy.

An alternative model to the current VAT scheme was proposed by a few respondents: namely to apply a VAT exemption on all transactions between VAT taxable persons using goods or services for their economic activities or even bring these kinds of transactions outside the scope of VAT. Only transactions towards the end-consumer should be liable to tax but then on a wide base entirely without, or with only a limited amount of, tax exemptions.

Lack of harmonisation

Description of the problems

The lack of harmonisation which is caused not only by differing legislation but also by divergent application of VAT law among the Member States leads, as many respondents stated, to the unequal treatment of taxable persons in similar circumstances and, thus, to the unequal scope of VAT in different Member States.

Among others, the following examples of different legislation were provided:

- Many respondents criticized the fact that the possibility of VAT grouping is only offered in a few Member States (partly with different conditions) whilst there is a need to form cross-border VAT groups.
- A few respondents referred to the fact that some Member States have implemented a single-stage VAT system for excisable goods whereas other Member States apply the regular multi-stage VAT system to such products.
- Several respondents mentioned the fact that the out-of-scope character of a transfer of a going concern (or parts of a concern) is currently optional for Member States, but they regard an out-of-scope treatment as being more sensible. The optional character leads to a lot of problems if the transferred concern is located in multiple Member States, especially if some of them do not consider the transfer to be out of the scope of VAT.

In addition to the general question of taxability, respondents pointed out that the requirements as to what is a transfer of a going concern are not sufficiently described in EU law. In practice, businesses encounter numerous problems with classifying their transactions as a transfer of a going concern or an asset deal. Moreover it is difficult to determine if transactions qualify as a non-taxable transfer of a part of a business. The lack of clear rules leads to a lot of litigation. Finally, respondents referred to the inconsistent treatment of the sales of businesses involving a sale of shares and those involving sales of assets. A share sale is exempt, whereas asset sales are either taxable or, if part of a transfer of a business as a going concern, outside the scope of VAT.

Several respondents reported on different interpretations of the VAT legislation as to what falls inside and outside the scope of VAT or of notions such as ‘taxable person’, ‘economic activity’, ‘commissionaire/agent’ and an inconsistent application of judgments of the Court of Justice of the European Union.

Proposals

- An important topic for many respondents was VAT grouping. According to the statements of these respondents the implementation of VAT-grouping rules should become mandatory for all Member States. The (harmonised) requirements for a VAT grouping should be clarified and applied consistently throughout the EU. Some respondents suggested that the availability of a pan-European VAT group should be considered.
- Another important issue was the out-of-scope treatment of a transfer of a going concern (or a part thereof) which should, according to several respondents, become obligatory for all Member States as well. Additionally, respondents pointed out that

the requirements of a transfer of a going concern should be more specifically described in EU law in order to avoid litigation. With respect to the different treatment of sales of businesses involving a sale of shares and those involving sales of assets, respondents stated that neutrality (especially as regards the deductibility of input tax) requires that both types of transaction are treated identically.

- Concerning the different application of VAT law in the Member States respondents suggested that notions such as ‘taxable person’, ‘economic activity’ etc. should be legally defined more precisely. Generally, the definition of relevant terms should only be subject to EU law and Member States should be obliged to implement them into national law without making use of national terminology.
- Some respondents referred to the necessity of restarting the discussion about a harmonisation of the VAT regime for postal services because the relevant exemption is not regulated and interpreted uniformly in all Member States.

Scope of supply and consideration

Several respondents stressed that it is often difficult to determine the scope of a supply, that is deciding whether a supply qualifies as 1) an ancillary or principle supply or 2) a single or a part of a multiple supply, always combined with the question how far tax exemptions or reduced rates are applicable. A further issue that was mentioned by several respondents is the question of whether subsidies or payments which are made in connection with compensation for damages, warranty obligations, certain contractual compensations, etc. qualify as (taxable) consideration or not. It was reported that in this area evaluation also varies between the different Member States. All these issues could cause uncertainty and litigation.

For all these issues, respondents called for a clarification in law and a harmonised application among the Member States.

3.3. Exemptions from VAT

Q6. Which of the current VAT exemptions should no longer be kept? Please explain why you consider them problematic.

The exemptions laid down in the VAT Directive cover a wide range of activities and the responses to the questions differ according to the type of exemptions. The analysis below will therefore be organised into different categories of exemptions.

General Comments

A number of respondents indicated that in principle exemptions should be abolished but accepted that in practice this would be difficult to achieve.

Several respondents considered there is a need to scrutinise thoroughly all the existing exemptions. It should be examined whether they still fulfil the conditions they fulfilled when the legislator agreed on them. Moreover, they should be revised with a view of ensuring a level playing field for all competitors. The scope of the exemptions leads to

very complex legal evaluations, e.g. regarding what constitutes financial services, real estate services and insurance services.

One respondent pointed out that exemptions should be based exclusively on objective criteria (types of goods and services) and not on subjective criteria (nature of the supplier).

A few respondents pointed out problems of inconsistency in the current exemption rules. This was notably the case for similar medical services which are subject to different taxation rules.

Instead of restricting the scope of exemptions – as some respondents stated – the option to tax transactions could be extended. Others said that they consider that the flexibility to opt for taxation or not does not fit well with the concept of a uniform taxation system and gives rise to uncertainty.

A number of respondents expressed the opinion that exemptions should be replaced by zero rating with a right to deduct. One respondent indicates this would be feasible when the current list of exempted activities would be reduced.

Exemptions in the general interest

A large number of respondents are of the opinion that the current exemptions in the general interest have been granted for social purposes and should therefore be maintained. This is notably the case for medical care, educational and cultural services.

Some respondents criticized the fact that Member States can make the granting of certain exemptions in the public interest dependent on certain conditions if the underlying activities are not carried out by public bodies (Article 133 of the VAT Directive). Certain respondents advocated for more consistency in the EU VAT legislation in this respect.

An issue pointed out by many respondents was the need to ensure the exemption not only for non profit organisations having activities in the sports sector but also for organisations setting up activities for the benefit of older people.

A few respondents expressed different views. One indicated that exemptions without deduction of input VAT are effectively taxed at a reduced rate (because of the non deductibility). This rate will be different since the level of input tax of schools, for instance, will differ from one to another.

Others respondents considered that a refund scheme outside the VAT system is the appropriate solution for dealing with irrecoverable VAT, especially in cases where the activities in the general interest are funded by donations from charities.

Another respondent explained that abolishing the exemption for activities in the medical sector would open a right to deduct and therefore facilitate investment in this sector.

Certain respondents defended the exemption for postal services. Others considered it as no longer appropriate since it creates competitive distortions in the market.

Some respondents regarded the requirements for outsourcing or cost-sharing arrangements pursuant to Article 132(1)(f) of the VAT Directive as too narrow. Under the current regime outsourcing in cases where a taxpayer is carrying out tax-exempt

activities is very unpopular because often the taxation of the outsourced activities cannot be prevented. Thus, tax-exempt activities could not be conducted in the most efficient way.

Exemptions for financial and insurance services

Respondents consider that the exemption is justified because it encourages consumers to save and to invest in their future. It was also said that since the flow of good and services is taxed, taxing the flow of money would lead to double taxation.

The exemption results in non deductible input VAT. The option to tax or even a zero rate are advocated as solutions as they would solve the issue of non deductible input VAT on outsourced services and allow European banks to compete on a level playing field.

Several respondents referred to the ongoing discussions in Council on this file and counted on a positive outcome of it. They considered that in the meantime no new initiatives should be undertaken in this area.

As regards the exemption for insurance services, it was pointed out that these transactions are often the subject of other, non-harmonised, taxes. Abolishing the VAT exemption on insurance services should imply the abolition of these other non-harmonised taxes; otherwise the transactions are double taxed.

Exemptions related to the property sector

Certain respondents were of the opinion that the current VAT rules on the property sector are satisfactory and should not be reviewed. Because of the nature of the good, there is no risk of distortion of competition within the internal market.

Other respondents explained that the exemption of the property sector affects the neutrality of the tax because of the non deductibility of input VAT.

As with insurance services, the supplies of immovable property are often the subject of non harmonised taxes in the Member States and the same argument about double taxation is made.

Exemption for gambling activities

Respondents indicated that the current exemption for gambling activities should be maintained because the way the different types of gambling activities are organised (sports betting, casino, poker games) make it difficult to apply VAT in a uniform manner.

Other exemptions

One respondent was of the opinion that the current exemptions for international trade should be clarified.

A number of respondents indicated that if passenger transport remains exempt, then B2C removal services should also benefit from the same exemption.

Q7. Do you think that the current system of taxation of passenger transport creates problems either in terms of tax neutrality or for other reasons? Should VAT be applied to passenger transport irrespective of the means of transport used?

Q8. What should be done to overcome these problems?

Replies of the respondents varied widely depending on the sector they originated from or represented.

Most of the respondents (mainly the general public and stakeholders from outside the passenger transport sector) agreed that the existing VAT arrangements governing the taxation of passenger transport, in particular the numerous exemptions, derogations and obligations as well as the rules determining the place of taxation are complex and lead to difficulties of application. They stressed that the lack of uniformity in taxation led to market distortions, an over-complexity for operators and consumers and a violation of the tax neutrality principle. They called for more uniformity and harmonised rules concerning the practical application of VAT to all passenger transport. Most of them opted for an equal treatment between various modes of transport. Some respondents clearly stated that sector or industry-specific exemptions are a factor in distorting competition and there were no longer any valid reasons to justify such exemptions.

Opponents of the current system (approximately half of the respondents) proposed either full taxation of passenger transport irrespective of the means of transport (some proposals included a unique VAT rate for all intra-EU passenger transport, others taxation at a reduced rate or even zero-rating, but combined with a special consumption tax), or a limit to current exemptions applicable to this sector. Some opted for exceptions for public transport. Others (mostly environmental and similar associations) only opposed certain exemptions, namely those given to the most polluting transport operators such as airlines.

Supporters of current VAT exemptions for passenger transport (mainly air and maritime companies) preferred to maintain the current exemptions. They represent the remaining half of the respondents and are satisfied with the current rules (mainly because of the exemptions that they enjoy) and considered that they operated smoothly, efficiently and without practical difficulties. They stressed that the current arrangement for intra-EU passenger transport (zero rating with full claim of input tax) was set up under the condition that it would be reviewed only if and when an agreement could be reached on rules and rates harmonisation. They confirmed that those exemptions were justified on the grounds of public interest, social inclusion and environmental protection.

Some respondents believed that current distortion of competition is not so much caused by VAT exemptions, but by other factors, such as subsidies and grants. Others noticed however a competitive disadvantage for a narrow category of means of transport. They believed that distortion in the economic sense was not caused by exemptions, but by the fact that they applied to some modes of transport, not to others, although the modes competed directly with one another in certain market segments. They proposed thus to extend the current VAT exemptions to cover other means of transport (some proposed to include all means of public transport by rail and road, some opted to also cover domestic passenger transport) in order to ensure a level playing field (mostly road and rail companies and travel/tour operators). Some sectors (removal companies), while opting for uniform taxation of passenger transport, urged that if zero-rating was applied to all

modes of passenger transport, then it should also apply to B2C movements of used household goods with a possibility to deduct VAT on inputs.

Air and maritime companies claimed that any imposition of VAT on passenger transport, or a limitation of the right to deduct input VAT, would harm the good functioning of their business, would have a negative impact on their profitability, and create administrative burdens. Such an imposition or limitation of the right of deduction could relocate some activities or include stopovers outside the EU to the detriment of some EU ports or lead to a lower quality of services, increased costs for operators and higher prices to the detriment of customers. Possible distortion of competition with third countries' operators and a potential conflict with international conventions (e.g. Chicago Convention for air transport) were also emphasised. Representatives of the airline sector pointed out at the same time that, having regard to all forms of taxation, the airline sector is not under-taxed. They further stressed that there was no economic justification to change the current VAT position since it would lead to over-taxation and create serious distortions.

A majority of respondents commented in general on exemptions vs. taxation in the sector. Only approximately one fifth of the respondents commented on the place of taxation of passenger transport. Some supporters of the current VAT rules confirmed that the place of supply should remain unchanged as the current rule ensures that passenger transport is taxed where it is consumed. Some observed that taxation where the transport effectively takes place, proportionate to the distances covered, is feasible, though complex.

Others believed that any change of the place of taxation with the introduction, for instance, of a single reference point, would on its own contribute to distortion. Some respondents disagreed that a remedy would be to shift the place of supply of passenger transport to the Member State of departure as it would also be difficult to apply and could lead to distortion of competition caused by different VAT rates and exemptions.

A few respondents believed that ideally, in an origin-based system, public transport should be taxed, regardless of the destination, at the point of departure.

Others proposed taxation of local B2C transport in the Member State of actual transport (place of consumption) by the supplier and for international transport either exemption or taxation according to the general rules for services.

Other proposals included among others identifying as the place of supply of passenger transport the Member State of establishment of the company-carrier for the entire distance. Some respondents considered that a simpler solution would be to tax passenger transport where the supplier is established (with possible corrections when the supplier is established outside the EU). Some stressed that a one-stop-shop mechanism like the one that would be introduced for the e-commerce sector in 2015 would be a significant improvement. Some proposed to apply a general reverse charge for B2B transport supplies and possibly a reduced VAT rate of the Member State where the ticket is purchased for B2C supplies. Others preferred no distinction in the treatment between B2B and B2C passenger transport supplies.

Alternatively, passenger transport could be taxed either at the beginning or the end of the transport for the entire route taken within the EU starting at the first stop where passengers board or leave the means of transport, ending at the last such point.

Finally, around one third of the respondents emphasised that only minor progress could be made when reviewing the current VAT arrangements for passenger transport unless the place of taxation, rates and exemptions were addressed as a whole. Some stressed that the place of taxation is not the only problem, even not the main problem, but that a more crucial issue is the different rates and exemptions in the EU and the inequality in VAT treatment between air, sea, road and rail operators. Therefore, an overall review of the rules applicable to transport is needed. Some stressed that any revision of those rules necessitates a prior agreement on the harmonisation of rates. A few respondents urged the European Commission to launch a study of potential impacts of any revision.

3.4. Deductions

Q9. What do you consider to be the main problems with the right of deduction?

The overall problem, reported by most of the respondents, seems to be the lack of harmonisation and/or the inconsistent approach by Member States regarding the different aspects of the right of deduction rules.

Differences and problems were mostly reported in the following areas:

- methods for calculation of the deductible proportion in the case of partial exemption (pro-rata and other allocation keys) or for overhead costs;
- (electronic) invoicing, documentation and evidence requirements to be met in order to qualify for deduction;
- tax blockings and deduction restrictions (goods and services which do not or only partly qualify for deduction even in the case of taxed business use);
- eligibility for deduction (deduction before registration, expenses incurred by employees, shared services centres, sales offices);
- deduction for groupings; national refund (or carry-over) practices in the case of credit position of the claimant;
- deduction of VAT paid at import;
- adjustment rules and the capital goods scheme.

