



TAX EXECUTIVES INSTITUTE, INC.

2015-2016 OFFICERS

24 May 2016

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Ambassadors to the
Permanent Representations of all
EU Member States

JANICE L. LUCCHESI
Senior Vice President
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Via Email

ROBERT L. HOWREN
Secretary
BlueLinx Corporation
Atlanta, GA

Dear Ambassador,

JAMES P. SILVESTRI
Treasurer
Wood Ridge, NJ

**Re: Request by Member States to Extend the Current Sector
Specific Domestic Reverse Charge Mechanism to a
Generalised Domestic Reverse Charge Mechanism**

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Vice President, Region I
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Calgary, AB

GARY P. STEINBERG
Vice President, Region II
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Rochester, NY

As president of Tax Executives Institute (“TEI”), I write in response to the recent request from the Czech Republic and Austria for permission to introduce a pilot program implementing a generalised reverse charge mechanism. TEI acknowledges the existence and importance of the VAT gap and fraud schemes the proposed pilot is intended to address. However, TEI maintains a generalised reverse charge mechanism would not stem such fraud and instead would create opportunities for new types of fraud, further disharmonize the European Union’s (“EU”) VAT system, and add to the already onerous compliance costs and risks for legitimate businesses. TEI thus urges Member States to reject requests for a generalised domestic reverse charge mechanism and to instead develop alternate means to address VAT fraud and to direct efforts toward establishing a single EU VAT area, as outlined in the Communication from the European Commission (“Commission”) to the European Parliament, the Council and the European Economic and Social Committee on an *Action Plan on VAT (“Action Plan on VAT”)*.¹

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About Tax Executives Institute

Founded in 1944 to serve the professional needs of business tax professionals, TEI is the preeminent association of in-house tax professionals worldwide. TEI espouses organisational values and goals that include

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¹ Communication from the European Commission to the European Parliament, the Council and the European Economic and Social Committee on an *Action Plan on VAT - Towards a Single EU VAT Area - Time to Decide*. Brussels, 7.4.2016, COM(2016) 148 final.

ELI J. DICKER
Executive Director

W. PATRICK EVANS
Chief Tax Counsel

integrity, effectiveness, efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators.

TEI's approximately 7,000 professionals manage the tax affairs of over 2,800 companies across all industry sectors around the world. Many of these members' companies have a business presence and/or sell into all 28 EU Member States. TEI's members are accountants, lawyers, and other corporate and business employees responsible for the tax affairs of their employers in an executive, administrative, or managerial capacity, and continually monitor consumption tax developments around the world.

TEI believes it is critical to maintain a dialogue between businesses and revenue authorities when developing rules for VAT to ensure they are workable and not overly burdensome on businesses or tax authorities. It is also critical to protect the neutrality of the VAT system for cross-border transactions by ensuring supplies are not subject to double taxation or unintentional non-taxation.

Background

The EU VAT system is characterised by a series of cascading payments, with consumers paying VAT on purchases at each stage of the supply chain. Suppliers generally collect VAT on sales, and may offset those collections with VAT they paid on their own purchases of taxable supplies (subject to limitations). This mechanism is a key strength of the VAT system because it spreads the risk of potential VAT shortfalls along various levels in the supply chain.

EU VAT is administered using the destination principle, which allows goods to be exported free of tax and subjects imports to tax at the rate of local production. When it comes to EU cross-border sales of goods (goods delivered from one EU Member State to another EU Member State), the sales are zero-rated in the Member State of dispatch and subject to acquisition VAT in the Member State of arrival. For the collection of acquisition VAT in the Member States of arrival, Member States have employed a reverse charge mechanism to eliminate the need for overseas sellers to register and account for VAT in Member States in which they are not established. Under this acquisition VAT reverse charge mechanism, the customer acquiring the goods becomes liable for reporting the acquisition VAT and can claim the amount back as input VAT (within the limit of its VAT deduction right) on the same VAT return. Because the acquisition VAT is simply an accounting entry for the acquiring business, it eliminates the cash risk on the cross border sale. However, the acquisition VAT reverse charge mechanism, set up in the current transitional EU VAT system, has also created additional compliance burdens and costs for legitimate businesses, such as EC sales lists and Intrastat obligations, as Members States have implemented them differently.

Fraudsters have found various ways to exploit the VAT rules. "Missing trader" fraud occurs when, for example, a business acquires goods tax free from a supplier in another Member State,

applies the acquisition VAT reverse charge mechanism in its Member State (mere reporting, no cash flow), then collects VAT from its customer on the subsequent sale, and “disappears” without remitting the VAT to the government. “Carousel” fraud is a variant of missing trader fraud where the same goods are eventually exported tax free to original seller, with the cycle repeating several times.

