

Opinion of the Economic and Social Committee on 'A strategy to improve the operation of the VAT system within the context of the internal market'

(2001/C 193/12)

On 8 June 2000, the Council decided to consult the Economic and Social Committee, under Article 262 of the Treaty establishing the European Community, on 'A strategy to improve the operation of the VAT system within the context of the internal market'.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 9 April 2001. The rapporteur was Mr Walker.

At its 381st plenary session of 25 and 26 April 2001 (meeting of 25 April), the Economic and Social Committee adopted the following opinion by 53 votes to six, with four abstentions.

1. Introduction

1.1. When the 1st and 2nd VAT Directives were adopted in April 1967, the Community undertook a legal and political commitment (as part of its objective to create the most efficient possible common market) to establish a common VAT system under which the taxation of imports and the non-taxation of exports in intra-Community trade would be abolished. This commitment underpinned the objective to design a VAT system which was tailored to the internal market and would operate within the European Union in the same way as it would within a single country.

1.2. The Commission put forward proposals for such a system in 1987 under the work programme to establish the internal market by January 1993. The key elements of these proposals, which were designed to achieve a genuine internal market by means of taxation in the country of origin, were:

- a harmonised structure with two rates of VAT;
- harmonisation, within a defined band, of the rates applied by Member States;
- a clearing mechanism for the redistribution of VAT receipts.

1.3. By 1989, it had become clear that it would be impossible to adopt the Commission's proposals by 1 January 1993 and the ECOFIN Council therefore decided to adopt a transitional system which would enable controls at the Community's internal borders to be abolished whilst allowing tax to continue to be collected in the Member State of destination. At the same time, the Council reaffirmed both legally and politically the commitment it had made in April 1967 to introduce a 'definitive system' of taxation where goods and services would be taxed in the Member State of origin by the new target date of 31 December 1996.

1.3.1. This transitional system, with a number of modifications, is still in force and there is no immediate prospect of replacing it, although it is generally accepted that it has a number of shortcomings because it is complicated, susceptible to fraud and out-moded.

1.4. The Commission put forward new proposals for the introduction of a definitive system by 31 December 1996. Before doing so, it carried out a thorough evaluation of the transitional arrangements⁽¹⁾ and polled the Member States on their views to avoid a repetition of the situation which had led to the rejection of the previous proposals.

1.4.1. Despite this, little progress has been made in the Council on the Commission's revised proposals; if a trader's economic activity across the entire EU is taxed in one single Member State, taxation systems have to be closely harmonised to ensure a uniform application. There also has to be some harmonisation of rates to ensure that the tax has a neutral impact on business competition. It has been impossible to achieve agreement to this degree of harmonisation because of differing domestic arrangements in the Member States.

1.5. The Commission believes that there is a patent need to modernise, simplify, strengthen and apply more uniformly the VAT system in order to bring it up to date and ensure that it encourages legitimate commercial transactions within the internal market without providing greater scope for fraud.

2. The Commission's proposals: a new strategy for 2000

2.1. The details of the Commission's proposals for a reappraisal of the programme proposed in 1996 are set out in Appendix 1.

⁽¹⁾ COM(94) 515 final, dated 23.11.1994.

2.2. The Commission's Action Programme is set out in Appendix 2.

3. General comments

3.1. In opinion after opinion⁽¹⁾ the Committee has reiterated its support for the principle of a new definitive system of VAT based on taxation in the country of origin and has called upon Member States to stop blocking progress in this direction. It has repeatedly high-lighted the defects in the transitional system and called for action to modernise the system and remedy its shortcomings, which are having a negative impact on legitimate business as well as facilitating fraud.

3.1.1. As long ago as 1988, the Committee pointed out⁽²⁾ that it is an anachronism that, within what is supposed to be a single market, transactions between Member States are treated as 'imports' and 'exports'. In a true single market these concepts should be reserved for transactions with external traders.

3.1.2. It is an indictment of the Member States that a concept which was accepted in principle thirty-three years ago still seems as far from realisation as it was then. The history of VAT legislation in Europe is a catalogue of failure, not on the part of the Commission, which has acted with commendable consistency and unrelenting effort in attempting to move the situation forward, but on the part of the Member States, who have continually frustrated these efforts.

