Paul P. Maeser and Volker Halsch

Reform of the VAT System in the European Union

Safeguarding Tax Revenues – Reducing Administration – Strengthening the Single Market

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FOREWORD

The value added tax (VAT) has just celebrated its 50th anniversary in its current incarnation in Germany. However, it is by no means a recent financial and fiscal policy invention: its origins go back to the sixteenth century.

In this paper, however, Paul P. Maeser and Volker Halsch tackle the necessity of reforming the VAT system in the European Union not in terms of the certainly very interesting history of this lucrative tax, but in terms of current questions that have nevertheless not been taken up in the political realm. They do so against the background that the VAT system in the European Union has been resistant to attempts at reform, apart from changes in the tax rate. This is all the more surprising because the development of the European Union and the creation of the economic and trade area that goes hand in hand with it make reforms aimed at standardisation all the more compelling.

While reforms in other areas are superseding previous ones that have not proven themselves policymakers have not yet faced the task of developing a VAT system that is adequate to the European market. Maeser and Halsch point out the urgent need for a coherent European VAT system. Vividly and in practical terms they outline the significance of the VAT, the weaknesses of the current system and possible reform paths. Within this framework they tackle the current problems and burdens for tax administrations, as well as for companies, without calling into question the fiscal importance and necessity of value added taxes.

This analysis of necessary reforms does not come to any fixed conclusions. However, the authors do emphasise that each of the conceivable reform approaches is capable of decisively improving the current VAT system in the European Union. In light of this they call on European policymakers to act swiftly to make the tax system more efficient – all taxpayers are entitled to this in a democracy!

DR HARALD NOACK
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1

INTRODUCTION: THE SIGNIFICANCE OF VALUE ADDED TAX

Distribution of VAT* in Germany

budget year 2017

	in %	Million euros
Total revenues	**100,00**	**226.650**
Federal government in advance for unemployment insurance	4,45	10.086
Federal government in advance for pension insurance	4,83	10.936
Municipalities	2,00	4.524
Federal government	44,10	99.949
Länder	44,63	101.155

Notes: Apart from this the federal government pays the so-called VAT-based own resources of 2.44 billion euros (around 1.08 per cent of total revenue) into the EU budget.

*Vakue added tax and import value added tax.

Federal Ministry of Finance – Department I A 6, session of the working group on tax estimates on 2–4 November 2016 in Nuremburg, Germany.

The European Union's value added system is in need of reform. One of the main reasons for this is the explosive growth in e-commerce. In the trade of goods and services this has boosted the importance of cross-border deliveries. Companies, in turn, are confronted by up to 28 sometimes very different VAT systems. On top of that, financial administrations throughout Europe are complaining of considerable losses in tax revenues. The tax system therefore needs a fundamental overhaul. Ways in which this might be done have already been developed, but they must be subject to a critical examination.

In Germany the value added tax is among the most lucrative taxes.[1] According to the last tax estimate from November 2016 revenues in 2017 will be around 227 billion euros.[2] At 31.3 per cent of the total tax take, the VAT is the second most lucrative tax after income tax (32.2 per cent).[3] Furthermore, it is a so-called combined tax. The federal level, *Länder* and municipalities split the tax revenues among themselves. The federal level and the *Länder* receive the lion's share; the municipalities and the European Union receive a smaller proportion.[4] In 2006, with the aim of stabilising social insurance contributions the Grand Coalition decided to allocate parts of value added tax revenues to the unemployment and pen-

1 For reasons of simplification the term »value added tax« (VAT) is used for all taxes on sales. These include, besides VAT on domestic deliveries and services and those from the rest of the European community, also import VAT. Import VAT has to be paid on imports from third states and are levied by the customs authority.

2 By way of comparison, revenues from inheritance tax total 5.3 billion euros.

3 Taxes on sales and wage taxes, as well as assessed income tax. Estimates for 2017. Federal Ministry of Finance, Department I A 6, conclusion of the 149th meeting of the »tax estimates« working group, 2–4 November 2016, in Nürnberg.