Linked to this non-harmonised approach is the complaint that the deduction system, as a whole, is too complex because, inter alia and apart from the above-mentioned problems, of excessive documentation requirements, rules linked to subsidies and discounts or even the 'knowledge test' rules (to determine involvement in fraud cases with a view to deny deduction).

Certain comments started by re-iterating the general principle that all VAT on input, used for business purposes, should be deductible. In this context, tax blockings related to, in particular, cars (and petrol), restaurants and catering, hotel accommodation, costs of entertainment and events were not perceived as in line with a proper VAT system.

Occasionally, some considered the lack of deduction for public authorities or charities as inappropriate.

On a slightly more technical level, reference was made several times to the rules (and subsequent problems) of chargeability and deduction, and the fact that deductibility, as a rule, is not linked to the payment. VAT can be deductible before being paid to the supplier who can become liable for the payment of this VAT to the Treasury, resulting in pre-financing and cash-flow problems. Some pointed out that the recovery period for the tax administration is at times longer than the deduction period.

As to invoicing, it was repeatedly mentioned that small, formalistic errors often result in non-deductibility of the input VAT, which was considered excessive and unfair.

A number of problems were reported in relation to the deduction rules for non-established traders via the Refund Directives (both for EU traders via an electronic system under Directive 2008/9/EC and for non-EU traders via a paper-based system under the so-called 13th VAT Directive). Issues vary from overall problems of complexity (e.g. in the case of partial exemption), delays, non-functioning or refusals and to more specific problems as regards the operation of web portals under the electronic refund system or reciprocity requirements (13th VAT Directive).

Certain comments were clearly inspired by sector-related problems and issues. For example, the financial and insurance sectors clearly pointed to specific problems of differences in application of partial exemption rules for banking and insurance activities, the calculation of the deductible VAT amount and to subsequent risks of distortion. The road transport sectors criticised the full right of deduction of airline companies whose output is nevertheless exempt from VAT.

Q10. What changes would you like to see to improve the neutrality and fairness of the rules on deduction of input VAT?

More or even total harmonisation of the different features of the deduction system would be the main solution for most of the respondents. Harmonisation across the Member States, of legislation or practices, was in particular requested in the following areas: (electronic) invoicing requirements; tax blockings and deduction restrictions; conditions and timing of refunds; the capital goods scheme; pro rata (or other methods); persons liable for the payment of VAT; recovery periods; evidence requirements; different types of formalities; chargeability rules; VAT deduction of VAT paid at import.

Some advocated in the first place a re-establishment of the general principle that all input VAT (even incurred by employees), linked to a business activity (also when outsourced), should be eligible for deduction. This was even put forward by some as a general idea to apply for public authorities, charities and for travel agents in relation to the margin scheme.

Linked to this, it was advocated by various respondents that tax blockings should either be limited, clearly defined and applied carefully and restrictively; or be abolished altogether insofar as it is related to business use (e.g. for cars (petrol), restaurant and hotel accommodation).

In addition, replies, mainly of banks and insurance companies, focussed in particular on deduction problems surrounding the activities which are partly exempt. In this context, it was suggested to allow – more economic-oriented – alternatives for the overall ‘pro rata’ system.

There were a few suggestions to replace the current fractional VAT system by a ‘generalised reverse charge mechanism’, under which VAT would not be paid to the supplier but accounted for by the acquirer and deducted via the same VAT return, especially as a possible answer to carousel fraud (no disconnection anymore between payment and deduction) or cash-flow problems.

In this context of eligibility and deduction issues, several supported a generalised application of a type of ‘cash accounting’ system, linking the deductibility to the time of payment and the chargeability to the time of receipt of the VAT amount. It should be pointed out that a limited number, however, were opposed to this idea of cash accounting, fearing an increased administrative burden.

A number of participants came back on a former Commission proposal, which is the ‘cross-border deduction’ to allow deduction in the Member State of establishment of VAT incurred in another Member State. Others recommended a more fully-fledged One-Stop-Shop system although others were against this idea fearing a repeat of the problems which occurred under the new electronic VAT refund system.

It was, regarding this electronic refund system, suggested to make it simpler, quicker and more flexible (e.g. as regards original invoices). Comments in relation to the 13th VAT Directive suggested a reform of the system as a whole, or at least the abolition of the reciprocity condition. For refunds at national level, it was occasionally suggested to abolish the ‘carry-forward’ system and to effectively repay at every single VAT return showing a credit position of the taxable person.

At a non-legislative level, it was several times suggested publishing online a single set of guidance rules for traders, which would improve clarity and coherence.

3.5. International services

Q11. What are the main problems with the current VAT rules for international services, in terms of competition and tax neutrality or other factors?

Q12. What should be done to overcome these problems? Do you think that more coordination is needed at international level?

Most respondents did not directly address these questions, whilst others interpreted the issues from the perspective of intra-EU operations only. In so far as this aspect of the consultation process is addressed elsewhere, it is not intended to duplicate it here. In some cases the replies mixed EU and non-EU perspectives but the following analysis reflects the substance of the points made to the extent possible. The need for a coordinated EU approach was widely noted.

Almost all respondents who were directly involved in international trade in services involving third countries (*i.e.*, countries which are not EU Member States) called for

continuing engagement in the OECD process for the development of guidelines on the taxation of such transactions although accepting that coordination at international level is not easy to achieve. Some pointed to the tax treatment applied in certain third countries (e.g., Canada) as a suitable model for international services.

Individual respondents identified problems with complicated procedures, difficulties in demarcation between goods and services particularly where the outcome is different places of taxation. The impact of globalisation was singled out but the reality will always be that there will never be a global model for VAT – a solution might be found in ‘merely symbolic’ taxation of services or no taxation at all.

For some, the issue was that global businesses operate through global business models. Here the view expressed was that since VAT is a tax on consumption, it should not fall on business activities. Some however saw that EU based businesses supplying partially exempt B2B services are at a competitive disadvantage compared with suppliers based in third countries. Some concern was expressed (without any evidence offered) that whilst B2C e-commerce for non-EU suppliers is ostensibly subject to VAT, these obligations are not enforced and in practice can be regarded as optional. There were also some concerns (unspecified) that the provisions no longer cover all of the services that can be provided from remote locations via technology.

It was recommended that taxation at the point of consumption should be considered in order to ensure tax neutrality and fairness of VAT or similar taxes (presumably GST). Whilst the planned changes around the place of supply for the telecoms industry and other sectors for 2015 may assist those sectors, these changes might need to be considered more broadly for other service industries in the context of EU competitiveness vis a vis third countries.

Some felt that in order to achieve a level playing field there would be a need for bi-lateral agreements between the EU and Third Countries, as well as guiding principles from the OECD in the area of VAT on intangible services and an examination of whether VAT can be collected directly from private persons when consuming intangible services provided by non-EU traders.

Respondents believed that it is necessary to create sufficient economic or legal pressure on the entities providing cross-border services so that such services can be taxed in the same way as the services provided by an entity having its registered office in the European Union. It is highly improbable that it could be possible to achieve a solution to this issue by way of an agreement (e.g. at the OECD level). It would probably be more appropriate to use other tools for assurance of a desirable result (e.g. by means of a similar pressure, through which the U.S.A. fosters, within the framework of the FATCA, provision of data concerning assets of the U.S. citizens out of the U.S.A., without using any interstate treaty for these results).

In today's global economy, it was considered important to ensure that pan-global corporate groups are not disadvantaged from a VAT perspective purely by their corporate structures. Consideration is needed with regard to outsourcing and in-sourcing within corporate groups. The growth of more efficient and economically robust cross border business models requires the introduction of cross border VAT grouping or cost sharing arrangements. It is necessary to ensure that outsource/insource service providers, which provide the same underlying services, are treated equally. The VAT treatment of

services performed cross border or in-country should be wholly dependant on the service performed

As far as transport is concerned, some respondents felt that there was a problem with such services operated by EU operators from establishments outside the EU. Such an operator might invoice these transport services without VAT and the taxation of the service will depend on the legislation of the country of establishment of the client and on potential bilateral agreements with the Member State of establishment of the transport operator. This is the result of the varying terms of the bilateral agreements between individual Member States and third countries that create distorted and unequal situations between road transport operators.

Submissions requested that the Commission address this fragmented and distortive situation by working towards harmonised EU level arrangements, to be negotiated and agreed between the EU and third countries.

Problems in the correct taxation of international services needing attention included some Member States requiring evidence of the business status of customers even where they are not located in the EU, which can be difficult when those tax authorities are looking for valid VAT numbers, which of course many non-EU customers will not be able to provide (although to some extent this should improve once the implementing regulation comes into force). A fall-back might be a commitment to a further review of the rules once the implementing regulation has been in operation for say 18 months with a possible fresh proposal to amend the regulation to clarify areas which are still causing difficulties.

Some sectors saw themselves as suffering from particular international trade problems because of the VAT system. They believe that the application of standard VAT rates of between 15% and 25% to newspapers in their digital formats, puts the European press sector at a competitive disadvantage to their U.S. counterparts. The U.S. does not apply similar indirect taxes on their digital markets.

This creates a competitive disadvantage for the English-language press, in particular, which has the potential to win greater audiences in North America and elsewhere. Other language markets will also have greater possibilities to offer international services in future as the popularity of newspaper applications grows.

Putting the EU on a level playing field with the U.S. would improve the business environment for European newspaper publishers, many of which are SMEs, in line with one of the flagship initiatives of 'Europe 2020', 'An industrial policy for the globalisation era'.

In relation to international services and the place of supply rules some respondents believe that the principal problems are:

- inconsistency of rules and application of rules in Member States, leading to at best confusion, and sometimes non-taxation or double taxation. Sometimes this is due to derogations, but often it is just a difference in interpretation; a good example is the current inconsistent treatment of financial services across Member States;
- the inconsistency of the application of 'use and enjoyment' principles in different Member States due to the flexibility of the scope of the rules;

- the self-interest shown by Member States that delays agreements being reached for the common good, e.g. the delay in reaching agreement on the modernisation of financial and insurance services.

Other respondents considered the problems to be such that in some cases, it can be more advantageous to trade internationally, which potentially puts pressure on domestic manufacturing markets. They see cash flow advantages in buying services in third countries or in other EU countries to avoid pre-financing the VAT.

More generally, the complexity and the lack of harmonisation of the VAT system were still seen as constituting obstacles to the international trade in services and intangibles in some cases. Not all countries (even within the EU) have the same approach regarding the difference between a supply of goods and a supply of services, complex services, composite services, supply and installation contracts, the application of the ‘use & enjoyment’ rules, etc. In some cases, it leads to double taxation.

Finally, although the point lies on the periphery of the current exercise, a point made on several occasions related to problems experienced by EU businesses where VAT (or equivalent taxes) incurred in countries outside EU is non recoverable. It was however noted that the Commission participates actively in the work of the OECD where guidelines are being developed on the neutrality of taxes in such circumstances.

3.6. The legal process

It was clear from the responses to questions 13 to 16 that overall the respondents are not content with the current legal process which is not seen as conducive to ensuring a uniform application of EU VAT legislation across the EU.

Q13. Which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?

A clear majority of respondents were in favour of the use of Council Regulations instead of Directives. The main arguments given in favour of Regulations were harmonisation of the provisions in Member States, the binding nature of Regulations for Member States and their direct and consistent application. It was mentioned that the use of Regulations instead of Directives would be to the benefit of SMEs and would reduce the administrative burden, leading to greater legal certainty and reducing distortions of competition.

A number of respondents pointed to the customs area where harmonisation has been achieved via Regulations.

Several respondents favoured Regulations at least for certain areas, namely the scope of the tax, the place of supply rules, exemptions, and the right to deduct.

But certain aspects of the obligations of taxable persons were also put forward by respondents: invoice requirements, VAT reporting (covering the content of the VAT return and the recapitulative statements), requirements for VAT registration, the one-stop-shop and the IT aspects related to these obligations.

Other areas mentioned by respondents where harmonised legislation is particularly vital were the date of the taxable supply, the exemption for cost-sharing activities, the taxable amount, the definition of fixed establishment, rates and measures put in place in cases of urgency. A respondent pointed out that a Regulation should be used when the amount of detail makes the use of this legal instrument preferable.

A few respondents wished for a hierarchy of the different legal instruments: general rules should be laid down in Directives and specific interpretation and application should be done via Regulations. Others pointed to the Commission's proposal on VAT on financial and insurance services which consisted of a Directive with an accompanying explanatory Regulation as a model to follow. A respondent concedes that it makes a Directive more readable if definitions are put into a separate legal act but points to the inherent contradiction when having a Regulation that is directly binding in conjunction with a Directive that leaves the choice of form and method to the Member States.

A number of respondents who were in favour of Regulations nevertheless pointed to Member States' sensitivity in the matter.

Some respondents advocated the use of Implementing Regulations as a tool for ensuring uniform application and legal certainty.

Several respondents did not favour one legal instrument over the other as long as harmonisation was achieved and rules were implemented uniformly. Political willingness was more important than the legal instrument. Several also underlined that the most important factor was that legislation was clearly formulated. A respondent considered that the legal instrument used would not make any difference because even a Regulation would not achieve harmonisation when resulting from compromises due to the unanimity principle. Another respondent considered that it could be even more time-consuming to try to adopt Regulations, but if it was achievable that would be preferable.

A minority of respondents were against Regulations, stating a variety of reasons:

- It was considered not to be realistic because of the fiscal sovereignty of Member States and the required unanimity.
- The use of Regulations reduced democratic accountability and scrutiny, and encroached on the fiscal sovereignty of Member States.
- The use of Regulations was not seen as a material step forward as it would not prevent different interpretations and different approaches by Member States. In addition, their direct effect would have an impact on businesses and citizens.
- It was doubted that Regulations would be realistic as a 'one fits all' solution currently would not be able to take into account all national and regional conditions.
- The benefit of Directives was that they could more easily accommodate different legal traditions of Member States. Directives give the possibility to Member States and other interested parties of considering and testing proposals prior to their implementation.

Q14. Do you consider that implementing rules should be laid down in a Commission decision?

A clear majority of the respondents would seem to be in favour of implementing rules laid down in a Commission Decision, at least under specific circumstances and procedures.

A number of respondents regarded the inclusion of implementing measures in a Commission Decision as an improvement on the current position in the majority of cases; for every Directive there should be a Commission Implementing Decision; or while basic rules should be laid down in VAT Regulations, the Commission should be granted decision-making power to adopt binding implementing decisions for practical details like administrative rules or procedural matters.

Some respondents underlined that the legal instrument is of less importance as long as the guidance is provided in a timely manner, is clear and comprehensive, has been established in consultation with business, is binding on Member States, and Member States implement rules in the most uniform way. One respondent indicated that implementation in a uniform and consistent manner was vital to ensure direct compliance by businesses trading in Europe.