3.2. It is widely accepted that the current transitional arrangements are complicated, susceptible to fraud and out of date. Moreover, they are incompatible with the principles of the Single Market. The Committee agrees with the Commission that there is a patent need to modernise, simplify, strengthen and more uniformly apply the VAT system in order to bring it up to date and to ensure that it encourages legitimate commercial transactions within the internal market while reducing the scope for fraud.

3.2.1. The Committee accepts the Commission's contention that the Single Market could, and would, function better with a VAT system based on the principle of taxation in the country of origin, as this would be easier to administer (and consequently less costly for businesses) and less susceptible to fraud, thereby providing a better guarantee of stable tax revenue.

3.2.2. The Committee considers it unfortunate that the current political climate renders it unlikely that such a system can be introduced in the foreseeable future.

3.3. The Committee is relieved that the Commission does not question in any way the idea of a definitive system of taxation in the Member State of origin as a long-term Community goal. Given the realities of the political situation, it accepts that there is a short-term requirement to define a viable strategy for the transitional system, based on the following objectives:

- simplification and modernisation of current rules;
- more uniform application of current rules;
- closer administrative cooperation.

3.4. The Committee recognises that this will only be possible if all Member States are prepared to consider changes to their national VAT systems and, in particular, a reduction in the large number of special schemes, options, exemptions and derogations which currently exist. Given the recent history of VAT legislation, the prospects are not hopeful.

3.5. The Committee agrees with the Commission that a continuation of the present transitional arrangements will require a greater emphasis on tighter controls and closer administrative cooperation than has been achieved in the past. The fact that, under the present system, goods can circulate between Member States without VAT being paid is an invitation to fraud.

3.6. The Committee endorses the Commission's insistence that the proposals already tabled under the 1996 programme and the SLIM exercise must be adopted as soon as possible and calls upon the Member States to cooperate with the Commission in simplifying, modernising and enhancing the transitional system.

3.6.1. The Committee has already issued opinions broadly approving the Commission's proposals concerning the right to deduction and abolition of the procedure provided for under the Eighth Directive⁽³⁾, determination of the person liable for payment of VAT⁽⁴⁾, the reform of the VAT Committee⁽⁵⁾ and the improvement of mutual assistance for the recovery of claims⁽⁶⁾. It is disappointed that these necessary and desirable measures have not yet been put into effect.

3.6.1.1. The Committee considers that the situation would be substantially improved if the time period for payments were harmonised across the Member States, or at least brought into closer approximation.

(1) OJ C 82, 19.3.1996, p. 49; OJ C 204, 15.7.1996, p. 94; OJ C 296, 29.9.1997, p. 51; OJ C 101, 12.4.1999, p. 73; OJ C 209, 22.7.1999, p. 53; OJ C 116, 20.4.2001, p. 59.

(2) OJ C 237, 12.9.1988, p. 14.

(3) COM(98) 377 final, ESC Opinion OJ C 101, 12.4.1999, p. 73.

(4) COM(98) 660 final, ESC opinion OJ C 116, 28.4.1999, p. 14.

(5) COM(97) 325 final, ESC opinion OJ C 19, 21.1.1998, p. 56.

(6) COM(98) 364 final, ESC Opinion OJ C 101, 12.4.1999, p. 26.

3.6.2. The Committee has also expressed its support for the proposal to abolish compulsory tax representation⁽¹⁾, and is pleased to note that the Council has now adopted a Directive abolishing this requirement from 1st January 2002.

3.7. The Committee agrees with the Commission's Action Programme and hopes that it will be possible to implement it but, given the current political climate, doubts whether this can be achieved within the timescale envisaged.

3.8. The Committee notes that, at a meeting of the Tax Policy Group on 2 March 2000, representatives of the Member States endorsed the pragmatic approach adopted by the Commission in tackling the problems presented by the present transitional system. It hopes that this endorsement will be translated into legislative action in the Council.

3.9. The multitudinous piecemeal amendments which have been made to the Sixth Directive over the years have resulted in a text which is complex, confusing and, at times, even contradictory. The Committee welcomes the information that the Commission has embarked upon a definitive rewrite of the entire Sixth Directive and that it has made this project a priority of its 2001 work programme.

