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Review and update of VAT strategy priorities

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1. INTRODUCTION

In June 2000, the Commission presented a communication setting out its strategic programme for improving the operation of the VAT system within the context of the internal market.¹

The strategy was for a pragmatic programme of action geared to four main objectives: the simplification and modernisation of existing rules, more uniform application of current rules and a new system of administrative cooperation.

The strategy was launched on the basis that, given the reservations of the Member States, it seemed unlikely that significant progress towards a common system of VAT based on taxation in the Member State of origin would be made in the near future.

Its main objective was to give new momentum in the Council towards concrete and essential improvements to the existing tax system in the near future, without, however, calling into question an ultimate shift to the origin principle (i.e. taxation in the Member State of origin) as a long-term Community goal.

Now, three years after the action programme was launched, it is time for an initial review of its progress. This Communication also presents the new initiatives that the Commission intends to propose under the programme over the next few years, and aims to define a number of emerging guidelines for future action. Lastly, it raises some questions about what kind of common VAT system is best suited to an internal market of 25 Member States.

2. A PROGRESS REPORT

This progress report has been drawn up in the light of the four objectives of the new strategy. However, the division between objectives is not absolute, since certain proposals relate to more than one objective. A complete list of proposals made in the context of this strategy, and either adopted or still being discussed in Council, is contained in Annex 1.

As well as reviewing progress with proposals already made, this Chapter introduces a number of new initiatives for which preparatory work has already been started.

¹ COM(2000)348 final.

2.1. Simplifying the system

2.1.1. Simplifying tax obligations

During the second stage of this exercise the SLIM² team came up with a number of recommendations for simplifying VAT obligations.³ There was a consensus that the obligations were so cumbersome that they placed a disproportionate burden on Community businesses, and this burden should therefore be eased.

In line with these recommendations, the Commission has presented a number of proposals for directives, which have generally been favourably received by the Council.

Initiatives taken

Elimination of the tax representative

The Council adopted a Directive concerning the person liable for payment of VAT⁴ which removed, as from 1 January 2003, Member States' right to require intra-Community traders to designate a tax representative for transactions carried out in Member States other than the one where they are established. Many Community businesses had seen this fairly costly and complex obligation as an obstacle to the development of their taxable activity in Member States other than the one where they were established.

Discharge of tax obligations by electronic means

From 1 July 2003, all taxable persons (established or not) will have the right to discharge their tax registration and returns obligations by electronic means. This is one of the lesser-known aspects of the Directive on electronically supplied services,⁵ whereby Member States are required to introduce the facility. However, this measure is part of a more general process of modernisation and facilitation and is not therefore confined to traders in e-commerce.

Harmonisation of the content of invoices and acceptance of electronic invoicing

The Directive concerning invoicing⁶ creates a legal framework in the field of taxation for electronic invoicing and invoice storage and lays down harmonised rules on the content of VAT invoices, sub-contracting the issue of invoices and self-invoicing.

² Simpler Legislation in the Internal Market.

³ COM(1997)618 final report from the Commission to the Council and the European Parliament on the results of the second phase of SLIM and the follow-up of the implementation of the first phase recommendations.

⁴ Directive 2000/65/EC (OJ L 269, 21.10.2000).

⁵ Directive 2002/38/EC (OJ L 128, 15.5.2002).

⁶ Directive 2001/115/EC (OJ L 15, 17.1.2002).

Pending initiatives

Study on VAT obligations

The study launched by the Commission on the simplification and modernisation of tax obligations is the final stage in the follow-up to the recommendations produced by the SLIM exercise. Its purpose is to determine how these obligations (setting aside the aspects referred to above, which have already been dealt with separately) can be simplified and modernised at Community or national level for all traders, and particularly for small businesses.

Its findings have been made available for public consultation via the site “Your Voice in Europe”,⁷ which was introduced as part of the “Interactive Policy Making” initiative. The content of future legislative initiatives in this field will take account of the results of this consultation.

2.1.2. Simplification through the use of new technologies

Initiatives taken

E-commerce

The Directive on electronically supplied services re-established a balance of competition between EU businesses and those not established in the EU when they export internationally or sell within the EU.

It imposes no additional obligations on providers from non-EU countries supplying services to businesses established in the EU, since the VAT is payable by the latter on the basis of self-assessment. On the other hand, e-service providers must apply VAT to sales to private individuals established in the EU just as EU service providers have to. To allow traders not established in the EU to meet the VAT obligations arising from these transactions, the Directive provides for special arrangements allowing them to identify themselves in a single Member State for all taxable transactions in the EU. Transactions are thus taxed in the Member State of consumption of service and at the rate applicable there, but the non-established trader discharges his returns obligations and pays tax on all his transactions in the EU in the Member State of identification, which then redistributes the VAT revenue among the Member States of consumption (a "one-stop shop").

