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COMMISSION STAFF WORKING DOCUMENT

**"Report on the state of play of the discussions on the conventional measures to combat
VAT fraud proposed by Member States"**

{COM(2007) 758}

1. BACKGROUND

The Commission's Communication of 31 May 2006 concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud¹ presented a range of ideas as a basis for a debate at EU level.

The follow-up of this Communication is set out in the Commission's Communication on some key elements contributing to the establishment of the VAT anti-fraud strategy within the EU.

As indicated in this Communication, the Council of June 2007 prioritised a number of conventional measures on which it invited the Commission to come forward with the necessary legislative proposals.

Moreover the Council invited the European Commission to promptly examine all other measures to combat tax fraud as proposed by Member States and mentioned in the annex to its report, and to submit a report on these in the second half of 2007, so that the Council may decide by the end of 2007 on how to proceed.

The present Commission staff working document is a response to this last demand; its objective is to provide the current state of play of the discussions which the Commission had with the Member States in the context of the Anti Tax Fraud Strategy (ATFS) expert group.

2. CURRENT STATE OF PLAY

The expert group examined a broad range of measures. Firstly there were the topics for which the ECOFIN Council of November 2006 specifically asked the Commission to do further work. Moreover, there was a general commitment from the delegates to allow for a discussion within the expert group on all ideas put forward by Member States.

The topics discussed are listed below.

2.1. Quicker exchange of information between tax administrations.

2.1.1. Reducing timeframes for recapitulative statements.

This topic was already highlighted in the Commission's progress report presented to the ECOFIN of June 2007 as an issue for which there was in the ATFS expert group support from a large majority of Member States.

The ECOFIN Council subsequently decided to prioritise this measure and invited the Commission to come forward with the necessary legislative proposals including an impact assessment. This request from the Council being clear, the Commission took the view there was no need for further discussion of this topic in the ATFS group.

¹ COM(2006)254, 31.5.2006

2.1.2. Automated access to data contained in each others' databases.

This idea was raised in the Commission's Communication of May 2006 and identified by the ECOFIN of November 2006 as an area to be further looked into. The idea is to allow the competent authority of a Member State automated access to information - to which it is already entitled today under Council Regulation 1798/2003 - which is contained in other Member States' databases.

Whilst delegates could see the benefit in terms of quick access to standard information, a number of practical as well as legal concerns were raised.

From a legal point of view, questions as to what extent this automated access is already covered by the provisions of Council Regulation 1798/2003/EC or whether legal changes to the Community legislation would be required and concerns about data protection were raised. The Commission is in the process of examining these legal aspects.

Delegates in the ATFS group have however already showed an interest in further developing the practical aspects. In this respect it was agreed to set up a small working group. The working group will establish a list of information for which automated access would be necessary for national and cross border tax fraud controls, they will investigate the technical implications, and will also define a realistic timetable for achieving such automated access. The working group will report back to the ATFS expert group.

Discussions so far show that this is a complex matter. The idea is promising but its implementation raises besides the legal aspect a range of questions from a technical point of view. It is a project which cannot be realised in a very short term and which is likely going to require further discussions within the ATFS group.

2.1.3. The possibility of allowing a Member State to request, in an automated way, turnover information concerning a third Member State.

A group of Member States, supported by the Commission, insisted on the usefulness in the fight against missing trader fraud of being able to obtain, in an automated way, information not only on the intra-Community supplies by a given supplier to a business on their territory but also on the supplies made to other Member States.

This information, essential for the detection of fraudulent transaction chains, is today exchanged on request and certain Member States have put conditions on such an exchange.

Having automated, and therefore instantaneous, access to this type of information would speed up the process and would be an important tool for fraud investigators.

There was a large support for this idea within the ATFS expert group but some legal aspects need to be clarified before the technological development can be started.

2.2. More detailed exchange of information between Member States on Intra-Community transactions

2.2.1. Additional reporting, transaction by transaction, of intra-Community supplies.

In addition to obtaining the information more rapidly, certain tax administrations also insist on the need for additional information on a transaction by transaction base in order to improve their control possibilities. Using the possibilities offered by the new technologies, Member States could compel taxable persons to declare, in advance of the periodic declaration, either their sales or their purchases, as recorded in their accounting records. This would include various data elements already required for invoicing such as the VAT identification numbers of the seller and purchaser, the invoice sequence number, the date of the invoice and the taxable amount.

By storing this information in a database, the administrations concerned would be able to detect any abnormal trade patterns, react quickly when payments are received at the end of the declaratory period that do not correspond to declared amounts, and thwart schemes that are destructive for the functioning of the internal market.