4 http://www.consilium.europa.eu/de/policies/eu-revenue-own-resources/2014-2020/

sion insurance system.[5] As a result VAT contributes to the financing of nearly all public service providers. Across Europe, too, value added tax is of considerable importance. In 2014 EU-wide around 977 billion euros in value added tax were collected.[6] That corresponds to around 7 per cent of the GDP of all the EU member states.[7]

A value added tax is also a so-called general consumption tax. That means that the consumer bears the tax burden. With the practiced *credit-invoice method*, the VAT is characterised by input tax deduction.[8] That means that the service provider is basically responsible for passing on the VAT to the tax office. They charge their customer the tax and at once issue a bill stating the charged VAT. Because a company is ultimately not supposed to be burdened with the VAT it can offset the VAT it has itself paid service and goods providers against the VAT received from customers (input tax deduction). As a result, each firm passes on to the tax office only the sum of VAT received minus taxes paid to services or goods providers. This difference corresponds to the VAT on that portion of value added that (in theory) is attributable to the company. The VAT is thus shifted via invoices along the value chain. The consumer has no right to claim an input tax deduction. Because consumers settle the VAT with the invoice, they bear the tax burden without being involved in the administration.[9]

According to Art. 113 TFEU the European Union is tasked with harmonising European VAT law, to the extent that this is necessary for a well-functioning single market. The European Commission thus pays particular attention to the regulations on intra-Community trade. Reform plans have been under discussion for some time now. In this paper we shall provide an overview of the current state of the discussion.

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5 http://www.spiegel.de/politik/deutschland/koalition-bundestag-beschliesst-groesste-steuererhoehung-seit-1949-a-417118.html

6 All the EU member states apart from Cyprus. https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09_vat-gap-report_final.pdf

7 GDP of the EU28 in 2014: 14,011 billion euros.

8 Tipke/Lang, Steuerrecht [Tax Law], 22nd edition, §17 point 16: 898.

9 Import VAT represents an exception if goods are brought in from third states. This shall apply when the value of the good is above the specified allowance. The VAT is, as a rule, levied together with customs duty when an individual re-renters the EU.

2

THE NEED FOR REFORM: WEAKNESSES OF THE CURRENT VALUE ADDED TAX SYSTEM

SHORTCOMINGS WITH REGARD TO TAX ENFORCEMENT AND TAX AVOIDANCE

It has to be assumed that tax shortfalls in the European Union are immense. According to European Commission estimates, in 2014 the so-called »VAT gap« – that is, the difference between value added tax that is supposed to be levied and actual tax revenues – in the EU (except Cyprus) stood at around 14 per cent of theoretically imputed tax revenues. There are substantial differences between the member states in this respect. Germany, for example, lies in the middle range, with around a 10 per cent shortfall.[10] In actual numbers, this means a tax shortfall of around 23.5 billion euros. The main causes of tax shortfalls include insolvencies, mistakes in the application of VAT law and tax crime. Therefore, there is a need for political action.[11]

Furthermore, the tax base is being put under pressure by the upsurge in new types of business models. Due to the strong growth in e-commerce it has become easier for consumers to obtain goods directly from abroad. In particular in the case of imports from within the Community area VAT cannot be levied together with customs on crossing the border. Instead, the possibility of an audit is needed in the case of taxable companies domiciled abroad, which for legal reasons is much more difficult than in the case of domestic firms. In some cases the responsible financial authority first has to become aware that a transaction has taken place between a consumer and a foreign company that is liable to value added tax. In practice, many foreign online traders are not even registered for VAT.[12]

On top of that, in the digital economy the significance of exchange transactions has grown. In particular on social media platforms customers use services without there being any financial compensation. Instead, customers by and large »pay« with their data, whose monetary value is difficult to estimate and thus in practice is not even recorded for VAT purposes. In a similar way in the so-called »shared economy« a large number of new, private vendors – for example, for accommodation – are entering the market who in fact do not pay VAT. If such vendors gain a substantial market share this structural transformation could have a deleterious effect on tax revenues. In order to safeguard the tax base the VAT law must respond to such leakage effects.