However, the Council decided that these provisions would only apply for a period of three years, starting from 1 July 2003. The Directive stipulates that, before 30 June 2006, the Council should either adopt measures on an appropriate electronic mechanism on a non-discriminatory basis for charging, declaring, collecting and allocating tax revenue on electronically supplied services with taxation in the place of consumption or, if considered necessary for practical reasons, extend this three-year period.

The European Union is the first tax jurisdiction in the world to have developed and introduced a simplified framework for the payment of consumption taxes on e-commerce in accordance with the principles agreed in the OECD.

⁷ <http://europa.eu.int/yourvoice> or at http://europa.eu.int/comm/taxation_customs/taxation/consultations_en.htm

In adopting this Directive the Council took an important step for the operation of the common system of VAT. The Member States abandoned the principle whereby the place of taxation of a taxable transaction determines the Member State in which tax returns and payment obligations for the transaction must be discharged.

The special scheme for travel agents

In response to the opinion of the European Parliament, the Commission amended its initial proposal regarding the special scheme for travel agents⁸ to include the “one-stop shop” facility for traders from non-EU countries falling within the scope of this special scheme (see point 2.3).

Replacement of the 8th Directive

The proposal for a Directive providing for cross-border deduction to replace the refund procedure under the Eighth Directive⁹ contains elements comparable to the one-stop shop system, since the taxable person will be able, in his Member State of establishment, to deduct VAT on expenditure in other Member States. During Council negotiations on this proposal, the Presidency suggested using a system of exchange of information and redistribution between Member States of the amounts involved comparable to the one for e-commerce.

2.2. More uniform application of the common system of VAT

Initiatives taken

VAT rates

To avoid growing differences between the standard rates applied by Member States leading to structural imbalances in the EU and distortions of competition in some sectors, it has been agreed that, until 31 December 2005, the standard rate must not be below 15%.¹⁰

The Commission has also presented a proposal¹¹ relating to the scope of reduced rates in order to simplify the rules in this area and achieve a more uniform application of the tax. This would give Member States equal opportunities to apply reduced rates in certain areas (e.g. restaurants, housing, the supply of gas and electricity and home care services). The proposal is also intended to rationalise the many VAT rate derogations currently available to individual Member States by making Annex H the sole reference list for all derogations from the standard rate. The objective is to improve the operation of the internal market and avoid potential distortions of competition.

⁸ COM(2002) 64 final of 8.2.2002 and COM(2003) 78 of 24.3.2003.

⁹ COM(1998) 377 final of 17.6.1998.

¹⁰ Council Directive 2001/4/EC of 19.1.2001 (OJ L 22, 24.1.2001, corrigendum OJ L 26, 27.1.2001).

¹¹ COM(2003) 397 final of 23.7.2003.

The proposal also takes account of the evaluation report on the experiment with labour-intensive services, which was drawn up on the basis of the reports provided by the Member States participating in the experiment. Taking into account the information provided by the Member States and the limitations of the analysis methods used, the report concludes that it was impossible to identify with any certainty any beneficial impact on employment or reduction of the black economy resulting from the experimental reduction of the rate of VAT on labour-intensive services. However, it should be noted that certain categories of services that took part in this experiment, and in particular the renovation and repair of private dwellings, are included in the proposed new Annex H.

Adoption of implementing measures and modernisation of the procedure for adopting derogations

The Sixth Directive provides the general framework for a common system of VAT, but does not contain a mechanism for introducing implementing measures.

Questions relating to the application of the common system of VAT are discussed in the VAT Committee. It is standard practice for the results of these discussions to be confirmed in guidelines, but the Committee does not have the power to give binding force to its guidelines.

Consequently, in 1997 the Commission presented a proposal for altering the status of the VAT Committee. However, the Council could not reach agreement on the matter and it is unlikely that significant progress will be made in the immediate future. The adoption of implementing measures in the field of taxation following the Comitology procedure is still the main obstacle to getting the proposal adopted. Probably only an amendment to the Treaty could give new momentum to this dossier.

However, given the importance of uniform application of the common VAT system, particularly for trade within the Community, the Commission has proposed,¹² under Article 202 of the Treaty, conferring implementing powers on the Council rather than the Commission. In practice, questions of interpretation will continue to be discussed in the VAT Committee. When these discussions produce results that should be confirmed in a binding legal text, the Commission will present a proposal for adoption by the Council acting unanimously.

The introduction of implementing measures at Community level offers advantages in terms of transparency and legal certainty for traders and national administrations.

In the same proposal, the Commission suggested modernising the procedure for adopting derogations, which the Council can authorise a Member State to apply in order to simplify the charging of tax or to help prevent tax fraud or evasion.

At present the Council can grant this authorisation by a procedure of tacit approval after a given period has elapsed.

The proposed Directive would ensure that every individual measure was the subject of a properly substantiated Council decision. This would ensure transparency and legal certainty for Member States and traders.

¹² COM(2003) 335 final of 10.6.2003.

Pending initiatives

Mechanism for eliminating double taxation in individual cases

Implementing measures are important for avoiding cases of double taxation. However, although the Commission frequently receives complaints and letters about individual cases of double taxation, when the case is looked into it usually transpires that the legislation of the Member States concerned complies with the Sixth VAT Directive. The problem is therefore the result of divergent interpretations of the situation in each particular case.

