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**COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL**

**concerning some key elements contributing to the establishment of the VAT anti-fraud
strategy within the EU**

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TABLE OF CONTENTS

1.	Background	3
1.1.	The Commission's Communication on fiscal fraud.	3
1.2.	Follow up of the Communication.	3
1.2.1.	Within the Council.	3
1.2.2.	Within the Commission.....	4
1.2.3.	With businesses.....	4
2.	A first milestone: the ECOFIN conclusions of 5 th June 2007.....	4
3.	Defining the future direction within the existing legislative framework	6
3.1.	First observation: tax administrations need accurate information to control the VAT system.....	6
3.2.	Second observation: Member States do not have a sufficient EU approach to ensure the functioning of the common VAT system	8
3.3.	Third observation: the importance of up to date information on the VAT status of traders.....	9
3.4.	Fourth observation: the need to enhance the capacity of tax administrations to collect VAT receipts in fraud cases	10
4.	Conclusions	11

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1. BACKGROUND

1.1. The Commission's Communication on fiscal fraud.

On 31 May 2006 the Commission presented a Communication concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud¹. The purpose was to launch a debate with all stakeholders (Council, European Parliament, businesses) on the different elements to be taken into account in an "anti-fraud" strategy at EU level. It is also recalled that a successful strategy must include a multidisciplinary approach including the action of investigation services as well as of judicial authorities. In that respect reference is made to initiatives developed in such areas including the proposal for a Regulation² and the modification of the Regulation 515/97³ that are already presented to the Council.

The Communication set out - for discussion - a whole range of pragmatic and realistic ideas that would contribute to the improvement of the current situation. Moreover, the question was also raised whether there is a need to modify substantially the current VAT system in order to tackle VAT fraud efficiently, either by providing Member States the option of introducing a generalised reverse charge system or by introducing a system of taxation of Intra-Community supplies of goods.

1.2. Follow up of the Communication.

1.2.1. *Within the Council.*

The ECOFIN Council of 7 June 2006 welcomed the production of the Communication and stated that it would examine all measures envisaged in the Communication.

The subsequent technical analysis carried out by the Council led to the ECOFIN Conclusions of 28 November 2006. The Council made clear that VAT fraud is its main concern and defined a number of aspects to which the Commission should give particular priority. Efforts have since then been fully devoted to the VAT area and unlike the abovementioned Communication, the present one only covers VAT fraud.

In addition, the Council stated that it would continue the work on the reverse charge mechanism and the taxation of intra-community supplies.

¹ COM(2006)254, 31.5.2006
² COM(2006)473, DOC 2004/0172/2006
³ COM(2006)866, DOC 2006/0290(COD)

1.2.2. Within the Commission.

As a response to the ECOFIN Council conclusions of 28 November 2006, the Commission created a new expert group with Member States, the "Anti Tax Fraud Strategy [ATFS] expert group" in view of fleshing out the priority areas identified by the Council.

1.2.3. With businesses.

The Commission organised on 29 March 2007 a "VAT fraud conference" in order to provide European businesses the opportunity to express their views on the way VAT fraud is tackled today, to comment on the ideas which have been put forward within the Commission's Communication, and to present any other ideas which could contribute to the fight against VAT fraud.

A general conclusion that resulted from the conference was the common interest of businesses and tax authorities in combating fraud and the willingness from traders to assist the tax administration in this task. Improving the communication between these two parties is a major element in this context. Today taxpayers are not convinced that the flow of information they have to provide to the tax authorities are used in an efficient way.

There was also a clear statement about disproportionate costs for businesses emerging from divergent national reporting requirements. Businesses pleaded for a win-win situation whereby a potential review of the reporting obligations should provide the tax authorities with the relevant information in a timely fashion on the one hand and facilitate compliance by a far reaching harmonisation of these obligations, including a deletion of certain obligations imposed at national level.

2. A FIRST MILESTONE: THE ECOFIN CONCLUSIONS OF 5TH JUNE 2007.

The Council Conclusions are divided in 2 main areas: conventional measures to reinforce the existing VAT system and more far reaching measures to modify the system.

As regards the conventional measures, the Commission presented a progress report on the work carried out since the previous ECOFIN Council meeting of November 2006.

Based on this progress report the Council prioritised a number of measures for which it invited the Commission to come forward with the necessary legislative proposals including an impact assessment by the end of 2007, at the latest, so that the Council can adopt these by the end of 2008.

These topics concern the more frequent reporting of intra-Community supplies and a quicker exchange of this information among tax administrations; the possibility of applying joint and several liability where the information on these intra-Community supplies is not properly reported; and improving the information on VAT identified businesses which is made available to operators active in intra-Community trade.

