

Request for the authorisation of derogation under Article 395 of Directive 2006/112/EC

The Czech Republic, the Republic of Austria, the Republic of Bulgaria, and the Slovak Republic (hereinafter referred to as “involved MS”)

Apply for the authorisation

of derogation under Article 395 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter referred to as “the VAT Directive”)

to introduce a special measure derogating from Article 193 of the VAT Directive with regard to the persons liable for payment of VAT, in order to simplify the procedures for collecting VAT or to prevent certain forms of tax evasion or avoidance¹.

Description of the measure and scope of derogation:

The involved MS shall be authorised to designate the taxable person registered for VAT purposes (the VAT payer) to whom taxable supplies of goods or services are made within its territory as the person liable to pay VAT.

The derogation shall apply to the following supplies:

Any taxable supply where the overall amount (exclusive of VAT) exceeds EUR 10,000.

Invoicing obligations:

A taxable person supplying goods or services subject to reverse charge shall ensure that invoicing obligations laid down by the VAT Directive are fulfilled.

Reporting obligations:

Any of the involved MS shall be entitled to apply the reverse charge mechanism if the minimum reporting standard is introduced by this MS. **The minimum reporting standard shall mean obligatory reporting of all transactions subject to the special measure by the supplier as well as by the recipient on a regular basis (monthly or quarterly).**

The submission of any listings relating to supplies of the goods or services subject to the reverse charge should be permitted by electronic means.

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1), Art. 395 (1), first sentence

I. Rationale for the application

1. The fight against the missing trader fraud (e.g., carousel fraud) and making the existing VAT system more operational remains one of the key priorities of all involved MS. Estimated losses on VAT collections amounting to more than EUR 177 billion and representing between 5% and 44% of the MS VAT revenues send an alarming message requiring a swift and comprehensive response. The missing trader fraud (e.g., carousel fraud) accounts for a significant portion of the lost VAT. An increase in fraudulent activity has been observed, despite efforts to tackle the problem.
2. In the longer run, EU aims at a “Robust, Resilient and Fraud-proof VAT System”. A comprehensive approach to reverse charge mechanism may serve these priorities very well. Key benefits of the reverse charge mechanism are that missing trader fraud (e.g., carousel fraud) is eliminated and a level playing field is ensured. However, a proposal for a new definitive regime is not likely to be presented before 2016 and is to be discussed in detail. There is a strong sense of urgency on the part of the involved MS to resolve this particular problem immediately.
3. In addition to timely action, more efficient and business-friendly tax collection in involved MS, this derogation may provide a valuable experience for a future regime.
4. The number of goods and services to which the reverse charge mechanism is being applied has gradually increased over the past years. No adverse impact on intra-community trading has been experienced so far; this is mainly because the application of the reverse charge mechanism is not a change in the VAT concept, but a country-specific measure to collect the harmonised tax. It is fair and neutral, and the possibility of different choices made by up to 28 different tax administrations does not act as a drag on the internal market, if compared to other VAT-collection regimes. Additionally, it shall be noted that a comprehensive reverse charge mechanism would make it easier for taxable persons to comply with the reverse charge system. Administrative costs will be reduced for taxable persons and tax administrations inasmuch as differentiation problems and legal uncertainty will be avoided.
5. The system of VAT in the EU is a common system but at the same time the administration of the system is very specific in each member state. This is because the harmonised tax is being collected by 28 different tax administrations. This derogation would have no effect on any structural element of VAT, such as tax base and tax rates, respectively. An identical amount of taxes is to be collected regardless of the derogation being granted or not. The fact that paying taxes in one member state may be less complicated than in another may actually benefit businesses.
6. One country by itself cannot combat VAT fraud; rather, it is incumbent upon the MS to tackle VAT fraud by applying measures that have been successfully employed (e.g., reverse charge mechanism) in the current system to fight fraudsters. Fraud is fast and flexible, therefore it requires fast, flexible, and transparent action. Unfortunately, no current regime provides for that.
7. The adoption of the amendments to the VAT Directive in 2013 was a step in the right direction. It broadened the possibilities of Member States to use the reverse charge mechanism in the fight against tax fraud, though still limited to particular circumstances and commodities; this positive trend is to continue. Anti-fraud measures need to be applied in a comprehensive, faster and more operational way. Despite the possibility afforded by the 2013 legislation, no member state has been able to benefit from the quick reaction mechanism yet.

