

# Editorial

## *The Future of VAT*

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The time has come to take a fresh look at the EU's VAT system to see how we can make it work better for European businesses and citizens. I doubt that there are many who would question the need to create a simpler and more modern regime, adapted to today's business environment and Member States' revenue needs. We need a VAT system that contributes to the Internal Market and economic growth; one that is less vulnerable to fraud and evasion. With this in mind, the Commission published its Green Paper on the future of VAT on 1 December 2010. In doing so, we threw open the door to a wide debate on any and every aspect of the current VAT system. The goal is to give all stakeholders a chance to express their thoughts and views on the problems that currently exist and how these can be addressed. There are no limits to this debate – the Commission welcomes contributions and ideas on all issues relevant to VAT. On the basis of the feedback we receive, the Commission will draw up a Communication on priority areas to be addressed and follow this up with legislative proposals for a new VAT strategy.

What makes now the right time to launch this review process? First, for the past seventeen years we have been working under a transitional VAT regime, never intended to be in place beyond the twentieth century. All evidence indicates that this system does not fit with our current needs. It is complex, burdensome for businesses and not designed for a marketplace where services now comprise 70% of all economic activity and new technologies play a central role. The Single Market Act, recently adopted by the Commission, confirmed that our VAT system can play a key role in strengthening the Internal Market, but only if the current regime is reviewed. At the moment, VAT appears to be more of a hindrance than a help to businesses wishing to engage in intra-EU trade. While the Commission has put forward measures to modernize and simplify the VAT regime over the past decade, with some success, this piecemeal approach is clearly no longer sustainable. If we want a more robust, effective and simpler VAT system, then a fundamental overhaul will be needed. No matter what is finally chosen as the new system, doing away with the so-called 'transitional' character of the VAT rules and replacing them with a more stable system which is flexible enough to adapt to the ever-evolving market, will already be a major step forward.

Second, the current economic situation has thrown into the spotlight the crucial contribution that VAT can

make towards economic stability and growth. Economic studies have shown that consumption taxes are more growth friendly than certain direct taxes such as those on labour and capital. In addition, VAT is a major source of revenue for national budgets; even the main source in some Member States. With the drop in income, capital and property taxes due to the recession, we can expect VAT to play an even more important role in funding national budgets in the years ahead. At a time when Member States depend so heavily on stable sources of income for their economic re-growth, we must ensure that there is a VAT system in place that is delivering to its full potential.

Finally, we need a stronger system in place to prevent, detect and stop VAT fraud. There are inherent weaknesses in the current VAT structure which make it particularly vulnerable to fraudulent activity, most notably the tax-free nature of cross-border transactions. I know that Member States give high political priority to tackling this problem, which robs them of millions of euros every year. Some Member States have even pushed for very substantial measures, such as the application of a generalized reverse charge system, to address VAT fraud. Clearly, any new VAT system that we consider building will have to be thoroughly fraud-proofed and be designed to stay one step ahead of criminal plots against the system.

With the abovementioned factors in mind, the Commission has based its Green Paper around a number of broad themes, with a view to drawing response on as wide a range of issues as possible.

The first issue to be looked at is whether we need to fundamentally review the principles on which the VAT system is based. While the VAT Directive states that definitive VAT arrangements should be based on taxing goods and services in the Member States of origin, Member States have so far been reluctant to follow through on this commitment. However, changes in recent years – such as greater convergence of the standard VAT rate amongst Member States and new technology that could help ensure that the Member State of consumption received the correct VAT receipts – may be sufficient to nudge national authorities back towards the approach they originally agreed upon. Alternative routes to taxation at the place of origin are also outlined in the Green Paper to ensure a full and balanced assessment of what the best approach might be.

The next part of the Paper looks at an extensive range of other important issues that need to be addressed in

relation to the current VAT system. For example, do VAT exemptions go against the idea of a broad-based tax and are they still relevant? Are reduced rates worth keeping, given the problems they can cause in terms of competitive distortions and high compliance costs? Are the current rules on deductions neutral and fair enough? And how can we simplify the VAT system and remove red tape to make it easier for businesses to operate within the Internal Market? Some other issues mentioned have been outstanding for a long time, such as VAT rules applicable to public authorities or to passenger transport. However, this is not a reason to exclude them from the debate. In fact, the Commission hopes that their inclusion in the consultation process will provide valuable input into if and how new impetus can be given to these files.

Finally, the Green Paper looks at the way in which VAT is collected and asks whether this could be improved. Considering that we currently have a VAT gap of more than EUR 100 billion per year, something

clearly is not working when it comes to collecting the receipts. The Commission is determined to find out whether more efficient ways of collecting the tax are available today. For this reason, it has launched a feasibility study on alternative ways of collecting the VAT and through the Green Paper also offers taxpayers and authorities the chance to submit their ideas. I am aware that any changes in the way VAT is collected will not happen overnight, but I do believe that sound analysis and strong reflection can help us find the right approach for the long term.

To conclude, the Green Paper on the future of VAT is the first step in what I hope will lead eventually to a radical improvement of the EU's VAT system. VAT is a tax that touches everybody: consumers, businesses, professionals, and tax administrations. As a result, everyone's views are important in our work in this area. I would urge anyone with an interest and opinion to participate in the consultation, because your feedback will be the foundations upon which any future proposal is built.