The respondents favouring the idea made the following observations:

- It would prevent incorrect and late transposition into national law. It would also facilitate the national implementing process as it would provide a clear steer and guidance and ensure uniform application.
- From a business perspective it would harmonise and simplify VAT rules.
- The Commission should set out the purpose of the Council's legal text and how it is to be interpreted by Member States and ensure actively that Member States implement it correctly. A major uncertainty for businesses arises from differences in implementation. It is the most convenient legal instrument facilitating general principles laid down in the VAT Directive.
- It is useful when it has to be done quickly and the Commission is also expected to be more neutral than Member States and Council.
- If a Council Regulation is not feasible. In principle yes, provided business is involved and can veto non-proportionate and unrealistic measures.
- Implementing rules have a role where clarification and guidance do not exist but they should not be seen as a replacement for clear legislation in the first place.
- The Commission should be assisted by the VAT Committee deciding by QMV and the EU permanent business group should also be involved.
- It could be a way forward to counter different implementation of Directives but this approach would require consensus across all Member States which could be very difficult to achieve.

The respondents opposing the idea gave the following reasons:

- A Commission Decision obtained by QMV voting would be against the Treaty requiring unanimity which would undermine Member States' sovereignty and there would also be the risk that a Member State who is the expert on a subject matter would not be heard. Unanimity should be preserved on fiscal matters and derogating from this principle could only be envisaged for purely 'technical' matters.
- National possibilities for structuring legislation could better take account of the national situation. It would create unnecessary ambiguities.
- Only Directives and Regulations could achieve a common VAT system.
- Businesses and individuals would be directly impacted without having a say.
- Interpretation of VAT legislation lies with the Court of Justice of the European Union.
- Implementing Regulations agreed by Council are the best way and reference is made to Council Implementing Regulation (EU) No 282/2011 as a model to follow in future. Commission should not be given any law making powers.
- It would lead to opposition from the Member States and block the legislative process.

Several respondents indicated that Member States and business have to be involved. One respondent suggests that a Joint VAT Forum could be created following the example of the Joint Transfer Pricing Forum. But also the example of the Trade Contact Group in customs matters was put forward. Respondents suggested cooperation with the VAT Committee and involvement of the Business Expert Group. A respondent advocated stakeholder input and pointed out that Commission implementing rules could have prevented the problems encountered with the Refund Directive (Directive 2008/9/EC).

Q15. If this is not achievable, might guidance on new EU VAT legislation be useful even if it is not legally binding on the Member States? Do you see any disadvantages to issuing such guidance?

An overwhelming majority of the respondents came out in favour of non-binding guidance at EU level, which they would see as useful and helpful.

Respondents referred to the good example of OECD guidance as a model to follow to achieve greater harmonisation through soft law.

A number of those respondents however clearly underlined that such non-binding guidance is not the optimal solution, describing it as 'second best solution as some Member States will not follow'; 'useful but only small progress'; 'guidelines are second step, first step is clear and effective legislation'; 'if nothing else achievable then preferable to leaving Member States to interpret and implement in their own ways'; 'only first step in the right direction'.

The main arguments given in favour of non-binding guidance were:

- Would harmonise Member States' approach and could be helpful for the interpretation and implementation of EU law. Timely guidance could indeed have a harmonising effect in the national transposition processes.
- Could clarify the intention of the legislator and help achieve legal certainty.
- Would provide important information and explanation to taxpayers, which would help them in preparing the upcoming changes. Explanatory notes could incite Member States to engage in an exchange with businesses before the national transposition of the Directive.
- Could provide to courts an understanding of the legislator's intentions and aid in defending one's position in a case. It could therefore be useful in disputes before a national court although it was not certain to be decisive for tax authorities and national courts in their decision-making.

It was noted, however, that 'if not binding it's a step backwards'; 'no point, if not binding'; 'their legal status would be hopelessly unclear'; 'would not provide sufficient certainty'; 'highly unlikely that Member States and businesses accept such non-binding guidance'; 'would be seen as sign of weakness; would clearly increase discretionary powers of Member States'; 'might result in greater legal uncertainty and more litigation'; 'not politically realistic; could result in trade-offs'; 'if not binding, no harmonisation'; 'are useless if not published; business as the one collecting tax has need for legal certainty'.

The arguments presented against non-binding guidance were:

- Risk that it will add to confusion that can arise in differences of treatment between various Member States.
- Should be avoided in order to leave the biggest possible flexibility to Member States.
- Would be a step backwards in terms of administrative simplification.
- If adopted, Member States would be free to follow or ignore them whereas in the single market procedures for application should be standardised.
- Only helpful if binding; otherwise they would not add value but increase legal uncertainty.
- Should not be too detailed but allow a certain flexibility in applying the law.
- Is the role of the VAT Committee to issue agreed guidance, relationships between Member States should be enhanced through this forum and this could contribute to greater consistency.
- Interpretation lies with the Court of Justice of the European Union.

A respondent was wondering what would happen if in Member States binding case-law already exists and it conflicts with such guidance.

A respondent suggested including VAT Committee guidelines adopted by majority vote. Another underlined that the use of soft law in EU law is common place and authorities would probably feel obliged to justify their position if they do not follow the guidance which might ultimately reduce the number of CJEU cases.

Q16. More broadly, what should be done to improve the legislative process, its transparency and the role of stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?

The main desideratum requested by the vast majority of respondents is enhanced stakeholder consultation covering the entire legislative process. Some respondents explicitly recognised the efforts made by the Commission. It was however pointed out that the transparency of the legislative process should be improved and that stakeholder input is essential at all stages of the process in order to arrive at understandable and workable rules. Some respondents wanted the consultation process to be mandatory, one of these specifying that consultation was also necessary at a national level before implementation of EU VAT rules.

Many respondents requested a formalised role for stakeholders from the business community. While some did not explain how they see this work in practice many others had specific ideas: Several advocated the setting up of a ‘permanent EU business group’, others pointed to the BIAC set up within the OECD as a model to follow. Further suggestions included reinforcing the role of the existing Business Expert Group, or establishing a ‘Trade Contact Group’ or a forum/platform for discussion between business and public authorities like the one already existing for transfer pricing. Three respondents advocated the review of proposals or amendments for their feasibility and applicability by a business ‘test panel’.

While in their replies several respondents remarked that the Commission should consult with stakeholders earlier and more systematically, there were also several voices that pointed out that the legislative process is more or less satisfactory up to the point that proposals are referred to Council, following which some consider the process enters a black box.

Apart from stakeholder involvement in the process another often repeated suggestion was the publication of VAT Committee minutes and all VAT Committee guidelines, Council meeting reports and updates on Council amendments of legislative proposals.

A number of respondents also stressed the importance of a systematic conduction of impact assessments. Of these, some insisted that after the political agreement in Council a fresh impact assessment should be carried out to examine the impact of the amendments introduced to the original proposal of the Commission. One respondent requested cost-benefit analyses whenever new EU and national provisions are adopted which should include the costs for taxable persons.

Focusing on the missing lead time for businesses between the national implementation of EU legislation and its actual entry into force, many respondents found that in numerous cases there is not enough time to adapt IT systems and other processes to the legislative changes in a proper way. Depending on whether small or major changes are necessary, it was suggested that at least 6 or 12 months are needed between the national

implementation of law and its entry into force and that future proposals should feature three dates: the date of adoption, the date by which Member States have to transpose the Directive and the date when the legislation should take effect. More time between the national implementation and the entry into force would also give public authorities time to get prepared and give the Commission a chance to check whether implementation errors occurred. Two respondents cited the late national implementation of the VAT package as a bad example.

Numerous respondents remarked on the role of the VAT Committee. Besides the publication of its discussions and decisions, several respondents indicated that stakeholders should be engaged in its work, either through the systematic consultation of the Business Expert Group or through their participation as members of the Committee. Involvement in the discussions in SCAC and SCIT was also mentioned.

Several respondents pointed to the benefits that could be derived from setting up an 'EU rulings function' that would deliver binding decisions – which would be published – on questions submitted to it, giving legal certainty to businesses seeking its opinion. Three of the respondents identified the VAT Committee as the body to which the function should be allocated. One respondent elaborated in more detail on the functioning of such a rulings commission: to be efficient the replies should be addressed in a defined timeframe; the scope of action should be restricted to future transactions, intra-EU cross-border transactions and conflicting interpretations of law between two or more Member States; rulings should be published and be granted prejudicial value. One other respondent suggested to supplement this rulings commission by an 'Express Answer Service' on the model of the one in Austria which is a service relating to enquiries from tax payers about international tax cases. Another respondent saw as an alternative to an EU function the setting up of public rulings panels in all Member States, citing the example of Australia.

Some respondents touched on the functioning of the Court of Justice of the European Union, also in relation to other actors. They pointed out that they are concerned about the trend of issuing CJEU judgments without the Advocate General's opinion and/or without detailed reasoning for the ruling. Three of these respondents found that national courts could be more efficient if they were not required to refer to the European Court.

A few respondents pointed out that a reform of the CJEU was needed to speed up decisions and that it should be able to decide which cases to take on. In addition, its rulings should be made binding on the final court. The same respondents also remarked that when Member States are asked to comment on a matter, a more systematic engagement by them must be ensured to avoid that the Court only receives limited feedback. One respondent saw the establishment of a corpus of EU law as desirable. Finally, one respondent claimed that it would be useful if the Commission were to summarise and publish its legal opinion on the Court's rulings. Even if not binding it could be a valuable aid for interpretation and would be taken into account by the Court, national courts, tax authorities and companies.

Respondents reiterated remarks on the need for legislation to be concise and clear, with some asking for a clear explanation of its objectives to be inserted into a piece of legislation. Two respondents wanted economic operators to have access to correlation tables on Member States' transposition of legislation. Some respondents pointed to the cost of constant legislative changes and one of them requested outright a three year

‘truce’ in legislation to obtain a consolidation of the system and reduce implementation costs.

Other ideas included:

- Public review of legislation, e.g. every 2 years.
- An arbitration committee should be installed for cases of double taxation.
- More centralised project management and feedback to business on Member States’ progress and problems when implementing legislation requiring substantial IT developments (e.g. refund, mini OSS).
- Legislation commencement dates should be adjusted to business activity calendar: 1 January or 1 July.
- Introduce checkpoints for Member States’ implementing process.
- VAT law should be aligned with any definitions which already exist in other legislation.
- Separate legal acts for undisputed rules and no ‘omnibus’ legislation (bad experience with Directive 2009/162/EC where adoption of important legislation was held up unnecessarily).
- All Member States should be required to provide translations of their legislation and guidance ideally in all official languages, if not at least EN, DE, FR.
- Right of initiative to the European Parliament, to Member States if they obtain a majority support for their proposals, and to the Commission. The right to transpose proposal into law should be with the European Parliament.
- Commission should be authorised to recast legislation at any time.
- Increased cooperation among the different national tax administrations could be helpful for the uniform application of VAT law

3.7. Derogations and the ability of the EU to react quickly

Q17. Have you encountered difficulties as a result of derogations granted to Member States? Please describe these difficulties.

Q18. Do you think that the current procedure for granting individual derogations is satisfactory and, if not, how could it be improved?

Very few respondents mentioned having encountered personal or direct problems with the application of derogations granted to and applied by Member States. However, a large majority of business representatives were of the opinion that derogations should either be abolished altogether or at least restricted to the absolute minimum (and until permanent measures could be agreed).

The most cited reasons for this restriction were: disharmonisation or distortion in the single market, complication of the VAT system, and extra compliance costs, especially for accounting and IT systems.

In parallel, it was argued that a derogation granted to one Member State should also be made available to other interested Member States or even integrated into the VAT Directive in cases where the measure has been assessed as beneficial.

The most cited derogation measure was in relation to the application of the 'reverse charge' mechanism, (in particular as regards mobile phones and integrated circuits). Questions were raised as to the Commission's overall criteria for proposing such derogations, the efficiency of the measure (risk of shifting of fraud), delimitation and other legal problems (exactly which products fall under the reverse charge and which do not).

Governments and public authorities pleaded unanimously to keep the system of derogations and referred in this context to the efficiency and the flexibility of it in addressing specific national needs. A minority of business organisations supported this idea.

As to possible solutions, several respondents suggested to increase, under certain conditions, the powers of the Commission (sometimes a committee of representatives of the Commission, Member States and the Council Presidency or another type of committee or panel) in order to decide very quickly on temporary derogations to combat fraud. In this context, one government preferred the former 'tacit' derogation system, which allowed Member States to apply derogating measures without prior authorisation; combined with the possibility for the other Member States or the Commission to oppose within a certain deadline.

Although probably going against the idea of speeding up the procedure, a few respondents pleaded for the prior consultation of businesses before adopting derogating measures. Some insisted on more transparency and pleaded for a central database or list of applicable derogations.

Some, more individual, views and solutions were expressed and were related to the following:

- Solutions to be developed in the field of criminal law, as VAT derogations are not suitable to combat certain types of fraud.
- Overall movement to an origin-based system.
- Improvement of the procedures and overall functioning of tax administrations to combat fraud instead of using derogations.
- Overall re-assessment of existing derogations (as some 'standstill' derogations were considered too favourable for particular Member States).
- Adoption of more objective or more rigorous criteria for adopting derogations.

3.8. VAT rates

The two questions relating to VAT rates were the ones which received the greatest number of replies. A series of contributions did however not reply to the questions but took the opportunity to call for a reduced rate, or even a zero rate in certain cases, for their sector. This was notably the case for those sectors whose activities are covered by Annex III of the VAT Directive to which a reduced rate may be applied but certain Member States do not currently make use of the option.

Q19. Do you think that the current rates structure creates major obstacles for the smooth functioning of the single market (distortion of competition), unequal treatment of comparable products, notably online services by comparison with products or services providing similar content or leads to major compliance costs for businesses? If yes, in what situations?

Some respondents clearly found that the rates issue would have to be assessed at a later stage, once the VAT arrangements for intra-EU trade are determined. The requirements of rate harmonisation will be quite different in an origin VAT system compared to a destination VAT system. In a destination-based VAT system, the rate structure would either be less of a factor or a non-factor in distorting competition.

On the existence of obstacles for the smooth functioning of the single market and the distortion of competition, there were almost as many answers saying that there are problems for the internal market as answers asserting the contrary.

Distortions of competition

Quite a number of respondents asserted that distortions of competition arise when goods or services can be purchased or used across regions and end customers are confronted with a different VAT charge. This is especially the case in border regions where private companies and VAT-exempt undertakings exploit the tax rate differentials when the variations are sizeable.

It was also pointed out that as a consequence of the differences in the level of the standard VAT rate, many non-EU businesses providing e-services have chosen a place of establishment in the EU with the aim of taking advantage of the lowest VAT rate.

On the other hand, some respondents indicated that the current rate structure does not interfere as long as the VAT is due in the place of consumption of the good or service.

Some other respondents explained that a certain degree of divergence leading to competition between Member States might be compatible with the single market. They even favoured competition – including between Member States – as the most profitable mechanism in the long term. Harmonisation would eliminate this competition. Therefore, weighing up the advantages on either side, they rejected harmonisation, along with the transfer of fiscal policy powers to EU level which it would entail.

