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

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The European Parliament adopted by 510 votes to 74, with 108 abstentions, a resolution on the implementation of the Sixth VAT Directive: what is the missing part to reduce the EU VAT gap?

This resolution assesses the implementation of the transposition of the 6th VAT Directive, as recast in Council Directive 2006/112/EC, in order to draw conclusions and to suggest ways to improve its application. It also aims to assess the VAT gap between Member States which is the difference between expected VAT revenues and VAT actually collected.

Tax rates, tax bases and VAT gaps in Member States

Members recalled that VAT revenue is one of the chief sources of public revenue, accounting for some 21 % of total tax revenue in the EU on average. They 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.

Parliament 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; notes that the total cost of VAT compliance ranges from 1 % to 4 % of company turnover within the Member States. Members considered that **digitisation** could make a significant contribution to reducing compliance costs for businesses. They noted that differentiated VAT regimes within the EU can discourage intra-EU trade for all businesses, especially SMEs which face proportionately higher compliance costs.

Parliament highlighted the potential of **distributed ledger technology** to prevent VAT fraud – e.g. missing trader intra-community fraud – and looks forward to the legislative proposal for modernising VAT reporting obligations. It pointed to the EU One-Stop Shop as an example of digital innovation allowing EU businesses to simplify their VAT bills and thus compliance costs in the area of e-commerce sales within the EU.

Members called for the expansion of **e-invoicing** and 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.

Member States are called on to increase and **improve cooperation between themselves** and thoroughly apply the set of rules on the exchange of VAT payment data to facilitate the detection of tax fraud in cross-border e-commerce transactions, which were adopted in February 2020.

The resolution 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.

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

Members noted that the application of reduced rates does not always result in permanent price reductions for the consumer and that the effectiveness of a reduced rate depends on a number of factors, such as the extent to which businesses pass it on to consumers, its duration over time, the size of the reduction and the complexity of the rate system.

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. However, Members pointed out that that empirical evidence on the effectiveness of reduced VAT rates in promoting socially desirable or environmental goods is scarce and ambiguous.

Parliament recalled that the effectiveness of reduced rates as a policy tool should always be assessed in the specific context of other existing policy tools. It added that reduced rates are often complementary to existing social and environmental policy instruments and that direct tax incentives are instruments that better target low-income households - for example a tax exemption threshold and progressive tax rates - and are generally less costly, provided that other conditions are met.

Towards a modernised and simplified system

Parliament called for a simplified and modernised VAT system with limits on exemptions and non-standard rates to promote fair and efficient business competitiveness within the internal market, reduce compliance costs and improve voluntary compliance. Such a simplified VAT system would still benefit from a one-stop shop in order to reduce compliance costs for EU businesses and boost intra-EU trade.

Members noted the proposals of the Portuguese and Slovenian Council presidencies to phase out at Member State level all zero and reduced VAT rates on **environmentally harmful goods and services**, such as fossil fuels, chemical pesticides and chemical fertilisers.

The resolution called for consideration to be given to the implementation of social measures for low-income households to compensate for the reduction in disposable income resulting from higher VAT rates on polluting goods and services. Member States are urged to adopt the proposal for a revised VAT rates directive rapidly.

Lastly, Parliament 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.