II. The objective of the requested measure

8. Certain businesses engage in tax evasion by not paying VAT to the tax authorities after selling products and supplying services. However, their customers, insofar as they are taxable persons with the right to claim VAT, being in possession of a valid invoice, remain entitled to tax deduction. In the most aggressive forms of this tax evasion, the same supplies are, via a carousel scheme, supplied several times without payment of VAT to the tax authorities. Following from the above, the derogation would remove the opportunity to engage in that form of tax evasion.
9. Such fraud is often sophisticated and combined with other criminal activity. It has a serious impact not only on the revenue loss, but it also distorts fair competition by enabling the fraudulent traders to sell goods at low prices. It gives them a significant advantage over honest businesses.

III. Selection of the method

10. The recent history shows that *missing trader fraud* (e.g., *carousel fraud*) may be definitively defeated by removing the opportunity for the missing trader. The reverse charge mechanism has turned out to be the only efficient and effective tool in combating *missing trader fraud* (e.g., *carousel fraud*), increasingly becoming more common in selecting anti-fraud measures, if available to tax administrations. Fraudsters may be altogether kept out of the market place even in economic sectors where fraudulent activities occur but are not currently known to the tax authority. This is of special significance as *missing trader fraud* (e.g., *carousel fraud*) may easily be carried out in every economic sector and may quickly shift to other activities where reverse charge is not applied at the moment. Potential risks connected with the change in the system may be tackled with less effort than the *missing trader fraud* (e.g., *carousel fraud*). Reverse charge is easy to apply and can simplify the administration of VAT. Beyond that, any broadening of domestic reverse charge further harmonises the treatment of domestic and intra-community supplies.
11. The conventional methods of the anti-fraud strategy (e.g., exchange of information, visits of businesses at the time of registration, risk-based audits and control activities, state-of-the-art technology, like internet monitoring and proven tools of tax fraud simulations and preparation of offender profiles to quickly spot risk areas, etc.) however, are inadequate to counter fraud comprehensively; above measures need to be supplemented with further available tools at hand. The equivalent measure (data exchange) to the one as proposed is actually already applied in case of cross border supplies (recapitulative statement) and some internal supplies as well.
12. The introduction of a comprehensive reverse charge mechanism constitutes derogation from Article 193 of the VAT Directive, thus requiring authorisation pursuant to Article 395 of the VAT Directive. According to Article 395 of the VAT directive, a MS may be authorised to introduce special measures for derogation from the provisions of the VAT Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance².
13. The measure is being proposed in order to also simplify the procedure for collecting VAT as the unification of the person liable to report or pay VAT (tax debtor) and the person able to claim VAT recovery is the same taxable person. Moreover, the implementation of reverse charge would entail, in conjunction with

² Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1), Art. 395 (1), first sentence

the deduction of VAT, a significant reduction in administrative costs for taxable persons (ECJ Case C-90/02, 1 April 2004, Bockemühl and ECJ Case C-95/07 and C-96/07, 8 May 2008, *Ecotrade*) and would give rise to a cash-flow advantage for the recipient of the supplies. It would prevent the situation when VAT payer rendering the supply did not pay his VAT even though the recipient of the supply claimed the input VAT for this supply.