4. Specific comments

4.1. The Committee agrees with the Commission that exemption of public-sector postal services is creating distortions in a situation where these services are increasingly being privatised in a number of Member States. Taxation of private-sector operators in this field while exempting the public sector infringes the principle of neutrality which lies at the heart of all taxation systems. It also distorts competition, both within Member States where there are both public and private sector operators and also between Member States where the service in one country is privatised and in another is still provided by the public sector.

4.2. The Committee has issued an opinion⁽²⁾ on the Commission's proposals on the treatment of e-commerce and radio and TV broadcasting.

4.3. The Committee welcomes the Commission's proposals for the acceptance of electronic invoicing for VAT purposes and to formulate rules for harmonising practices within the

Community. It regards this as a highly desirable, and long overdue, improvement which will substantially reduce the compliance burden and the cost for many businesses.

4.4. The Committee has also issued an opinion⁽²⁾ approving the Commission's proposals for revision of the rules on administrative cooperation and mutual assistance.

4.5. The Committee has supported the extension for a further five years of the provisions of Article 12(3) of the 6th VAT Directive setting the minimum standard rate of VAT at 15 %, which is due to expire on 31 December this year⁽³⁾. It regrets that proposals for the introduction of a standard rate band have been twice rejected.

4.6. The Committee notes that, pursuant to Article 12(4), the Commission will present a report reviewing the scope of reduced VAT rates, which will look at the harmonisation of rates and assess the impact of their structure on the functioning of the single market. It would point out that this is a highly contentious area where the prospects of obtaining the necessary political agreement are not great.

4.7. The Committee accepts that the increasing privatisation of activities which were previously the exclusive reserve of the public sector is leading to greater distortions of competition between exempt, non-taxable and taxable services; as a consequence, the principle of neutrality is being undermined. The Committee agrees that the system needs to be modernised in respect of such services but would counsel that this should not necessarily result in VAT being levied on activities which are currently exempt.

4.7.1. The Committee also agrees with the Commission's proposal to examine the VAT treatment of subsidies in order to ensure simpler and more harmonised treatment within the EU. It concurs that exemptions without the right to deduction for social, educational, cultural and other activities need to be reviewed to determine whether there is an ongoing justification for their existence.

4.8. The Committee notes that the Commission intends to address the issue of the VAT treatment of financial and insurance services. It agrees that the sector has increased both in size and complexity in recent years and that its structures and operating methods have undergone considerable change. This certainly warrants an examination of the subject but these factors will increase the difficulty of evolving a suitable VAT regime; the Commission tacitly acknowledges the possibility

⁽¹⁾ COM(98) 660 final, ESC opinion OJ C 116, 28.4.1999, p. 14.

⁽²⁾ OJ C 116, 20.4.2001, p. 59.

⁽³⁾ OJ C 116, 20.4.2001, p. 67.

of failure when it says 'even if this proves neither desirable nor feasible'. The Committee would stress that one of the most important criteria for any VAT system in this sector is that it should not act in such a way as to hinder or curb the development of markets which are such major contributors to economic growth and employment.

4.9. The Committee accepts the logic of changing provisions of the Sixth Directive which have been rendered ambiguous, incomplete or out of date by decisions of the European Court of Justice.

4.10. The Committee agrees that the current rules regarding the place of supply of goods need to be standardised in cases where the supplier is responsible for assembly and installation on the customer's premises.

4.10.1. The Commission notes that the growing liberalisation of the utilities sector means that supplies are increasingly being thrown open to competition between private sector producers to the benefit of consumers, who are able to use the most competitive suppliers; it concludes that steps must be taken to ensure fair competition in this environment. The Committee would point out that, strictly, it is not the function of tax regimes to ensure fair competition; they should simply be structured in such a way as to avoid themselves creating distortions of competition.

4.10.2. The Committee understands the need to review the procedures under the transitional arrangements governing distance selling within the Community. This is increasingly being effected by electronic means and many of the considerations which apply to e-commerce are valid here.