The Commission intends to present at the beginning of next year appropriate legislative proposals on these issues, where necessary, taking into account the further technical discussions which have taken place on these topics and the outcome of the impact assessment. In case of information on VAT identified businesses, the improvement can be achieved without any legislative changes.

Furthermore, the Council wanted discussions to be continued on all other measures mentioned in the Commission's progress report and asked for a report on the state of play of these discussions by the end of 2007.

The Commission Staff working document - "Progress report on the state of play of the discussions on the conventional measures proposed by Member States" [SEC(2007) ... of .../11/2007] presented today provides a detailed state of play of the discussions which have taken place in the ATFS expert group.

As regards the taxation of Intra-Community supplies, the Council noted that taxation of Intra-Community supplies in the Member State of arrival raised considerable reservations. Taxation of these supplies in the Member State of departure received more support from Member States and therefore the Council invited the Commission to explore this system further.

The Council also observed that the majority of Member States expressed reservations concerning the introduction of an optional generalised reverse-charge mechanism. The Council therefore invited the Commission to analyse the effects of such an option on the internal market, and in particular the possibility of running a pilot project for a limited period of time in an interested Member State.

The Council invited the Commission to submit its findings on both far reaching measures by the end of 2007.

Much preparatory work has been carried out (questionnaire to Member States, external studies, public consultation and meetings with businesses, including SME's) as a response to these demands of the Council. Considering the substantial degree of analysis required and the fact that the Commission did not receive the required input from all Member States within the specified deadline, the Commission will only be in a position to report on its findings at the beginning of next year.

Moreover, once the Commission will have finalised its analysis on the taxation of Intra-Community supplies and on the introduction of a generalised reverse charge system, there will be a need for a political debate at Council level on the way forward. The possibility of running a pilot project for a limited period of time in an interested member State will certainly be a key element in this discussion. The technical analysis of this complicated question is ongoing and two bilateral meetings with the Member State concerned have already taken place and another meeting is scheduled before the end of the year.

3. DEFINING THE FUTURE DIRECTION WITHIN THE EXISTING LEGISLATIVE FRAMEWORK

Notwithstanding its commitment to complete an analysis of potential changes to the VAT system, the Commission sees no contradiction in continuing in parallel a debate on the so-called conventional measures. Providing the tax authorities with more modern and efficient tools for combating tax fraud is an objective to be pursued in any event, independently of the decisions which will be taken on the more far reaching measures.

The discussions in this context until now have been intense and have generated a wide range of ideas. On a number of key elements the discussions have come to a point where there is a need for strategic decisions on the future direction to take in defining an EU wide approach. In particular, the Commission has drawn the following conclusions from the on-going debate.

3.1. First observation: tax administrations need accurate information to control the VAT system

One of the main problems is that the system which was put in place in 1993 for the exchange of information between Member States on intra-Community supplies of goods does not provide relevant and timely information for tackling VAT fraud efficiently.

The legislative proposals planned for the beginning of next year will provide for more frequent reporting of intra-Community supplies and for a quicker exchange of this information among tax administrations and hereby constitute a response to this problem.

However, some Member States want to go beyond that and have expressed the view that taking into account the possibilities offered by electronic technologies, an exchange of information on Intra-Community supplies at transaction level best answers their needs as an appropriate tool to fight tax fraud efficiently.

At the outset however, it should be kept in mind that all measures that are discussed in the context of the fight against VAT fraud have to respect other EU policies, and in particular the general target of the European Council to achieve, by 2012, a reduction by 25% of the existing administrative burden, as set out in the "Action Programme for Reducing Administrative Burdens in the European Union"⁴.

Furthermore, the obligations imposed upon cross-border trade should not be disproportionate to the obligations imposed on national transactions thus making the internal market less attractive in comparison with the domestic market.

Is high level transaction based information within a 1 month time period on domestic and on Intra-Community transactions the ultimate solution for controlling the VAT system?

⁴ COM(2007)23 final, 24.1.2007

It is clear that the concerns set out above (related tot the renewed Lisbon Strategy and the proper functioning of the Internal Market) have to be included in the debate on potential new reporting obligations as a tool to fight fraud in respect to their global impact on businesses.

Additional reporting requirements should be limited to information that is already available in businesses' accounting systems so that business can fulfil them without major difficulties. Furthermore, electronic transmission of the information to the tax administrations has to be ensured in order to reduce compliance costs and to allow an efficient processing of the data.

Small and medium sized businesses that are not involved in intra-community trade should be excluded from applying additional reporting obligations.

The minimum level of information that needs to be reported to and exchanged between tax administrations should be determined at Community level.