DISPROPORTIONATE ADMINISTRATIVE BURDEN FOR COMPANIES

Likewise, companies have to cope with the defects of the existing VAT system. Above all for companies active throughout Europe the current VAT regime is characterised by an unreasonably high administrative burden. According to the current regulations intra-Community deliveries between two companies (»B2B transactions«) are basically not liable to VAT.[13] If a taxable item is produced domestically, but processed or consumed abroad no VAT falls due in the exporter's state of domicile. On the other hand, a purchasing company is obliged to notify the tax authorities of this intra-Community purchase in the so-called recapitulative statement and to deduct the VAT. In the case of genuine B2B transactions only the domestic financial administration has to be notified by the exporting company.[14] There are no direct points of contact with foreign financial administrations. The situation is otherwise with regard to sales to consumers (»B2C transactions«).

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10 Close to the median, also of around 10%.

11 Already in 2006 »the federal finance minister and those of the Länder came to the conviction that the options for improving the fight against fraud within the framework of the existing procedure for VAT in Germany have largely been exhausted,« Federal Ministry of Finance, Monthly Report, January 2006, p. 45.

12 There are also difficulties with tax enforcement with regard to online traders outside the EU. Cf. http://www.rbb-online.de/wirtschaft/beitrag/2017/02/steuerhinterziehung-onlineplattformen-amazon-berlin.html

13 §4 para 1 sentence 1. No.1b German VAT Act in conjunction with §6a German VAT Act.

14 In the case of intra-Community deliveries, in the so-called recapitulative statement.

Consumers have to be shielded from administrative charges. Thus the exporter is duly obliged to pay the VAT in the consumer's country of residence. Registration with a foreign financial administration is necessary for this purpose. According to the European Commission, companies incur compliance costs in the amount of around 8,000 euros on average for a registration in each member state.[15] Compliance costs accrue also in the member states in which a company registers, but is not domiciled.

This cost burden distorts competition. Companies with few or smaller cross-border sales accordingly have more difficulty generating sufficient marginal returns in intra-Community business to cover the costs of VAT registration. The »investment« in VAT registration is associated with a significant risk of loss. Thus a small company faces two options: either restrict themselves to B2B transactions or – depending on its business model – even to renounce intra-Community transactions altogether. From a business standpoint the administrative costs of the European VAT system represent an impediment to growth or a business risk. Consumers are likely to feel the consequences of the lack of competition in the form of higher prices and lower product diversity.

DISTORTIONS IN THE EUROPEAN SINGLE MARKET

Furthermore, in some member states there are long waiting times for acquiring a VAT identification number (VAT ID). According to established practice a seller does not charge a customer in another European country VAT if the latter is able to show itself to be a business by means of a VAT ID. Previously the presentation of a VAT ID was a mandatory criterion for tax exemption.[16] For example, if a newly established company has not yet acquired its VAT ID when it makes a purchase it is charged VAT in the country of the seller. This doesn't pose a problem if buyer and seller are domiciled in the same state. In that case, the acquiring company can offset the VAT it paid in its next tax declaration against VAT it has received. However, there is a settlement problem if the buyer imported the goods. In this case it first has to pay the seller the VAT in its country of domicile and also report the import in its home country in the recapitulative statement and pay tax on it. Although the buyer can reclaim the paid tax after receiving the VAT ID, it nevertheless suffers a liquidity cost in the meantime. Without a VAT ID a company has an incentive if possible to procure inputs only in its home country.

URGENT REFORM OBJECTIVES

Reform of the European VAT system should thus pursue the following three objectives:
– safeguard tax revenues;
– reduce administrative costs for taxable companies;
– eliminate trade barriers in the single market.

15 https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/commission_presentation.pdf

16 The European Court of Justice made it clear that in the case of intra-Community deliveries a VAT exemption may not be denied by the financial administration on the grounds that a tax identification number is lacking, if there is no evidence of tax evasion. The precise consequences of this judgment on practical tax enforcement remain to be seen. Cf. ECJ ruling in Case C-24/15 of 20.10.2016 (Josef Plöckl vs Schrobenhausen Tax Office).

3

REFORM ALTERNATIVE 1: REVERSE CHARGE MECHANISM

In contrast to the net all phases VAT system with its input tax deduction, in the case of the reverse charge mechanism it is not the supplier but the recipient that settles the tax burden with the tax office. This means that the buyer has to inform the tax office about the taxable acquisition. If a company receives a service it is obliged to declare it and pay tax on it. The company can, however, recover the VAT due to be paid.