4.11. The Committee is strongly of the opinion that a much closer administrative cooperation between the tax authorities of the Member States than currently exists is essential to the operation of the transitional arrangements or, indeed, of any tax system. It is pleased to note that this problem is being addressed by the Commission and the Council. It would agree that the existing Community legal instruments for administrative cooperation and mutual assistance need to be enhanced in order to deal with the fraud arising from the fact that goods can circulate within the Community without VAT being paid but it would observe that improvements in legal instruments will be of little use unless there is a willingness on the part of the Member State tax administrations to make effective use of them.

4.12. The Committee approves the concept of closer coordination between customs and tax authorities and awaits with interest the outcome of the deliberations of the *ad hoc* group which is addressing this issue.

4.13. The Committee notes with approval that there will be a general and thorough review of the rules governing the place of supply of services under Article 9. It joins the general consensus that the scope of taxation at the place where the customer is located (reverse charge procedure) should be extended or made the general principle for taxation of services. It considers that this principle is more important than protecting the system of fractionated payments. In a previous opinion⁽¹⁾, the Committee pointed to the fact that abolishing the system of fractionated payments would represent the single greatest contribution that could be made to the reduction of the compliance burden for businesses.

4.13.1. The Committee reiterates this position. It does not consider that abandoning the system of fractionated payments would in any way reduce the ability to police the system. Indeed, it is of the opinion that, by dramatically reducing the compliance costs for business, it would encourage a greater degree of voluntary compliance and thereby reduce the incidence of fraud. Many small businesses, and particularly sole traders, evade registration not because they wish to obtain a competitive advantage or defraud the Revenue but because they do not have the resources to cope with the burden created by the administrative requirements of completing returns.

4.14. The Committee agrees with the desirability of rationalising the derogations which have been granted to Member States under Article 27. The present situation is rightly described by the Commission as 'chaotic'. The differences between the regimes of the different Member States created by the number and diversity of these derogations constitutes a major disincentive to generating cross-border activity within the Community, especially for SMEs.

4.15. The need for a general rationalisation of options, rights and derogations is just as acute. As the Commission points out, even temporary derogations have proved impossible to abolish because of the lack of an unanimous consensus to do so. Member States which have secured derogations seem to feel compelled to hang on to them at all cost; they have also, on too many occasions, become bargaining counters. There can be no doubt that many of them constitute real obstacles to the proper functioning of the Internal Market and that their abolition would ensure more uniform application of VAT. The Committee therefore agrees that a review of the Thirteenth Directive would be timely and apposite.

⁽¹⁾ OJ C 116, 28.4.1999, p. 14.

4.16. The Committee notes the intention of the Commission to carry out a review and rationalisation of the rules and derogations applying to the definition of reduced VAT rates once the current pilot project introduced by Directive 1999/85/EC has been completed. It would comment that, however desirable this step may be, it is a contentious issue on which it will be difficult to obtain the necessary unanimity.

4.17. There have been repeated calls, in which the Committee has joined, for a thorough overhaul of the special schemes applying to small businesses and, in particular, to these exemptions, which differ widely from one Member State to another. By creating differences between the tax regimes of the Member States, these schemes, which are supposed to assist small businesses, have too often acted against their interests by discouraging them from entering into cross-border transactions. The Committee welcomes the fact that there are plans to deal with this issue but would wish that any harmonisation should be on the basis of those existing schemes which are most favourable to small businesses.

5. Conclusions

5.1. The Committee reiterates its position that the manifold and serious weaknesses of the present transitional system can only be finally removed by the introduction of a new definitive system based on the principle of taxation in the country of origin. It deeply regrets the total lack of progress which has been made towards achieving this goal and, while it welcomes the Commission's continued dedication to this as a long-term measure, it wonders how many more years of the ramshackle transitional system will have to be endured before this objective can be attained.

5.1.1. It calls upon the Member States to realise the advantages for the European Union which would accrue from a system which would make a reality of the Single Market, rather than undermining it, and do so much to stem the current tide of VAT fraud.

5.2. In the continued absence of the political consensus that would bring this about, the Committee accepts the need for further amendments to the transitional system which would mitigate some of its worst defects and hopes that this much progress can at last be made.

