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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.4.2009
COM(2009) 183 final

Proposal for a

COUNCIL DECISION

amending Council Decision 2007/250/EC authorising the United Kingdom to introduce a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax

(only the English version is authentic)

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

Pursuant to Article 395 of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ (hereafter: 'VAT Directive'), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from the provisions of that Directive, in order to simplify the procedure for collecting value added tax (VAT) or to prevent certain forms of tax evasion or avoidance.

By letter registered with the Secretariat-General of the Commission on 28 July 2008, the United Kingdom requested authorisation to extend a derogating measure, previously granted by Council Decision 2007/250/EC of 16 April 2007².

In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 17 March 2009 of the request made by the United Kingdom. By letter dated 20 March 2009, the Commission notified the United Kingdom that it had all the information necessary to consider the request in the way set out below.

Under Council Decision 2007/250/EC, the United Kingdom was authorised, until 30 April 2009, to apply a reverse charge mechanism in relation to certain supplies, where the taxable amount was equal to or higher than GBP 5 000, of mobile phones and integrated circuit devices. Under these circumstances, the taxable person, to whom the supplies of the goods were made, became liable to account for the VAT on the supply. This resulted in the supplier of the goods not charging the VAT to his customer in so far the customer qualified as a taxable person for VAT purposes. Such a customer, provided he had a full right of deduction, would simultaneously declare and deduct the VAT corresponding to the supply; thus leading to no effective payment of VAT to the Treasury. It would therefore be the retailer, supplying to non-taxable clients, who would actually pay the full amount of VAT to the Treasury. This situation derogated from the general VAT fractioned payment system whereby each taxable person (with a right of deduction) in the chain pays a part of the total VAT amount to the Treasury amounting to the difference between the VAT amount received from the client and the VAT amount paid to his supplier.

This derogation had been requested by the United Kingdom in order to deal with tax fraud of suppliers who, under the normal regime, charge VAT and then disappear without accounting for the VAT due, but leaving the customer with a valid invoice for deduction. This had evolved into Missing Trader Intra-Community fraud (MTIC), abusing the VAT system of exempt supplies in the Member State of departure to taxable customers in another Member State, and even into carousel fraud in which the goods circulate a number of times between Member States.

¹ OJ L 347, 11.12.2006, p. 1

² OJ L 109, 26.4.2007, p. 42

It is against this background, and after having demonstrated the historical seriousness of problem in the United Kingdom, that a derogation was granted to apply a reverse charge procedure at a set threshold of GBP 5 000 and for a limited number of products, which are most subject to fraud, in an attempt to remove fraud possibilities for potential missing traders as no VAT would be charged.

However, the derogation, aiming at preventing certain types of tax evasion or fraud and which led to additional compliance burdens, was subject to several conditions and only granted for a short period, as it could, according to the eighth recital of Council Decision 2007/250/EC, not be ascertained with certainty that the objectives of the measure would be achieved.

Questions were raised as regards the possible impact of the measure on fraud being shifted to other products or to the retail level. In this respect, the Council Decision obliged the United Kingdom to introduce appropriate control and reporting obligations as to guarantee that the necessary information would be available and inform the Commission of these specific measures and of the monitoring and the overall evaluation. Doubts also existed as regards the effect of the measure on the possible shifting of fraud to other Member States and therefore of the functioning of the VAT system in the internal market. This impact had to be assessed properly.

In this context, the United Kingdom was furthermore required to submit a report by 31 March 2009 to the Commission on the overall evaluation of the operation of the measures concerned and in particular as regards the effectiveness of the measure and any evidence of shifting of tax evasion to other products or to the retail level.