14. The procedure for collecting VAT would not adversely affect the overall amount of the tax revenue of the MS collected at the stage of final consumption, given the threshold of EUR 10,000.³ On the contrary, it will most likely favourably influence the revenue of the MS as it would eliminate false VAT recovery claims in case of missing trader fraud (e.g., carousel fraud). The special measure as such will have no negative effect on the own resources of the EU. Involved MS will be obliged to ensure the minimum reporting standard so that the VAT will not be lost at the end of the business chain. Moreover, the implementation of a comprehensive reverse charge mechanism would also narrow the VAT gap by preventing VAT losses for MS because of bankruptcy of receiving taxable persons. Therefore, this measure would also fulfil the intent and purpose of Article 199 paragraph 1 e-g of the VAT Directive.
15. The development of the VAT gap (see table below) shows very high resistance of VAT fraud towards conventional measures that were being introduced in the respective period. Although involved MS have introduced a number of large-scale and robust conventional measures, legislative and non-legislative ones, over the past it is fair to say that the VAT development has not produced the desired effect.

Table: Development of the VAT gap in the involved MSs in 2009-2012

(The VAT GAP of 2013 to be completed when published at the submission date)

| Involved MSs | VAT GAP development (% of VAT Total Tax Liability) | | | |
|----------------|---|------|------|------|
| | 2009 | 2010 | 2011 | 2012 |
| Czech Republic | 19 % | 23 % | 17 % | 22 % |
| Austria | 9 % | 11 % | 13 % | 12 % |
| Bulgaria | 25 % | 22 % | 24 % | 20 % |
| Slovakia | 34 % | 36 % | 33 % | 39 % |
| EU (26) | 19 % | 15 % | 16 % | 16 % |

Source: CASE (2014): 2012 Update Report to the Study to quantify and analyse the VAT Gap in the EU-27 Member States, TAXUD/2013/DE/321

16. Due to the scale, complexity and sophisticated nature of the *missing trader fraud* (e.g., *carousel fraud*), organisational measures taken by themselves, are insufficient to counter that fraud through the isolated introduction of conventional methods. Efforts and energy expended by involved MS over the past years in

³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1), Art. 395 (1), second sentence

determining the supplies and/or commodities prone to fraud to which the reverse charge mechanism may be applied in line with the VAT directive backs up above finding as well. Unfortunately a large variety of supplies lend themselves to *missing trader fraud* (e.g., carousel fraud). The currently available measures including the one providing for the quick reaction are insufficiently quick and efficient.

17. VAT fraud significantly harms competition and proper functioning of the internal market. Uncollected taxes show up as shortfalls in state budgets, thus undermining a level playing field for businesses. The proposed measure shall eliminate *missing trader fraud* (e.g., carousel fraud) and ensure fair rules of the game for businesses, both large and small.
18. The proposed measure would simplify tax administrations' work via the decrease in caseloads where tax administrations will need to examine the claims for VAT deduction and subsequently the reduction in caseloads for tax audits.

IV. Elimination of new risks

19. It is often feared that a wider application of reverse charge increases the risk of fraud at the end of business chain. This risk and the risk of micro fraud are tackled by introducing the threshold and the control measures with the use of electronic means.
20. Application of modern technology and reporting measures will ensure that the tax will not be lost at the end of the business chain. The tax will be collected only once, therefore tax audits will be more efficient, imposing fewer burdens on businesses. Tax administrations will be able to focus on the end of the business chain.
21. The risk of fraud shifting to other member state does not seem very meaningful in this context. Such risk is comparable to the risks when one member state introduces a large-scale and successful conventional measure against VAT fraud. In other words, it would be wrong to specifically link the reverse charge mechanism and its scope to this particular risk.

V. The approach of involved MS

22. The Czech Republic works on an overall reform of tax administration with the aim of increasing its efficiency and ability to combat VAT fraud. The reform consists of the three interconnected building blocks (i) electronic filing of VAT listings (on line crosschecking of invoices), (ii) electronic filing (registration) of sales and (iii) wide application of reverse charge mechanism. The Czech Republic is soon going to be the only country in the EU with both Electronic Registration of sales and Electronic filing of VAT listings in place. The wider application of reverse charge mechanism is seen as a third pillar of our reform complementing the two former. Our new electronic tools will go far beyond the minimum standard requested by this application and they are fully capable of ensuring that the tax is not lost at the end of the business chain.
23. The Republic of Austria plans to implement a system which supports businesses to reduce their administrative costs and tax administrations to simplify their procedures by electronic means. Austria requires a monthly reporting obligation for all transactions subject to the special measure, both on part of the supplier and the recipient.
24. The Republic of Bulgaria's revenue administration possesses information about the purchases and sales carried out by all persons registered under the Value Added Tax Act (hereafter "VATA"). The monthly return under the VATA is accompanied by ledgers containing information on the purchases and sales

during the relevant month. This information submitted monthly allows monitoring of supplies and documents related thereto.

