TAX EXECUTIVES INSTITUTE, INC.

31 May 2011

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Via email: TAXUD-VAT-greenpaper@ec.europa.eu

Re: *Green Paper on the future of the VAT*

Dear Sir or Madam:

On 1 December 2010 the European Commission released a GREEN PAPER consultation titled *On the future of VAT: Towards a simpler, more robust and efficient VAT system.*[1] On behalf of Tax Executives Institute, I am pleased to respond to the consultation questions as well to provide the following summary of the Institute's high-level comments.

Background of Tax Executives Institute[2]

Tax Executives Institute (TEI) was founded in 1944 to serve the professional needs of business tax professionals. Today the organization has 54 chapters in North America, Europe, and Asia. As the preeminent association of business tax professionals worldwide, TEI has a significant interest in promoting sound tax policy, as well the fair and efficient administration of the tax laws, at all levels of government. Our 7,000 members represent 3,000 of the largest companies in the United States, Canada, Europe and Asia.

In 1999, TEI chartered a chapter in Europe (recently extended to include Europe, the Middle East, and Africa in an EMEA chapter), which today encompasses a cross-section of European, Middle Eastern, and African multinational companies. TEI 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. The Institute espouses organizational values and goals that include integrity, effectiveness and efficiency, and dedication to improving the tax system for the benefit of tax payers and tax administrators alike.

[1] COM (2010) 695 (1.12.2010).

[2] TEI's ID number for EU consultations is 52413445902-12.

The members of TEI generally work for large multinational businesses that operate in corporate groups with numerous VAT registration numbers in multiple countries and large volumes of transactions with third parties and related parties (intercompany transactions) managed by large Enterprise Resource Planning (ERP) information systems. The businesses generally (i) are audited by external accounting firms, (ii) possess strong internal controls in order to satisfy regulatory and legal requirements (such as the *Sarbanes Oxley Act* in the United States or the Senior Accounting Officer measure in the United Kingdom), and (iii) have a senior finance executive with oversight responsibility for financial, management, regulatory, and tax reporting. We believe the education, training, and experience of our members affords a balanced perspective on the issues raised by the consultation paper.

General Comments

The European Commission's consultation document raises fundamental questions about the current and prospective application of the European Union (EU) VAT regime. The purpose is to "address options for removing the differences in treatment between domestic and intra-EU transactions and to design a simpler and business-friendly VAT system while allocating revenue to the Member State of consumption, reducing administrative burdens for businesses and limiting collection costs and the scope for fraud."[3]

TEI commends the European Commission for initiating the consultation and is pleased to provide comments to ensure that the VAT system reflects the manner in which business is conducted across the EU and globally. Indeed, the development of the EU's consumption tax policy and administration should not take place in a vacuum. It is important that the European Commission consider the consumption tax policy and administrative developments elsewhere, including, for example, the work of the Organisation for Economic Co-operation and Development (OECD) under the auspices of Working Party 9 and its technical advisory groups.

As a general comment, we believe the current VAT system in the EU is unsatisfactory, principally because of the lack of standard application of the rules across Member States. While initiatives to improve the current VAT system are welcome, the benefits of any proposal will be fully realised only to the extent they are implemented uniformly and consistently by the Member States.

The questions raised in the GREEN PAPER can be grouped around several themes. In some cases, they address issues where revisions of current rules or practices could be implemented rapidly to achieve significant improvements in tax compliance and administration, including the questions relating to the proper interpretation of the current rules. In other cases, the GREEN PAPER asks broader, more fundamental, questions about the structure of the tax — the answers to which will have far-reaching consequences. For example, answers to the questions relating to the place of taxation (*i.e.*, origin vs. destination) will have significant consequences in terms of revenue, administration, and compliance. To provide stakeholders (and the Commission itself)

[3] COMMISSION STAFF WORKING DOCUMENT: Accompanying document to the GREEN PAPER *On the future of VAT Towards a simpler, more robust and efficient VAT system*, SEC (2010) 1455 (1.12.2010).

with a sense of priorities, the action items flowing from the consultation should be grouped into categories, taking into consideration the magnitude of costs and benefits of the changes and the timeline for implementation:

- "Quick wins," *i.e.*, initiatives that could be agreed upon and implemented in short order. Examples include prescribing legally enforceable guidelines for interpreting the rules consistently, sharing of best administrative practices by Member States, and a mandatory requirement to accord businesses a relief scheme for VAT on uncollectible bad debts.