5.3. The Committee agrees that the key elements in improving the transitional system are simplification and modernisation of current rules, more uniform application of the rules and closer administrative cooperation. It accepts the Commission's proposition that 'modernisation and simplification' and 'administrative cooperation and fraud prevention' form a single package and must go hand in hand.

5.4. The Committee broadly approves the agenda set out in the Commission's New Strategy for 2000 and in its Action Programme 2000/2001.

5.5. The Committee agrees with the majority view that the reverse charge mechanism should be extended or made the general principle for taxation of services. It reiterates its position that removing the system of fractionated payments would do more than any other measure to reduce compliance costs for business without providing any greater scope for fraud.

Brussels, 25 April 2001.

The President
of the Economic and Social Committee
Göke FRERICHS

APPENDIX I

to the Opinion of the Economic and Social Committee**A reappraisal of the programme proposed in 1996***Defining a viable strategy to improve the present system*

It should be pointed out from the outset that the internal market could and would function better with a VAT system based on taxation in the Member State of origin as this would be easier to administer (and consequently less costly for business) and less susceptible to fraud (providing a better a guarantee of stable tax revenue). However, it must also be recognised that in the current climate (where the conditions are not propitious for rapid progress towards closer harmonisation of VAT rates and legislation and it would be difficult to introduce a really reliable system of reallocating revenue) it is unlikely that significant progress will be made in the immediate future.

It is not in any way the Commission's intention to question the idea of a definitive system of taxation in the Member State of origin of transactions giving rise to consumption in the Community as a long-term Community goal. However, in the interest of improving the functioning of the internal market in the short term, the Commission considers it necessary to reappraise the programme it proposed in 1996 and to define a viable strategy based on four main objectives: simplification and modernisation of current rules, more uniform application of current rules and closer administrative cooperation.

The objective of such an exercise is to create fresh impetus within the Council to achieve the much needed improvements to the present system as quickly as possible. This will of course only be possible if all Member States are prepared to consider changes to their national VAT systems (and, if necessary, to agree to a reduction in the large number of special schemes or options, derogations, etc. which exist at present) which can help bring about an overall improvement in the way the common VAT system operates. If the present transitional arrangements are retained Member States will also have to accept the need for greater emphasis on tighter controls and closer administrative cooperation in order to deal with the problem of fraud highlighted in the Commission's report on administrative cooperation and VAT control⁽¹⁾. The fact that under the transitional VAT system goods can circulate between Member States without VAT being paid⁽²⁾ inevitably creates risks, particularly of 'carousel fraud' and stringent counter-measures are required. 'Modernisation and simplification' and 'administrative cooperation and fraud prevention' form a single package and must go hand in hand.

Proposals already before the Council must be adopted

This does not mean that the Council does not have to adopt the proposals already tabled by the Commission under the 1996 programme and the SLIM exercise (Simpler Legislation for the Internal Market). On the contrary, these proposals were specifically designed to simplify, modernise, enhance and ensure more uniform application of the current VAT system in areas where improvements are essential.

⁽¹⁾ Report from the Commission to the Council and the European Parliament — Third Article 14 report on the application of Council Regulation (EEC) No 218/92 of 27.1.1992 on administrative cooperation in the field of indirect taxation (VAT) and Fourth report under Article 12 of Regulation (EEC, Euratom) No 1553/89 on VAT collection and control procedures (COM(2000) 28 final of 28.1.2000) http://europa.eu.int/comm/taxation_customs/publications/official_doc/com/com.htm.

⁽²⁾ Intra-Community trade is valued at EUR 930 billion annually. VAT accounts for 15 to 25 % depending on the Member State, i.e. EUR 162,75 billion. According to the Commission's estimates fraud accounts for 5 % of this amount, in other words a loss of EUR 8 billion in tax revenue.

The proposals concerning the right to deduction and abolition of the procedure provided for under the Eighth Directive (COM(98) 377)⁽¹⁾ and determination of the person liable for payment of VAT (COM(98) 660)⁽²⁾ are crucial to the simplification of existing procedures. They cover areas where refunds of VAT are difficult to obtain from other Member States and deal with the cost and complexity of using tax representatives who are considered to be the main source of problems for traders operating in other Member States, particularly for small businesses which are directly affected by the cumbersome procedures involved. These proposals will be reviewed in the course of their examination by the Council to ensure that they are compatible with the proposed changes to the current rules.