ELIMINATION OF PRE-FINANCING BY TAXABLE COMPANIES

There are two advantages to this: first, under the reverse charge mechanism the company's liquidity situation is improved. At the moment, a company has to pay the input tax in advance because sometimes a considerable time can intervene between the purchase of an input and and the (further) sale of a product. At the time of the purchase the VAT initially flows out of the company. Only when the outgoing invoice is settled do funds flow back into the company. Until then further inputs can be acquired in the course of the production process, so that there can be outstanding input taxes for a prolonged period. In the reverse charge mechanism the recipient pays the tax and at the same time reclaims it. In that way the tax liability is set off immediately. That means that in the extreme case there is no cash flow. Prefinancing would no longer be necessary.

LOWER RISK OF SHORTFALLS FOR THE STATE

Secondly, the risk of shortfalls is reduced for the tax authority. Because in the present system the seller functions almost as a »collection agency« for the tax office with regard to the buyer's tax liability, the tax office has to wait until the supplier transfers payments to the exchequer when making the advance VAT return. This time lag harbours the danger that in the meantime the supplier may become insolvent.[17] The tax office is dependent on the assertion of a claim arising from the insolvency assets. Thus the tax demand is often worthless. In the reverse charge mechanism this danger would be averted. The »diversion« via the seller would thus cease because the buyer would settle the VAT to be paid directly with the exchequer.

EXPERIENCES AND IMPACTS IN INTRA-EUROPEAN BUSINESS DEALINGS

In the European single market a fundamental transfer of the tax liability to the recipient of goods or services already applies in cross-border transactions (B2B). Furthermore, the European legal framework – the so-called EU VAT Directive – allows the application of the reverse charge mechanism for certain tax situations.[18] Most important of these are transactions involving suppliers from certain branches in particular, such as construction. This is because the risk of default due to insolvency or fraud is particularly high.[19] In §13b of the German VAT Act, German tax law makes use of the reverse charge options made available by European law. General application of the reverse charge mechanism is not allowed in internal transactions in Europe, however. Nevertheless Austria and the Czech Republic have requested to test a general reverse charge mechanism in a pilot project. However, the Economic and Financial Affairs Council (ECOFIN) has not yet given its approval.[20]

The reverse charge mechanism does not remedy all the shortcomings of the VAT system, however. Rather it gives rise to new delimitation problems. In order to keep administrative costs down, consumers shall continue to be excluded

17 One way, among others, of avoiding such shortfalls is the so-called split-payment mechanism, by which the VAT is paid directly to the tax office when the invoice is paid. However, this procedure gives rise to a variety of practical obstacles and to date there has been no majority for it among the member states.

18 Cf. Art. 193-199 and 202 of the EU VAT Directive.

19 Cf. Tipke/Lang, Steuerrecht, 22. Auflage, §17 Rz. 73, p. 923.

20 http://www.ey.com/Publication/vwLUAssets/EY-VAT-News-week-to-04-07-2016/$FILE/EY-VAT-News-week-to-04-07-2016.pdf and http://data.consilium.europa.eu/doc/document/ST-10426-2016-INIT/en/pdf

from the administration of VAT also in the future. This means that the seller will have to adequately assess every trading partner and determine whether they are a consumer or a business. A new obligation on the part of the taxpaying company arises. At the same time, in the case of B2C transactions in the European single market there would still be a need for a VAT declaration with the financial authorities in the consumer's country of domicile. Companies' administrative costs can only be reduced to a limited extent with the reverse charge mechanism.

A SOLUTION: IDENTIFICATION OF BUSINESS PARTNERS VIA MEANS OF PAYMENT?

One approach developed in the United States is the identification of tax exempt trade partners by means of their credit card.[21] Credit cards for employees that are settled directly via the company's account entail only a small risk of fraud. It remains to be seen, however, how improper use of credit cards can be prevented. It remains questionable whether the legislator would leave obtaining proof of identity to the financial institutions issuing the cards. Furthermore, the credit card account would have to be settled by means of income from regular business operations. Apart from that there is a risk that an employee may misuse such a company credit card. In that event, the firm – provided there is no insurance – will have to settle the loss. In addition, the abuser will have to pay the VAT that is due as the acquired goods or services were consumed. Whether the company can be made liable for such a tax loss requires further clarification. Consequently, as a means of tax identification credit cards appear to have considerable risks attached.