- Medium-term actions, *i.e.*, initiatives where consultations with all stakeholders will be necessary to identify, develop, and implement the best solutions. As an example, the Commission should consider revising the rules on cross-border supplies of goods.

- Long-term projects, *i.e.*, initiatives that would entail fundamental changes to the VAT regime. An example would be providing an alternative means of collecting VAT.

We believe the three groups of activities can (and should) progress in parallel, albeit at different speeds. The larger policy questions will require significant consultation and debate, but they should not be left to the side. In other words, work should begin immediately on shaping the long-term future of VAT even though it may take several years of consultations to develop proposals for some areas. Moreover, some short- and medium-term revisions may have a significant effect on larger or long-term ambitions. For example, a successful rollout of the compliance and administrative models initiated in the United Kingdom and the Netherlands (including "horizontal monitoring" and "risk assessment") may affect how (or even whether) it is necessary or advisable — to change the way VAT is collected.

TEI also encourages the Commission to consider carefully the costs and benefits of changes, bearing in mind that major legislative and regulatory amendments require expensive and time-consuming revisions to information technology and recordkeeping systems for both businesses and the tax authorities. Hence, proposed changes should not go forward unless they offer clear and measurable benefits.

Finally, we encourage the Commission to work diligently to finalise the *2010 VAT Package*, including revisiting the implementing regulations to ensure that revisions that were not addressed in the first set of regulations, which are effective from 1 July 2011, are finalised; that a vouchers proposal is adopted by the Commission and negotiated by the European Council; that the 2015 changes for e-commerce are dealt with efficiently and with better guidance than earlier tranches. In addition there would be merit in generally revisiting the rules on invoicing, especially electronic invoicing, to standardise them across the EU by reference to Member State best practices.

Conclusion

TEI would welcome the opportunity to meet with the Commission staff to discuss our general comments and specific responses to the questions that follow. The comments were

prepared by TEI's European Indirect Tax Committee, whose 2011-2012 Chair is Siegert Slagman. If you have any questions about TEI's comments, please contact Mr. Slagman at +41 (58) 242 6513 (or Siegert.Slagman@pmi.com), or Jeffery P. Rasmussen of the Institute's legal staff at +1 202 638 5601 (or jrasmussen@tei.org).

Respectfully submitted,

Tax Executives Institute

Paul O'Connor
International President

Comments

of

Tax Executives Institute
ID # 52413445902-12

on

The European Commission's GREEN PAPER COM (2010) 695

On the future of VAT: Towards a simpler, more robust and efficient VAT system

Submitted

to

The European Commission

31 May 2011

Q1. Do you think that the current VAT arrangements for intra-EU trade are suitable enough for the single market or are they an obstacle to maximizing its benefits?

Prefatorily, while there is one Directive, there are 27 sets of Member State legislation and the arrangements for intra-EU trade set forth in the VAT Directive are not applied by all in the same fashion. Indeed, including the European Commission's views, there are potentially 28 different interpretations of the same rules and principles. Without standardised rules, consistently interpreted and applied, it is extremely challenging for businesses to comply.[1] Consequently, the complex system of rates, exemptions, derogations, and options accorded to Member States and the myriad special rules for cross-border transactions present an obstacle to the proper functioning of the single market.

Examples where inconsistent application of the VAT regulations among Member States present challenges are, as follows:

[1] In addition, the current VAT system, which was initially designed as a temporary solution, has become a playing field for fraudsters. Legitimate businesses suffer enormous VAT consequences and related reporting obligations because no effective means has been devised by the tax authorities for attacking and curbing VAT fraud.

- In chain transactions involving multiple companies located and operating in multiple Member States, the rules for determining which country's VAT regime should be applied to which transactions are challenging. Even the European Court of Justice has difficulty resolving complex chain transaction questions, as evidenced by its decisions in *EMAG*,[2] *Facet Trading BV* and *X*,[3] and *Euro Tyre Holding BV*.[4]

- Triangulation simplification regulations have been adopted in many Member States, but they are applied inconsistently. In some Member States the triangulation simplification rules can be applied when more than three parties are involved, but this is not the result in other Member States. In some Member States the triangulation simplification rules cannot be applied where the intermediate party (party B) has a VAT registration in the country of party C in the chain.

- Reporting requirements relating to invoices for incoming goods on intra-EU acquisitions compel the declaration to be made on the date the goods enter the country. Where a purchaser receives a late invoice from a supplier and reports the acquisition late, the purchaser faces late-reporting penalties.