Two other proposals which the Commission still considers to be essential are the reform of the VAT Committee (COM(97) 325)⁽³⁾ and the improvement of mutual assistance for the recovery of claims (COM(98) 364)⁽⁴⁾. The VAT Committee plays an important role in ensuring existing rules are more uniformly applied, but its effectiveness depends on finding a way of involving it in the procedure by which the Commission adopts binding implementing decisions. The proposal on the recovery of claims is crucial to closer administrative cooperation and should be adopted as quickly as possible. It will also be a perfect adjunct to the proposal to abolish compulsory tax representation (COM(98) 660).

Other measures

The proposals already before the Council will be supplemented by other measures under a new strategy covering a number of areas where Community legislation needs updating (e.g. postal services, e-commerce, etc.).

These areas are described in the annex. The list is in no way exhaustive and in no way excludes others being included. The Commission will ensure that account is taken of the EU's international obligations and their VAT implications.

(1) Proposal for a Council Directive amending Directive 77/388/EEC as regards the rules governing the right to deduct value added tax and proposal for a Council Regulation (EC) on verification measures, measures relating to the refund system and administrative cooperation measures necessary for the application of Directive 98/xxx/EC presented by the Commission on 17 June (COM(98) 377 final) (OJ C 219, 15.7.1998, pp. 16 and 20).

(2) Proposal for a Council Directive amending Directive 77/388/EEC as regards the determination of the person liable for payment of value added tax presented by the Commission on 27.11.1998 (COM(98) 660 final) (OJ C 409, 30.12.1998, p. 10).

(3) Proposal for a Council Directive amending Directive 77/388/EEC on the common system of value added tax (the Value Added Committee) presented by the Commission on 26.6.1997 (COM(97) 325 final) (OJ C 278, 13.9. 1997, p. 6).

(4) Proposal for a European Parliament and Council Directive amending Council Directive 76/308/EEC on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties and in respect of value added tax and certain excise duties presented by the Commission on 26 June 1998 (COM(98) 364 final) (OJ C 269, 28.8.1998, p. 16) and (COM(1999) 183 final) (OJ C 179, 24.6.1999, p. 6).

APPENDIX II

to the Opinion of the Economic and Social Committee**The action programme**

A meeting of the Tax Policy Group was held on 2 March 2000 to sound out Member States' views on a new approach to VAT and to establish where improvements could be made. Member States' representatives endorsed this pragmatic approach which demonstrated a determination to quickly tackle the problems encountered by traders and provide them, as far as possible, with a solution which will enable them to benefit more effectively from the single market.

The Commission has drawn up an action programme to implement this new VAT strategy based on four objectives: simplification and modernisation of current rules, more uniform application of current rules and a new approach to administrative cooperation.

Phase One: 2000/2001 — Adoption by the Council of the proposals already tabled

The following proposals are to be adopted as soon as possible:

- Changes to the status of the VAT Committee (COM(97) 325);
- Improving mutual assistance on recovery (COM(98) 364);
- Proposal on the right to deduction and the Eighth Directive (COM(98) 377);
- Proposal on the person liable for VAT (COM(98) 660).

Phase Two: 2000/2001 — Presentation of new proposals by the Commission

The Commission has tabled or will table proposals for Directives in the following areas in the course of the year:

- taxation of postal services;
- e-commerce;
- invoicing including electronic invoicing;
- revision of rules on administrative cooperation and mutual assistance;
- a minimum standard rate of VAT;
- the Commission will also present a report on the application of the reduced rate.

Phase Three: 2001 — Evaluation and definition of future priorities

Future priorities will largely depend on the progress made by the Council in adopting the proposals already tabled. The Commission will present a progress report in 2001 and, once it has been discussed by the Council, will use it to draw up a work programme setting future priorities, initially for 2001/2002. These priorities will be defined in the light of the findings of a review of the issues discussed in the annex and any subsequent new requirements. Each of the subsequent phases will largely depend on the proposals already presented being adopted by the Council. The aim is to avoid a whole package of proposals waiting for the Council's approval.