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21 http://www.euractiv.com/section/digital/news/experts-reject-google-tax-back-vat-move-against-amazon/

4

REFORM ALTERNATIVE 2: ONE-STOP-SHOP (OSS)

In the policy debate the European Commission has been pursuing a conceptually different approach since early 2014.[22] With the so-called one-stop shop (OSS) intra-Community deliveries are to be put on an equal footing with domestic ones in procedural terms. That means that, ideally, for taxable businesses it would make no difference whether the customer is domiciled in the home country or in another EU member state. As in the current recovery procedure the OSS takes on board the so-called destination principle.[23]

REDUCTION OF BUREAUCRATIC COSTS

Under OSS, in all taxable transactions the seller includes VAT in the buyer's bill, regardless of whether the buyer is domiciled in the home country or in another EU country. The difference between companies and private persons also lapses. However, the seller puts the destination country's VAT in the bill. Within the framework of its tax reporting obligations the seller, at the next stage, declares all Europe-wide transactions to the financial authorities in its country of domicile. It pays the tax (minus input tax paid) to its tax authorities. The financial authorities of the state of domicile then passes on the corresponding tax revenue to the destination country.[24]

In comparison with the current system this reduces the bureaucratic costs. All that is required is one registration in an EU member state; the taxable party only has to submit a tax declaration. At present this procedure is applied across Europe as the so-called Mini One-Stop Shop (MOSS). However, its scope of application covers only digital services (for example, video streaming).[25]

CHALLENGES OF CROSS-BORDER TAX ENFORCEMENT

If OSS is to be introduced the member states have to be willing to entrust other EU states with the enforcement of their own taxes. This might give rise to conflicts of interest. Why would a state levy tax on its own taxable parties with the same thoroughness as in the case of its own revenues? In general, is it assured that all EU states maintain comparable quality standards in tax administration? A lack of enforcement in this sense could lead to revenue shortfalls in another member state.[26]

Other open questions include who and under what conditions may order and carry out a tax audit of the taxable party. It would have to be possible for a foreign tax administration to assess if and how tax enforcement is conducted. At the same time, it would be unreasonable to expect taxable parties to undergo up to 28 different tax audits for the same period. One proposed solution is to put together international teams for tax audits and to have the results recognised by all tax authorities.

It is evident that whatever solution is chosen administrative competences would have to be established at the European level. This would impinge on member state sovereignty. It is doubtful whether there is either the political will or sufficient trust for this among the member states.

DANGER OF DISTORTIONS OF COMPETITION IN THE SINGLE MARKET

Apart from that, enforcement deficiencies could lead to considerable allocation effects. In the case of big enough differences in tax enforcement taxable parties would, ceteris pari-

22 http://www.euractiv.com/section/digital/news/experts-reject-google-tax-back-vat-move-against-amazon/

23 Cf. Tipke/Lang, Steuerrecht, 22. Auflage, §17 Rz. 393, p. 1039 and https://www.theguardian.com/small-business-network/2014/dec/08/newvat-regulations-affect-smes

24 In Germany the Federal Central Tax Office would be responsible for this.

25 http://ec.europa.eu/taxation_customs/business/vat/telecommunications-broadcasting-electronic-services_en

26 In the case of the Mini One-Stop Shop the federal government replied to an inquiry from the Bundestag that »virtually all individual aspects of the Mini One-Stop Shop suffer from shortcomings«. The federal government does not explicitly mention shortfalls caused by enforcement problems, however. Cf. Deutscher Bundestag, Drucksache 18/10229, 08.11.2016. http://dip21.bundestag.de/dip21/btd/18/102/1810229.pdf

bus, shift their OSS to the member state with the simplest requirements.[27] Depending on the business model this could also be accompanied by relocation of parts of the value chain.

Distortion of competition cannot be ruled out, either. Take the example of two suppliers who serve the German market with same good; if one of the two competitors benefits from patchy VAT enforcement they receive a »cost saving« of around 16 per cent if the regular VAT rate is applied.[28] Given that, for example, in the German retail sector the return on sales in 2014 was around 3.5 per cent,[29] the macroeconomic dimension of distortion in the event of tax enforcement failures becomes clear.