- Some Member States provide simplification measures that permit non-established businesses holding a stock of goods in a Member State not to register locally for VAT. Such measures are helpful for businesses (and should remain in force), but since the rules are not harmonised they are difficult to track and implement in a large business operation. In addition, in some Member States the application of simplification arrangements are constrained by time limits.

- The process for validating VAT identification numbers varies across the EU. A standardised validation approach would be welcomed because it would enable automation of business processes.

- The VAT treatment of supplies with installation (Article 14(3) of the VAT Directive) is problematic. Some Member States treat a supply with installation as a supply of goods, but others treat the transaction as one of services. The inconsistency can result in double taxation or unintentional non-taxation when a supply with installation occurs cross border. Standardised rules on the treatment of a supply with installation would eliminate this problem.

In summary, the current VAT arrangements for intra-EU trade are an obstacle for multinational businesses that operate in multiple EU countries because there is considerable uncertainty about which countries' rules, exemptions, and VAT rates apply to many transactions.

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[2] *EMAG Handel Eder OHG,* C-245/04 (6 April 2006).

[3] *Facet Trading BV*, C-539/08 (22 April 2010); *.X,* C-536/08 (22 April 2010).

[4] *Euro Tyre Holding BV*, C-430/09 (16 December 2010).

The complexity of the rules and the exceptions imposes substantial recordkeeping and compliance costs on businesses.

Taking a broad view of the system as a whole, we believe that the origin-based system proposed by the European Commission in the 1990s has been largely overtaken by events. Specifically, the globalisation of trade; the principles agreed by the Organisation for Economic Co-operation and Development (OECD) at its 1998 conference in Ottawa in respect of e-commerce (*i.e.*, that consumption taxes should aim to tax in the country of consumption); the changes adopted by the European Union in the *2010 VAT Package* subjecting services to tax in the country of consumption; and experience with the special scheme for e-commerce for non-EU registrants collectively suggest that the EU VAT system should be overhauled and based on the destination principle. Indeed, to minimise double taxation or unintentional non-taxation it is critical to ensure that the EU VAT regime works with non-EU jurisdictions. To that end, TEI believes the best way to tax cross-border supplies of goods and services at origin would be to treat the EU as a single trading bloc (a true single market), but we recognise that the Member States are unlikely to take that step. Hence, the EU should abandon the origin system and adopting a destination-based system for cross-border supplies of goods and services.[5]

Of more immediate concern, a solution for cross-border chain transactions for goods delivered intra-EU is long overdue. Since the parties in a chain transaction are (until the final supply) generally taxable businesses, no "sticking VAT" should apply. Outside the EU, many countries zero-rate (or treat as out of scope) serial transactions in a chain as long as the goods are in transit. A similar arrangement should apply within the EU. Thus, the EU should recognise how businesses trade and not provide that only one zero-rated intra-community supply can apply to a cross-border supply movement.

Q2. If the latter, what would you consider the most suitable VAT arrangements for intra-EU supplies? In particular, do you think that taxation in the Member State of origin is still a relevant and achievable objective?

TEI believes that taxation in the country of the origin of a supply would be acceptable to businesses only if, regardless of which country's VAT is charged, the VAT for a cross-border supply could be recovered on the business's domestic VAT returns. This broad principle is in line with the single-market concept. In the absence of such a process, businesses would bear significant burdens, especially the loss of cash flow from delayed or even non-recovery of VAT. Given the current fiscal climate as well as the opportunities for abuse by fraudsters, we recognise that Member States are unlikely to embrace this concept in their administrative procedures. Hence, we recommend that the European Commission abandon its long-held position on taxing supplies of goods under the origin principle.

Another option would be to apply a zero rate or an exemption with a right of input tax deduction to tax transactions between taxable persons in domestic and EU cross-border transactions. We believe this option is in line with the EU's *Europe 2020 Strategy*. Such an

[5] For services, a destination-based system has effectively been in place since 2010.

approach would decrease the possibility of VAT fraud and make the VAT system less complex. Because of the burden of proof that would be placed on both suppliers and purchasers, the Commission would have to prescribe very clear rules to minimise uncertainty and protect against Member States imposing disproportionate documentation requirements on business. Transactions with delivery to end consumers would not change and would still be subject to tax in the country where the supply of goods takes place physically. This option aligns with the destination principle and with the aim of imposing the VAT at the place of consumption. In addition, since the rules for determining the place of taxation for a cross-border supply of services between taxable persons have been aligned with the destination principle, it would be incongruous for a different principle to govern the supply of goods.