Under these circumstances there is no reason to initiate an infringement procedure against the Member States. However, where Member States hold to their positions, the person concerned still suffers from double taxation. The Commission considers this situation unsatisfactory and contrary to the principles of the single market. We should therefore consider ways of passing from the stage of implementing measures, which are of a general nature, to a further stage at which a mechanism is introduced at Community level for solving individual cases of double taxation.

Such a mechanism already exists for direct taxation. Bilateral double taxation agreements drafted on the base of an OECD standard text provide for a mutual agreement procedure to eliminate cases of double taxation. Experience shows that simply getting the national authorities of the Member States concerned to discuss a case very often results in a settlement.

Also in the field of direct taxation, and more specifically in relation to transfer pricing, the Arbitration Convention No 436/EEC of 23 July 1990 provides for a compulsory arbitration procedure binding on the signatory Member States to eliminate double taxation in cases where the mutual agreement procedure has not achieved that objective within two years.

The Commission is currently considering what legislative initiatives could be taken at Community level to improve the present situation regarding cases of double VAT taxation.

Rationalisation of existing derogations

The Commission has also started on preparatory work towards rationalising the large number of derogations currently in force. In some cases such this could involve extending certain particularly effective derogations to all Member States.

There are a number of points in common between most existing authorisations.

A typical example is the setting of the VAT taxable amount for taxable transactions between connected persons, for which a number of derogations have been authorised. This concerns transactions between connected businesses, between a business and its staff or between a taxable person (natural person) and his family. In practice, national administrations have great difficulty in taking action in cases in which the price charged has been set abnormally low for purposes of tax evasion.

However, it is clear that some specific measures are designed to deal with a particular situation in a single Member State. The rationalisation exercise should not call into question this kind of authorisation.

Examination of the different options, rights and transitional arrangements.

Rationalisation of derogations under Article 27 will be followed by an examination of the range of options, rights and transitional arrangements provided for in the Directive. The objective is to analyse, on a case-by-case basis, the grounds for maintaining them from the standpoint of the single market and, where their continued existence seems justified, to give all Member States equal opportunities to apply them.

The recast of the Sixth VAT Directive

The Sixth Directive constitutes the legal framework for the common VAT system. However, it has been amended more than twenty times since it entered into force, and has therefore become a complicated piece of legislation and difficult to consult.

The Commission has undertaken to recast the Directive so that it becomes an effective instrument that clearly sets out the legislation currently in force.

This should not involve a debate on the substance of the 6th VAT Directive; this will come later, when specific proposals are made for implementing the new strategy.

Therefore, the recast in no way entails abandoning the ultimate objective (a VAT system based on the principle of a single place of taxation); its objective is to create a usable tool for the period during which the present system remains in force.

The Commission has launched a public on-line consultation¹³ on the basis of a preliminary draft of the recast drawn up by Commission staff. The purpose is to collect positive contributions that can be used to improve the quality of the legislative text.

2.3. Modernisation of the present system

Technological developments, changes in commercial practice and privatisation and liberalisation trends in some sectors have created the need to revise certain provisions of the Sixth VAT Directive which are unsuited to business transactions.

Initiatives taken

Liberalisation of the gas and electricity market

The liberalisation of the gas and electricity market highlighted the problems posed by application of the VAT rules, making it necessary to deal with them as a matter of urgency and separately from the broader issue of the place of taxation of supplies of goods generally. The directive concerning the rules on the place of supply of electricity and gas¹⁴ is intended to facilitate transactions between traders active in those sectors and ensure that the place of taxation corresponds to the place of consumption of the energy. Under the rules adopted, where the buyer is a trader reselling the supplies, the place of taxation is the place where the buyer is established. Where the sale is to a final consumer, the place of taxation is the place of consumption.

¹³ <http://europa.eu.int/yourvoice> or at

¹⁴ http://europa.eu.int/comm/taxation_customs/taxation/consultations_en.htm

Council Directive 2003/92/EC of 7.10.2003 (OJ L 260, 11.10.2003, p. 8).

Developments in the travel business

The proposal for a directive concerning the arrangements for travel agents (see point 2.1.2) is intended to modernise those arrangements and make their application more uniform. At the same time it should eliminate distortions of competition between Community and non-Community traders. As a result of commercial developments in this sector, one of the primary objectives of the special scheme, namely the distribution of VAT revenue among the Member States where the travel took place and the one where the travel agency is established, was no longer being achieved.

Competition in the postal sector

The Commission has also submitted a proposal for revision of the VAT rules applicable to postal services¹⁵ designed to take account of developments in this sector. When the Sixth Directive was adopted in the 1970s, the postal sector was in a monopoly position, providing a limited number of services for which there was no competition. Because of the changes that have occurred in this sector, the VAT exemption allowed for postal services now creates problems involving distortions of competition.