25. The Republic of Bulgaria estimates that in order to exercise more effective control over the overall process related to the supplies and the movement of the goods from producers and importers to end consumers, an additional control measure to monitor the movement of goods could be introduced on its territory, wherein all taxable persons to declare information on the movement of goods, both for supplies within the territory of the country and for intra-community supplies and acquisitions. Similar systems for control over the actual movement of goods have been deployed in Hungary and Portugal. Application of enforcement administrative measures and sanctions are envisaged for the persons whose goods move without an identification code. The above control measure would prevent the shifting of VAT frauds from the Republic of Bulgaria to other EU Member States and final consumption.
26. The Slovak Republic has adopted a number of legislative measures with the only aim to combat the VAT fraud. The most important of them is a control statement in effect since 1st January 2014. The control statement represents a complex overview of the chargeability of VAT due and VAT deduction from all issued and received invoices which are to be submitted by every tax payer for every taxable period. As since 2014 an electronic filing for every business registered as a tax payer has been introduced, also the control statement is to be submitted only electronically.
27. The involved MS have positive experiences with the application of the reverse charge mechanism, namely in case of supply of gold, emission permits, waste, scrap metal, services related to their utilization, cereals, industrial crops or construction works. Reverse charge mechanism works without any problem in a number of areas. In accordance with Article 199a of the VAT directive, the Czech Republic has introduced the reverse charge mechanism for a number of items including corn and technical products, metals and precious metals etc. The Czech Republic assumes further broadening the application of this method during this year, namely to include cereals. It stands to reason that this measure would not be new for the Czech and EU businesses as it has already been applied to a large number of commodities. Concerns about any disproportionate administrative burden are therefore unwarranted. The Republic of Austria successfully introduced the reverse charge mechanism also for metals and precious metals, gas and electricity (certificates), game consoles, tablet PC's, laptops etc. The Republic of Bulgaria has introduced since 1 January 2007 a reverse charge mechanism for supplies of waste and scrap and for services related to their utilization on the grounds of Article 199, paragraph 1 of the VAT Directive. Before the introduction of the reverse charge mechanism, the most complex and sizeable VAT frauds had been found for this type of supplies. As regards these supplies of goods and services, no tax fraud has been traced since the introduction of the VAT reverse charge mechanism. Since 1 January 2014 the Republic of Bulgaria has also opted to apply the VAT reverse charge mechanism to supplies of cereals and industrial crops on the grounds of Article 199a of the VAT Directive. The Bulgarian Republic intends to extend the application of this reverse charge measure to the end date set in the VAT Directive, i.e. 31st December 2018. . As of 1st January 2014 the Slovak Republic has also broadened the list of commodities which are subject to reverse charge mechanism. In particular, it concerns supply of cereals and oil seeds, metals and selected semi-finished metal products, mobile phones and integrated circuit devices. All above mentioned commodities are subject to reverse charge only in case the taxable amount for their supply, as shown on the invoice, is at least EUR 5,000.
28. Missing trader fraud (e.g., carousel fraud) can be carried out on a wide variety of products and services and is very flexible to move back and forth. The Czech