Proceeding to a far reaching harmonisation of the VAT reporting obligations within the EU would reduce the compliance costs for businesses having economic activities in several Member States. Businesses have repeatedly declared that the 27 different types of reporting obligations is an irritant for them, considerably enhancing their compliance costs since their software needs to be adapted to the specific situation in each Member State.

A closer harmonisation of the invoicing rules could also be taken into account in this context.

New reporting obligations can only be considered when compensated by a reduction of the administrative burdens in other areas.

The capacity of tax administrations to make efficient use of the data collected should be guaranteed before new reporting obligations are considered.

Collecting detailed information from traders would allow for the automatic matching of data provided by the supplier and purchaser. The great majority of the information will relate to genuine transactions but material errors and different interpretation of the rules will probably result in numerous mismatches being brought to the attention of tax administrations.

In order to manage the massive flows of information, highly efficient risk analysis and risk management systems will have to be set up to select from the bulk of mismatches those transactions and traders which require special attention.

Tax administrations do not have sufficient information available in time to act efficiently against VAT fraud, especially missing trader fraud. There is a need for an in-depth analysis of the accuracy of the information currently collected from businesses and the use that tax administrations make of it. However, a review of the reporting obligations has to take place in the context of the renewed Lisbon Strategy's objective of decreasing red tape for businesses by 25%

3.2. Second observation: Member States do not have a sufficient EU approach to ensure the functioning of the common VAT system

The proposed changes in the place of supply of services currently under discussion in the Council have highlighted the importance of Member States not only taking an interest in the protection of their own VAT revenues but also playing a major role in the protection of the VAT revenues of other Member States.

This issue is, however, much broader. The growth of cross border trade triggered by the establishment of the internal market and the adaptation of the common VAT system to the requirements of that internal market (abolition of obligatory fiscal representatives) means that there are an increasing number of transactions where the place of taxation and the place of establishment of the person liable to pay the VAT are located in two different Member States.

The development of the internal market obliges Member States to allocate more resources to administrative cooperation in order to ensure a proper functioning of the common VAT system.

The Commission recognises that this involves significant financial and resource efforts for Member States.

However, there is potential for reducing the administrative costs for tax administrations. Allowing tax authorities of other Member States automated access to non sensitive data would eliminate the costs of human intervention in the Member State holding this information in cases of routine requests for information.

A discussion on more far reaching ideas such as the implementation of a system of incentives or cost sharing to stimulate an EU approach would be desirable. Such a system would give Member States a financial incentive to increase their efforts to improve control of cross border trade. The mutual assistance for recovery of taxes could be an appropriate area for testing the efficiency of such a mechanism.

Some member States have advocated an even more ambitious approach, namely the setting up of an informal structure, composed of officials from national tax administrations, with the aim of largely facilitating the exchange of information between national tax authorities. The creation of such a structure could provide a solution to certain obstructions in the current functioning of administrative cooperation (language, resources) but also for some legal concerns related to new instruments, like automated access to data. Insofar as such approach could not be achieved by the development of existing structures and would not lead to duplication of existing structures at EU level, the Commission is prepared to further explore the idea if Member States show a sufficient interest in it.

Risk management needs to profit from experiences gained by other Member States

Besides the obvious need to share responsibility for control, there are other situations, for instance in the early detection of missing traders, where the information available in one Member State is essential for early detection of potential VAT losses in another Member State.

Obtaining very rapidly the information gathered in other Member States on certain fraudulent transactions or on fraudulent traders in order to use this information in its own risk management system is a major tool for a Member State in combating missing trader fraud.

A system for a quick and selected exchange of information and risk analysis has been developed by the Belgian tax administration in cooperation with other Member States and with the support from the Commission. Currently 24 Member States are participating in this project. The Commission recognises the benefits of the targeted approach of these exchanges. It would therefore be important to eliminate existing political barriers to the participation of all Member States to these exchanges.

Criminal proceedings against fraudsters

The issue of criminal prosecution of persons involved in fraud resulting in tax losses in another Member State has been discussed on several occasions in Council and in the ATFS Expert Group.

As reciprocity in prosecution of trans-national VAT fraud cases is not sufficiently guaranteed in Member States, the necessary legislative steps need to be taken to improve the protection of VAT receipts by criminal law.

The Council should clarify that the PFI Convention also covers the protection of VAT.

In response to the ATFS expert group's suggestion that ECOFIN would invite the Justice and Home Affairs Council to come forward with an initiative to put appropriate legislation in place, the Commission recalls that the Convention on the protection of the financial interests of the European Community (PFI Convention) already offers a level of criminal law protection to be implemented by all Member States regarding fraud to the detriment of the financial interests of the Community including VAT fraud.