DELIMITATION PROBLEMS OF THE DESTINATION PRINCIPLE NOT SOLVED

Despite initially simplified obligations to cooperate there are also uncertainties for those liable to pay tax under the OSS. This is because with the application of the destination principle the seller still has to ascertain the country to which the goods were shipped. In this respect it is should not make any difference whether the goods were delivered by the seller, delivered by a courier or picked up by the buyers themselves. However, in the last instance in particular difficulties arise. How can the seller ensure, in the case of an »ex works« sale that the collecting customer, on one hand, really takes the goods away and, on the other, that the goods actually reach the destination country nominated by the buyer?

Although the risk of abuse appears low in the case of established business relationships or orders with long lead times, things are quite otherwise in the case of previously unknown buyers who approach the seller out of the blue. If it turns out that the seller has not included the VAT of the destination country in the invoice the seller might be liable for back payments. It seems improbable that it would be possible to have any recourse against the buyer. Apart from that, there need to be regulations concerning how swiftly and under what conditions VAT that has been charged erroneously has to be repaid by the member states. In practice, delays can sometimes be lengthy, which can put undue strain on the taxable company's liquidity.

APPLICATION OF FOREIGN TAX LAW BY TAX PAYERS AND FINANCIAL ADMINISTRATION

If the destination country is identified correctly, however, the next step must be to determine the applicable VAT rate. The seller must reliably ascertain whether the regular or a reduced VAT rate shall apply. As in the case of domestic transactions buyers and sellers must have a common understanding of the legal situation. It is difficult if at the next stage the tax authorities and the tax payer are at odds. Under the OSS, then, the two parties must interpret foreign tax law. This, too, is fraught with uncertainties for both sides.

One possible solution is a uniform Europe-wide statutory classification of tax cases. In Germany, tax cases with reduced VAT rates are as far as possible demarcated using European Union's combined nomenclature (CN).[30] The CN is applied mainly in the levying of customs duties. In the VAT system directive member states are allowed to refer to the combined nomenclature with regard to delimitation.[31] To avoid disputes to the extent possible, however, the member states could be obliged to apply the combined nomenclature in future. A further refinement of the classification of tax cases should first be modelled in the CN. In that way a uniform understanding of tax cases in the case of both the tax payers and all participating tax authorities could be generated in the member states. Disputes concerning interpretation and delimitation would then be dealt with at the European level.

Destination Principle versus Country of Origin Principle

In VAT law the destination principle or the place of consumption principle generally apply. This means that the right to levy the VAT is attributed to the state in which the end consumption takes place and which provides the public framework needed for consumption (cf. Tipke/Lang §17 point 13, sentence 897).

From an economic standpoint VAT is a consumption tax, which taxes the consumer surplus. This case is similar to the income or corporation tax which taxes the producer surplus (profit). In both instances the tax is levied as far as possible where value creation in fact occurs. The consumer surplus arises at the place of consumption, that is, where the buyer uses the good or service. Consequently, the local state is supposed to be assigned the right to levy the tax. In practice, tax incidence – that is, determining on whom the tax burden lies – is difficult to determine even with the help of empirical analysis.

By contrast, there is the origin or country of origin principle. In this case, generally speaking, the VAT regulations of the country of the seller shall apply. However, some experts have rightly pointed out distortions of competition (cf. Tipke/Lang §17 point 395, sentence 1040).

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27 Taxable parties from third countries without domicile in the European Union register their OSS in a member state of their choice. As long as registration requirements remain unharmonised this can provide an incentive to register in the state with the least onerous reporting requirements.

28 An addition of 19 per cent to the net sales price corresponds to 16 per cent of the gross sales price.

29 https://www.verdi.de/++file++5547620bbdf98d187700010e/download/2015_Einzelhandel_Branchendaten_KURZ_online.pdf

30 Annex II German VAT Act.

31 Art. 98 III EU VAT Directive.

> In particular in a single market the seller would merely have to relocate to the country with the lowest VAT rate and simply ships goods to its customers, thereby gaining a price advantage from the lower tax burden. This would result in a steering effect that could induce undesired tax competition. The neutrality principle, according to which the VAT system should affect purchasing decisions as little as possible, would be seriously undermined. In international business transactions the destination principle has prevailed (cf. OECD http://www.oecd.org/tax/consumption/36177871.pdf point 4).