Many Member States have thus introduced a “domestic” reverse charge mechanism to combat fraud on sales of goods and services commonly traded in missing trader or carousel frauds (such as computer chips, SIM cards, and emissions trading). Domestic reverse charge rules create even greater compliance burdens and costs for legitimate businesses because businesses must monitor to whom they are selling, what they are selling, and in what quantities (as smaller value sales are treated differently from larger value sales).

Unfortunately, “domestic” reverse charge requirements have not eliminated such fraud in such sectors because the rules do not tackle the root cause of such fraud. For example, many fraudsters regularly switch commodities or change Member States to avoid the reverse charge requirements, thus enabling them to continue to commit the fraud. As a result, reverse charge requirements do not successfully combat the basic problem while placing significant burdens on legitimate businesses.

Austria and the Czech Republic have recently requested permission from the European Commission to introduce a “generalised” reverse charge mechanism applying to supplies of all goods and services. Such a mechanism would fundamentally alter the administration of VAT in those countries by shifting responsibility for remitting VAT from the seller to the purchaser.

Comments

TEI has concerns about efforts to combat VAT fraud with a general domestic reverse charge system. First, TEI is concerned the introduction of a generalised domestic reverse charge would further fragment and disharmonize the current transitional EU VAT system. As mentioned earlier in this letter, VAT is designed to operate as a cascading tax with VAT flowing through the supply chain. This approach provides inherent protection of the revenue. A generalised domestic reverse charge would adversely impact this protection and tear asunder the very principles on which VAT is designed.

Second, the Commission has not assessed the risks and costs to businesses and other Member States from implementing such a pilot. Nor has it established any criteria to evaluate whether a pilot program is a success and, if not, the consequences arising from its failure (such as the risk and cost for businesses and tax authorities to change tax systems back and forth). TEI is particularly concerned about the prospect of Member States running different pilot programs without regard to what other Member States are doing, which will increase the compliance burdens of legitimate businesses even more.

Third, experience tells us that reverse charge mechanisms do little to stem the problem of VAT fraud. Legitimate businesses will always strive to comply with ever more complex and burdensome rules, while the dishonest businesses will merely find ways to circumvent the new rules and exploit weaknesses in the legislation, such as shifting to new products and services or moving to other Member States. Indeed, the more complex the rules, the greater the opportunity for dishonest parties to find loopholes.

TEI was privileged to participate in a very successful Fiscalis meeting of Member States organized by the Irish Finance Ministry in 2014. At that meeting, the parties discussed many promising alternatives to combat VAT fraud. TEI urges the Commission to further develop the alternatives raised at this Fiscalis meeting. TEI also maintains tax authorities should work together more closely and exchange information more readily, as fraudsters take advantage of tax authorities' reluctance to share information.

Fourth, generalised domestic reverse charge would remove the incentives for Member States to explore more pan-European approaches, such as re-examining how cross border supplies of goods within the EU should be taxed. As acknowledged by the Commission, the current VAT rules for supplies of goods between EU Member States are so burdensome that businesses find it easier to sell to non-EU businesses than to EU-based entities. This point was a key message from businesses who responded to the Commission's *Green Paper on the Future of VAT* in December 2010,² is the basis for the Commission's current efforts to explore possible change to the current rules for taxing cross border supplies of goods within the EU, and is the focus of the Commission's recently published *Action Plan on VAT*.³

The Commission's *Action Plan on VAT* foresees definitive rules for taxing cross border supplies of goods within the EU that would require vendors to charge the VAT of the destination country while supporting such vendors with a one-stop shop VAT registration scheme that would minimise administrative burdens for businesses. This direction is underlined by the Commission's belief that extending the use of the reverse charge to all transactions would do nothing to stem the tide of fraud. The current requests for a generalised reverse charge therefore run entirely counter to the proposed future treatment of cross border supplies of goods within the EU and risk slowing the Commission's efforts to explore a definitive destination-based regime. TEI maintains the Commission, Member States, and businesses should focus on that objective, which requires much work and in-depth analysis.

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² COM(2010) 695, Commission Staff Working Document SEC(2010) 1455, 1.12.2010

³ Communication from the European Commission to the European Parliament, the Council and the European Economic and Social Committee on an *Action Plan on VAT - Towards a Single EU VAT Area - Time to Decide*. Brussels, 7.4.2016, COM(2016) 148 final.

Extending the use of the domestic reverse charge to all transactions has been found to be a short-term solution to the problem at best. TEI thus urges Member States to reject requests for a generalized domestic reverse charge mechanism and to instead develop alternate means to address VAT fraud and direct efforts toward establishing a single EU VAT area.

TEI's comments were prepared by TEI's European Indirect Tax Committee, whose chair is Paula Regales. If you have any questions about TEI's comments, please contact Ms. Regales at +34 (91) 426-3557 or paula.regales@jci.com, or Pilar Mata of TEI's legal staff at +1 202 464-8346 or pmata@tei.org.

Respectfully submitted,
Tax Executives Institute



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International President

cc: Pierre Moscovici
Valdis Dombrovskis
Jean-Claude Juncker