Pending initiatives

Sales promotions using vouchers and payment cards

The tax treatment of vouchers, mainly used as part of sales promotion campaigns, has been the subject of a number of Court of Justice rulings in recent years.

A number of principles can be derived from these rulings relating to specific cases, but their application to the multiplicity of forms that promotion systems can take continues to pose considerable problems.

Member States have also found that the lack of clear rules has been exploited to set up tax arrangements designed to artificially reduce the VAT taxable amount for the supply of certain goods and services.

In addition, changes in the way certain goods and services are paid for, for instance payments by telephone cards, raises issues of interpretation regarding the point in time at which the tax becomes chargeable and the nature of the taxable amount for transactions conducted through intermediaries.

These subjects have been discussed with the Member States on a number of occasions in order to arrive at a common interpretation of the existing rules. However, the Commission has concluded from the discussions that there is a link between the two subjects and that they should be further studied in a broader context with a view to drafting a proposal for a directive.

¹⁵ COM(2003)234 final of 5.5.2003.

Other topics

The Commission is aware that the proposals made so far in the context of modernisation are aimed at specific sectors of activity and therefore only affect a limited number of traders.

However, preparatory work covering broader areas, such as the VAT arrangements applicable to public authorities and financial services, is also underway. These are complex subjects with an impact on other spheres. In particular, when considering the revision of the VAT arrangements applicable to public authorities, account must be taken of the knock-on effects of such changes on the system of exemptions for certain activities in the public interest under Article 13 of the Sixth Directive, the treatment of subsidies and the right to deductions.

The Commission had initially planned to make a proposal on the VAT arrangements applicable to public authorities in 2003, but given changing priorities (the need to speed up work on the place of taxation of services) and the decision to carry out an in-depth impact assessment, it has been postponed until 2004. The impact assessment will analyse the economic, environmental and social impact of the proposal, including its effect on the final consumer.

2.4. Administrative cooperation

There has been major progress in this area in recent years.

Initiatives taken

Mutual assistance in the recovery of claims

The Council approved the directive on mutual assistance for the recovery of claims,¹⁶ an essential component in improving administrative cooperation and a necessary concomitant to the elimination of compulsory tax representation (see point 2.1.1).

Administrative cooperation for VAT

The Council adopted a proposal for establishing a single legal instrument covering all aspects of administrative cooperation in the field of VAT,¹⁷ as the existence of two different legal bases was found to have an adverse affect on cooperation in the field of VAT control. The new regulation not only replaces Regulation (EEC) No 218/92 and the VAT clauses of Directive 77/799/EEC, but tightens up on their substance. It lays down clearer and more binding rules for Member States, and provides for easier and more direct contact between officials and an enhanced exchange of information between administrations.

¹⁶ Council Directive 2001/44/EC of 15.6.2001 (OJ L 175, 28.6.2001).

¹⁷ Regulation (EC) 1798/2003 of 7.10.2003 (OJ L 264, 15.10.2003, p. 1).

The Fiscalis programme

The 2003-2007 Fiscalis programme¹⁸ has been approved by the European Parliament and the Council under the co-decision procedure. The programme is designed to help Member States collaborate more closely in combating tax fraud, through improved electronic systems for the exchange of information between national administrations, the introduction of cooperation between administrations for investigations, training seminars for officials and experts of national tax administrations and exchanges of officials between national administrations.

Proceedings of the SCAC

The Standing Committee on Administrative Cooperation (SCAC), jointly with the Commission and the Member States, has been working hard on risk analysis, computerised audits and targeting of checks to prevent carousel fraud.

A multilateral agreement drawn up by the SCAC has been concluded between the authorities of 14 Member States with the aim of stepping up exchanges of information about intra-Community deliveries of new means of transport to help prevent tax evasion and fraud in this area.

Pending initiatives

Revision of the VIES system

VIES was set up in 1993 to enable Member States to monitor intra-Community exchanges of goods between taxable persons. The information exchange system was made necessary by the abolition of cross-border administrative formalities and internal frontiers as from 1 January 1993.

The system was built to last four years, the time the transitional arrangements were initially expected to last. It has now been running for much longer and its shortcomings are becoming more and more apparent.

Rather than simply extending it to cover services, therefore, the Commission believes it would be better to replace the existing VIES with a higher-powered and more flexible system, able not only to produce data in a more user-friendly form for customs administrations but to help them fulfil their obligations towards traders.

The project is still in its early stages and both the IT and legislative aspects will involve a great deal of work. It is seen, therefore, as a medium-term objective.

¹⁸ Decision 2235/2002/EC of the European Parliament and of the Council of 3.12.2002 (OJ L 341, 17.12.2002).

3. FUTURE DIRECTIONS

We have already mentioned a number of the Commission's planned short-term legislative initiatives. A table of pending initiatives, together with a timetable, can be found at Annex 2.

Under this section, however, we must also draw attention to work under way on a crucial aspect of the common system of VAT - the place of taxation of taxable operations. Work in this area is proceeding in accordance with two guidelines: reaffirming the principle of taxation at the place of consumption, and simplifying traders' obligations.