A specific feature of this system would be to tax the supply of goods to a taxable person in the EU in the country where the recipient is located with a complementary mandatory reverse-charge mechanism in the country of the recipient. This option would minimise the administrative obligations for businesses. Since this would only apply to business-to-business (B2B) transactions, it would also achieve final taxation in the country of consumption by the consumer.

In summary, the keys to an efficient VAT regime are to increase standardisation and harmonisation and to minimise cash-flow disadvantages that businesses incur. Variations in the Member States' transpositions of the rules as well as subsequent interpretations create challenges in application and administration, increasing the risks of double taxation and unintentional non-taxation.

Q3. Do you think that the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality, and if not, why not?

In principle, every person, legal entity, or public authority conducting "business" activities should be able to register for VAT. Consequently, they should also have the right of deduction of input VAT. With respect to holding companies, the many court decisions on the applicability of the VAT rules have made a complex body of law even more confusing and challenging to understand and comply with.

Q4. What other problems have you encountered in relation to the scope of VAT?

The VAT Directive contains many optional provisions that Member States may implement. The so-called may provisions create difficulties for businesses that operate in multiple EU countries because different rules can apply to the same or similar transactions. Examples are, as follows:

- A provision in Article 19 of the Directive states that Member States may consider that no supply of goods takes place in the event of a transfer or contribution of a totality of assets or part thereof. Some Member States apply this "no supply" rule, but others do not. Where such a transaction takes place cross border within the EU, it is very

difficult to comply where one jurisdiction applies the "no supply" rule but another treats the transaction in a different fashion.

- Pursuant to Articles 160 and 161 of the Directive, Member States may exempt certain supplies of goods and services connected with certain customs procedures (*e.g.*, a supply of goods placed in temporary storage or intended to be placed in a free trade zone). This can lead to undesired results where, for example, an intra-EU supply of goods under a customs procedure such as T1 from one country is within the scope of VAT but the acquisition of that same good in another Member State is not considered an intra-EU acquisition.

- Few Member States currently permit domestic VAT grouping options and none permit grouping of businesses from different countries (*i.e.*, a pan-European VAT grouping). The requirements for a domestic VAT grouping scheme also differ among the Member States. Businesses would welcome (i) standardisation of VAT grouping rules based on current best practices (such as the grouping rules adopted in the United Kingdom, the Netherlands, and Germany), (ii) an obligation for Member States to offer domestic VAT grouping, and (iii) the availability of an option for a pan-EU VAT group.

- Some Member States have implemented a single stage VAT system for excisable goods, whereas other Member States apply the regular multistage VAT system to such products. Standardisation of the VAT levy mechanism would be welcome, with a single stage VAT system as the preferred norm.

- Some, but not all, Member States afford relief for VAT on uncollected bad debts. Those that do provide such relief often impose onerous conditions for obtaining it. In some countries, the debtor must be classified as insolvent before the creditor can claim the VAT back; in other jurisdictions, the person seeking bad-debt relief must show that it has initiated court proceedings to collect the debt before claiming back the VAT. In slow economic times, the recovery of VAT on bad debts may be a lifeline for a struggling business. An alternative, moving to cash-basis accounting for VAT as discussed in the GREEN PAPER, would obviate bad debt relief schemes since the VAT would not be paid to the taxing authority until it was collected from the customer.

- Some countries apply local reverse-charge mechanisms for a domestic supply of goods made by a non-established company. Where a country applies a local reverse-charge mechanism to such supplies and delays the processing of VAT refunds, a non-established company will bear a significant competitive disadvantage. This constitutes a barrier to trade.

- The treatment of warranty services for VAT purposes is inconsistent within the EU. Some Member States view a payment for warranty services as compensation outside the scope of VAT, whereas others treat it as taxable.

- The regulations for VAT rate transitions should be standardised.

- The inconsistent interpretation of the following Articles in the VAT Directive results in confusing and disparate treatment around the EU:

  - Article 12 and 14 in respect of transactions related to immovable property.
  - Article 59a in respect of the effective use and enjoyment of certain services.
  - Article 66 in respect of the date when VAT becomes chargeable and deductible.
  - Article 199 in respect of the person liable for payment on the sale of scrap and recycling material.
  - Article 146 in respect of exemptions for exports where the VAT treatment differs depending on whether the buyer is or is not established in the country of departure.
  - Article 135 in respect of the interpretation of the exemptions for financial services.

Q5. What should be done to overcome these problems?