Complexity and compliance costs

Respondents widely agreed that the current VAT rate structure is too complex and that harmonisation is really needed to simplify the rules and to reduce the administrative burden as well as compliance costs. The complexity touches in particular on SMEs which do not enjoy the real benefits of the single market. Monitoring the various VAT rates in the EU and regular changes to them, checking and implementing changes in the systems creates a huge administrative burden and results in high hidden costs. Some also deplored the lack of transparency surrounding rate differences and expressed the need for EU definitions.

Some respondents alleged that the current VAT rate structure clearly generates compliance costs but it was difficult to measure these since rules on VAT rates are often associated with national or EU regulations in other areas (for instance the definition of pharmaceutical drugs).

More harmonisation

A number of respondents sought more harmonisation but had different views on what the concept of harmonisation actually implies. Harmonisation notably meant:

- One standard rate and the abolition of all the options, derogations and exemptions.
- One standard rate and one reduced rate on a compulsory list of specific goods and services (basic supplies, labour-intensive services, ecological supplies, etc.).
- Harmonised levels of rates but flexibility for the scope.
- Harmonised rate for intra-EU supplies.
- Harmonised rates for similar supplies – zero rate being often suggested – for comparable off and on-line products, passenger transport, tourism and tourism intermediaries, movers, cultural sector, etc.

While recognising that harmonisation would be ideal from a technical perspective, some respondents expressed doubts on its feasibility because of Member States' desire to maintain their fiscal sovereignty and the unanimity requirement under Article 113 of the Treaty on the Functioning of the European Union for taxation issues. Others indicated that the application of one single rate could lead to formation of inflationary elements in the EU economy.

In this context, some added that if one single VAT rate is not possible, the VAT system should refer to a single EU list of products and services that are all subject to a compulsory reduced rate (i.e. no option for Member States to select some products or services). Some respondents recognised that the existence of certain reduced rates provides for a more equal access to the cultural, educational and health sector. Moreover, reduced rates on local services represent no risk of distortion of competition in the internal market. Consequently, some of them must be kept for economic and social reasons.

Others advocated defining at EU level the goods and services that can be subject to a reduced VAT rate, preferably organised in 'packages' or groups of goods and services. This would significantly enhance the transparency and harmonisation of the VAT

system, since Member States would have to pick the ‘packages’ on which they would like to apply a reduced rate.

The additional revenue following the abolition of reduced rates would imply room for tailor-made policy measures and/or a lower standard rate at EU level. Taking into account the inefficiencies of reduced rates and the lack of real added value compared with other policy instruments, they believed that reduced rates (including those based on standstill and accession treaty clauses) should not be replaced at the EU level when moving to the proposed model.

Some respondents indicated that in principle all items should be subject to VAT across all Member States unless they are zero rated across all Member States. Where Member States have previously granted zero rates on specific items, then the governments in these countries would have to use an alternative method to providing certain consumers with cheaper products or beneficial treatment.

This position is contradicted by respondents defending the current derogations in particular for sectors largely benefiting from zero rates such as newspapers. Some respondents asked for the extension of zero rates to new homes, building repair and renovation; to all cultural, creative and media works; tourism services; to movers’ services; to supplies to charities or non-profit associations; etc.

Equal treatment of comparable products

As for the VAT treatment of comparable products, publishers’ representatives largely supported the extension of the reduced and even zero rates currently applied to p-publications to e-publications. Some respondents asked that all cultural goods and services offline and online should be eligible for a reduced rate. At the very least, the discrimination between cultural goods should be removed such as the current unequal treatment between music and books. This issue was the subject of a petition (more than 20% of the replies received) from representatives of the music sector. According to some respondents, a survey suggested that increased sales would compensate governments for any loss of revenue resulting from a VAT reduction on sound recordings.

A number of respondents acknowledged that unequal treatment of comparable goods or services providing similar content leads to compliance costs but did not mention the level of rate to apply. Moreover, unequal treatment also concerns sectors other than online services: the food sector (ice-cream compared to ready-to-eat chilled desserts, take-away compared to restaurant services); the publishing sector compared to music or audio-visual sectors; comparable services such as hairdressers and beauticians; passenger transport (zero rates for international aviation and not for high speed trains); travel agency representatives (call for intermediaries to be allowed to apply the same VAT rate or VAT exemption as the underlying services in which they mediate irrespective of the nature of the vendor or the quality of the product sold); etc.

Definition problems

There were different definitions given of the concept of ‘culture’. For some respondents, culture covered books, music, TV and audiovisual sectors. For others, culture concerns historic and heritage buildings or art and movable property of cultural importance whilst for others it also covers the tourism sector.

Different views were also expressed on what is to be understood by ‘social’ or ‘basic goods and services’: food; products and services essential to the welfare of children; health which also includes sports in general and equestrian activities for some respondents; education; access to all cultural activities; housing as well as maintenance in the building sector in particular historic and heritage buildings but also the renovation of urban centres; sectors with a high potential of job creation; etc.

A Database with information on the VAT rates applicable in the EU

Some respondents suggested that a practical instrument for dealing with the differences in VAT rates amongst the Member States would be an on-line real time VAT rate database containing the official, accurate and up-to-date rates applicable in each Member State. In order to facilitate compliance for those businesses making cross-border supplies, VAT rates and definitions would be set out in a standard format.

Each national tax authority would be required to update the database before any changes took effect.

Other issues

Additionally, the following issues were mentioned:

- Setting the level of the rates should be left in the hands of the Member States for some respondents whereas others requested not only a minimum but also a maximum rate as a first step towards harmonisation.
- Minimum reduced rate could be set at a percentage of the standard rate applied in the same Member State, e.g. one-quarter of this rate.
- Reduced VAT rates should be abolished but zero rates should be maintained.
- The need to narrow the gap of standard rates between Member States.
- Greening VAT by applying different rates according to the environmental performance of the products.
- Demolishing dilapidated buildings to have them replaced by new buildings is the most efficient way of achieving three EU objectives: the regeneration of urban centres, social cohesion and boosting the efficiency of residential buildings. This activity clearly has to be underpinned by a reduced VAT rate.

Other more individual wishes expressed by respondents include:

- First, general principles on which various exceptions and reduced VAT rates could be reviewed should be established and then their scope defined.
- VAT reduction could be linked to healthy foods or to eco-label products.
- The necessities of life, notably food, newspapers, public transport, property rental, health and education, should be liable to zero-rating to remain affordable to all, while luxury items should be subject to higher rates.

- The Commission should create a systematic impact study, and a comprehensive inventory on the impact of reduced VAT rates.
- The Commission should use much more of its power to launch infringement procedures against Member States who violate EU rules.

Q20. Would you support a compulsory and uniformly applied reduced VAT rates list in the EU notably in order to address specific policy objectives as laid out in ‘Europe 2020’? Or would you prefer to have no reduced rates (or a very short list), which might enable Member States to apply a lower standard VAT rate?

Both suggestions mentioned in Q20 were supported but with some amendments.

Some respondents asserted that a broad tax base with a lower standard rate and no reduced or zero rating has the advantage of simplicity which offers a greater degree of certainty. The more complex the rate structure the more time both business and government spend on arguing about the application of complex rules on liability.

Some respondents mitigated their opinion. More simplicity and harmonisation is required while at the same time Member States should have more flexibility or at least keep their current leeway because each Member State within the EU is different and the existence of different reduced rates reflects the fact that governments have to tailor the VAT system to take account of their domestic social conditions.

Some respondents welcomed a substantial reduction in the number of reduced VAT rates so that the standard VAT rate could be reduced accordingly. Other respondents would prefer to keep the possibility of applying reduced VAT rates.

A compulsory and uniformly applied reduced VAT rates list

More than 22% of respondents, mainly business representatives, supported a compulsory and uniformly applied reduced VAT rates list. Harmonisation of VAT rates across the EU would certainly be a step towards greater transparency of the VAT system, and consequently, towards its simplification and a reduction of costs. This would also prevent this macroeconomic instrument from being used for political purposes and discourage the use of VAT as a tool giving a competitive edge over other Member States.

Additionally, where there is a broader tax base it may also be possible to reduce rates of direct tax which could have significant social benefits. Equally, the role of environmental taxes should not be underestimated and a co-ordinated tax strategy at EU and Member State level needs to consider all the forms of taxation together and not just VAT in isolation. There may be other ways to achieve the social aims set out in Europe 2020 without retaining a range of VAT rates.

In many contributions, there was always this ambivalence/duality between the need for more simplicity and the need to keep some flexibility for Member States. A number of respondents were aware of the difficulty to combine harmonisation and the political interest to use reduced rates for social and economic reasons. A narrower tax base with a range of EU-wide uniformly applied rates that are compulsory would appear to offer a

less complex outcome than at present. However, the use of the term ‘compulsory’ could be seen as politically controversial in view of Member States’ view of ‘tax sovereignty’.

Some respondents mentioned that harmonisation of VAT rates would be the best solution to ensure that competition is focussed on the quality of the goods and services supplied and not solely on the price. Nevertheless, it has to be considered that different social and economic situations in Member States may justify differences.

The most requested categories to be put on the list concerned basic goods and services such as food, health and sport, social and care services and children's products; local and labour-intensive services such as services in the building sector, gardening, car repair, etc. In short, supplies based on social and environmental criteria determined at EU level in order to help citizens, families, and businesses by offering affordable basic goods and services; to boost employment and promote sustainable development, notably by promoting property renovation; by using energy-saving equipment, products and materials for energy efficiency or for alternative energy; by supporting water and waste treatment and recycling as well as services leading to reuse.

No reduced rates (or a very short list) and a lower standard VAT rate

16% of respondents preferred to have no reduced rates (or a very short list) and a lower standard VAT rate mainly for the sake of simplicity and a substantial decrease of costs. Undoubtedly, a single rate would make the single market more efficient, reducing distortions and compliance costs. Some respondents asserted that a single rate would be more consistent when implementing an EU VAT system based on the principle of taxation in the place of origin (place of establishment of the supplier).

Some respondents suggested however that the best way to keep the standard rate of VAT low is not to broaden the base but to impose a higher rate on ‘luxury’ goods or those of high environmental impact.

To date, the national legislations have a double reduced rate system, whose application involves substantial administrative costs. This scheme should be replaced by a system tending towards a single reduced rate. To achieve this, Member States should only be allowed to apply a single reduced rate to a circumscribed and well defined group of goods and services.

However, some respondents asserted that the VAT Directive should not set the precise value of the reduced rate. It would suffice for a range of rate values to be indicated: otherwise, Member States would be deprived of an important tax policy instrument for the purpose of achieving the Europe 2020 objectives – one which can be used, for instance, to favour employment in certain production sectors and to improve protection of the environment.

A reduced rate would be acceptable where the reduced rates do not create compliance costs, where they present no risk of distortion of competition for the internal market or in cases where they are in the interests of public policy. Even stating that it is undeniable that harmonisation would bring about simplification and a more level playing field, some respondents expressed their doubts on its feasibility, mainly for political reasons but also because of the unanimity rule for taxation in the Council.

From a private business point of view, a single VAT rate to all goods or services with some exceptions (a short list) would be appreciated. However, taking into account the

different levels of development and economic wellness of the Member States, there were doubts on the feasibility from the State budget point of view. Others found it utterly unrealistic that a matter such as a lower VAT rate could be a common EU concern (and decided unanimously), in a way that would, for instance, address any overall Europe 2020 objectives. Because there would be substantial political barriers to overcome, decisions on reduced and differentiated VAT rates will continue to be taken at national level.

Almost the same number of respondents (16%) defended the need to keep or to introduce reduced VAT rates which contribute towards achieving the social-political goals of the Europe 2020 Strategy.

Reduced VAT rates, an efficient policy instrument or economically inefficient

On the use of VAT reduced rates as a policy instrument, the positions were also quite contradictory.

On the one hand, some respondents were convinced that VAT incentives can be a powerful policy instrument for Member States. They therefore insisted on at least keeping the present categories of goods and services eligible for a reduced VAT rate (Annex III) but a number of them also wanted to extend it with new categories. The most cited reasons for this extension are: social reasons; to boost employment in labour-intensive sectors and combat fraud; to give access to culture, in particular electronic and on-line services; to help sectors undergoing major structural changes (publishers' sector); to encourage investments and support the development of new technologies; to boost environment protection; to improve the efficiency of residential buildings and encourage energy efficiency in EU; and to combat the illegal economy.

A number of respondents advocated reduced VAT rates to promote environmentally respectful goods and services as a tool against global warming or to promote sustainability. They asserted that greening VAT by applying different rates according to the environmental performance of products will not compromise the neutrality of the impact of VAT, but rather iron out some distortions in the current market for energy and resource-intensive products. This is because while different products are associated with very different environmental costs during their life-cycle, these costs are not reflected in the prices of these products, i.e. these costs are not internalised. Thus, products that are environmentally damaging may be cheaper than products that are more beneficial to the environment and thus associated with lower environmental costs during their life-cycle. Differentiated VAT rates in line with clearly defined environmental impacts and goals can be one way of internalising these costs and creating a level playing field between products or services.

Greening the VAT system in this way – not only in relation to transport, but also in relation to other products and services – would not compromise the amount of revenues raised, but rather would shift the tax base towards products that are more environmentally damaging. This would mean that the polluter-pays principle would be applied to VAT in the EU. Greening VAT would also support complementary policy approaches such as energy efficiency labelling by giving consumers additional information on the energy performance of products in the price of that product and the VAT rate applicable.

In this context, the reduced rates should concern the following categories: building sector (for which adherence to sustainability principles means making the best use of the environmental capital invested in the existing built fabric, especially in urban areas); greener collective passenger transport (rail traffic); greener agriculture and forestry; energy/water-efficient equipment; refuse collection and waste treatment, recycling and reuse services; products with a high-level of recycled or reused materials, such as recycled paper products; highly energy-efficient white goods, recycled items. The full VAT rate should be applied to resource- or energy-intensive products and services (e.g. air travel, international shipping or food, meat and dairy products).

Some respondents considered that abolishing Member States' derogations from the main VAT rates structure as well as reduced rates in favour of standard rating across most supplies of goods and services are likely to impact the most on low-income households.

A number of respondents indicated that the existing provisions should be preserved until a detailed analysis and assessment of the impact of any deletion or restriction of these provisions has been carried out in Member States.

On the other hand, other respondents explained that, at first sight, reduced rates seem to be indispensable in order to provide easier and more equal access to basic products, such as food and clothing, and to essential services, such as social housing and medical care. However, they listed several reasons for the abolition of reduced rates. In particular, reduced VAT rates are not the only and/or best instrument for taking policy measures. Member States have other means at their disposal for reaching the same results: subsidies (e.g. food coupons); income tax deductions (e.g. certain building costs); income tax credits or targeted benefit schemes; third party payment systems (e.g. social services), etc. Moreover, these mechanisms allow policy makers to focus more on certain categories of people, for whom the government intervention is intended at a lower cost.