5

A BRUSSELS COMPROMISE – WITH NEW IMPONDERABLES

CTP STATUS IN A »DEFINITIVE VAT REGIME« FOR EUROPE

Because of their strengths and weaknesses both models have their opponents and supporters among member state governments. Can a compromise be achieved on this? In order to come up with a definitive VAT system, the European Commission has proposed a middle way:[32] As a first step intra-European goods (but not services), in the case of both B2B and also B2C transactions, are to be recorded and processed via the OSS as far as VAT is concerned. In a second implementation step, among other things, services will be included in the OSS..

However, all taxable, trustworthy companies can apply for the status of »certified taxable person« (CTP) in their member state. When a CTP acts as a buyer it is subject, in principle, to the reverse charge mechanism. Because the VAT no longer has to be pre-financed there is a liquidity benefit to the CTP status and thus there is an incentive for companies with a lot of intra-Community trade to apply for it. On the other hand, companies with a strong B2C focus or whose intra-Community sales are modest can use OSS. Thus, there would be no need to register with a foreign financial authority. However, the CTP approach must be scrutinised more closely from the standpoints of taxation and competition.

A REGULATORY CHALLENGE: WHO IN FACT CAN OBTAIN CTP STATUS

At this point two aspects should be discussed as examples. On one hand, the question arises of the conditions under which CTP status should be granted. In terms of regulatory policy no serious company may be denied access. The effect of excluding a group of companies from CTP status would be discriminatory due to the possibly simplified administration and competitors' liquidity advantage. There is also the possibility of de facto exclusion if the costs of applying were prohibitively high for small companies. The certification procedure for companies must therefore be simple.

Against that is the absolute requirement to make the issuing of CTP status as fraud-proof as possible. For example, companies must be prevented from purchasing a large volume of goods from the Community area and becoming insolvent before the VAT is paid. In order to fend off abuses financial authorities should be provided with a right of cancellation at short notice, as a matter of urgency.[33] That means that taxable companies have ascertain their counterparties' CTP status on a regular basis. The CTP approach can thus be expected to entail ongoing costs for the authorities and for companies. It has to be assumed that finding a viable path between these conflicting interests is one of the main challenges facing implementation of the Commission proposal.

UNIFORM REGULATIONS VERSUS EUROPE-WIDE MINIMUM STANDARDS

On the other hand, it remains to be seen whether CTP status is to be issued in accordance with rules harmonised on a European basis or based on national guidelines with European minimum standards. An argument in favour of decentralised guidelines is that each state can take into account individual legal idiosyncrasies. Having said that, harmonised rules obviate regulatory arbitrage; in contrast to minimum standards tax fraudsters have no opportunity to submit applications in the member state with the weakest approval requirements. In particular in the case of minimum standards the question also arises of whether CTP status shall be applied throughout Europe. If, for example, the taxpayer purchases goods that

32 Definite VAT Regime. Cf. https://circabc.europa.eu/sd/a/8bf976d1-b735-4927-929c-0dac7f5b6521/57%20-%20Definitive%20regime%20for%20intra-EU%20trade%20-%20First%20step%20-%20Issues%20to%20be%20examined.pdf

33 From this another procedural question arises: when and how often can a seller be expected to verify his customer's CTP status? For this purpose the financial authorities should make corresponding IT capacities available, that enable bulk queries. In particular in large companies a single invoicing run can sometimes give rise to up to several thousand invoices a day. In some instances all customers would have to be checked for a valid CTP status.

are not destined for delivery in their home country there is no VAT liability there, but rather in another member state. In practice, this happens often with trading companies. Goods can be stored in another member state or delivered directly to a customer there. In this case the domestic company, its supplier, and the relevant financial authorities have to reach a consensus on which party has to settle the VAT. If CTP status remains limited to intra-Community purchase transactions for domestic delivery, however, not only the CTP status of the contracting parties would have to be ascertained. Instead, the contracting parties and the authorities would have to assess each transaction for VAT individually. This would increase the system's proneness to error. Tax offices' audit procedures would also become more complex.

