

Editorial

Some Remarks on the Future of VAT

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On 1 December 2010, the European Commission published its 'Green Paper on the future of value added tax (VAT)' with the challenging subtitle 'Towards a simpler, more robust and efficient VAT system'.¹ In this Green Paper, the Commission launches a process to review the present transitional VAT regime that came into force on 1 January 1993 – a transitional regime never intended to be in place beyond the twentieth century, as Algirdas Šemeta, Commissioner for Taxation, Customs, Audit and Anti-fraud, wrote in his editorial in EC Tax Review 2011/1. As a kick-off, the Commission invited all stakeholders to express their problems with the present VAT regime and to indicate preferred solutions. The deadline for response was 31 May 2011, and the Commission has announced to present, by the end of 2011, a Communication in which priority areas for further actions will be identified.²

The VAT, nowadays taking more than 21% of the national tax revenues of EU, has become one of the major sources of revenue for national budgets and, in many EU Member States, is the main revenue raiser. Since the 1990s, the tax structures of many Member States have shifted from less robust income-based direct tax revenues to more robust consumption-based indirect tax revenues. This shift in the tax mix can be rationalized by striving at reducing the negative effect of taxation on growth and employment and achieving less dependency on taxes on labour and capital income in ageing societies. An even more robust and prominent role for the VAT, however, requires more attention to the problems of the current VAT system. Changing business models, increasing cross-border services, on-going technological development and complex VAT fraud are challenges to make the VAT simpler, more efficient, less costly for business and tax authorities, and less sensitive to fraud. The Commission is of the opinion that the piecemeal approach of step-by-step improvements of the system is not sustainable, and a fundamental overhaul of the VAT regime will be needed. The Green Paper goes into the principles of taxation of intra-EU transactions and addresses issues that need attention,

irrespective of any choice to be made on the treatment of intra-EU transactions. In this editorial, I would like to make some remarks on the questions raised by the Commission.

1 ALTERNATIVE PRINCIPLES?

As regards the principles of taxation of intra-EU transactions, the Commission has requested input from the stakeholders on possible ways forward: maintaining the principles of the transitional VAT regime or moving toward alternatives. The Commission mentions three alternatives, each of them based on the underlying principle that taxation shall take place where the consumption occurs or where the customer is established.

The alternative of levying VAT in the country of origin means that intra-EU transactions are taxed the same way as domestic transactions. Although this may be the most logical alternative, earlier attempts in 1987 and 2006 to introduce such a system have failed due to unwanted cash flow effects, resistance against clearing cross-border VAT (directly or through statistical data) and lack of trust between the Member States.

The second alternative is the introduction of a general 'reverse charge' system for both intra-EU transactions and domestic transactions. This system would not have any cash flow effects for business-to-business transactions, as the VAT liability would be shifted forward to the taxable customer and VAT would be charged only to customers who are not taxable persons for VAT (i.e., final consumers). The general reverse charge system has been mentioned as one of the solutions against carousel fraud. Although it would be a true modern VAT system, a move toward this system is not yet feasible. It would not only require a more reliable VAT Information Exchange System (VIES) than we have at the moment but also more sophisticated and cheaper IT solutions for tracing both domestic and intra-EU transactions.

The third alternative mentioned by the Commission is taxation of intra-EU supplies of goods and services in the country of destination. This alternative would require a one-stop-shop system in the country of origin

¹ COM (2010) 695 final.

² Commission Work Programme 2011, COM (2010) 623.

for suppliers who have to deal with VAT liabilities in Member States other than those in which they are established. We already have some experience with the one-stop-shop system. Since the introduction of the VAT rules for the supply of services by electronic means (online e-services), non-EU suppliers of inbound online e-services to non-taxable persons (final consumers) in all EU Member States should register in a simplified way for VAT in one of the Member States to comply electronically with their VAT obligations. The VAT charged by the supplier at the rate applicable in the Member States of the consumers and paid to the Member State where the supplier has his one-stop-shop should then be cleared between the Member States concerned. It cannot be expected that, on short term, Member States are willing to extend the one-stop-shop system to all intra-EU transactions (business-to-business and business to consumer), as this alternative requires mutual trust in the quality of the tax administrations of the other Member States. Yet I think that this third alternative may have the best chances on longer term. A step-by-step extension of the use of the one-stop-shop system for intra-EU transactions on specific goods and services would give tax administrations opportunities to share experience and develop best practices at the EU level. In this context, it would be useful to further investigate the possibilities for simple cross-border registration of groups of companies within the internal market.