For businesses operating throughout Europe, it would be beneficial if all Member States were obliged to follow a standardised set of rules across the EU. The so-called may provisions in the VAT Directive should be eliminated or their number reduced to an absolute minimum. In addition, information reporting and documentation requirements should be standardised insofar as possible. For example, the implementation of a single, uniform VAT declaration (as described in paragraph 9.7 of the *Commission Staff Working Document accompanying the Green Paper on the future of VAT* (hereinafter the Commission Staff document))[6] for all Member States would be beneficial as long as the information reporting and documentation obligations were streamlined and not based on the jurisdiction with the most stringent documentation requirements or the most elaborate information reporting obligations.[7] In other words, a standardised return form should contain the fewest number of information requirements as possible.

In addition, we believe that publication of legally binding interpretations of the rules would facilitate compliance by taxpayers and administration by tax authorities. Examples of where legally binding EU-wide interpretations or definitions would be helpful include:

- Immovable property.
- Consignment stock.
- Means of transport.

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[6] COMMISSION STAFF WORKING DOCUMENT: Accompanying document to the GREEN PAPER On the future of VAT Towards a simpler, more robust and efficient VAT system, SEC (2010) 1455 (1.12.2010).

[7] Paragraph 9.6 of the Commission Staff document refers to this approach as establishing "a maximum list of standardised obligations in Article 273." TEI supports a pre-defined list of information obligations as long as each of the requirements is scrutinised for its costs and benefits and the list is not based on an aggregation of the requirements of every Member State or even necessarily of a majority of the Member States.

- Operational lease.
- Financial lease.
- Entertainment.

Q6. Which of the current VAT exemptions should no longer be kept? Please explain why you consider them problematic. Are there any exemptions which should be kept and, if so, why?

VAT exemptions should be standardised. Accordingly, the optional exemption provisions should be eliminated (*e.g.*, the exemptions in Chapter 10 of Title IX of the VAT Directive) or reduced to as few in number as possible.

Q9. What do you consider to be the main problems with the right of deduction?

Current rules limit the right of deduction of input VAT to purchases made for a business purpose, *i.e.*, generating business income. Where business assets or resources are converted to personal use, the current rules already require a VAT charge be self-assessed for such use. Because internal controls will prevent the diversion of assets or resources to personal use, managers of large businesses should be free to exercise their judgment about the best means to increase revenues, reduce costs, or improve productivity without tax authorities imposing restrictions on input tax deductions by second guessing whether a particular expenditure has a legitimate "business purpose."

In addition, many regulations affect the right to deduct input VAT. Regrettably, the regulations are not harmonised throughout the EU, making it difficult for multinational businesses to operate efficiently. This is especially true where a company with multiple EU affiliates uses a shared-service-centre business model or a single enterprise resource planning (ERP) information reporting system to manage its pan-European activities.

Specific examples where tax authorities unduly restrict the right of deduction of input VAT include the following:

- To exercise the right to deduct input VAT, a taxable person must hold an invoice drawn in accordance with the invoicing requirements in Article 178(a) of Directive 2006/112. The invoicing requirements in Article 226, however, can vary from one country to another. Consequently, businesses must understand and adhere to the specific — and often highly formalistic — invoicing requirements in each Member State to ensure that the VAT is refundable and that a claim for deduction is not rejected because of a minor, immaterial invoicing mistake.

- Where input VAT exceeds output tax, it can take years for a business to recover the excess VAT regardless of whether the company is a domestic or a non-established company. Delays in processing legitimate business refund claims adversely affect cash flow and may threaten the viability of a business.

As a general matter, tax administrations should not place undue weight on formalistic invoicing requirements when auditing the right of input VAT deduction. Invoices are only one form of documentary evidence and invoices that do not satisfy a formal invoicing requirement but are otherwise supported by valid business documents, such as contracts, purchase orders, or transport documents, should not result in disallowance of an input VAT deduction. Moreover, electronic invoices should be accorded the same weight as paper invoices when evaluating the right to input tax deductions.

Q10. What changes would you like to see to improve the neutrality and fairness of the rules on deduction of input VAT?

There are three areas where a better alignment and harmonisation of the rules would improve the neutrality and fairness of the rules governing the deduction of input VAT: invoicing requirements, limitations or restrictions on input VAT deduction, and the time period in which refund claims are processed and paid.