A number of delegates, however, expressed concerns on the costs for businesses of such a change, on the capacity of the tax administrations to deal with the massive flows of information and the effectiveness for the tax authorities of collecting information at such a level of detail.

The impact on businesses of reporting at transaction level of intra-Community supplies within the recapitulative statement is part of a study launched by the Commission. It was agreed to postpone the discussions on this topic until the results of this study will be available.

2.2.2. A system of pre-notification of Intra-Community transactions.

The expert group discussed the appropriateness of more far reaching alternative systems, which were based on an exchange of information in real time between taxable persons and the tax authorities or even information exchanges before the transaction takes place.

The expert group considered such systems as too radical a change in the reporting obligations and decided that further analysis of such systems was not a priority for the expert group at this stage.

2.3. Shared responsibility between member States for the protection of revenues

The Commission is of the opinion that in the context of an internal market Member States should take comparable measures against fraudsters, especially in terms of control proceedings and in the area of sanctions and criminal proceedings, regardless of whether the fraud leads to losses of revenue on their own territory or on the territory of other Member States.

As regards the sanction and prosecution aspect, there was a large majority of delegates agreeing that the best way forward would be that the ECOFIN Council would transmit a request to their colleagues from the Justice and Home Affairs

Council to take the necessary steps in order to ensure that appropriate legislation is put in place.

2.4. Improve the functioning of the validation of VAT numbers.

A concern relating to the existing VAT intra-Community system that is often aired by the business sector concerns the functioning of the VIES VAT identification number validation system. Member States do not always keep the information contained in the VIES system up to date and therefore traders do not always obtain a correct reply from the system when requesting the validity of the VAT identification number of their customers. At the last meeting there was a first exchange on how the situation can be improved. Moreover, it is important that businesses would get reliable up to date information from the VIES system that they could use as proof when being challenged during a control visit.

Furthermore, on the central public validation database operated by the Commission, some Member States provide traders with the name and address of a customer, while other Member States only provide a confirmation of the requested number. A more harmonised community approach would be appreciated by the business sector.

This idea also received general support and it will be part of the work carried out at IT level with a view to provide at least confirmation of the VAT number, name and address for all Member States.

2.5. Making the common VAT system more fraud proof

Several provisions of Council Directive 2006/112/EC on the common system of VAT (hereinafter referred to as "the VAT Directive") have been put forward by the Member States in order to discuss whether these provisions provide opportunities for fraud, whether they can be used as a tool against VAT fraud and whether there would be a need to review or clarify these provisions.

These discussions concerned:

- Article 90(2) of the VAT Directive which allows Member States not to apply a reduction of the taxable amount in cases of partial or total non-payment of the price by the customer. Discussions focussed on the exact scope of this provision, on the divergent application that is currently made of this provision and on its efficiency in combating fraud;
- Article 183 of the VAT Directive which provides that when a trader has a VAT credit the Member States may, under the conditions they determine, either make a refund or carry the excess forward. The group discussed whether transferring the VAT due to traders to the next tax period is an effective measure to tackle certain types of abuse. Where the current wording of Article 183 offers Member States considerable flexibility, some Member States advocated the need for clarification on the practical application of this provision in the light of the limitations laid down by the general principles of Law. The possibility of denying repayment in cases where it is established that the right to deduct has been relied upon for fraudulent ends has been discussed in the same context;

- Article 273 of the VAT Directive which allows Member States to impose, under certain conditions, additional reporting obligations. The discussion concerned the idea whereby either the supplier has to list all his domestic supplies or the purchaser has to list all his national purchases or a combination of both of them in order to allow for a direct matching of the information;
- Title X of the VAT Directive which governs the rules on deduction and Article 205 which allows Member States to provide that a person other than the person liable is to be held jointly and severally liable for payment of VAT. There was a discussion in the group on how Member States could sanction traders that do not fulfil their national reporting obligations. This could be done either by introducing a limitation or a suspension of their right to deduct input VAT or alternatively, when not fulfilling the national reporting obligations linked to a domestic supply, by making the supplier jointly and severally liable for the payment of the amount of VAT due to the state budget.
- Article 167 of the VAT Directive which determines the time of the right to deduct arises. The idea was raised to make the right to deduct input VAT subordinated to the condition of effective payment for the supply. Discussions covered a global as well as a targeted and limited application of such a provision.
- Article 205 of the VAT Directive on joint and several liability. The group discussed the possibility to make traders that do not submit their recapitulative statements jointly and severally liable for the payment of the VAT due upon the intra-community acquisition or the loss related to a subsequent onward supply of those goods.

