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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 395 of Council Directive 2006/112/EC

1. BACKGROUND

Pursuant to Article 395 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ (the VAT Directive), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. As this procedure provides for derogation from the general principles of VAT, in accordance with the case-law of the Court of Justice of the European Union (CJEU), the national derogating measures referred to in Article 395 of the VAT Directive which are allowed ‘in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance’, must be interpreted strictly and those measures must also be necessary and appropriate for realising the specific objective which they pursue and have as little effect as possible on the objectives and principles of the VAT Directive².

By letter registered with the Commission on 17 June 2020, Hungary requested an authorisation to continue applying a measure derogating from Article 193 of the VAT Directive. In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 16 September 2020 of the request made by Hungary. By letter dated 17 September 2020, the Commission notified Hungary that it had all the information it considered necessary for appraisal of the request.

As a general rule, the person liable for the payment of VAT to the tax authorities under Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the derogation whose extension Hungary requests is to place that liability on the taxable person to whom the supplies are made (the so-called reverse charge mechanism), in the case of supplies of staff engaged in activities other than those covered by point (a) of Article 199(1) of the VAT Directive. Article 199(1)(b) of the VAT Directive allows Member States to apply the reverse charge mechanism to supply of staff engaged in construction work, including repair, cleaning, maintenance, alteration and demolition services in relation to immovable property. Therefore, the derogating measure allows Hungary to apply the reverse charge mechanism to the supply of staff in all sectors of economic activity. The aim of the requested derogation is the fight against fraud.

2. REVERSE CHARGE

The person liable for the payment of VAT pursuant to Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the reverse charge mechanism is to shift that liability onto the taxable person to whom the supplies are made. The reverse charge is often used in order to tackle VAT fraud taking place in

¹ OJ L 347, 11.12.2006, p. 1

² See judgment of 27 January 2011 in case *Vandoorne* C-489/09, EU:C:2011:33, paragraph 27.

targeted sectors of the economy, in particular through the use of ‘missing trader’ structures.

Missing trader occurs when traders sell goods or provide services, collect the VAT from their customers and subsequently disappear without remitting the VAT they collected from their customers to the tax authorities. By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT in such cases, the domestic reverse charge mechanism has been found to eliminate the opportunity to engage in that form of tax evasion.

In the additional information submitted to substantiate its request, Hungary stated that the fraud committed on the supply of staff sector had similarities with missing trader structures, given that these services are easy to provide and the main cost for service providers is the cost of employees, which does not entail any VAT to be paid. Therefore, the gain for fraudsters is, in practice, the whole amount of VAT charged to the customer.

3. THE REQUEST

In order to combat VAT fraud in the sector of temporary employment agencies, Hungary requested in 2014 authorisation to introduce a special measure derogating from Article 193 of the VAT Directive to provide that, for supplies of staff engaged in activities other than those covered by point (a) of Article 199(1) of that Directive, the person liable for payment of VAT is the taxable person to whom the supplies are made. The authorisation was granted by Council Implementing Decision (EU) 2015/2349³, and expired on 31 December 2017.

In 2017, Hungary submitted another request in order to make, for the same services involving the supply of staff, the recipient liable for the payment of VAT. As a result, Council Implementing Decision (EU) 2018/486⁴, granted that authorisation until 31 December 2020.

Hungary now requests, under Article 395 of the VAT Directive, that the Council, acting upon a proposal of the Commission, authorises it to continue applying this special measure derogating from Article 193 of the VAT Directive as regards the application of the reverse charge mechanism to domestic supplies of services involving the supply of staff engaged in activities other than those covered by point (a) of Article 199(1) of that Directive.

³ Council Implementing Decision (EU) 2015/2349 of 10 December 2015 authorising Hungary to apply a measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 330, 16.12.2015, p. 53).

⁴ Council Implementing Decision (EU) 2018/486 of 19 March 2018 authorising Hungary to apply a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 81, 23.3.2018, p. 15).

The request covers the supply of staff provided through temporary employment agencies, secondment of staff, school cooperatives, pensioners' cooperatives and to all supplies of services which are not provided under these legal forms, but in terms of their content actually entail the supply of staff. Therefore, the authorisation whose extension is requested, allows Hungary, in practice, to apply the reverse charge to all services consisting of the supply of staff.

According to the Hungarian request, the supply of staff sector is extremely vulnerable to tax fraud. The main costs for temporary employment agencies are the salaries and related taxes and contributions, which do not entail any input VAT, while their purchases are insignificant by comparison. Consequently, if the reverse charge is not applied, the amount of VAT charged by operators in the sector to their customers, that is to say the output VAT, is far higher than the amount of deductible VAT, the input VAT. This should normally lead to a position of debt towards the Treasury regarding VAT. Further, supply of staff services are very simple to provide, as no special knowledge neither special equipment are required to start the economic activity, making very easy to enter the supply of staff market.

