Implementation of the 6th VAT Directive: what is the missing part to reduce the EU VAT gap?

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The Committee on Economic and Monetary Affairs adopted the own-initiative report by Olivier CHASTEL (Renew Europe, BE) on the implementation of the Sixth VAT Directive: what is the missing part to reduce the EU VAT gap?

In 1977, the Council adopted the Sixth VAT Directive with a view to achieving a uniform tax base under which harmonised rates were to be set out. The aim was to abolish fiscal borders and controls at internal borders for all operations carried out between Member States with a view to the completion of the internal market on 31 December 1992.

The VAT Directive has recast and repealed the Sixth VAT Directive, for the purposes of greater clarification. The Directive provides for the transitional rules to be replaced by a definitive system based on taxation in the Member State of origin. However, the transitional system is complex, flawed and structurally vulnerable to fraud. This report also analyses the VAT gap between Member States.

Tax rates, tax bases and VAT gaps in Member States

The VAT gap is the difference between expected VAT revenues and VAT actually collected. VAT revenue is one of the chief sources of public revenue, accounting for some 21 % of total tax revenue in the EU on average. Members welcomed the fact that the **overall trend is positive**, with the VAT gap falling to 10 % in 2019 from 20 % in 2009 in the Member States, which suggests that VAT fraud in the EU is in decline and VAT revenue as a proportion of gross domestic product is on the rise.

The report called on national tax authorities to take initiatives to reduce the VAT gap in order to improve public finances, especially in the light of the economic downturn caused by the COVID-19 pandemic and increase EU own resources.

Members stressed that the system is becoming increasingly complicated because of the different rates, but also because of exemptions and derogations. The COVID-19 pandemic justified VAT-related exception rules, which proves the need for a **degree of flexibility** when facing urgent or unexpected circumstances.

Impact of the wide variety of reduced rates on businesses

The current diversity of reduced rates creates additional administrative burdens for businesses with the total cost of VAT compliance ranging from 1 % to 4 % of company turnover within the Member States. Digitalisation can contribute greatly to the reduction of compliance costs for businesses. While digitisation can help cut costs, it imposes a burden in the short term on businesses, and particularly **SMEs**, as they must acquire the latest technology and know-how. Looking ahead, the Member States will need a harmonised IT system.

Members also support the idea of expanding the scope of the **VAT One-Stop Shop**, which has been in place since 2015, to the declaration and payment of VAT. More specifically, they underlined the need to specifically target the adaptation of the One-Stop Shop at the expanding **e-commerce** market.

Moreover, Members called for the expansion of **e-invoicing** and for the introduction of an EU e-invoicing standard harmonising, in particular, the information contained in an e-invoice in order to facilitate cross-border interoperability, ensure legal compliance, increase transparency in commercial transactions and thus limit fraud and errors.

The report underlined the urgency of tackling VAT cross-border fraud and carousel fraud through the proper implementation of efficient **exchange of information** mechanisms and adequate means (both human, financial, technical and technological) for national authorities and other authorities such as OLAF. Companies need simplified and centralised access to information on rates, the correct VAT rates for different goods and services in the different Member States, and the conditions for zero-rate VAT, as well as and clear and unambiguous VAT rules to encourage cross-border business and reduce their administrative burdens.

Impact of reduced VAT rates on consumers and social and environmental objectives

Reduced rates normally pursue the legitimate purpose of ensuring that essential goods are accessible to everyone. They can be more effective in societies with significant income disparities and a high level of social and economic inequality. The report noted that in order to promote environmentally friendly consumption, it is of primary importance for Member States to phase out all zero VAT rates and reduced rates for harmful environmental goods and services. Evidence suggests that reduced VAT rates are often a rather inefficient instrument to achieve social or environmental objectives since they lead to considerable costs for governments owing to the size of the rate gap, reduced tax revenues, increased administrative costs, costly checks and inspections, pressure from social and economic representatives compliance costs, economic distortions or even tax evasion, and difficulties in reaching target groups.

The Commission and the Member States are called on to explore all the possibilities of the **taxpayer identification number** as a mechanism to safeguard high efficiency standards for reporting.

Stressing the importance of guaranteeing the full transposition and proper implementation of the VAT e-commerce package, Members called on the Commission to evaluate the state of play in this regard and present concrete proposals to adapt the rules, where needed, taking the exponential growth of e-commerce into consideration.

Lastly, the report stressed the need to move to a definitive VAT system based on the principle of taxation in the country of destination. It called on the Council to adopt the proposal for a directive of 25 May 2018 as soon as possible, given the extent of the loss of national and EU budgetary resources under the current regime.