Discussions on these topics have proved the complexity of the issue, since several aspects need to be taken into consideration

- First of all there is the renewed Lisbon Strategy objective to reduce administrative red tape for businesses by 25 %. This implies that Member States have to be very careful when imposing additional obligations upon businesses, in order not to violate this objective.
- When imposing additional burdens or other obligations upon traders, Member States should ensure that these measures do not go beyond the goal of reducing fraud. They should avoid that the situation of genuine, compliant traders is not worsened because of measures applied across the board, whereas the risk is only limited to a specific sector or a specific category of traders.
- The current Community VAT legislation already offers Member States several possibilities to take appropriate measures, provided of course such measures respect the general principles of proportionality, neutrality and legal certainty. Such measures should respect the delicate balance between the need for flexibility for Member States as well as the need for more legal certainty for Member States and businesses.
- The measures envisaged should also strike the balance between the Community level, where common rules are necessary, and that of the Member States where respect of subsidiarity in the field of controlling and collecting the VAT means the

national tax authorities should decide on how they make best use of the additional available tools.

Until now, the discussions with Member States have not been conclusive and the Commission is prepared to continue the debate with Member States on these various issues, provided the above mentioned framework is respected.

Based on the work carried out by the expert group, the more efficient use of the joint and several liability looks most promising, again provided it can be targeted to specific cases whereby the tax authorities would lose an amount of tax due to their budget and the person that is made jointly and severally liable to pay the tax on a specific transaction is not acting in good faith.

Moreover, at the last meeting delegates demonstrated a clear interest in pursuing the idea of making the right to deduct input VAT subordinated to the condition of effective payment for the supply in targeted situations. The Commission was invited to do further work on this issue.

2.6. Partnership between businesses and tax authorities

This idea as such has not been discussed but it has been raised on several occasions during the discussions of other topics, for instance in the framework of additional reporting obligations at domestic level.

In this situation traders can conclude a partnership agreement with the tax authorities. Through this partnership, tax authorities could give traders that are very compliant and that refrain from fraudulent activities some compensation in the form of e.g. quicker repayment of VAT amounts, less administrative burdens, fewer control visits.

The result is profitable both for the trader as it receives a less constringent treatment and for the tax authorities as it can ease the control efforts for the specific trader concerned.

Nevertheless, such agreements will need to respect the general principles of law and ensure equal treatment between traders that operate in similar conditions.

3. CONCLUSION

The ATFS expert group, set up in the beginning of 2007 and meeting for the first time in March 2007, has played a very important role in the overall debate on combating VAT fraud.

The work of the group constituted the basis for the Council' Conclusions on the conventional measures for combating fraud of June 2007.

Since the ECOFIN of June, the ATFS expert group:

- made progress on the exchange of information which tax authorities have available in their databases. The time required for obtaining information from another Member State is a major stumbling block for tax authorities in the fight

against VAT fraud. Having automated access to data electronically available in the other Member State would represent a considerable step forward;

- agreed on a way forward to improve the functioning of the validation of VAT numbers;
- made the suggestion, supported by almost all delegates and the Commission, that ECOFIN Council would invite the Justice and Home Affairs Council to examine the possibility to put in place appropriate legislation in order to ensure that comparable measures are taken against fraudsters in terms of sanctions and criminal proceedings, regardless of whether the fraud leads to losses of revenue on their own territory or on the territory of other Member States;
- discussed a range of potential changes to the VAT system in order to enhance the possibilities to fight VAT fraud. A targeted use of joint and several liability in case of non compliance with reporting obligations and the right to deduct input VAT subordinated to the condition of effective payment for the supply in targeted situations have been identified as the most promising avenues to explore;

The discussions on other issues are not finalised yet. Moreover, there are a number of other topics, like the establishment of an action plan for improving the use of administrative cooperation which still need to be debated in this group. The role of the European Anti-Fraud Office (OLAF) and its existing infrastructure in the support of operational and intelligence activities in the fight against VAT fraud may also need further consideration.

In addition, bringing together the ideas put forward within this expert group and the views expressed by businesses in the discussions on VAT fraud highlight the need for a political steering on some major aspects within the ongoing debate on the fraud proofing of the existing VAT arrangements. These elements are the subject of today's Communication of the Commission concerning some key elements contributing to the establishment of the VAT anti-fraud strategy within the EU.