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CONCLUSIONS

All the alternatives presented here could solve the problems with VAT only to a certain extent. While the reverse charge mechanism can increase the barriers for tax fraud, the OSS helps to eliminate obstacles in the single market. On the other hand, the reverse charge mechanism would not reduce the administrative costs of B2C transactions and change little in intra-European trade. Tax liability has already been largely reversed under the existing system. The OSS, too, would, for all its simplification of registration, bring about new delimitation cases and thus unknown legal risks.

While, in view of the increasingly digitalised and cross-border organisation of the economy, practical constraints have necessitated a stronger Europeanisation of VAT for some considerable time now, such a step is fraught with political concerns, as things stand at the moment. The main obstacle for European cooperation lies in the risk that a botched reform might lead to dramatic disruptions in the member states' public finances. Any reform must therefore be implemented with caution.

If the European Commission wants more political support for its VAT action plan and the introduction of an OSS it has to be more responsive to the justified criticisms of some member states. First and foremost, this applies to the lack of trust that some member states currently feel towards other tax authorities. EU-wide levying of customs duties, however, is an example of how shared sovereignty in financial administration is entirely possible. Member state support can be obtained only if the Commission presents credible solutions concerning how poor tax enforcement can be promptly identified and sanctioned if necessary. One solution would involve the regular assessment of VAT enforcement in all member states by an independent auditor appointed by the European Commission. These audit reports should be made accessible to the public. In the case of flagrant enforcement failures companies from the member state in question could be excluded from the OSS for a period; in that case they would have to pay their VAT directly to the relevant state. Companies would have an interest in avoiding unnecessary registration obligations. Transparent reporting would in itself give companies an incentive to lobby for effective tax enforcement. Furthermore, allotting a share of the tax revenues to the levying member state be another motivation for effective Europe-wide tax enforcement.

Despite the shortcomings that have been identified the Mini One-Stop Shop could serve as an experimental case. The European Commission should continue to collect findings from this model, remedy defects promptly and evaluate options for extending the system. Going forward, the Commission and the member states should find solutions for new economic developments. A VAT classification of social media platforms and shared-economy models should, in principle, be coordinated Europe-wide right from the very beginning. This way the European Union would contribute early on to a uniform regulatory framework for these fledgling business models. Later harmonisations would thus be reduced or even unnecessary.

By contrast the EU should refrain from temporary solutions, such as the introduction of the reverse charge mechanism for a limited period. Such measures give rise to high conversion costs for companies and administrations in the first place without yielding lasting benefits. Similarly, unilateral moves by countries with regard to systemic changes should be rejected. Different VAT regimes within the EU would probably lead to new delimitation difficulties in determining the place of supply and thus fiscal sovereignty.

A VAT for Europe, which is sometimes called for, is also no solution for the challenges set out here.[34] Apart from the legal obstacles it would lead neither to a simplification of procedures nor the safeguarding of tax revenues. Furthermore, new distribution conflicts would probably emerge among the member states, while at the same time governments' fiscal policy freedom would be hemmed in.

Whatever procedural model the European Union eventually decides on, it needs to step up the pace of reform to cope with the already pronounced tax shortfalls for the member states and the sharply increasing complexity facing taxable companies. In doing so they need to bear in mind that even a reformed VAT will not be a panacea. However, a future VAT system can certainly be an improvement on the current one.

34 https://www.welt.de/politik/ausland/article161104044/Bruessel-will-separate-Steuern-fuer-Europa-erheben.html

Imprint:

© 2017
Friedrich-Ebert-Stiftung
Publisher: Managerkreis of the Friedrich-Ebert-Stiftung
Hiroshimastraße 17, 10785 Berlin
www.managerkreis.de

Orders/contact: managerkreis@fes.de

ISBN: 978-3-95861-882-4

Title image: ©industrieblick – fotolia
Design concept: www.stetzer.net
Layout: www.zumweissenroessl.de
Printing: www.bub-bonn.de

July 2017

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www.fes.de/de/politik-fuer-europa-2017plus/