However, the United Kingdom was, at the time the request for a renewal of the derogation, not in a position to provide the necessary information and justification and in particular not able to specify to which extent the derogation might have led to a reduction on the missing trader or carousel fraud in relation to the products covered by the derogation. In fact, a substantial reduction of such fraud had already been observed before reverse charge had been introduced. Substantial evaluation of possible shifting to the retail sector or to other Member States is, so far, also lacking while, at the same time, it is acknowledged that the deadline for the United Kingdom to submit the report was fixed at 31st of March 2009. In the Commission's understanding, the report should be made available to all other Member States.

The United Kingdom has argued that more time would be needed in order to be in a position to allow for a better assessment of the measure as to its successfulness to combat MTIC and carousel fraud going beyond the theoretical argument that is already set out in the Commission Communication on possible measures to change the VAT system to fight fraud³. The United Kingdom has not proposed evaluation criteria that would support such statement. It should, however, be noted that in the original proposal of the previous derogation⁴, the Commission proposed an end date of 31 December 2009 but the Council, anxious to shorten the application period of the derogation because of the possible negative impact, finally unanimously agreed on an end date of 30 April 2009.

³ COM(2008) 109 final, 22.2.2008

⁴ COM(2006) 555 final, 28.9.2006

In order to provide the United Kingdom a final opportunity to better justify their request to extend the current derogation over a longer period, the Commission had the intention to re-iterate its original proposal and thus to propose a prolongation of the measure until 31 December 2009. However, the ECOFIN Council of 10 March 2009 reached a political agreement to extend the current derogation even beyond the end of this year and finally agreed on an extension of two years until 30 April 2011.

This extension is not to be understood as a basis for any further prolongation of the measure which otherwise, in time, would become almost permanent. The Commission is, however, willing to examine the possibility of allowing a pilot project on a similar targeted use of the reverse charge mechanism by any interested Member State, including the United Kingdom, on the basis of a legislative proposal to amend the VAT Directive in this respect. In view of the uncertainty of the effects of the measure, its derogation from one of the fundamental principles of the VAT system, which is the fractioned payment, the creation of a specific legal basis for such a pilot appears to be the only possible way forward in the medium term and in line with the principles spelled out in the Commission's Communication on possible measures to change the VAT system to fight fraud⁵. With predefined evaluation criteria, such a pilot could produce the so far lacking assessment of the usefulness and proportionality of a sector-targeted application of reverse charge. Nevertheless, in view of the upcoming elections for the European Parliament, it would not be possible to have such a proposal adopted by the Council before the end of 2009, which could leave a legal gap for the application of the measure by the UK. These very exceptional factual circumstances provide additional grounds to prolong the deadline until 30 April 2011 unless the aforementioned proposal for a Directive was adopted earlier.

2. CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

There was no need for consultation or external expertise.

The prolongation of Council Decision 2007/250/EC aims at combating VAT fraud and evasion and is likely to have a positive impact on VAT receipts in the UK. It was, however, during the previous application period of the derogation, not possible for the United Kingdom to clearly demonstrate that the fraud had been eliminated or decreased because of the derogation. The prolongation for a short time should allow for a proper justification of the extension request.

3. LEGAL ELEMENTS OF THE PROPOSAL

The Decision amends Council Decision 2007/250/EC authorising the United Kingdom to introduce a special measure derogating from Article 193 of the VAT Directive as regards the use of a reverse charge mechanism for domestic supplies of mobile phones and integrated circuit devices.

This Decision is based on Article 395 of the VAT Directive.

⁵ COM(2008) 109final, 22.2.2008

This Decision concerns an authorisation granted to a Member State upon its own request and does not constitute any obligation.

Given the strict limitation in time, the special measure appears to be proportionate to the aim pursued.

Under Article 395 of the VAT Directive, derogation from the common VAT rules is only possible on the authority of the Council acting unanimously on a proposal from the Commission. A Council Decision is the only suitable instrument since it can be addressed to an individual Member State.

4. BUDGETARY IMPLICATION

The proposal has no negative implications for the Community budget.