As a first principle, input VAT should always be deductible for taxable business expenditures. Where there is an element of private consumption or personal use, the regulations already require a business to charge output tax. Only for limited expenses and in limited situations (*e.g.*, where the taxpayer is not registered in the Member State) *and* for which a private consumption or personal use is made, should the input VAT deduction be disallowed. Restrictions on input VAT deduction should be standardised across the EU.

We also believe that standardisation of the invoice requirements is critically important. Specifically, *regulations* (rather than a Directive) should be issued governing the invoice requirements to ensure that tax authorities do not restrict input tax deductions because of immaterial mistakes on an invoice.

In addition, Member States should be required to apply uniformly the regulations concerning the reimbursement of excess input VAT set forth in Article 183 of Directive 2006/112. The inconsistency in administration by the Member States imposes significant burdens in terms of satisfying myriad procedural requirements and in cash flow from delays in processing the claims.

Member States should also be required to comply with the regulations in Article 171 of the Directive 2006/112 concerning the time for refund of VAT to taxable persons that are not established in one Member State but are established in another Member State. Even though the European Court of Justice has repeatedly upheld the right of non-established businesses to obtain timely refunds of VAT, Member States continue to delay the processing of such claims. The Commission should rigorously enforce the time limits because they are essential to ensuring the neutrality of the VAT system.

Q11. What are the main problems with the current VAT rules for international services, in terms of competition and tax neutrality or other factors?

The rules for applying VAT to cross-border services were significantly revised and simplified with the implementation of the *2010 VAT Package*. Business taxpayers welcome that initiative. Indeed, the package can serve as a model for further simplification and harmonisation of the VAT system.

Despite the changes in that legislation, the application of VAT to cross-border services remains challenging in the following areas:

- Inconsistent application by Member States of the "Use and Enjoyment" provisions.
- Different interpretations of the term "services connected with real estate."
- Different treatment of cross-border leasing (as illustrated by the recently decided *RBS* decision[8]) and bundled supplies.
- Lack of clarity in the place of supply rules about what should be treated as an admission to educational events.

In addition, some Member States still impose excessively stringent documentation requirements for cross-border services. For example, some Member States require evidence of the business status of customers when they are not located in the EU. Since many non-EU customers will be unable to provide a valid VAT identification number, such a requirement effectively renders compliance impossible. (This concern may diminish when the implementing regulation for the *2010 VAT Package* comes into force.) We recommend that the Commission review the efficacy of the *2010 VAT Package* approximately 18 months after the implementing regulation comes into force; if difficulties persist, a fresh proposal to clarify troublesome areas should be developed.

Q12. What should be done to overcome these problems? Do you think that more coordination is needed at [the] international level?

A. To assist taxpayers in determining when and where services are subject to VAT, the term "effective use and enjoyment" should be clarified. Some Member States interpret the term literally, *i.e.*, they impose tax based on where the services are used and enjoyed, especially when the service is supplied within their territory. Other Member States look to the location of the customer. In the latter case, the customer's location is often determined by the customer's place of residence, but sometimes location is determined by reference to the customer's VAT registration number regardless of where the services are actually consumed.

[8] *RBS Deutschland Holding GmbH*, C-277/09 (22 December 2010).

The inconsistency in Member State interpretations leads to confusion for business and inadvertent noncompliance. As important, the inconsistency imposes considerable burdens on business when programming their ERP information systems. For pan-European service providers, the inconsistent rules lead to enormous challenges in programming an automated system to capture numerous locations where the service might be performed or deemed performed. The information to be captured and reported for any particular service depends on the country from which the services are sold or supplied, the location of the customer, and, in some cases, either the nature of the services or the extent to which the service provider knows where the recipient will actually use the services. Thus, regulations limiting the application of the "effective use and enjoyment" rules to certain categories of services or service recipients would be helpful.

Businesses expend disproportionate efforts today to ensure that restrictions on input tax deductions do not result in unnecessary costs. In a global economy, businesses need the flexibility to implement contracts for services on a global basis, but VAT restrictions within and outside the EU often hinder efficient contracting practices. Tax authorities should recognize that for direct tax purposes, there will always be an economic driver, including, for example, an obligation to comply with transfer-pricing rules, to charge out costs incurred in one country to another where the benefit is incurred in the other country. By applying first principles, each transaction in a chain would have its own VAT attributes and VAT would ultimately apply at the appropriate stage. The courts have concluded that, for consumption tax purposes, one does not "look through" the transactions. The VAT system should be based on this principle even where the tax authority may have to wait slightly longer for the tax payment.