Republic has introduced a number of measures since 2011, including deemed guarantees for the unpaid tax (e. g., of the recipient for the supplier), the status of unreliable payer, specific registration obligations for petrol distributors and specific guarantees in this sector and specific conditions for deregistration ex officio and unification of the monthly taxable period for newly registered payers. The Republic of Austria has introduced several conventional anti-fraud measures e.g. visits to businesses at the time of registration, risk-based audits and ongoing monitoring, state-of-the-art technology, such as Internet monitoring and proven tools of tax fraud simulations and preparation of offender profiles to quickly pinpoint risk areas. Furthermore, a special anti-fraud unit, “the Financial Police”, has been established. The experience of many years shows that the only reliable common denominator is the high value of the supply that ensures a payoff to fraudsters. It is possible to eliminate this type of fraud only by determining the relevant sector by the size of the transaction. The Republic of Bulgaria has adopted the following conventional anti-fraud measures: application of joint and several liability institute between traders within the supply chain in cases of VAT abuse, visits to businesses at the time of registration, risk-based audits and ongoing monitoring, post-registration control, database maintenance for risky operators, etc. Since 2014, a specialized directorate has been created within the Bulgarian tax administration called “Fiscal control” with the mission to track movements of high risk goods across the territory of the country such as intra-community supplies and acquisitions, domestic supplies of goods or supplies of goods between Member States involving the Republic of Bulgaria. As already stated, the Slovak Republic has introduced a number of anti-fraud measures since 2012, e.g. VAT guarantee upon registration for risky taxable persons applying for the VAT registration, obligatory monthly taxable period for all newly registered businesses and for businesses with turnover above EUR 100,000, improvement of the joint and several liability and the control statement. As regards the measures of non-legislative nature, a closer, systematic and organized cooperation between the financial administration and the prosecuting authorities within the coordinated activities towards the most risky tax cases (so called “TAX COBRA”) has been established.

- 29.** Tax administrations’ experience has shown that any significant fraud has always been connected with the invoices of very high amounts. The measure needs to be well-targeted in order to observe the principle of proportionality. The essential VAT concept will remain preserved.
- 30.** The threshold of the taxable amount of EUR 10,000 per taxable supply of services or goods will strike a reliable balance between the prevention of tax fraud and proportionate administrative burden. The special measure based on the supply specified by limit of taxable amount will create any excessive burden neither on the tax administration nor on businesses. The administrative burden will be fully eliminated in the retail space where it will not be necessary to provide evidence of the customer status.
- 31.** The implementation of the proposed measure will not require disproportionate resources, for it will be confined to situations where there is a real risk of tax avoidance or evasion and with regard to the proposed threshold it will affect only a limited range of business transactions.
- 32.** For the Czech Republic and the Republic of Austria, the introduction of a comprehensive reverse charge system with a threshold of EUR 10,000 would mean that approximately 10 % of all transactions would be covered by this measure. For the Republic of Bulgaria, this would mean that the reverse charge mechanism would apply to around 34 % of all transactions. We therefore believe that these transactions can be traced by modern electronic means and reporting systems without causing additional burden to businesses.

- 33.** With regards to the reverse charge measures actually applied the Republic of Bulgaria has introduced the following additional measures in order to prevent the shifting of VAT fraud to the processing industry: identification of the persons using the reverse charge mechanism, strengthened monitoring and control over their activities; monitoring and strengthened control over the cereal and industrial crops processing sectors; strengthened control over the supplies of cereal and industrial crops and over the transport vehicles transporting cereal and industrial crops – trucks, railway wagons and ships.

VI. Conclusion

- 34.** The Czech Republic, the Republic of Austria, the Republic of Bulgaria and the Slovak Republic apply for the authorisation of the derogation because they consider the proposed measure to be fully compliant with all tests required by Article 395 of the VAT Directive and necessary in order to combat VAT fraud. The measure does not require any complex or systematic derogation from general principles of the VAT Directive⁴ and it is restricted to situations where the transaction falls within the scope. The proposed measure is necessary and proportionate to the purpose at hand and in conformity with the purpose and general principles of the VAT directive.
- 35.** Involved MS seek a solution for reducing the current huge amount of the VAT gap and call on the Commission to show readiness to assist and allow them to collect the VAT due which accounts for a substantial portion of both MS and EU budgets.

⁴ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1), Art. 193