Some respondents added that reduced rates cannot adequately cope with Member States' changing policy needs, as the relevant categories of goods and services would have to be adapted, implying a long drawn out legislative process (unanimity rule in the Council for taxation issues).

3.9. The Commission Action Programme for Reducing Administrative Burdens and streamlining VAT obligations

Q21. What are the main problems you have experienced with the current rules on VAT obligations?

For the vast majority of respondents the main problems with regard to the current rules on VAT obligations arise from the lack of uniformity and of consistency across Member States. The diverse implementation at national level of the rules on VAT obligations makes VAT compliance very burdensome and is a source of legal uncertainty for businesses with cross-border activities within the EU.

Strictly related to the low degree of harmonisation across the Member States, respondents also widely reported the problem of obtaining all necessary information in each Member State of registration, which makes it hard to follow the different compliance rules applicable across the Member States.

As a matter of fact, respondents largely indicated that doing business is difficult and expensive from a compliance point of view in the EU and regretfully admitted that because of the onerous, differing and disproportionate reporting obligations, it is significantly less burdensome to trade with non-EU countries than it is with other Member States.

Respondents further noted the difficulty in standardising VAT compliance processes in financial shared service centres when there is no consistency across the Member States in respect of the setting up and maintenance of ERP systems, the issuing and retention of invoices and the reporting and filing of returns.

Differences and problems were notably widely acknowledged as regards:

- The need for businesses to understand and comply with the individual requirements of 27 different VAT systems and to provide more reporting information than they can easily obtain.
- Differences in the application of exemptions and reduced rates, derogations, all the different options taken by the individual Member States, including the implementation of obligations that go beyond EU requirements.
- Non-standardised and in many instances unclear VAT registration requirements in each Member State in respect of non-established businesses.
- Inconsistent VAT registration and Intrastat thresholds across Member States.
- Inconsistencies in the format, frequency, and deadlines for filing VAT returns, intra-EU sales listings and Intrastats across Member States. This lack of consistency creates confusion, increasing the risk of possible penalties for failing to comply with deadlines.
- Excessively complex invoicing rules which differ from Member State to Member State and divergent practices regarding electronic invoicing (need for electronic signature in some Member States).
- Rectifying invoices (credit notes and corrections) and rules for archiving invoices, including retention period and the place where invoices can be stored.
- Obligation to issue invoices for exempt services.
- Rules regarding the regularisation of VAT paid in relation to bad debts are also different in each Member State, and in many cases these rules are very complex.
- Different processes for the refund of excess credits.
- Different rules in different Member States with respect to the requirement to provide insurance guarantees to secure refunds of excess VAT credits.
- Different and sometimes excessive penalties, also for infringements which result in no loss to the treasury.
- Too many requirements with questionable effectiveness in combating fraud.

- The proof of export and the evidence requirements for exempting or zero-rating intra-EU supplies.
- The non-availability of forms and/or explanatory notes on the internet.
- Tax authorities which are not approachable.
- Element of repetition in some of the current reporting requirements.
- The language barrier in respect of the above points.

In relation to the above issues, respondents shared the view that these are sufficient to make it unattractive for many businesses, particularly small enterprises, to seek customers in other Member States.

Certain comments were more related to sector-specific problems and issues, in particular:

- Bus and coach operators complained that they have to account for VAT on sales and reclaim VAT on inputs according to procedures which differ in each Member State.
- Removal companies noted that the present scheme does not cater for practical compliance with VAT requirements for the transport of B2C consignments originating in a Member State other than the Member State in which the removal company is registered for VAT purposes.
- The rules governing the place of supply for on board supplies of catering services provided during the section of train passenger transport affected within the EU were reported as problematic: problems with multiple VAT registrations with the new rules on place of supply as of 1 January 2010. These rules lead to an increased administrative burden resulting from the processing of a higher amount of tax reports in various Member States, including the keeping of additional compulsory records and recapitulative statements which are required according to the legislation of the Member State concerned.
- In relation to cross-border transport: it was mentioned that the amount of red tape involved in complying with VAT obligations has increased constantly. In particular, the necessary forms, which are available exclusively in the national language, were reported to pose enormous problems. The different processing methods in the tax offices in the Member States mean that an operator has to deal with 27 different procedures. That is claimed to be hardly manageable without consulting a tax adviser.

Other problems referred to by individual respondents relate to:

- High penalties in case of late VAT registration.
- Determining the degree of liability for tax (full, mixed, or partial) and the associated right to deduct in accordance with the exemption rules and those transactions that are performed free of charge (e.g. for sports clubs, holdings and financial institutions).
- New system of VAT refunds.

- Complex processes for receiving refunds of VAT incurred on short business trips to Member States where the business has no tax presence.
- Difficulties in obtaining fully compliant invoices from non-EU suppliers as required by the EU legislation resulting in doubts for the EU tax payer on the right of deduction.
- Regular detailed reporting is a huge burden, especially for SMEs.

Q22. What should be done at EU level to overcome these problems?

To reduce the administrative costs and the compliance burden on businesses, to improve legal certainty and to make it easier for them to trade across the EU, the vast majority of respondents highlighted the need for VAT compliance obligations (but also for the VAT regimes as such) to be streamlined and harmonised across all Member States based on current best practices.

In particular, respondents strongly supported the introduction of a standardised EU VAT return available in all EU languages. In addition to easing administrative burdens for businesses (including SMEs), it was suggested that an EU standard VAT return could also allow Member States to exchange data more easily and swiftly.

Opinions differed as to whether reporting periods and time limits need to be harmonised. Whilst some respondents took the view that VAT return periods and filing deadlines should be standardised across all Member States, others were of the opinion that if VAT returns in all Member States were due on or around the same date each period, this could create a serious resource bottleneck especially if use is made of a shared services centre.

Additionally, a large majority of respondents suggested that:

- Invoicing requirements, including electronic invoicing and archiving, should be further harmonised, with some even pointing out that additional national requirements should not be allowed. It has been suggested that a template or so-called model invoice could be incorporated in the VAT Directive for companies to use on a voluntary basis.
- Standardisation of the intra-EU sales and purchases listings and Intrastat reporting obligations.
- IT systems and technology used by VAT authorities should be harmonised to ensure that VAT return processes can be centralised within businesses, e.g. in shared service centres, in order to generate economies of scale for businesses operating in multiple jurisdictions.
- It would be very helpful if maximum requirements could be set at EU level as this would assist in the introduction of IT systems that are designed to handle a predefined range of information and which could operate on a cross-border basis.
- Establishment of a comprehensive one-stop-shop (OSS) system so that taxable persons could fulfil all VAT obligations in the Member State of establishment. A

OSS would greatly reduce the burden (such as registration and filing of VAT returns) on businesses, and especially SMEs which very often have transactions with end consumers, since it would allow them to file one VAT return for transactions in different Member States. Today, businesses must register and file a VAT return, even if only one invoice for a supply of a good or a service has been issued.

- EU-wide harmonised forms of proof to be furnished for exemption of intra-EU supplies of goods or service to be valid.
- Electronic communication between taxpayers and tax authorities should be encouraged (e.g. via email or perhaps an on-line portal).
- There should be a standard VAT registration process (including registration forms) across all Member States.

A majority of respondents also stressed that:

- There should be better access to information at Member State and EU level, possibly via a database with relevant information permitting business to comply accurately and timely.
- It would be useful to have a unique IT tool for compliance with VAT obligations EU-wide. It would avoid having to enter into the websites of 27 tax administrations for submitting electronic VAT returns and it would avoid having to have different electronic certificates to enter these websites and submit VAT returns.
- Additional reporting over and above VAT returns and sales lists should be abolished, including the obligation to submit Intrastat returns.
- Cross-border VAT grouping to be allowed as well as the option for Pan-European/multinational companies to file one VAT return for all group company transactions in all Member States (i.e. one consolidated VAT return for all group members).
- Timely announcement and implementation of new legislation so that businesses have sufficient time to adapt their IT systems.
- Harmonised penalties that apply only in the case of loss or potential loss for the treasuries.
- In the case of reverse charge for B2B cross-border supplies of services, the tax should accrue on receipt of the invoice or by no later than the end of the calendar month following the supply.
- At EU level, the administrative burden could be streamlined and reduced if the European Commission is provided with sufficient instruments for a more active role (e.g. the possibility to adopt regulations for certain specific subjects; for very specific kinds of provisions; the abandoning of the unanimity principle in the Council in certain cross-border areas in order to ensure the functionality in the VAT area, etc).

Certain individual suggestions reported by respondents include:

- Many of the current reporting obligations could be abolished if the origin principle was adopted for all supplies between Member States.
- Every entrepreneur to be automatically VAT registered.
- Full harmonisation of the VAT system and its management through a single Regulation.
- Since change is very expensive some voiced concerns about frequent changes in relation to administrative obligations and suggested that the latter should be changed as little as possible.
- Carousel fraud and other fraudulent schemes must be combated by specific measures, aimed at those fraudulent taxpayers, rather than by means of generic measures.
- Introduction of a pan-EU certification procedure for VAT calculation and reporting systems.
- An optional alternative VAT return which allows SMEs with a permanent base in only one Member State to report all transactions in all other Member States based on the VAT rules in the country of establishment.
- A comprehensive transition to taxation of actual receipts.
- Removal of different time limits for VAT recovery by non-established businesses compared to locally established businesses for VAT recovery.
- Abolish intra-EU sales listings.
- Standardised definition of a permanent establishment for VAT purposes.
- Reduce the frequency and burden of periodic VAT returns (annual returns for small businesses and quarterly returns for everyone else with monthly returns strictly on an optional basis).
- Limit the discretionary power of Member States as to the use they make of Article 273 of the VAT Directive.
- There should be a standard data set to be provided for audit purposes in every country.
- Non-established entities should be treated similarly in every Member State and treated the same as established entities in terms of their compliance responsibilities.
- Any VAT registration applied for should automatically be active for intra-EU purposes, and immediately and automatically added to the VIES system.
- Administrative costs could also be reduced by eliminating the invoice requirement in relation to supplies to private individuals.
- A standard EU procedure should be adopted for bad debt relief.

Finally, some sector specific suggestions relate to:

- A request to allow for an exemption with the right of deduction for supplies of catering services on board means of transport and for ship supplies.
- For intra-EU B2C supplies by removal companies, it was suggested that the threshold needs to be at a harmonised level for each Member State i.e. not at a total level for all Member States.
- The thresholds for VAT registration and distance selling should be standardised.

Q23. What are your views particularly on the feasibility and relevance of the suggested measures including those set out in the reduction plan for VAT (N° 6 to 15) and in the opinion of the High Level Group?

The vast majority of the respondents noted the need to reduce administrative burdens. Few respondents expressed a general agreement with all the measures included in the VAT reduction plan and the High Level Group recommendations. However, the majority of the responses favoured certain measures and excluded others.

The minority of the respondents who opposed the suggested measures observed that the cost of VAT compliance is already high and increases with any change of legislation due to the changes in the administrative routine and the costs of IT systems. Therefore, a number of respondents suggested making a careful impact assessment and a wide consultation of business organisations before implementing any new harmonised measures. A few respondents argued that the suggested measures may not effectively reduce the administrative burden.

On each individual proposal, not more than 35 respondents made specific comments.

The only proposal which raised more opposition than support is the introduction of a real time VAT collection system. The majority of the respondents were strongly opposed to this because of its complexity, the costs of introduction and maintenance, the impact on cash flow, the security of the data and the technological difficulties in realising the split payments.

The vast majority of respondents who commented on the annual VAT returns, the intra-EU acquisition listings and the nil intra-EU sales listings agreed with their abolishment. Some respondents also noted that the system should ensure a notification of a nil intra-EU sales listing in order to avoid any confusion with a late submission of a regular listing. A few respondents observed that the annual VAT returns and the intra-EU acquisition listings do not exist in many Member States.

With regard to the reduction of the frequency of VAT returns, the opinions were divided. Many respondents agreed with the general principle of a reduced frequency; however a number of respondents requested to have an option to file a monthly VAT return. Summarizing, the respondents were in favour of monthly, quarterly and yearly VAT returns based on the turnover with the right to opt for a more frequent VAT return.

The vast majority of the respondents who commented on the common export proof were in favour of its introduction. Some respondents mentioned the need to introduce supporting proof in cases where the main proof is unavailable for certain reasons.

The vast majority of the respondents who commented on the increased e-government solutions were in favour of such solutions. Some respondents were concerned about the impact of such solutions for small businesses as this may require specialised knowledge and investment in IT systems which they do not possess.

The majority of the respondents who commented on the inclusion of the VAT registration into the business registration process were in favour of this solution. However, this solution also raised a lot of opposition based on the current legislative practice where business and VAT registration are based on different criteria.

The vast majority of the respondents who commented on the harmonisation of the anti-fraud measures in principle favoured a harmonised approach to countering fraud. However, many respondents were concerned that such solutions may disproportionately increase the administrative burden by transferring the obligation to combat fraud to the taxable persons and increase the costs of VAT compliance.

The vast majority of the respondents who commented on the facilitating of the use of the power of attorney to submit VAT returns and listings were in favour of this proposal.

Several respondents emphasised the need to introduce harmonised rules on VAT grouping. The VAT grouping was seen by those respondents as an essential cost-cutting measure. However, it was stated that a further harmonisation of the rules is required to improve its effectiveness.

Generally speaking, many respondents were in favour of more harmonisation of VAT obligations. The majority of the respondents who commented on this issue mentioned the need for a standard VAT return, using the lowest common data set. Almost as many respondents also supported a single VAT return as a part of the OSS.

Other comments repeated by several respondents were to:

- introduce a list of standardised obligations under Article 273 of the VAT Directive;
- further harmonise the invoicing (also e-invoicing) requirements including common rules on storage;
- introduce the thresholds (e.g. per amount and per customer) for intra-EU sales listings;
- abolish the Intrastat and the intra-EU sales listing;
- revise the thresholds for VAT registration and distance selling;
- introduce a single window for all obligations.

3.10. Small businesses

Q24. Should the current exemption scheme for small businesses be reviewed and what should be the main elements of that reassessment?

A large majority of the respondents were in favour of reviewing the current exemption scheme for small businesses. Some respondents suggested abolishing the scheme. A few respondents found there is no need to review the scheme.

Many respondents who were in favour of reviewing the scheme stressed the need for high exemption thresholds. Furthermore, it was found important that – to avoid distortion of competition – the same thresholds are applied in all Member States.

Currently there is, as a few respondents suggested, no common definition of what constitutes a ‘small business’. The rules applied differ to a great extent between Member States and some have not even implemented such rules at all. Applying different thresholds in the Member States would significantly reduce the benefits of the scheme to small businesses.

To avoid distortion of competition between established and non-established small businesses operating in the same Member State, several respondents advocated an EU-wide exemption threshold for small businesses, applicable irrespective of the place of establishment. To allow small businesses to develop their business in other Member States, there should also be a threshold for VAT registration in the Member State where the small business is not established.