3.1. Guidelines for future work

3.1.1. Taxation at the place of consumption

VAT is fundamentally conceived as a general consumption tax, with revenue going to the Member State where actual consumption takes place.

Current VAT rules are therefore structured in such a way that the operation of the system itself assigns the tax to the Member State where final consumption of goods or services is deemed to occur. In practice, this means that rules governing the place of taxable operations are devised to ensure that the tax goes to the Member State of consumption.

But there are limits to the application of this principle. The rules cannot result in excessive tax obligations on traders which might hamper business activity - such rules would run counter to the principles of the Single Market itself.

Globalisation, deregulation and technical change, however, have altered economic conditions, particularly as regards the volume and structure of trade in services. Increasingly, services can be provided remotely and some operations which used to be classed as supplies of goods (supply of software) are now classed as supplies of services.

In the past, the origin principle, i.e. the rule that provision of services was taxed at the place where the provider was established - with a few well-defined exceptions - broadly achieved the aim of assigning revenue correctly, but this is rapidly changing. Firms providing remote services often choose their place of establishment mainly for tax-planning reasons.

Transactions taxed at the place of consumption (destination principle) are always neutral in terms of VAT rates. Regardless of the place where the taxable person carrying out the transaction is established, it is taxed at the rate applied in the Member State of consumption, so Member States' freedom under the current VAT regime to set the rate of VAT will not distort competition for these transactions.

3.1.2. Simplifying tax obligations

Reverse charge mechanism

For B2B (business to business) transactions between taxable persons, making the business customer the taxable person (reverse charge mechanism) means taxation occurs in the place of consumption and the supplier does not acquire tax obligations in the Member State of consumption. For B2B transactions, therefore, we need to look at a broader application of this mechanism to cover cases where the taxable person carrying out the transaction is not established in the Member State of taxation.

"One-stop shop" mechanism

For business to consumer (B2C) transactions, where the customer is generally a private individual, taxation at the place of consumption currently means traders have to be identified and make returns and payments in every Member State where they carry out taxable transactions .

As Member States are, to a great extent, free to determine tax obligations, the content and frequency of VAT returns vary widely from one Member State to another. This issue has already been examined in the study on VAT obligations mentioned in section 2.1.1.

A trader suddenly faced with a slew of obligations is likely to be less enthusiastic about expanding activities in Member States other than the one in which he is established, in other words taking advantage of the opportunities offered by the Single Market. This applies particularly to SMEs. This results in those consumers domiciled in a Member State other than the state where the supplier is established experiencing difficulty accessing the services, or even with the supplier refusing to sell to the consumer. The internal market cannot therefore realise its full potential with regard to the choice of goods and services offered to the consumer.

Surveys carried out by the Commission suggest that 26% of traders regard the VAT system and VAT obligations as a hindrance to the Single Market, and 10% think the obligations imposed by VAT are the costliest for business. Overall, businesses rank VAT legislation fourth (after employment, product conformity and environmental legislation) in terms of compliance costs.

The Commission believes the one-stop shop system, which has so far been confined to non-EU traders, could also overcome administrative difficulties for Community businesses. It thus provides the hope that, in future, the processing of transactions carried out in a Member State other than the one where a business is established can be substantially simplified.

This view was reinforced by the findings of the study on VAT obligations: one of its main recommendations was the introduction of the one-stop shop system.

The Commission also endorses the recommendation that the system be introduced in stages, initially as a simplification in those cases where a trader carries out taxable transactions as a taxable person in a Member State other than the one in which he is established.

In such cases the one-stop shop system would not increase the existing level of risk in terms of monitoring or recovery, since a taxable person not established in the Member State in question is already entitled to fulfil his tax obligations in the Member State where he is established. The Member State where the transaction is taxed would need the same facilities for control (production of accounts etc.) as it has today, in order to verify the accuracy of the amounts declared for locally taxable transactions.

The one-stop shop system does rely heavily on computerisation to ensure that all Member States concerned receive the necessary information. As previously stated however (see point 2.1.2), within the framework of the e-commerce directive, the Council has demanded an examination of an appropriate electronic mechanism for charging, declaring, collecting and allocating tax revenue.

The Commission considers that it would be appropriate, rather than limiting this review only to the electronic supply of services, to extend it to all operations for which a trader is liable for tax in a Member State where he is not established. It is anticipated that discussions with Member States on this issue will begin during the current year.

Admittedly, adding other transactions to the one-stop shop system would mean significantly extending its scope. However, using the system for a wider range of tasks would provide a higher return on the investment required for computerisation.

The United States is about to introduce a very similar system, the “Streamlined Sales Tax Plan” (SSTP), which will make it possible to recover sales tax on distance sales in 38 American states when the vendor is not established in the customer’s state.

The Commission believes it would be possible to apply the one-stop shop system even if not all the Member States were involved. This is one field that lends itself to the “enhanced cooperation” procedure enhanced by the Treaty of Nice. The aim of simplifying traders’ obligations without affecting Member States’ revenue falls squarely within the rationale of this procedure, which allows those Member States able and willing to do so to proceed further in the direction of European integration.