Fraudulent undertakings providing temporary employment agency services typically build up a chain, and the undertaking at the end of the chain that actually provides the supply of staff service does not pay the VAT applicable to the service. This practice distorts competition thus jeopardising the operation of law-abiding undertakings. Furthermore, tax evasion in the sector involves not only VAT, but also employment taxes and contributions, which are about 40 per cent of the total cost of employment.

According to the information submitted by Hungary, the introduction of the reverse charge in the supply of staff sector led to a reduction in the number of providers operating in the sector, despite an increase in the taxable amount of the supplies provided. This trend, in their opinion, indicates an effect of "cleansing" of the market.

Hungary states in its request that the measure has proved to be an appropriate and effective instrument in combating abuse and has helped reducing VAT fraud in the sector. Considering the specific nature of the temporary employment agency sector, which does not require any particular expertise to operate and where the amounts of VAT to be paid are much higher than the amount of deductible VAT, if the reverse charge mechanism could no longer be applied the original conditions would according to Hungary soon be restored and the fraudulent chains would re-emerge in no time.

Furthermore, Hungary stresses that the worldwide economic downturn caused by the COVID-19 pandemic has seriously affected employment and, in particular, the supply of staff sector. Flexibility as regards the use of workforce would help businesses to recover from this situation. Thus, it is expected that the rate of leased workforces through the temporary agency services will exceed the rate before the outbreak of the COVID-19 pandemic. This could be an incentive for fraudsters to try to enter this sector. Therefore,

the extension of the derogating measure would help avoiding the appearance of fraudsters in the sector.

4. THE COMMISSION'S VIEW

When the Commission receives requests in accordance with Article 395 of the VAT Directive, these are examined with a view to ensure that the basic conditions for granting a derogation are fulfilled, i.e. whether the proposed specific measure simplifies procedures for taxable persons and/or the tax administration or whether the proposal prevents certain types of tax evasion or avoidance. In this context, the Commission has always taken a restrictive, cautious approach to ensure that derogations do not undermine the operation of the general VAT system, are limited in scope, necessary and proportionate.

Any derogation from the system of fractioned payment can, therefore, not be more than a last resort and an emergency measure and must offer guarantees as to the necessity and exceptional nature of the derogation granted.

These conditions were fulfilled when the initial derogation was granted by Council Implementing Decision (EU) 2015/2349. The 2015 report on the “Study to quantify and analyse the VAT Gap in the EU Member States”⁵, published by the European Commission, showed that the VAT Gap in Hungary, for year 2013, reached 24.4%, well above the EU median of 13.9%. Therefore, exceptional measures were needed in order to tackle the VAT fraud.

When Hungary requested in 2017 to continue applying the reverse charge to the supply of staff sector, it was stated that a significant number of measures were introduced to combat VAT fraud. Further, other anti-fraud measures with particular focus on temporary employment agencies were planned by Hungary. Notwithstanding those measures, Hungary considered that the protective reverse charge mechanism should continue to apply to further reduce the damage done to the sector. Nevertheless, in recital 11 of Council Implementing Decision (EU) 2018/486 it was stressed that the measures to be undertaken by Hungary should eliminate fraud in the sector concerned and, therefore, no further derogation from Article 193 of the VAT Directive should be required again in the future with regard to the supply of staff.

The measures implemented by Hungary to reduce VAT fraud, not only in the supply of staff sector but in all sectors of the economy, include the following:

- On 1 January 2012 it was introduced a tax registration procedure and enhanced tax authority supervision to curb the formation of bogus companies and company transfers and to weed out persons engaging in risky behaviour.

⁵ https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/vat_gap2013.pdf

- The fine for tax evasion in connection with the concealment of income has increased significantly. In certain cases, the system of sanctions to be applied in the event of non-compliance with the registration and document-retention obligations has been tightened. A fine replacing the closure of a business has been introduced for violations where activities are pursued without any business premises.

- In 2012, the general time limit for VAT disbursements and, therefore, inspections, was raised to 75 days to increase audit efficiency and eliminate unlawful VAT refund claims.

- On 1 January 2013, the domestic VAT recapitulative statement was introduced. Taxable persons are required to report to the tax authority specific details on the invoices issued and received by them. Initially, the reporting obligation applied to all invoices where the amount of the output VAT was at least HUF 2 million. The threshold has been gradually reduced. From 1 July 2020, anyone issuing an invoice is required to report data on all invoices issued in respect of taxable persons registered in Hungary, for transactions performed in Hungary, including transactions subject to the reverse charge mechanism and tax-exempt transactions, except intra-Community supplies. From 1 January 2021, the reporting obligation will also apply to invoices issued to non-taxable persons, and the threshold for invoices received will be abolished. The tax authority uses the data reported for risk analysis purposes and the fastest detection of invoicing chains.

- Since 1 January 2013, taxable persons are allowed to pay a maximum of HUF 1.5 million in cash per month as consideration for goods or services.