5. ADDITIONAL INFORMATION

The proposal amends the sunset clause included in Council Decision 2007/250/EC.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax⁶, and in particular Article 395(1) thereof,

Having regard to the proposal from the Commission⁷,

Whereas:

- (1) In a letter registered by the Secretariat-General of the Commission on 28 July 2008, the United Kingdom requested authorisation to continue to apply a special measure derogating from Article 193 of Council Directive 2006/112/EC as regards the person liable for the payment of the value added tax (VAT) to the tax authorities and previously provided for by Council Decision 2007/250/EC of 16 April 2007⁸.
- (2) In accordance with Article 395(2) of Directive 2006/112/EC, the Commission informed the other Member States by letter of 17 March 2009 of the request made by the United Kingdom. By letter dated 20 March 2009, the Commission notified the United Kingdom it had all the information it considered necessary for appraisal of the request.
- (3) The person liable for the payment of the value added tax under Article 193 of Directive 2006/112/EC is the taxable person supplying the goods. However, the current derogating measure enabled the United Kingdom to apply, under certain conditions, a reverse charge mechanism which implied that the liability for the payment of the VAT was shifted to the taxable person to whom the supplies were made as regards certain supplies of mobile phones and integrated circuit devices, provided the taxable amount of the supply was equal or higher than GBP 5 000.

⁶ OJ L 347, 11.12.2006, p. 1

⁷ OJ C , , p. .

⁸ OJ L 109, 26.4.2007, p. 42

- (4) The purpose of that derogating measure was to deal with certain aggressive forms of tax evasion, and in particular with 'carousel' schemes whereby goods were supplied several times without VAT being paid to the tax authorities but leaving the customers in receipt of a valid invoice for VAT deduction. The application of the reverse charge, without actual payment of VAT from the customer to the supplier, would remove the possibility of that form of tax evasion.
- (5) As, at the time the derogation was proposed, it could not be ascertained that the objectives would be achieved and that there would be no negative impact, only a short period was allowed for the derogation to apply. In this context, it has not yet been established by the United Kingdom whether the current arrangement has effectively enabled the prevention of these forms of tax evasion. The United Kingdom has furthermore problems with the obligation to evaluate the overall operation of the measure, in particular the possible shifting of tax evasion to other products or to the retail level and its impact on the functioning of the internal market.
- (6) The Commission understands that the United Kingdom is not yet in a position to provide the necessary information and that some more time is needed to justify their request for an extension of the initial derogation over a longer period.
- (7) In its original proposal for Council Decision 2007/250/EC⁹, the Commission had proposed an expiry date of 31 December 2009, which has been altered by the Council to 30 April 2009, and therefore would find it acceptable that the measure would be extended until that date. However, the ECOFIN Council of 10 March 2009 agreed that the derogation of the United Kingdom should be extended for two years.
- (8) Given the apparent seriousness of VAT fraud in the United Kingdom, as attested by the information submitted by the United Kingdom with their initial application, the measure remains proportionate as the extension in time is limited to a reasonable period and without forming either the basis of an overall measure for a generalised reverse charge system or the start of a more permanent application of this derogation.
- (9) Following the Commission's Communication on possible measures to change the VAT system to fight fraud¹⁰ and given that such measures, in practice, could include a similar measure in the form of a Commission proposal to change Directive 2006/112/EC to introduce a pilot project available to all Member States, this Decision should expire if this measure comes into force before the foreseen end date of this derogation.
- (10) The derogation has no negative impact on the Community's own resources accruing from VAT,

HAS ADOPTED THIS DECISION:

Article 1

Article 4 of Council Decision 2007/250/EC is replaced by the following:

⁹ COM(2006) 555 final, 28.9.2006

¹⁰ COM(2008) 109final, 22.2.2008

This Decision shall expire on 30 April 2011 or on the date an amendment to Directive 2006/112/EC, allowing for such measure in the form of a pilot project, enters into force.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels,

For the Council
The President