B. More broadly, greater international coordination to promote common principles in the taxation of goods and services would be beneficial in minimising double taxation or unintentional non-taxation. Currently, the OECD, the World Trade Organization, and World Customs Organization all provide guidelines or negotiate global agreements to promote harmonisation of the rules governing global trade.[9] The OECD is currently developing global guidelines to promote VAT neutrality in the more than 150 countries that currently impose a VAT. We commend the OECD's work to the Commission. By working with the OECD in adapting the EU's VAT regime to meet the challenges of the 21st Century, the European Union would demonstrate again that it is a leader in the development of worldwide consumption tax policy and administration.

[9] Regrettably, none of the organisations has an efficient method of ensuring that Member States adhere to their guidelines or global commitments. Compliance with OECD guidelines, for example, is generally voluntary, with individual countries having a right to make reservations or objections to model treaty provisions or to interpret the transfer-pricing guidelines in a different fashion. Members of the WTO or WCO that suspect others of engaging in practices violating global agreements must challenge the other country in time-consuming litigation. Similarly, experience in the EU confirms that obtaining agreement among 27 countries is challenging. Where EU Member States fail to adhere to the VAT Directive or regulations, an infringement action can be instituted, but this rarely provides a prompt solution to the practical problems that businesses face.

Q13. Which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?

Paragraph 5.2.1. of the GREEN PAPER explains that

> Council directives give Member States some freedom in transposing EU VAT law into their national legislation, taking account of their legal particularities. The outcome, however, is often that VAT legislation in the different Member States is inconsistent. Using Council regulations rather than directives would achieve greater harmonisation, enabling in particular the EU to avoid double or non-taxation or to set out the VAT obligations of non-established businesses.

To achieve the goal of a single market within the EU, it is paramount that VAT rules be clear and consistently applied across the EU. Since Council regulations have a direct legal effect, Member States are not required to transpose them into domestic legislation and, consequently, can make no changes. The uniformity is beneficial for businesses operating in multiple countries. Hence, TEI prefers Council regulations over Directives.

Q14. Do you consider that implementing rules should be laid down in a Commission decision?

We believe that the implementing rules should be based on Council regulations rather than Commission decisions. The Commission should concentrate on ensuring that regulations are adopted as efficiently as possible and that the guidance provided is comprehensive and workable.

Q15. If this is not achievable, might guidance on new EU VAT legislation be useful even if it is not legally binding on the Member States? Do you see any disadvantages to issuing such guidance?

Nonbinding guidelines on new VAT legislation would generally be better than no guidance since taxpayers would have an indication of how the rules should be interpreted. In addition, the European Court of Justice should be encouraged to take nonbinding guidelines, which often provide important explanatory background about new legislation, into consideration when deciding cases.

Q16. More broadly, what should be done to improve the legislative process, its transparency and the role of stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?

In any VAT system, businesses are responsible for charging, collecting, and remitting tax and thus are effectively "partners" with tax authorities in ensuring revenues are properly collected. We believe that greater consultation with the business community would be helpful since company tax officials are in a position to provide lawmakers with insight on the practical administrative and compliance challenges proposed rules might engender. In the current process, businesses are unable to monitor how proposals are being developed in Commission

deliberations or negotiated and thus unable to provide timely and effective advice. If texts of proposals were shared publicly, businesses could draw attention to impractical or unworkable proposals and offer potential solutions before negotiating positions become entrenched.

In addition, where legislative proposals will make significant changes to the VAT regime, the legislation should clearly prescribe three dates: the date of adoption, the date by which the Member States are required to transpose the legislation into domestic law; and the date at which the overall legislation takes effect. Businesses — and the software vendors and consultants for the ERP systems that most businesses use — need substantial lead time (often six months to a year) to revise, test, and implement significant changes to information systems. Without a clear understanding of local requirements (*i.e.*, the options and derogations adopted by each Member State), businesses are unable to make the final system changes necessary to comply in each jurisdiction.

Q17. Have you encountered difficulties as a result of derogations granted to Member States? Please describe these difficulties.

Member States may seek derogations in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance by means of specific measures. Derogations are intended to be temporary and tailored to a particular domestic situation. Regrettably, many of the current derogations were grandfathered into the system on 1 January 1978 under Article 394 of the VAT Directive or were tacitly approved under the previous derogation procedure without review. Finally, as noted in paragraph 7.3.2 of the Commission Staff document, the number of requests for derogations is increasing.