- Since 1 January 2015, newly established undertakings have to submit monthly VAT returns, making it possible to detect earlier and weed out undertakings established for tax evasion purposes. In addition, with effect from the same date, it is no longer possible to submit annual VAT returns for sales revenue in excess of HUF 50 million. Instead, quarterly returns have to be submitted, making it possible to detect abuse during the course of the year.

- On 1 January 2016, a system was introduced in which the tax authority classifies taxable persons as reliable or risky. The classification of taxable persons is reviewed by the tax authority on a quarterly basis.

- On 1 July 2017, invoicing software was introduced for real time invoice reporting, initially on a voluntary basis. It was made compulsory on 1 July 2018, and from 1 January 2021 will be extended to B2C invoices. The continuous inflow of data helps the tax authority to identify risks in real time.

Furthermore, other measures directly targeting the temporary employment agency sector have been introduced:

- Introduced in 2015, the legal instrument entitled ‘notification of evasion of tax liability’ was extended in 2020 to employees as recipients. If, while auditing an employer, the tax

authority identifies circumstances relating to the employment relationship and issues a final decision establishing circumvention of the provisions of taxation legislation, it will bring those circumstances to the relevant employees' attention. This obligation applies even where the employee is no longer in an employment relationship with the taxable person at the time of notification.

- The tax authority can also take action to combat the evasion of employment taxes and contributions, gathering data from the forms on declarations of employment and changes in employment and declarations of tax liabilities available in its databases. The reason is that the most common form of tax evasion is where employment is declared, but no tax liabilities are declared or paid. One way to resolve these discrepancies, in keeping with the taxpayer-friendly approach of the tax authority, is through a supportive procedure in which the taxable person is informed of the type of error and the necessary corrective action, which the taxable person can take of their own accord. Audits may be ordered in respect of taxable persons who fail to react of their own accord.

- The tax authority developed an 'Employee alert' IT system in 2017 to identify and react swiftly to fraudulent behaviour on the part of employers. The system has been successful in helping to combat the shadow economy.

According to the data estimates provided by Hungary, these measures have allowed to reduce VAT fraud in the supply of staff sector from more than 15 per cent in 2015 to less than 5 per cent in 2019.

Hence, the package of measures implemented by Hungary have demonstrated their effectiveness to curb the VAT fraud and have led to a spectacular decrease in the amount of VAT fraud in all sectors of the economy, as it is shown in the VAT gap reports successively published. As previously mentioned, in 2013 the VAT gap for Hungary amounted to 24.4%. For 2015⁶, the VAT gap amounted to 13.74%, still above the EU median of 10.85%. In the latest "Study and Reports on the VAT Gap in the EU-28 Member States - 2020 Final Report"⁷, the VAT gap in Hungary for 2018 amounted to 8.4%, below the EU median of 9.2%. The forecast for 2019 is that the descending trend continues, estimating a VAT gap of 6.6% for that year.

It should be noted that the figures for the VAT gap in relation to all economic sectors do not diverge much from the estimates provided by the Hungarian authorities for the size of VAT fraud on the supply of staff sector. As a result, the continuation of special measures in the latter sector, such as the reverse charge mechanism, does not seem justified.

⁶ https://ec.europa.eu/taxation_customs/sites/taxation/files/study_and_reports_on_the_vat_gap_2017.pdf

⁷ https://ec.europa.eu/taxation_customs/sites/taxation/files/vat-gap-full-report-2020_en.pdf

Measures such as the tax registration procedure and enhanced tax authority supervision and real time reporting, should be useful to detect VAT fraud at an early stage, avoiding the setting up of bogus companies. Since these measures have proved effective in other sectors of the economy they should overcome the concern expressed by the Hungarian authorities that fraudulent chains would re-emerge in no time if the reverse charge mechanism is no longer applied to the supply of staff sector.

Therefore, the request submitted by Hungary does not fulfil the condition of being a last resort and an emergency measure, which must offer guarantees as to the necessity and exceptional nature of the derogation granted. The conventional measures implemented by Hungary of a general nature, together with the specific measures abovementioned for the temporary employment agency sector, should be enough to address the VAT fraud in the supply of staff sector.

Furthermore, the measure requested by Hungary does not seem limited in scope, necessary and proportionate to address the specific fraud situation linked to the supply of staff sector. The measures of a general scope and the specific ones implemented by Hungary, in particular the tax registration procedure and enhanced tax authority supervision and real time reporting, should be sufficient to tackle the VAT fraud in the supply of staff sector.

Finally, the Commission has objected by means of a Communication to the Council⁸ to a similar request from Italy to apply the reverse charge mechanism to the atypical supply of staff.

5. CONCLUSION

On the basis of the above-mentioned elements, the Commission objects to the request made by Hungary.

⁸ Communication from the Commission to the Council in accordance with Article 395 of Council Directive 2006/112/EC (COM/2020/243 final).