Fraud mechanisms which make use of the advantages of the internal market cannot be tackled properly by an essentially national approach. The integration of a real EU approach into the management of the VAT system by the national authorities should result in a higher level of protection of the revenues for all Member States.

3.3. Third observation: the importance of up to date information on the VAT status of traders

The VAT identification number is a key factor in the VAT arrangements applicable to intra-Community trade. The VAT status of his customer is an essential element for a supplier to decide whether he can make his supply VAT exempt or not. There is a need to continuously update the register of taxable persons identified for VAT purposes in order to provide the necessary legal certainty to businesses.

Today traders can often obtain only very fragmented information on this status. Where a trader makes a wrong judgement on the VAT status of his business partner on the basis of this fragmented information, he runs the risk that the tax authorities

will afterwards try to recover the tax from him. Therefore, Member States should be responsible for the information they put into the register and should also suffer the consequences for outdated or erroneous information on the register.

An agreement has already been reached on the improvement of the central access to VAT registration data on the Europa website with a view to allowing traders to obtain confirmation of the VAT number, name and address of trading partners in all Member States. Nevertheless, this alone is not sufficient and the reliability of the available information should also be improved.

Vigilance at the time of issuing a VAT number should avoid fake taxable persons entering into the system and ensure that tax authorities put suspicious traders for whom identification cannot be refused under close scrutiny.

A possible solution could be to introduce an obligation for Member States to keep newly registered persons under close scrutiny and notably to carry out a control visit within 6 months or 1 year in order to verify whether the person having obtained a VAT identification number is in fact carrying out taxable transactions.

Within this period the tax administration could further assist and educate traders by providing the necessary assistance in becoming a compliant business, something that might prove very useful for small businesses.

Deleting taxable persons from the database as soon as it is established they no longer carry out taxable activities is equally important. Unfortunately, there is evidence that sleeping companies, sometimes even identified “missing traders” currently remain too long in the VIES database because of stringent national procedures. Therefore, it is essential that tax administrations automatically check whether the VAT identification numbers are still active and delete them from the VIES database as soon as this is no longer the case.

Without a strong commitment from Member States to tackle this long outstanding issue and a readiness to change national procedures, fraudsters will continue to misuse this weakness in the functioning of the current VAT arrangements.

The establishment of minimum standards at EU level for registration and de-registration would be the way forward, since it would increase the confidence of businesses and tax authorities in the information they obtain via VIES on the VAT identification of traders.

Updated information on the VAT status of a person is essential for tax administrations and for businesses in combating VAT fraud. There is a need for a common approach to registration and de-registration of traders. VAT losses in a Member State due to the negligence of another Member State in updating the database should be borne by the latter.

3.4. Fourth observation: the need to enhance the capacity of tax administrations to collect VAT receipts in fraud cases

A further problem tax administrations encounter when tackling fraud is collecting the money due from the parties involved once they succeed in exposing fraudulent

activities. Two different elements that assist Member States in this area should be looked at more closely.

Joint and several liability

Today Community VAT legislation already provides a legal base for the Member States to introduce rules that make a person other than the person liable to pay the tax jointly and severally liable to pay this amount to the state budget, provided the fundamental legal principles of Community law are respected.

In the context of missing trader fraud, whereby a number of actors intervene with the sole objective of hiding the fraudulent character of the transaction chain and thereby making the detection more complicated, the Commission sees the benefits of invoking this provision.

However, the use of this provision requires striking the right balance between ensuring legal certainty for genuine businesses and improving the capacity of the tax authorities to recover the huge amounts of non collected VAT receipts due to VAT fraud.

The topic has already been discussed on several occasions and the Commission is certainly prepared to contribute further to this debate and, if suitable, to present appropriate legislative proposals in order to determine some common grounds.

Review of the Recovery Directive

Another tool that the Community legislation offers Member States in order to assist them in collecting the money due is the mutual assistance scheme for the recovery of taxes. The present results of this recovery assistance make it clear that this instrument needs to be improved. In order to remedy the shortcomings of the current rules, the Commission is preparing legislative proposals, which will be presented in 2008. The new legislation should stimulate the recourse to mutual recovery assistance and facilitate its application in practice.

Collecting the money due in fraud cases is also a major concern for all tax administrations. Therefore, it is important to further develop the conditions for applying the joint and several liability and to improve and strengthen the administrative cooperation in the field of recovery of taxes.

4. CONCLUSIONS

The Commission will shortly deliver the various reports and initiatives that were requested by the Council in June 2007.

However, the Commission is aware from the discussions in the ATFS expert group that other aspects still need to be debated concerning the fraud proofing of the existing VAT arrangements as indicated in Section 3 above.

The Council is therefore invited to indicate whether it endorses the above observations and provide the necessary political guidance for the Commission's further work in this area.