Future of VAT

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PURPOSE: to launch a debate on the future of the VAT system in the European Union (Commission Green Paper).

BACKGROUND: **VAT is one of the main sources of revenue for Member States.** By 2008, VAT receipts accounted for 21.4% of the national tax revenues of EU Member States (including social security contributions), a rise of 12% since 1995. VAT receipts represented in 2008 on average 7.8% of the GDP of a Member State.

The **financial and economic crisis** has resulted in severe challenges for public finances in many Member States. Several Member States have recently increased VAT rates or are considering it, either as a reaction to the consolidation needs resulting from the crisis or in the context of a longer-term shift towards indirect rather than direct taxation.

Moreover, given the **impact of ageing societies** on labour markets, savings and consumption patterns and public expenditure in the years to come, taxation systems will have to be adapted. The financing of the welfare state may have to rely less on labour taxes and tax revenues from capital income (savings), thereby further arguing in favour of a shift to indirect taxation.

The approach followed in the last decade has been to simplify and modernise the current VAT system by increments. It has produced positive results, although it has reached its limits. The **complexity of the current VAT system** results in unnecessary costs and burdens for businesses and administrations and may be an **obstacle to the single market**. Furthermore, due to certain endemic weaknesses, it appears to be susceptible to fraud and tax evasion. Lastly, **technological developments** may also offer new or alternative ways of collecting VAT to reduce burdens on business and VAT losses.

This is why, after 40 years, the time has come to have **a critical look at the VAT system** with a view to strengthening its coherence with the single market, its capacity as a revenue raiser by improving its economic efficiency and robustness, and its contribution to other policies whilst reducing the cost of compliance and of collection.

CONTENT: discussions on the future of VAT have been divided between two major headings. The first of these concerns the **principles of taxation of intra-EU transactions** on which an EU VAT system, fully adapted to the single market, should be based. It examines, firstly, if it is appropriate to revise the basis of the current VAT system and whether goods and services should be taxed **in the Member State of origin or in that in which they are sold**.

The second heading covers those **major issues** which need attention irrespective of any choice to be made on the treatment of intra-EU transactions. These relate to the introduction of a more robust, but simplified and more efficient VAT system, which would be more in keeping with the principles of the single market. The issues are the following:

1) How to ensure the neutrality of the VAT system: among other things, this concerns:

- whether the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality;
- problems encountered in relation to the scope of VAT;
- whether certain current VAT exemptions should be maintained;
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- the main problems with the right of deduction and what changes would improve the neutrality and fairness of the rules on deduction of input VAT;

- the main problems with the current VAT rules for international services, in terms of competition and tax neutrality or other factors, and whether more coordination is needed at international level.

2) What degree of harmonisation does the single market require?: any rethink of the VAT system must identify, on the one hand, the extent to which further harmonisation is essential in order to improve the functioning of single market and reduce compliance costs for businesses and, on the other hand, the degree of flexibility needed by the Member States that is compatible with these objectives. The following need to be determined:

- which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?;
- whether guidance on new EU VAT legislation would be useful even if it is not legally binding on the Member States;
- what should be done to improve the legislative process, its transparency and the role of stakeholders in the process;
- whether 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;
- whether there should be no reduced rates (or a very short list of them), which might enable Member States to apply a lower standard VAT rate, or whether there should be a compulsory and uniformly applied reduced VAT rates list in the EU.

3) Reducing 'red tape': following on from the European Council's endorsement in 2007 of the Commission Action Programme to reduce the administrative burdens arising from EU legislation by 25% by 2012, the Commission presented, in 2009, a plan for VAT, among other areas. This plan contains 16 measures such as abolishing the annual summarising VAT return or intra-EU acquisition listings and reducing the frequency of VAT returns. The Green Paper asks:

- what are the main problems experienced with the current rules on VAT obligations;
- what is the feasibility and relevance of the suggested measures including those set out in the reduction plan for VAT;
- whether the current exemption scheme for small businesses should be reviewed and the main elements of that reassessment;
- whether additional simplifications should be considered and what should be their main elements;
- whether the one stop shop concept is considered as a relevant simplification measure;
- whether the current VAT rules create difficulties for intra-company or intra-group cross-border transactions and, if so, how these difficulties might be solved.

A more robust VAT system: as part of the ongoing debate on the strategy to combat VAT fraud, which questioned the efficiency of this collection method, in 2009 the Commission launched a feasibility study on ways of improving and simplifying the collection of VAT by means of modern technologies and/or via financial intermediaries. The Green Paper asks interested parties to identify which model looks most promising, as well as for their views on the feasibility and relevance of an optional split payment.

The Commission invites all interested to contribute to the public consultation, which will be open until **31 May 2011**. Based on the feedback received, the Commission will present the priorities for the future VAT system in a Communication at the end of 2011.