The Commission considers that the advantages of the one-stop shop would be fully realised if it were backed up by a right to cross-border deduction so that a taxable person is able to deduct VAT in his Member State of establishment on expenditure incurred in other Member States (see section 2.1.2).

Combining the one-stop shop for payment of VAT due on taxable transactions in the EU with a right to cross-border deduction, so that VAT can be recovered on expenditure in Member States other than the country of establishment, would enable taxable persons to deal with all their VAT obligations via the administration in their own Member State, which for its part would gain a much wider overview of these businesses’ operations.

Reviewing the scheme for small businesses

As part of the drive to simplify VAT obligations the Commission is also planning to look at the special arrangements for small businesses whereby Member States offer tax relief if a taxable person's turnover is below a particular threshold. The rules currently in force under the Sixth Directive are fairly strict, and a number of Member States would like to extend the benefits of this scheme more widely. We hope to achieve greater consistency in threshold levels, while giving Member States greater flexibility to decide on the coverage of the scheme.

3.2. Review of rules regarding place of taxation

3.2.1. Review of the rules regarding the place at which supplies of services are taxed

Preliminary discussions with the Member States suggests that we should initially concentrate on services to taxable persons (B2B).

The individual amendments to the rules made at the time the Single Market was set up, and since, have one thing in common - they shift taxation from the service provider's place of establishment to the customer's.

Some of the changes were needed to prevent distortions of competition affecting Community traders, by ensuring that traders inside and outside the Community were treated the same for tax purposes (telecommunications, radio and television broadcasting and electronic services).

Others were aimed at simplifying tax obligations in relation to the intra-Community service provision (intra-Community carriage of goods and related services, services performed by intermediaries).

In the light of this general trend, we should consider an across-the-board switch from the origin to the destination principle though there would, of course, still be exceptions to the rule, as there are today.

We have started consultations with business; a consultation paper was published on the "Your Voice in Europe" site and generated a wide and constructive response from contributors, demonstrating the industry's interest in this issue.

A draft directive on B2B transactions will be proposed later this year, and will at any rate address the specific problems of some Member States, including cross-border leasing of means of transport.

The Commission will then start working on a revision of the rules on place of taxation for B2C transactions.

The current rule (taxation at the service provider's place of establishment) is very straightforward for traders, but when services can be provided remotely it does not ensure that the tax goes to the Member State of consumption, and is increasingly likely to distort competition.

When the Council adopted the e-commerce directive it provided for a review of the provisions before 30 June 2006 with a view to having electronic services taxed at the place of consumption.

The Commission would like the review extended to cover all services to final consumers. The rule should be revised in such a way as to ensure that the destination principle is applied more carefully without leading to any significant increase in traders' administrative costs.

The Commission believes that this can be achieved by using the one-stop shop system for distance supplies of B2C services.

This will also be an occasion for looking at the issue of tax on passenger transport. In addition to the place of taxation, we should also be looking at the exemptions currently available in this area, particularly as regards any resultant distortion of competition between different modes of transport.

3.2.2. Revision of the rules on place of taxation of supplies of goods

When the Single Market came into being on 1 January 1993 special arrangements were incorporated into the common system of VAT to provide for taxation at destination in the case of intra-Community sales of new means of transport, intra-Community sales to exempt taxable persons or non-taxable legal persons, and distance sales.

It is clear that the rationale for setting up the special schemes in 1993 - i.e. the risk of insufficiently harmonised tax rates leading to distortion of competition - still exists. Rather than calling for abolition of the special schemes, therefore, we should be considering the changes needed to simplify and monitor their application.

The planned shift in the place of taxation of supplies of goods will mainly affect supplies to individuals (B2C). Apart from that, the Commission is not looking at any fundamental change in the way the place of taxation is determined, but rather at ways of simplifying the obligations of traders supplying goods in more than one Member State.

The special scheme for distance selling is typical of the areas in which the one-stop shop could bring about substantial simplification for traders established in the Community.

The Commission therefore believes it would be desirable to subsume the proposal regarding the place of taxation of supplies of goods into the upcoming initiative on the simplification and modernisation of tax obligations, with the one-stop shop as one of its main components.

The proposal on the place of supply of goods was originally scheduled for 2003 but we think it would be better if the Commission and the Member States first had a chance to evaluate the operation of the one-stop shop for electronic services, which was introduced on 1 July 2003.

This would mean programming the proposal on the simplification of tax obligations, to include a section on the place of taxation of supplies of goods, for the third quarter of 2004.

3.3. Consistency with the definitive regime

The Commission accepts that the developments outlined above show the common system of VAT moving away from a regime based on the origin principle.

It should be pointed out, however, that in an origin-based taxation system as envisaged by the Commission in 1996 the rules regarding the place of taxation merely identify the Member State to which the taxable person must pay tax. It is then up to the system that reassigns VAT revenue to ensure that each Member State gets the appropriate revenue.