Other, more individual, comments made by respondents were:

- Compliance obligations should be reduced. Simplification for small businesses is needed.
- The access to information about foreign VAT rules and practices should be improved for small business, since the costs of seeking professional advice are high.
- The exemption threshold should be reviewed regularly.
- The periodicity and the number of declarations should be limited.
- The scheme should mainly be applicable in the start-up phase of a small business and be limited to physical persons.
- There are too many different schemes applied in the Member States (exemptions, flat-rate schemes, graduated tax relief). There should only be an exemption.
- The scheme should also take into account profitability.
- The entire retail sector should be exempt.

The respondents who suggested abolishing the scheme gave various reasons: the scheme creates distortions of competition; there is a risk of fraud; small businesses close to the

threshold might be tempted to not develop their economic activity further; and simpler systems are possible.

The respondents, who took the view that no review of the scheme is needed, argued the current scheme works well.

Q25. Is there a need for another simplification scheme for SMEs besides the exemption scheme for small businesses and what should be the main elements of that scheme?

To a certain extent respondents included their answer to this question in their answer to question 24. In addition the following simplifications were suggested.

A few respondents took the view that simplification is possible in the context of the optional cash accounting scheme for small business. The thresholds concerned, however, need to be harmonised within the EU. Another group of respondents advocated reducing the frequency for submitting VAT returns to the tax administration by small businesses (for instance annually).

Some respondents were positive about a system of taxation based at the place of origin since it would simplify the VAT rules for small businesses, reduce the administrative burden and limit the scope for cross-border VAT fraud. Such a change, however, should be accompanied by allowing VAT-registered business to reclaim VAT incurred in other Member States on their domestic returns. A few respondents wanted a flat-rate scheme for small businesses based on turnover as this would reduce the administrative burden.

A few respondents were of the opinion that the general VAT rules should be simplified in a way that a special scheme for small businesses is no longer needed. Other respondents stressed the need for less bureaucracy and a simplification of the obligations for small businesses.

The view was also defended that the crossing of the turnover threshold needs to be modulated by granting some time to small businesses to adjust themselves to the new situation. It was also suggested to allow for simplified invoices or zero rates in relation to certain supplies.

Other, more individual, comments made by respondents were:

- Any additional simplification should be uniformly applicable in the EU.
- To apply the reverse charge mechanism more often would be an effective simplification.
- Small businesses should not be obliged to submit electronic tax returns.
- If an Expert Committee were to be set up which takes account of the position of small businesses, the operators of small businesses could provide practical input to those bodies considering simplification.

- European benchmarking of declaration obligations could result in a common list of minimum and simplified requirements recognised in all Member States.
- There should be a one-stop shop in respect of the distance selling of goods and a central database of country compliance requirements.

Q26. Do you think that small business schemes sufficiently cover the needs of small farmers?

A majority of the respondents stressed the special scheme for small businesses does not sufficiently cover the needs of small farmers. Several arguments were given. It was stated that small farmers are not comparable to other small businesses. Contrary to other small businesses, small farmers have to make big investments and therefore have a lot of input VAT. Also, the special scheme for small businesses is based on annual turnover, whereas small farmers may have – due to the nature of their production – no or very little turnover for a number of years followed by a year of very high turnover. Since the application of the special scheme for small businesses differs in the Member States it would be difficult to apply this scheme to small farmers.

Other respondents sought to set out why the special scheme for farmers is better suited to the needs of farmers: many small farmers would be excluded from the application of the special scheme for small businesses; the special scheme for small businesses does not give a right to deduct; and the special scheme for farmers reduces the administrative burden, would be more effective and create less fraud. Some respondents pointed at the fragility of the farming sector and it was stated that it is in the public interest to support the competitiveness of the sector.

A smaller group of respondents, however, took the opposite view and did not see a justification for a special scheme for small farmers next to a special scheme for other small businesses. It was found that the traditional farming activity has evolved in recent years with the increase of automation and farmers have also become subject to other complex rules (such as rules related to the environment, animal health and food protection). Moreover, in order to simplify tax, more coherence is a key aspect and the similar VAT treatment of small farmers and other small businesses is therefore desirable. It was suggested to examine the usefulness of the special scheme for farmers and whether it is widely used in the Member States.

It was stated that the general VAT rules should be simplified in a way that no special scheme for farmers is needed. The suggestions were made to introduce a maximum turnover threshold for the special scheme for farmers at EU level and to clarify the concept of ‘small farmer’. Improvements of the scheme for farmers would be needed in the context of cross-border trade.

3.11. Other potential simplification initiatives

3.11.1. A one-stop-shop mechanism

Q27. Do you see the one-stop-shop concept as a relevant simplification measure? If so, what features should it have?

Many respondents noted that VAT registration and compliance in multiple Member States represents a huge burden for businesses, especially for SMEs. Diverse VAT regulations in national languages of the Member States were also considered to be an obstacle. On those grounds, the vast majority of the respondents considered the one-stop-shop (OSS) as a desirable simplification measure.

Those respondents who opposed the OSS considered that Member States do not have the capacity to implement efficient IT systems. Furthermore, the impact of the OSS on the revenues of Member States should be carefully assessed. Some respondents were of the opinion that the OSS could only operate if single VAT rates were introduced. Several respondents, who favour the VAT collection under the origin principle, noted that an OSS would not be needed if that principle was implemented.

A number of respondents requested to learn from the negative experience of the implementation of the new VAT refund system in order to avoid similar problems. Some also thought that the full OSS should follow the implementation of the mini-one-stop-shop (which will come into force in 2015) as this could provide valuable experience for its construction.

Of those respondents in favour of the OSS, the majority were of the opinion that the OSS should cover both output and input tax and should cover the refund of excess VAT. Several responses specified that the OSS should cover both B2B and B2C supplies, however, the supplies between related parties should be considered outside the scope of VAT or handled under the reverse charge mechanism. Many respondents were in favour of an optional OSS so that businesses would have the possibility to apply for a 'regular' VAT registration in any Member State if they so wished.

Many responses stressed the need to align the VAT rules for the proper functioning of an OSS: at least the thresholds and the VAT return periods should be harmonised. However, the full harmonisation of VAT rules should be seen as an objective in the long term. For that reason, harmonised IT systems providing the information to taxable persons on the VAT rules in all Member States would have to be developed. Businesses (both SMEs and large businesses) should be consulted during the creation of such an IT platform.

In general, responses pointed to the need to build an OSS along the following principles:

- be optional;
- cover VAT deduction and VAT refund;
- a single payment;
- a single VAT return;

- a single VAT registration;
- be based on a common IT platform;
- cover B2B and B2C supplies;
- VAT rules should be aligned (in particular the thresholds) in order for the one stop shop to operate smoothly.

3.11.2. *Adapting the VAT system to large and pan-European businesses*

Q28. Do you think that the current VAT rules create difficulties for intra-company or intra-group cross-border transactions? How can these difficulties be solved?

Although the majority of respondents choose not to address this question, those who did clearly attached some importance to it and several went to some length in expressing their views. Both the fully taxable and exempt sectors were represented in the responses.

For many, they saw a problem in so far as the VAT system is based on rather old perceptions of business models and does not sufficiently take account of the way in which operations are structured, particularly cross-border operations, and as a result disproportionate burdens fall on these businesses. It is seen as designed primarily for transactions between un-related parties whereas there is considerable evidence that the greater part of intra-EU operations are now between related entities, both for goods and services. Removing these transactions from the scope of VAT would greatly simplify the process and remove burdens from business without endangering tax revenue. Significant IT saving might also be expected. Consistency with the Commission's proposal on CCCTB was also mentioned a justification for enhanced cross-border VAT structures.

Many references were made to the lack of consistency between Member States and the additional costs this causes to businesses. The FCE⁶ judgement has highlighted the absence of neutrality for similar transactions between organisations with different legal structures and between goods and services. The introduction of pan-EU VAT grouping or special measures for transactions between related entities were seen as panaceas for such problems. Where businesses operate in several Member States, there should be mechanisms to simplify administration, facilitate flexibility in business models and to prevent VAT acting as an obstacle to an optimal corporate structure. Neutrality should mean that VAT considerations should not drive how a business is structured and many businesses are obliged to follow other EU regulatory obligations in fixing their corporate structure (such as Solvency II in the case of the insurance industry). Many tax authorities regard all intra-group cross-border transactions as within the scope of VAT, irrespective of the nature of the transaction notwithstanding that many such transactions are undertaken purely for transfer pricing reasons and are merely a contribution to shared costs with no underlying supply. The Commission is urged to consider how to achieve a

⁶ Case C-210/04

more consistent understanding and application of the views expressed by the Court in EDM⁷.

For a fully integrated international manufacturing or distribution business, VAT has to be accounted for on multiple occasions through a distribution chain before there is any charge to a third party. The intermediate stages are seen as generating no real VAT revenue but yet carry administrative burdens as if revenue was actually at stake. This applies to operations involving both goods and services and the allocation of central costs was identified as giving rise to particular problems even in a fully taxable environment. Pan-EU VAT grouping would allow the transfer of such costs between members of a corporate group to take place outside the scope of VAT. It is however recognised that any solution should not infringe the principle of freedom of establishment and avoid distortion of competition. Moreover, rules for calculating deduction should be laid down for such groups to ensure that the deductible proportion is calculated in the same way in all Member States concerned and determined on the basis of the VAT group as a whole (probably implying some form of EU wide pro-rata in such cases).

For financial institutions, respondents from this sector drew attention to the manner in which these act through a global network of fixed establishments which can be either branches or subsidiaries. Operations between branches are usually outside the scope of VAT but this does not apply when a subsidiary is involved. There is also inconsistency and a lack of clarity in the treatment of branches in third countries or the EU established branches of institutions whose head office is elsewhere. The concept of fixed establishment and the significance of local intervention are not uniformly understood and applied by Member States, resulting in little consistency in how taxing obligations fall between the recipient and the supplier in intra-group or intra-company cross border transactions. In this respect, some saw the VAT Package as imposing further administrative costs on companies involved in cross-border operations.

Other respondents identified scope for invoice numbering provisions to apply at EU rather than national level which would simplify the arrangement of a single numbering series for an integrated group. Some groups encounter problems relating to the storage of goods for periods exceeding six months in Member States where they are not identified for VAT purposes.

Cost sharing arrangements were identified as having a role to play in cross-border structures and the Commission is urged by several respondents to prioritise developments here. The current provisions of Article 132(1)f have not been implemented by several Member States and, where implemented, is seen as having unnecessary restrictions such as being restricted to domestic entities. Given that this measure will no longer be discussed in the ongoing Council discussions on financial services, the Commission is urged come forward with clear guidelines or other practical assistance.

Several respondents used this question as an opportunity to express dissatisfaction that not all Member States had enacted domestic grouping arrangements, urging the Commission to encourage them to do so. The discretion of Member States regarding this provision is seen as creating inconsistencies and discouraging trade in the single market. Some even went so far as to make a case for compulsory VAT grouping in all Member States.

⁷ Case C-77/01

3.11.3. Synergies with other legislations

Q29. In which areas of VAT legislation do synergies with other tax or customs legislation need to be promoted?

The responses to this question outlined different areas in which more synergies between legislations are required. These areas are the following: (1) VAT and customs, (2) VAT and excise, (3) VAT and direct taxation, (4) VAT and statistics.

In the customs area, the majority of respondents mentioned the need to find a proper VAT solution for the centralized customs clearance facilitation which is expected to come into force with the Modernised Customs Code.

Some respondents requested further simplifications in the customs clearance procedures, such as the single window, the one-stop-shop and postponed accounting of import VAT.

The respondents encouraged using simplified VAT obligations and payment procedures in combination with the AEO certification. For AEO certified businesses simplified VAT reporting formalities could be introduced; alternatively a separate AEO certification for VAT procedures could be created, only if the costs of such a procedure would not undermine its benefits.

The respondents expressed the need to harmonise the concept of importation between customs and VAT. In that regard the definition of importer could be adjusted and a common taxable base for VAT and customs duties could be introduced. The respondents also expressed the need to harmonise the treatment of goods under customs control, such as customs warehouses for customs, excise and VAT purposes.

The respondents also requested to harmonise the concept of exportation and exporter between customs and VAT legislations. Some respondents mentioned the need to establish a single export proof for VAT purposes at EU level.

Many respondents mentioned that they have to provide the same data several times for excise, customs, VAT and statistical purposes. This could be avoided by revising and rationalizing the reporting requirements. Some of the reports (such as Intrastat) could become redundant if the data flow was managed differently.

Some respondents pointed to problems in relation to VAT and customs duty relief systems, including regarding small consignments.

In the field of direct taxation, the respondents proposed to harmonise the concepts between VAT and specific areas of direct taxation: in particular, the definitions used for insurance premium tax and transfer pricing purposes could be applied uniformly.

Some respondents thought that both businesses and the tax administrations could benefit from the adjustment of the concepts of the allowable expenses with the deductible VAT.

3.12. Reviewing the way VAT is collected

Q30. Which of these models looks most promising in your view and why, or would you suggest other alternatives?

General comments

Many respondents found the explored models innovative, ambitious and potentially workable but stressed that for all it is important that the Commission and the Member States balance the investment and efforts for all parties with the expected benefits.

The respondents believed that none of the presented options is sufficiently developed to be able to assess their practicality with any confidence.

Further work, study and discussion are therefore needed between the Member States, the Commission and all the stakeholders to establish differences in investment and implementation costs. Simplification, the reduction in administrative and financial burdens on business, cash flow and commercial considerations are factors to be taken into account at all times.

Several respondents suggested that first of all, a thorough analysis has to be done to look into which reason(s) is/are the predominant factor behind the VAT gap in each Member State. In particular, the VAT gap could be caused by shortcomings both in the VAT rules and in the collection method.

Several respondents would prefer to see a more targeted approach where additional reporting procedures are only necessary for higher risk sectors. This also would mean that those schemes should be optional for taxpayers rather than obligatory.

Some respondents however thought that whatever model is further investigated, it is important that the model is made obligatory in all Member States and that the implementation is fully harmonised in all Member States.

Unreliable data and analysis

Many respondents recognised that there are problems with fraud but wondered if it is wise to review the way the VAT is collected with considerable business impact only on a perception of the VAT gap and without a proper analysis based on reliable data.

The respondents questioned in particular the figures and results as they depend on a number of assumptions. They are based in particular on an assumption of total harmonisation. The results therefore include the effect that a full harmonisation could trigger.

Administrative burdens and compliance costs

Many respondents considered that all the options would impose additional compliance costs on the taxpayers, significantly increase the bureaucracy and disruption in developing new processes, training and IT system. This is in contradiction in particular with the aim of the Better Regulation Programme without providing real tangible benefits for them and, on the contrary, with adverse impact on the competitiveness of the EU.