2 ALTERNATIVE VAT COLLECTING MODELS?

Mainly in order to reduce the 'VAT gap' of more than EUR 100 billion per year, caused by fraud, involuntary failures, bankruptcies and the black economy, the Commission suggested some other VAT collecting models, such as a split payment model, a central VAT monitoring data base model, a data warehouse model and a certified taxable person model.

In the split payment model, the bank splits the payment by the customer into the taxable amount paid to the supplier and the VAT amount paid directly to the tax authority, thus avoiding the supplier to keep the VAT paid by his customer and disappear without paying it to the fisc ('missing trader fraud'). The system may look attractive on the drawing board, but what should be done if there is no bank involved (cash payments, barter trade, intra-group transactions) or in case of late payments, credit invoices and self-billing?

A central VAT monitoring database model would lead to filling in real time an EU-wide database with all electronic invoice data of all transactions in the twenty-seven Member States. Even if problems with diverging standards for e-invoicing could be overcome, security issues may arise as this ever growing central database would contain sensitive financial and market information outside business control.

The data warehouse model would lead to as many decentralized databases as there are taxable persons, each set up according to the same EU-wide format. These data warehouses would be run by the taxable persons and be constantly accessible online by the VAT authorities, a more futuristic than realistic idea.

The suggestion for a certified taxable person model, although in my view is not a real VAT collecting model, seems to build further on the 'horizontal monitoring' concept, in which a taxable person's reliability and thus the risk of VAT fraud are assessed on the basis of its tax control framework and *modus operandi*.

VAT fraud leads not only to a VAT gap for the governments but also to the distortion of competition for bona fide taxpayers. So it is also in the interest of these taxpayers to combat fraud. However, the instruments to be used should not create new hurdles for intra-EU business. In my opinion the first three models mentioned above would not be efficient, as they will lead to higher administrative costs for businesses and tax authorities and create unworkable databases with information, without any focus on risk assessment. The certified taxable person model has the advantage of focusing on risk assessment and therefore identifying low- and high-risk taxable persons. This model could indeed be a more effective and efficient way of reducing the VAT gap and combating fraud than just gathering more and more information from all taxable persons. In my view, it may be worth to further investigate this model under the condition that the criteria for certification are objective, transparent and dynamic.

Meanwhile, the combat against VAT fraud requires more effort in improving the cooperation between the VAT authorities of the Member States and the quality of the VIES.

3 MORE HARMONIZATION?

As regards the questions raised by the Commission on the degree of harmonization required, I am of the opinion that business and industry in the internal market would indeed benefit from a more harmonized VAT regime with less exceptions at the national level. VAT should be made simpler, more transparent and less uncertain for businesses by harmonizing the rules for VAT deductions and bringing more clarity and uniformity in determining whether a supply qualifies as good or services and whether there is a single or combination of supplies. The great number of national derogations and discretionary provisions should be reduced in order to reduce complexity and create a more level playing field within the internal market. Last but not the least, simplified and harmonized VAT return and reporting procedures would contribute to achieving the objective of lower administrative costs for businesses as VAT collectors for the governments.

What will the next stage of this review process bring? By the end of 2011, we hope to learn which priority areas the Commission has identified for moving toward a simpler, more robust and efficient VAT system. However, the political climate for a fundamental overhaul of the present EU VAT regime is far from ideal. As long as the distressing situation of high government

debts will go on, Member States will give high priority to ensuring robust national tax revenues from VAT and will be hesitating to agree with Commission proposals on the essential changes in the VAT system – especially if such changes would mean that a Member State has to rely more on other Member States to collect its part of the VAT revenue.