

Value added tax (VAT): application of the reverse charge mechanism to supplies of certain services susceptible to fraud

2009/0139(CNS) - 29/09/2009 - Legislative proposal

PURPOSE: to allow the temporary application of the reverse charge mechanism to combat VAT fraud in relation to trade with emission certificates and to transactions involving certain fraud-sensitive goods, and amending Council Directive 2006/112/EC.

PROPOSED ACT: Council Directive.

BACKGROUND: fraud is a major concern for the correct functioning of the Internal Market and poses a threat to Member States' tax revenues. Certain Member States have requested, by means of a derogation granted on the basis of Article 395 of Council Directive 2006/112/EC ("the VAT Directive") a targeted reverse charge system in relation to a particular fraud sensitive sector or to certain goods in order to combat fraud.

The most common form of evasion consists in invoicing supplies by a VAT registered supplier who disappears without accounting for this VAT but leaving the customer (also a taxable person) with a valid invoice for deduction. This means that the treasury does not receive VAT on the supply, but must give the next trader in the chain credit for input VAT.

This has, in certain cases, developed into Missing Trader Intra-Community Fraud (MTIC) which is an organised attack on the VAT system. The supplier receives credit for the input VAT through a refund of VAT when his onward supply to a taxable person in another Member State is exempt. In addition, such frauds are often organised in a series of supplies in which the same goods may circulate several times between Member States ("carousel fraud") and the treasury may lose several times the amount of tax on single goods. It is to be noted that this type of fraud is extending to services as well. The reverse charge mechanism results in no VAT being charged by the supplier to taxable customers who, in turn, become liable for the payment of the VAT. In practice, customers (insofar as they are normal taxable persons with a full right of deduction) would declare and deduct at the same time without effective payment to the treasury. In this sense, the theoretical possibility of committing fraud is removed.

CONTENT: the purpose of this proposal is to allow the temporary application of the reverse charge mechanism to combat existing fraud in relation to trade with emission certificates and to transactions involving certain fraud-sensitive goods. The application of a targeted reverse charge mechanism should, however, not alter the fundamental principles of the VAT system, such as the fractionated payment, and should therefore be restricted to a pre-defined list of goods and services.

Member States will have the option of applying this targeted reverse charge mechanism to a prescribed list of goods and services which have been identified by Member States themselves as sensitive to fraud.

The proposal concentrates on the following areas:

- 1) the Commission has some information on alleged cases of fraud in the area of **trading greenhouse emission allowances**. The differences in individual Member States responses have prompted the Commission to prepare this proposal. Although further analysis is still required as regards the precise circumstances and the actual dimension of the fraud problem, the information

already provided by several Member States is such that it is appropriate to take swift action and include it in this proposal. Accordingly, included in the scope of the proposal are allowances to emit greenhouse gases as defined in Article 3 of Directive 2003/87/EC, transferable in accordance with Article 12 of that Directive, and other allowance units that may be used by operators for compliance with the same Directive;

- 2) **mobile telephones and integrated circuit devices** have also been included in the scope of the proposal. Member States should produce an evaluation report on the application of the mechanism before the end of the application period so as to enable a timely assessment of its efficiency;
- 3) **perfume, and precious metals** where they are not covered by the special arrangements for second-hand goods, works of art, collector's items and antiques pursuant to Articles 311 to 343 or the special scheme for investment gold pursuant to Articles 344 to 356 are included in the scope of the draft Directive.

In **procedural terms**, Member States should first inform the Commission about their intention to introduce the mechanism. The experimental application of a targeted reverse charge must be subject to detailed conditions so as to guarantee the functioning of the scheme, avoid potential negative impacts as far as possible and allow for a proper evaluation of the results.

Before applying this reverse charge scheme, the taxable persons who will be affected by the application of this scheme, as a supplier or as a customer, must be identified for VAT purposes under an individual number. It is furthermore stipulated that the Member States concerned have to introduce reporting obligations in order to guarantee a sufficient follow-up of the measure in order to ensure that the measure is operating effectively.

Moreover, to ensure that the application of reverse charge remains targeted and exceptional to the normal VAT rules, the goods and services have been listed and each Member State may choose to apply a reverse charge mechanism to a **maximum of three categories of which two can be goods**.

The interested Member States should implement **effective control measures** to monitor and to avoid, as much as possible, all forms of fraud and in particular new forms of fraud which would consist in the spilling over of fraud patterns to other products, to the retail level or to other Member States. For the implementation of these measures, it would be recommendable that the findings on the reverse charge mechanism, as described in the Commission document on measures to change the VAT system to fight fraud (see [SEC\(2008\)0249](#), would be taken into consideration.

The experiences stemming from this temporary application of the scheme to fraud sensitive goods or services should allow, on the basis of an information and evaluation procedure as set out in the proposal, a better overall assessment of the usefulness and the proportionality of the targeted application of reverse charge.

Lastly, the Directive will apply **until 31 December 2014**.

BUDGETARY IMPLICATION: this proposal has no negative impact on the Community budget.