In a regime of this kind revenue is collected by a given Member State when taxable persons pay their VAT to the treasury, regardless of whether actual consumption took place locally, and hence regardless of the final amount that a Member State is ultimately entitled to. This is fundamentally different from the way the present regime is structured and could only work if VAT rates were much more closely aligned than they are at present (see section 3.3.1.).

For, so long as there is no political will to switch to an origin-based system, any improvements to the existing common VAT system must be in line with the structure of the system as it exists. To ensure that the revenue goes to the Member State of consumption, transactions should be taxed as close as possible to the place of destination (consumer) rather than the place of origin (supplier). This regime still allows Member States a degree of flexibility in setting the rates.

4. COMBATING FRAUD

VAT fraud, particularly carousel fraud, has become a real worry to Member States. There are no reliable statistics for its incidence at EU level, but the amount of VAT evaded is undoubtedly considerable.

Carousel fraud works by combining transactions on which suppliers charge VAT to their customers (as a rule transactions within a Member State) and those on which they do not (intra-Community transactions). By exploiting this loophole in the current system a taxable person is able to acquire goods without paying VAT in advance, and subsequently charge VAT on an internal delivery of the goods. That person then vanishes without paying the VAT owed to the treasury, while the purchaser of the goods claims his deduction.

Quite apart from loss of revenue, this distorts competition to the benefit of dishonest traders.

In the light of Member States' concerns about fraud, the Council set up an ad hoc group which agreed broadly, regarding VAT, with the conclusions set out in the Commission's third report on the application of Regulation No 218/92 on administrative cooperation in the field of VAT.¹⁹ On the strength of its conclusions, the Commission proposed, and the Council swiftly adopted, the new regulation concerning administrative cooperation on VAT (see point 2.4.).

More recently continuing concern has prompted further consideration of a substantial change in the way the VAT regime operates, and national authorities, industry representatives and academics are studying the possibilities.

¹⁹ COM(2000)28 final.

The various proposals, focusing on B2B transactions, all envisage a ban on combining transactions on which VAT is paid and those on which it is not, and aim to ensure that transactions inside a Member State and intra-Community transactions are accorded equal treatment throughout the EU .

Actual payment of VAT on all transactions in the EU

One possibility is to charge VAT on all transactions within the EU.

First of all we must point out that a VAT regime based on a single place of payment, as suggested by the Commission in 1996,²⁰ would eliminate the loopholes in the current system that allow carousel frauds. However, such a regime would require a far greater degree of harmonisation than currently exists.

Another suggested way of combating fraud is to switch to a system based on actual payment of VAT on all intra-Community transactions at the rate applying in the Member State of destination.

Suspensive arrangements

The other possibility is to stop charging VAT on B2B transactions within the Community.

One place where this has been discussed is Austria, where the authorities have been considering a system that allows traders to opt out of paying and deducting VAT on national transactions between taxable persons.

In Germany the authorities in some of the *Länder* have argued for the reverse charge mechanism to be applied more widely, perhaps up until sales to wholesalers or even until the retail sale to the end customer.

Such strategies undermine one of the basic principles of VAT, the cascade payment mechanism designed to ensure that the tax system is self-managing and clearly shares out responsibilities between buyer and seller.

They do admittedly offer certain advantages when it comes to combating carousel fraud, but they entail a considerable extra administrative burden for traders, since all domestic transactions then involve a check on the customer's status, which then has to be declared to the authorities. In any case such a system, where the entire burden of tax collection falls on the retailer, generates its own opportunities for fraud.

²⁰ Common system of VAT - working programme for the Single market (COM(1996)328 final of 22.7.1996).

Combating fraud under the existing system

There are in fact several ways of combating carousel fraud - which, it should be said, involves a relatively small number of traders.

The first is to improve administrative cooperation. The new legal framework coming into force on 1 January 2004 gives Member States the legal instruments to step up cooperation, and the Commission will be working with Member States to ensure that these instruments are used in an effective way.

Secondly, the Commission believes Member States could improve their controls by drawing on experience elsewhere in the EU, using risk analysis techniques, and giving the necessary staffing priority to this work.

SCAC has carried out an in-depth examination of carousel fraud and produced a guide giving an overview of various national enforcement techniques.

This is not a definitive list of recommended Community measures. What works in one Member State will not necessarily be effective elsewhere given differences in administrative structures and national rules.

Nevertheless, the Commission believes that intelligent use of such measures, tailored to the circumstances of a particular Member State, could substantially reduce the incidence of carousel fraud. A number of Member States have recently introduced national strategies targeting defaulting traders - a characteristic feature of carousel frauds - and seen a steady decline in the scale of losses detected.

Such measures can be refined and extended. Working closely with the Member States, the Commission will continue in the SCAC and under the Fiscalis programme to work intensively on this issue. It will shortly be submitting its fourth report on the application of Regulation No 218/92 concerning administrative cooperation on VAT, the bulk of which deals with carousel fraud.