Moreover, such additional obligations and costs would exclusively be at the expense of honest participating taxpayers as the fraudsters would not abide by the rules in any of the suggested models. Compliant businesses would carry the full weight of the administrative burdens while they also suffer from unfair competition from fraudsters.

All these models would require a very high degree of computerisation, bringing additional IT requirements and costs, and would be difficult to implement especially for smaller firms as many of these still use manual record-keeping and do not have in-house expertise. They would therefore impose substantial and disproportionate costs on small businesses.

If the Member States individually define the technological requirements, control protocols etc, then besides reducing effectiveness, it would increase the set up and maintenance cost for businesses.

Several respondents indicated that a key consideration for all models would be how such costs should be funded, bearing in mind the relative benefits to all of the parties.

Some respondents also considered that all these models would increase the cost of control for the tax authorities as well.

Inefficiency

Some stakeholders considered that none of the models suggested are likely to achieve the desired aim of reducing fraud and providing any advantage for the tax authorities in the management of the system and revenues.

The respondents emphasised that the theoretical VAT gap consists of fraud but also errors due to the complexity of the rules, bankruptcies, and the black economy, areas which the proposed models would be unable to tackle.

The merit of the proposed models would be based on fraudsters choosing to follow the rules for each respective model, which is something that they would be rarely eager to do. There would be a risk of having more parallel economies if the system is made even more complicated and intrusive and those who would be affected are again the reputable traders.

Risks

Several respondents considered that the Member States would not be ready to cope with a major change in the system for the collection of VAT given the limited amount of public finance available for further technological advancement. It would be too dangerous to rely on a new VAT collection system at current times. The problems related to the introduction of the new cross-border VAT refund portal demonstrates what happens when there is too much reliance on technology that all Member States have to operate and implement correctly, and on time.

Moreover, rather than creating further harmonisation of the single market, such moves could lead to further fragmentation as Member States would develop divergent IT systems at national level.

Other ways forward

Several respondents believed the best and first way to reduce the VAT gap is for the tax to be simple, fair, certain and easy to pay.

Some respondents suggested keeping the current collection mechanism which would be adequate as it strikes, on the whole, a proportionate balance between the cost of compliance for business and the needs of tax authorities whilst being flexible and scalable.

Moreover, there would be a number of Member States having a well working VAT collection system. The starting point must then be to learn from the best practices of an efficient VAT collection system in order to improve the average revenue collected and to reduce the VAT gap across the EU.

The cooperation between the Member States, tax administrations, customs and police should also be increased in order to combat the black economy and VAT fraud. Furthermore, other non-VAT-related measures must be used to address the issue of the black economy.

Others respondents believed that the collection system should only be reviewed once the working assumptions such as full harmonisation are achieved including in particular a ‘single rate’ approach and no zero-rating of intra-EU supplies which enables fraudster to maximise their benefit.

Some respondents stressed that the VAT rules should not be made more complicated and costly for all taxpayers simply in order to combat fraud. This problem should be dealt with in other ways such as changing/enhancing the VAT system itself, including VAT audits, and addressing the underlying opportunity for fraud in the specific areas where it exists. The resources should be devoted to those few enterprises that have the intention and opportunity to commit fraud, instead of subjecting all enterprises to additional burdens.

Several respondents proposed some alternatives and ideas to tackle the VAT gap such as reducing or forbidding the use of cash, exempting B2B transactions, replacing VAT by a retail tax or an excise tax, applying a generalised reverse charge, a generalised margin scheme, implementing an ‘Electronic VAT collection’, centralising the administration of VAT obligations at EU level (registration, returns, payments etc), implementing positive incentives for VAT collection i.e. businesses keep a fraction of VAT that they collect to partially cover the costs of VAT collection, the fraction could be proportional to the size and complexity of the companies concerned and the quality of its VAT collection process, systematic controls before registering new business in national VAT registers and VIES, and more interaction between the tax authorities and taxable persons.

Combination of the models

Some respondents were of the opinion that a combination of all or some of the different models could be the best way forward as it is apparent that none of the methods will on their own achieve the required aims.

Specific comments

First model (split payment)

Some respondents considered that this model might provide an effective solution to tackle fraud and therefore warrants further consideration. Moreover, it would make the accounting more transparent and would reduce inspection of the collected receipts.

However, some respondents in favour considered that it should be of general application, including B2C transactions, and that it should be combined with the data warehouse

model. They also suggested that some ways of compensating the cash-flow effects for the business should be considered. Since the revenue benefits would accrue to the national tax authorities, the associated costs (the initial cost contribution and the increased bank charges for transaction handling) should not be borne by businesses.

Some respondents would prefer a simpler and less costly method of split payment such as the optional mechanism envisaged at Section 5.4.2 of the Green Paper although this mechanism could have a detrimental impact on supplier and customer relationships. Consideration could also be given to making this form of collection mandatory for transactions over a specified value in sectors where missing trader fraud is prevalent.

Some banks saw some merit in this model but only where the customer is responsible for determining the VAT amount through split payment instructions for the banks to process. If the banks would have to take the responsibility for separating the VAT then this would not be achievable without considerable cost, system development, and the sharing of customer data in order for the banks to have the knowledge and information to determine the VAT amounts contained with the payment instructions.

The main issues for the banks would be to assess their capacity firstly to deal with a doubling of payment instructions and secondly to capture and provide the information which must accompany the VAT payment to the authorities. Significant time would be needed both to review feasibility and to increase capacity if required. Any such review could only be done adequately when there is clarity on both the scope of this payment splitting and on the mandatory information required to accompany the payment. If banks must make payments to the tax authorities in multiple Member States, any lack of harmonisation would be totally impractical.

Many of the respondents dismiss such a model and have identified the following flaws:

- It would give tax authorities direct access to taxpayers' money, in particular in cases of overpayments by the customer. A tax liability should not arise until a transaction has been completed, and even then, it would be for the taxpayer to decide how it should, or should not, be included in a VAT return. Any move towards automatic taxation would blur the lines of responsibility. The consumption tax should remain collected based on self-assessment by businesses under the supervision of tax authorities.
- It would entail significant costs for the business (in particular a substantial expenditure on IT systems). Besides investment costs, the number of payments and the amounts of reconciliations would be doubled. Shifting responsibility to the banks would result in additional bank charges for customers. It would be mandatory for business to have a (frozen) VAT bank account in every Member State where the VAT is to be paid. The prevention of MTIC fraud should not override other objectives such as minimising the costs of VAT compliance and VAT collection.
- There will be an enormous cost to the banks involved. It would require them in particular to change existing IT-based payment and transfer systems, forms would need to be revised completely. The impact of this model would be comparable to the implementation of the SEPA Regulation throughout the EU. It would seem likely that the banks would want to pass on those costs to business.

- If the customer's bank has to determine itself the VAT amount to split, this would impose on the banks further additional handling costs and new risks regarding correct processing and examination of invoices. This would be an impossible task since the banks do not have the information to determine what VAT must be paid to the tax authorities. There would be uncertainty on the legal and contractual implications. It would also be necessary to make substantial changes in national civil law regulations.
- It would have a huge cash flow impact on business. The sellers would not have the possibility to manage the VAT part as is the case today and to use the VAT funds in their business. This could have a significant impact on corporate liquidity, particularly in those Member States imposing high VAT rates and on SMEs which are often more dependent on VAT payments. Businesses would continue to act as collectors of VAT, but would no longer be entrusted to manage the outgoing tax. This could lead to VAT rules affecting payment terms.
- It would impose an additional layer of complexity. It would require a full harmonisation such as a single rate of VAT applied to all supplies across all Member States in order to make the model somewhat efficient. In the absence of such simplicity, it would be extremely difficult to implement. It would be difficult to cope with administratively, particularly where there were many clients and many invoices.
- It would not capture all transactions. B2C transactions, inter-company settlements (many transactions within a group of companies do not result in any payments), netting, instalments, payments on account, cheque, credit card payments, payments in kind, cash payments, payments by third parties and barter would not be covered. Many transactions, such as most retail sales, bypass the banks. Other problems would be errors, price reductions, partial payments, late payments, default payments, fringe benefits, credit invoices, debit notes, bad debt relief claims and bulk payment (i.e. one payment for multiple invoices).

Some of those respondents concluded that this model is unrealistic and disproportionate to the objective of combating VAT fraud. It should be targeted at either high risk trade sectors, certain traders (for instance non-certified businesses) or at significant transactions. If it was confirmed that cash payments would not be covered, the method would actually function in a very limited area and thus would not necessarily eliminate all MTIC fraud. Moreover, the respondents feared that new black markets would be created, increasing the payments in cash in order to avoid VAT.

Second model (all invoices data sent to a central VAT monitoring database)

Some respondents thought that it is feasible, worth further elaboration and the more promising since the current technologies can support its creation. These respondents considered that nowadays even micro-enterprises (or their accountants) are equipped with software and technology enabling them to send such data without undue costs and/or effort.

They believed that it would enable quicker detection of possible frauds or suspicious behaviours. The tax authorities could take immediate steps for prompt verification of the transactions and for recovering sums unpaid in the event of non-compliance.

It could also have the virtue of exempting the taxable person from numerous obligations. As the flow of invoices would be available in real time to the tax administrations, there would be no need to submit these data again in the form of lists of intra-EU supplies or VAT returns. No financial impacts would affect businesses with a change to the current method of VAT collection.

Implementing this system would require general and compulsory use of electronic invoicing and electronic registration of transactions, which would help simplify bureaucratic procedures and reduce costs for taxpayers. Some respondents suggested that in order to be applicable also to intra-EU trade, the proposed system should be integrated with an EU-wide uniform system for invoicing, registering transactions and submitting VAT-relevant data, accompanied by the establishment of a central database, accessible by all the Member States' tax administrations. Some respondents suggested that business should nonetheless be given adequate time to prepare for the provision of data.

Many respondents however dismissed such a model and have identified the following flaws:

- Inefficiency of tax administrations. The tax administrations would be overloaded with information (i.e. millions of invoices each day) which they would not be able to use at an early stage and in an efficient, selective and regular manner. It would in any case demand a lot of resources for the development of the central database and the data mining.
- Inefficiency of the model. It would not solve the problems of the black economy and not prevent the raising of false invoices, missing traders or problems arising from non-payment and insolvency. The fraudulent traders would abscond.
- Loopholes: As no invoice is required, B2C transactions would not be covered. Not all Member States require the issue of a VAT invoice for exempt supplies. Cross-border transactions with non-EU countries would still have to rely on paper-based invoices.
- It would have a significant cost as system enhancements and changes would be needed to adjust to e-invoicing and to be able to provide such information on a real time basis. The model would assume a degree of IT automation that is not currently present in many businesses especially smaller ones. It would make the VAT system more burdensome.
- To work properly, it would also require imposing electronic invoices for all B2B transactions which is unrealistic, at least for the moment. One precondition for increasing the use of electronic invoices would be a standardised model. On the contrary the recent simplification on e-invoicing would dilute the need to carry out true electronic invoicing i.e. sending data which is automatically imported and readable into an accounting system. That could also mean 27 different systems for e-invoicing, the Member States having very different views on security for e-invoicing.
- Security issues would arise for businesses since sensitive information on all their economic and financial activities (names of suppliers and customers, prices etc.) would be registered in the central database. It is questioned whether the Member State would be able to guarantee data protection and integrity.

Third model (VAT data warehouse)

Some respondents thought that such a model would be the most promising one. It would be in line with recent business developments and could increase the efficiency of tax audits significantly by asking business to hold transaction data electronically and make it accessible to the tax authorities.

It would be feasible as it reflects the current reality of how many businesses, in particular certain large ones, are already controlled by their tax authority. Business would already have the systems and processes in place to make the data submission.

Mandatory adoption of the model across the EU could create a standard that would allow technology firms to offer both taxpayers and tax authorities cheap, comprehensive and reliable tools to automate these processes. The main problem currently in providing such technologies would lie in the disparate requirements of the various Member States. The standard should be common both for direct and indirect taxation.

An EU standard format would allow the development of standard reports and files for each country readily available for audit. This would minimize the preparation time needed for the audit and any disruption for businesses. This would assist with a standardised and simplified approach of tax audit across all Member States. It should be accompanied by a simplification of reporting obligations.

This model would ensure that all data – including both taxable and non-taxable transactions – are recorded in the warehouse, thereby giving greater visibility than the split payment model (which focuses on transactions where VAT is charged). It would also ensure that all data is available for both B2B and B2C transactions. This model would allow monitoring all activities (sales, invoices, payments) within an entire sector and supply chain.

Some respondents dismissed such a model having identified the following flaws:

- It would be inefficient for addressing MTIC fraud. A real time system is needed for detecting missing traders and it would only allow post hoc controls. Tax administrations already have extensive powers to access the data of businesses and it would therefore have no added value. This model would simply become another audit tool for the tax authorities and its efficiency would depend on tax authorities analysing the data on a timely basis. Fraudulent suppliers would not comply.
- The development cost of a data warehouse could be significant. The accounting system would need to be able to generate a standard audit file which would in turn need to be stored in a data warehouse that can be accessed by the tax authority. If the 'predefined transaction data' is different in format to what the businesses already hold, this would present them with considerable costs e.g. the proof of export and proof of delivery, there would be thus a significant number of paper documents that would need to be scanned and uploaded to the warehouse. It would be too onerous for small businesses who do not currently maintain data warehouses. Large enterprises typically do not operate a single invoicing and accounting system, so the creation of a data collection would be likely to entail considerable costs owing to the need to conflate systems.
- It would presuppose that all technical features of the VAT data warehouse are harmonised across the EU. Otherwise it would not be realistic. Experience shows

problems relating to the large amount of data and problems of compatibility with different business software.

- Keeping information regarding all transactions by a business available on-line at all times would also entail high security risks and requires investments in control systems.

Fourth model (certification)

Some respondents thought that this model is promising. It would be the easiest to achieve in the short term and would require the lowest initial investment as there are no real changes to the collection system. Amongst the proposals put forward, it would seem however to be the least efficient in preventing carousel fraud.

Such a measure is already in place in some Member States; it would thus build on known principles and it would align with other financial and transactional initiatives that seek to verify the existence and strength of controls. It should not increase the administrative burdens for businesses.

To be truly attractive to businesses, it should provide the certified business with incentives e.g. the possibility of reduced obligations, fewer audit queries, the reduction of penalties, faster refunds of tax credits and a greater legal security and reliability. Some respondents insisted that the conditions of the certification process should be the same in all Member States. They should in any event not be too rigid and be based on controls that businesses already have in place as part of their own internal control systems and for the purposes of statutory requirements (e.g. Sarbanes-Oxley). The certification obtained in the Member State of residence should be valid in all other Member States.

The model should increase the level of cooperation between the business and the tax authorities, leading to a more correct taxation, reduced need for audits and to the reduction of the workload of the tax administrations and the businesses in the long run, in particular for large businesses carrying out a huge number of transactions. This would allow for the better targeting of audits to those businesses which pose greater risk.

