Value added tax VAT: simplify the procedure, assist in countering tax evasion and avoidance, repealing decisions granting derogations (amend. Directive 77/388/EEC)

2005/0019(CNS) - 16/03/2005 - Legislative proposal

PURPOSE : proposal to amend the 6th VAT Directive (Directive 77/388/EEC) to provide Member States with the option of quickly adopting measures in order to counter avoidance and evasion in certain specific and targeted areas and rationalisation proposal aimed at simplifying the application of the tax in certain circumstances where those liable to pay the tax are in financial difficulties.

PROPOSED ACT : Council Directive.

CONTENT : under Article 27 of the Sixth VAT Directive, the Council may authorise any Member State to introduce special measures for derogation from the provisions of the Sixth VAT Directive, in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance. Currently, Member States have been allowed to apply over 140 derogations. This number will grow in the near future, since Member States which joined the EU on the 1st of May 2004 are now introducing requests for derogations.

The Commission has undertaken in previous communications to rationalise some of the large number of derogations currently in force. It was envisaged that such a rationalisation would involve making certain individual derogations available to all Member States through an amendment to the Sixth VAT Directive. These derogations would be those which had already proved themselves effective and which tackled problems which were shared by more than one Member State.

The number of derogations and the similar problems they tackle is indicative of the fact that in recent years VAT avoidance and fraud has become a very real issue. Both the national authorities of the Member States as well as business federations have pointed out that evading VAT has become so widespread in certain sectors that it puts honest traders under a competitive disadvantage. Charging VAT but not paying it over to the State results in not only a loss of revenue for the State but also enables dishonest traders to offer goods or services at lower prices than their compliant competitors. In addition, Member States are more frequently confronted with artificial constructions – often involving a series of transactions - set up with the sole purpose of obtaining a VAT advantage either by lowering the final VAT charge or by increasing the recovery of VAT. While the artificial character of the chain of transactions is usually obvious, counter measures or court action inevitably take a long time. In the meantime, experience in Member States demonstrates that VAT avoidance schemes are worked out by specialists and successful ones subsequently marketed as a product to businesses. It is therefore questionable whether a piecemeal approach to tackling this problem where there is evidence of common problems is still appropriate.

The Commission is therefore of the opinion that specific known schemes could be more effectively tackled through an amendment to the Directive to provide a permanent viable alternative to the standard treatment where it can be justified through evidence of avoidance or evasion activity. The proposal, therefore, introduces changes in some areas where there are proven difficulties with the operation of the sixth Directive and a demonstrable need to allow some limited flexibility more generally. In common with

the derogations from which they spring, these measures represent an alternative to the normal rules and are only being made available to all Member States to help counter avoidance and evasion or to simplify the operation of the tax.

The measures provide Member States with the option of using the alternative rule, rather than making their application mandatory. In addition, given the variety of mutations through which avoidance schemes pass in response to counter-measures, the proposal allows Member States some room to adapt the measures to their specific national situations. Thus, once having opted to apply the rule, Member States are authorised to limit their application of the new rules in order to target their specific avoidance or evasion problem.

The following specific points are to be noted:

- the Commission is taking the opportunity to propose changes to strengthen areas which Member States find can be exploited to avoid VAT. In both the area of "grouping" in Article 4(4) of the Sixth Directive and in "transfers of going concerns" (Article 5(8)) the proposal allows for Member States to take steps to ensure that the operation of the rules does not allow an unfair result which would unjustifiably benefit or prejudice those concerned. Member States already have the discretion to set the circumstances in which the both of these rules can apply. The new rule, already applied to capital goods through Article 20(6), would help Member States prevent unfair results arising from the operation of the rules;

- there is the deletion of the current definition of “open market value”;

- several Member States already apply a special measure on the basis of Article 27 to counter an arrangement which avoids the payment of VAT on untaxed investment gold used as a raw material for making consumer goods. It is now proposed to provide within the Sixth VAT Directive the means for all Member States to apply this measure;

- one of the vulnerable areas for avoidance relates to the valuation of supplies since that directly affects the amount of tax which is charged. The new paragraph (6) to Article 11(A) of the 6th Directive, to be found in Article 1(3)(b), introduces an optional rule which enables Member States to revalue certain supplies.

- the proposed amendment in Article 1(6) is intended to clarify that adjustment of deductions relating to capital items under Article 20 of the Sixth Directive may apply equally to services - provided that they are of a capital nature and are treated as such;

- Article 1(7) extends the use of an optional reverse charge mechanism for specified supplies made to taxable persons. These are in sectors of the economy which have proved particularly difficult for Member States to police, for example because of the nature of the industry or its structure. The areas covered are services relating to buildings (including any, or all, of the services of construction, repair, cleaning and demolition); supplies of staff relating to building services; land and buildings on which the option to tax has been exercised; and supplies of waste, scrap and recyclable material together with some products resulting from their treatment and some treatment services.

- the proposal covers details of the repeal of certain legislation as well as implementation and notification by Member States.