5. CONCLUSION

Since the new strategy was initiated some three years ago, the Council has adopted nine proposals on VAT.

This suggests that the pragmatic approach has succeeded in one very important aim - giving fresh impetus to discussion of VAT within the Council.

But if the veto continues to apply after enlargement to decisions on tax matters this achievement will be under threat. Since work will be continuing under Article 93 of the Treaty the Member States will have to show even more flexibility in negotiations than they do now to keep things moving, especially as future activities will be dealing with a key aspect of the VAT system - the place of taxation.

The more widespread use of electronic communications between traders and the tax administration, and among the different national tax administrations, could make the VAT system simpler for businesses to operate while preserving or even enhancing control methods.

Introducing the one-stop shop would make it possible for traders established in the EU to handle all their declaration and payment obligations via their local administration, a valuable facility for traders carrying out taxable transactions involving liability for VAT in other Member States. It would also secure the principle of taxation at the place of consumption without imposing administrative burdens on EU traders that could jeopardise the working of the Single Market.

Taxation at destination, at the rate prevailing in the Member State of consumption, is not only conducive to the working of the Single Market but leaves the Member States free, up to a point, to set their own national VAT rates.

The Commission is continuing with its efforts to modernise the existing system and ensure that it is more uniformly applied. The proposal to give legal status to the proceedings of the VAT Committee, and the planned initiative to set up machinery for dealing with individual cases, should make it possible to deal with the double taxation cases which still arise; a situation which would be unthinkable in a genuine Single Market

It is hardly news to anyone that the current system has its defects and contains scope for fraud. Carousel fraud exploits loopholes that are inherent in the regime.

The Commission believes, nevertheless, that with increasing cooperation among Member States and backing from the Commission it should be possible to keep fraud within acceptable limits.

If, despite these efforts, carousel fraud takes on such proportions that it starts to affect the workings of the economy by distorting competition to an extent that is unacceptable for honest traders, then a debate must be launched at Community level on the future of the common system of VAT. The Commission must be prepared to engage in such a debate with an open mind.

ANNEX 1

Proposals before the Council when the launch of the new strategy was launched

Proposal	State of play in the Council
Change the status of the VAT Committee [COM(1997) 325]	No progress
Improve mutual assistance for the recovery of claims [COM(1998) 364]	Adopted as Council Directive 2001/44/EC of 15.6.2001 (OJ L 175, 28.6.2001)
Right to deduct VAT [COM(1998) 377]	Still being discussed in the Council
Determining the taxable person [COM(1998) 660]	Adopted as Directive 2000/65/EC of 17.10.2000 (OJ L 269, 21.10.2000)

Proposals presented after the launch of the new strategy (June 2000)

Proposal	State of play in the Council
Electronic services [COM(2000) 349]	Adopted as Directive 2002/38/CE and Regulation 792/2002 of 7.5.2002 (OJ L 128, 15.5.2002)
Setting the minimum normal rate of VAT [COM(2000) 537]	Adopted as Directive 2001/41/CE of 19.1.2001 (OJ L 22, 24.1.2001)
Invoicing [COM(2000) 650]	Adopted as Directive 2001/115/CE of 20.12.2001 (OJ L 15, 17.1.2002)
Administrative cooperation in the field of VAT [COM(2001) 294]	Adopted as Regulation xx/2003 of 7.10.2003 (not published yet)

Extension of the Fiscalis programme [COM(2002) 10]	Adopted as Decision 2235/2002/EC of the European Parliament and of the Council of 3.12.2002 (OJ L 341, 17.12.2002)
Special scheme for travel agencies [COM(2002) 64]	Still being discussed in the Council
Extending the scheme allowing Member States to apply reduced VAT to certain labour-intensive services [COM(2002) 525]	Adopted as Directive 2002/93/EC of 3.12.2002 (OJ L 331, 7.12.2002, amended 23.1.2003 (OJ L 18, 23.1.2003).
Place of supply of electricity and gas [COM(2002) 688]	Adopted as Directive 2003/XX/EC, 7.10.2003 (not published yet)
Postal services [COM(2003) 234]	Still being discussed in the Council
Procedure for adopting derogations and conferring implementing powers [COM(2003) 335]	Still being discussed in the Council
Scope of reduced rates [COM(2003) 397]	Still being discussed in the Council

ANNEX 2

Legislative proposals in the pipeline

Proposal	Scheduled date of presentation by the Commission
Place of taxation of services (B2B)	4th quarter 2003
Recast of Sixth Directive	4th quarter 2003
Rationalisation of derogations	2nd quarter 2004
Promotions and payment cards	2nd quarter 2004
Simplification of obligations (including review of place of taxation for goods and small business scheme)	3rd quarter 2004
Elimination of double taxation in individual cases	3rd quarter 2004
VAT regime for public authorities	4th quarter 2004
Place of taxation of services (B2C)	2005
Survey of various options, facilities and transitional provisions	2005
Taxation of financial services	2005
Revision of VIES	p.m.