Some respondents however dismissed such a model after having identified the following flaws:

- There are some concerns with the time, additional complexity and costs for both tax authorities and compliant business associated with the certifying procedure and maintaining the certification. The model would actually imply that the control of businesses is shifted from tax authorities to the businesses themselves, at their expense.
- Small business could neither afford to hire help nor to handle in-house the process of applying to VAT rules in a way to achieve certified status.
- The certification could force businesses into certain processes thereby impacting on business decisions or influencing commercial decisions such as which type of IT system to use in order to meet the certification requirements.
- It could result in businesses being regarded as potential fraudsters just because they chose not to certify their processes. The non-certified business could eventually be excluded from certain calls for tender or activities. Distortions of competition

between companies, being particularly detrimental to new entrants or SMEs, could occur.

- The certification would be a pointless exercise because it would not be really different to any situation now where businesses strive for compliance. The people most likely to engage in certification would therefore be those who are already compliant. It would also correspond to the checks that a tax auditor would perform during an external audit and therefore describes the tax authority's 'everyday' inspection procedure rather than offering a real alternative.
- It would be unable to eliminate frauds. Even if fraudulent traders comply with certification it is unlikely to prevent them from committing fraud.
- It would have a limited effect, as the nature of such a method means that only a small number of traders could be certified.

3.13. Protecting bona fide traders against potential involvement in VAT fraud

Q31. What are your views on the feasibility and relevance of an optional split payment?

Before assessing the merit of the optional split payment, several respondents stressed that protecting bona fide traders is a crucial point in the field of VAT and should be given special attention. Genuinely innocent entities caught up in MTIC fraud chains should be allowed to obtain a reclaim of any input tax incurred and the current position is untenable where such 'innocents' are uncertain as to whether a reclaim of input tax will be upheld by the tax authorities. Some respondents questioned whether such a particularly severe penalty for the bona fide trader is necessary to combat fraudulent tax evasion.

They emphasised that it is not acceptable to oblige EU businesses to perform checks on the compliance of each of their suppliers in order to achieve this aim. Guessing whether a trader knew or should have known they were involved in an MTIC fraud is highly subjective and only adds to uncertainty for business.

Some respondents considered that the optional split payment would benefit the tax authorities as it would provide certainty to VAT collection and would have the potential to reduce missing trader fraud. A system of this type already exists in some Member States.

Such a measure could also help a customer to reduce significantly the risk of being held liable for the potential fraudulent evasion of VAT committed by his supplier. It would therefore represent a relevant method of protecting customers acting in good faith against being involved in VAT fraud.

It should be applicable for both B2C and B2B transactions if the reverse charge principle is not applicable. Some respondents suggested that additional incentives for the businesses which do the optional payment of VAT should be proposed. Some would suggest that it could be limited to certain sectors with a disproportionate rate of missing traders, or at request of the tax administration.

Some respondents suggested that the tax authorities should explicitly state whether or not there is a reason to be suspicious of a particular contractor. If they give the 'red light', a split payment is compulsory, if they give a 'green light', it is not. The system would have to be simple, easy to consult and would have to unconditionally release the trader, with a limited administrative burden, from joint and several liability. These respondents indicated that in Belgium a similar system has already been developed for the building sector if a contractor has tax and social debts.

Some respondents added that an optional model would lose many of the benefits of full implementation and would result in far fewer benefits in terms of fraud reduction, administrative burden reduction and a level playing field.

Several respondents concluded that this measure is worth further in-depth analysis.

Several respondents did not, however, consider the optional split payment a feasible solution and some referred to their negative comments on the split payment model (Question No 30).

These respondents mentioned in particular:

- It would be pointless: an honest trader would not be trading with a supplier if he suspected that they are involved with VAT fraud. Customers should be exercising due diligence when entering into any commercial contract with a supplier. The option presented as an advantage to the customer instead of having to check their suppliers' compliance seems to be over-exaggerating the risk to the customer.
- It would be either ineffective or have limited benefits for various reasons: it would be limited to B2B transactions, in many missing trader cases the defaulting trader is not the immediate supplier but someone elsewhere in the supply chain, it would not cover cash, cheque and credit card transactions, anyone intent on becoming involved in fraudulent activities would be unlikely to voluntarily participate in such a protection scheme, so optional participation may be pointless and likely to have very small, if any, take-up.
- It would have a detrimental and adverse impact on supplier and customer relationships where it would signify a degree of mistrust towards a business partner. SMEs in particular, which are often in a weaker position in relation to their suppliers, would bear the consequences of this.
- The customer would be worse off than today: He would exchange the burden of demonstrating his care in dealing with suppliers for either the administrative burden of splitting payments or by taking a potential financial risk in leaving himself vulnerable to financial loss by failing to detect a new trend in fraud. The failure of the customers to use this option may be counted against them in the case of fraud.
- The system would shift the risk from the customer to the supplier as a reverse payment would always leave the supplier being the party liable to pay VAT. So the supplier would only deliver his goods or services after having got the net payment by the customer and the relevant information by the tax authority. There may be no practical way for the supplier to verify whether the customer has in fact paid the VAT.

- It would have negative cash-flow effects on suppliers as it would deprive them of the possibility to use the VAT in their business facilitating cash-flow. As this option would be exercised specifically in the case of businesses new to the market or small businesses, they would be deprived of the liquidity advantage which is of such importance, particularly for start-ups.
- It would increase administrative burdens and complexity as it would be implemented on a customer-by-customer basis, it would be difficult to manage (two payments for an invoice instead of one, every supplier would need to track whether his customer has paid the VAT to him or to the tax authority), increase complexity to bookkeeping processes, trigger more bank charges, and require the provision of a substantial amount of data. It would actually only be workable for large businesses.
- Additional cost as it would require significant system, IT, accounting and VAT reporting changes.
- It would trigger a new possible fraud of the customer pretending to have made use of the option. There would be the opportunity for input tax fraud to replace output tax fraud.
- There would be a risk of double payments where the customer pays VAT to the tax authority after the supplier's filing period has closed.

Alternatives

Some respondents suggested instead to review in the first place the joint and several liability applications and draft clear, simple and uniform guidelines on the 'knowledge test'. Currently, the detailed legislation varies from Member State to Member State.

Several respondents believed that other methods would eliminate missing trader fraud and thus the need for the 'knowledge test' or would reduce the risk for honest traders to be involved in fraudulent transactions. Therefore the optional split payment would be superfluous:

- Improving co-operation between tax authorities and faster exchange of information.
- Tax authorities should use their resources differently to combat fraud in the same way the traders manage their customer's credit management, by allocating more resources on the high risk segment.
- The generalised (domestic) reverse charge, the targeted reverse charge on individual transactions exceeding specific value thresholds or the exemption of B2B transactions.
- An 'Electronic VAT collection system'
- Improving the efficiency of VIES to protect bona fide traders, by constantly updating it, with the obligation to provide a greater amount of information on taxable persons. This would help traders identify whether their supplier is a potential missing trader or avoid having their VAT number hijacked by fraudsters. The database should therefore also indicate, in real time, the name, legal form,

address(es), start date, end date, the bank account numbers (linking VAT number and bank account number would prevent the hijacking of VAT numbers), whether the trader has filled all his VAT returns or he has nil returns, or he has fully paid his VAT liabilities, the trader's total intra-EU acquisitions or a 'VAT compliance indicator' or whether the trader is 'certified'.

- They also suggested the possibility for the businesses to 'flag' certain VAT numbers so that they are automatically informed of all changes in the VIES system concerning these VAT numbers.
- They suggested that significant mismatches between sales listings and purchase listings of suppliers and clients are to be communicated to both parties.

3.14. An efficient and modern administrating of the VAT system

Q32. Would you support these suggestions to improve the relationship between traders and tax authorities? Do you have other suggestions?

Out of 140 answers, only two were a little reserved about the suggestions presented in the Green Paper.

So, almost all respondents agreed that an enhanced relationship between traders and tax authorities is of utmost importance and comes as a priority. In particular, the opening of a permanent channel/platform of dialogue between tax authorities and other VAT stakeholders was broadly endorsed.

Quite a number of respondents underlined the difficulty for companies to ensure compliance due to the complexity of EU VAT legislation which triggers legal uncertainty.

Some respondents wished to have further harmonisation not only of the legislation but also, and more importantly, of control and audit procedures. However, they insisted that any further harmonisation should not increase red tape and the financial burden on the business. Many respondents believed that simplification of VAT legislation would be highly desirable although they acknowledged the difficulty of achieving it.

Recalling that business is responsible for tax collection in practice, a comment broadly shared by respondents was that VAT stakeholders should be associated at an early stage with the legislative process. Tax authorities and operators have common goals and seek to be more effective and to reduce costs. Different views were expressed as to the modalities of this consultation process, for most respondents it could be informal but there was also the suggestion that business representatives could attend the VAT Committee.

When it comes to IT aspects, the consultation of business was strongly advocated as little changes in the legislation can require considerable time and effort to be implemented in the IT application of the companies. Also, it is essential to make sure that sufficient time is given to operators for adjusting their IT tools, at least one year ahead. However, almost

all respondents were in favour of using new IT resources to be more effective. This would imply that proper cost benefit analyses have to be conducted.

Respondents broadly agreed that they should receive more information and guidance from the tax authorities. Some of the respondents referred to non-binding information but the vast majority valued binding information. Administrative rulings, or advanced rulings which already exist in some Member States are considered to be the most valuable tools. Some respondents insisted that the guidance provided by tax authorities regarding a specific transaction is given for free. Also publication on a no name basis of all significant rulings on which taxpayers with the same pattern could rely on was evoked. A few respondents asked for EU rulings covering all Member States.

Many respondents advocated a more efficient fight against fraud, as to separate the good from the bad. The companies which tax authorities can trust should benefit from a fair business environment. To this end, many suggestions were made taking into account existing tools and practices in some Member States. For instance, some respondents highlighted the advantage of a certification procedure and of a risk rating approach. It was also suggested to upgrade the EU VIES system in particular to include a VAT compliance indicator.

Many respondents encouraged ‘partnerships’ between companies and the tax administration, provided it is not only for big companies. A lot of respondents asked for ‘smarter audits’ during which the company can rely on a voluntary disclosure regime.

Also, many respondents criticised tax authorities’ unforgiving attitude towards simple administrative mistakes and the level of sanctions imposed which can be disproportionate. In this respect, a code of conduct for the tax authorities was mentioned.

3.15. Other topics

Q33. Which issues, other than those already mentioned, should be addressed in considering the future of the EU VAT system? What solution would you recommend?

The contributions to this question covered a wide range of issues and solutions.

Some respondents advocated the abolishment of VAT and its replacement by another tax. A retail tax, a financial transaction tax or additional income tax were put forward as alternatives to VAT.

A number of replies from respondents to this question related to issues already dealt with in previous questions. They will therefore not be repeated here.

There is also a certain link between the replies given under questions 1 and 33. Indeed, some of the issues considered to be an obstacle to maximising the benefits of the internal market are quoted again under this question. In particular, this is the case for the following topics: the need to find simplification measures for cross-border chain transactions, warehousing arrangements and the proportionality of sanctions and interests, especially in cases where there is no tax loss for the treasury.

A number of respondents pointed to some specific issues within the VAT Directive which need to be addressed:

- Special scheme for travel agents.
- Second-hand goods scheme.
- Moment of chargeability of the tax.
- Repayment of VAT.
- Vouchers.
- Cross-border transfers of going concerns.

A number of respondents advocated a review of the 13th VAT Directive, which concerns the refund of VAT to taxable persons not established within the EU. This Directive contains the option for Member States to apply the so-called reciprocity principle. The respondents suggested that the Commission should negotiate the reciprocity with the third countries for the whole of the EU and not the Member States individually as is the case today.

Other issues raised which require a solution within the VAT Directive were:

- The VAT aspect in the case of insolvency procedures or non payment by the customer. Member States have the discretion to determine under which conditions a recovery of VAT on bad debts is possible, and these conditions were described as too narrow in some Member States.
- The VAT rules applicable to charities and NGOs.

Other issues which respondents pointed out were of a more general nature.

Some respondents suggested solutions for increasing compliance. One suggestion consisted in allowing a small part of VAT to be deducted from income tax. This would stimulate consumers into requiring a receipt. Another suggestion was to reduce the tax rate for compliant businesses.

Finding a way of dealing with double taxation issues was also pointed out by several respondents.

Involving businesses in pilot projects was also advocated.

Finally, a number of respondents made suggestions requiring the setting up of an EU entity dealing with VAT matters. The suggestions were:

- the creation of a EU agency for designing a common set of forms;
- the creation of a European Tax Commission with 2 levels of judgement;
- a single EU VAT authority as a long term objective;
- the creation an EU interpretation body;

- the creation of a VAT observatory.

Table 1 Total No. of replies per profile of respondent

Type of respondent	No. of replies
<i>Businesses</i>	195
<i>Citizens</i>	55
<i>National Associations</i>	219
<i>European Associations</i>	75
<i>International Associations</i>	22
<i>Public Authorities/ Governments</i>	33
<i>Academics/ Universities</i>	12
TOTAL	611

Table 2 Total No. of replies per country and profile of respondent

Origin Country	Total Number of replies from:					
	Businesses	Citizens	National Associations	Public authorities/ Bodies/ Governments	Academics	Country
<i>Austria</i>	9	0	3	1	0	13
<i>Belgium</i>	16	4	13	1	2	36
<i>Bulgaria</i>	1	2	0	0	0	3
<i>Cyprus</i>	0	0	0	0	0	0
<i>Czech Republic</i>	2	3	2	1	2	10
<i>Denmark</i>	1	0	17	1	0	19
<i>Estonia</i>	1	0	1	1	0	3
<i>Finland</i>	1	1	5	1	0	8
<i>France</i>	15	8	36	1	1	61
<i>Germany</i>	70	7	56	9	1	143
<i>Greece</i>	1	1	1	0	0	3
<i>Hungary</i>	1	0	0	0	0	1
<i>Ireland</i>	1	0	0	1	0	2
<i>Italy</i>	10	4	8	1	3	26
<i>Latvia</i>	0	0	0	0	0	0
<i>Lithuania</i>	1	0	1	1	0	3
<i>Luxembourg</i>	2	0	4	0	0	6
<i>Malta</i>	0	0	0	0	0	0
<i>Poland</i>	2	2	0	1	0	5
<i>Portugal</i>	1	4	0	0	1	6
<i>Romania</i>	1	0	0	0	0	1
<i>Slovakia</i>	2	0	0	1	0	3
<i>Slovenia</i>	0	2	0	0	0	2
<i>Spain</i>	1	1	5	3	1	11
<i>Sweden</i>	5	3	11	2	0	21
<i>The Netherlands</i>	12	1	11	1	1	26
<i>United Kingdom</i>	33	11	42	5	0	91
<i>Non EU</i>	3	0	3	1	0	7
<i>Not specified</i>	3	1	0	0	0	4
TOTAL	195	55	219	33	12	514