By their nature, derogations affect the common VAT system and diminish the efficiency of the single market that the Commission seeks to promote. The increasing number of derogations, moreover, contributes to an even more fragmented VAT system. Although derogations afford flexibility to Member States to adopt national approaches in specific administrative or policy areas, the resulting diversity of rules spawns substantial complexity and imposes significant burdens for businesses. The often temporary nature of derogations also undermines the stability of the tax system, creates legal uncertainty, and increases costs for taxable businesses that must revise their systems when derogations are approved and then expire.

One example where the diversity of rules imposes excessive business costs is in the application of domestic reverse charge or non-resident VAT rules. Germany, for example, refuses to permit a company resident in Germany to apply a reverse charge on a movement of goods from a related non-resident company into Germany where the German company subsequently makes a domestic sale of the goods. Instead, to reduce fraud, the non-resident affiliate is required to follow the cross-border sale rules.

Other examples include:

- Derogations relating to reverse charges for construction services (because of conflicting Member State rules about the scope and definition a "construction service").

- Derogations relating to reverse charges for specific goods (*e.g.*, sales of mobile phones in the UK).

As noted in paragraph 5.2.2 of the GREEN PAPER, "the patchwork of particular and changing rules [that derogations afford to Member States] adds to the complexity of the VAT system, especially for businesses operating in more than one Member State, and undermines the notion of a level playing field for EU businesses." We recommend circumscribing the number of approved derogations.

Q18. Do you think that the current procedure for granting individual derogations is satisfactory and, if not, how could it be improved?

As noted in paragraph 7.3.2 of the Commission Staff document, "derogation requests are not subject to an impact assessment by the Member States and often have no ex post evaluation." TEI encourages the Commission to require that Member States submit an impact assessment in connection with every application for a derogation. Moreover, before approving an application for a derogation, the Commission should canvass business for its views on the effect of the proposal in order to ensure that the measures are proportionate and not overly burdensome.

More broadly, TEI encourages the Commission to evaluate existing derogations to assess whether they are necessary, effective, and proportionate.

Q19. Do you think that the current rates structure creates major obstacles for the smooth functioning of the single market (distortion of competition), unequal treatment of comparable products, notably online services by comparison with products or services providing similar content or leads to major compliance costs for businesses? If yes, in what situations?

The basic rules for VAT rates set out in the Directive are simple. Articles 96 and 97 require Member States to apply a standard rate of at least 15 percent. In addition, Articles 98 and 99 stipulate that Member States may apply one or two reduced rates of not less than 5 percent to a restricted list of goods and services eligible for a reduced VAT rate. The Commission Staff document notes that this rate structure is regrettably complicated by multiple derogations (zero rates, super-reduced rates, individual reduced rates, parking rates, *etc.*).

TEI supports moving away from the current origin-based VAT system and toward a destination-based VAT. By adopting a destination-based VAT system, the rate structure would either be less of a factor or a nonfactor in distorting competition because the customer would pay the same VAT rate regardless of where the supplier is based or registered.

The GREEN PAPER notes inconsistencies in the VAT rates applied to comparable products or services. Specifically, Member States may apply a reduced VAT rate to certain cultural

products (such as books) and services, but must apply the standard rate to competing online services such as electronic books and newspapers. TEI believes the discriminatory taxation of goods or services, *i.e.*, the application of a different VAT rate depending on the means of delivery (*e.g.*, digital vs. physical), should be eliminated.

Q20. Would you prefer to have no reduced rates (or a very short list), which might enable Member States to apply a lower standard VAT rate? Or would you support a compulsory and uniformly applied reduced VAT rates list in the EU notably in order to address specific policy objectives as laid out in particular in 'Europe 2020'?

TEI supports reducing the number of products and services eligible for reduced rates. Eliminating the diversity of rates that can be applied by Member States would make it easier for taxable persons to determine the VAT rate to be applied to a particular transaction since, in many, if not most cases, the regular VAT rate would apply. In addition, reducing the number of products and services eligible for reduced rates would broaden the VAT base. The reduced rate should apply for basic human needs (*e.g.*, food, clothing, and health-related goods or services).

Q21. What are the main problems you have experienced with the current rules on VAT obligations?

The main problems encountered by businesses in satisfying VAT obligations have been addressed throughout TEI's responses. In summary, businesses operating in multiple Member States must apply for multiple VAT registrations and comply with the attendant reporting obligations (filing of periodic VAT returns, Sales and Purchase Listings, and Intrastat-related filings). In addition to the compliance burdens connected with a foreign VAT registration, information technology (IT) systems must be programmed to handle myriad transactions. Thus, compliance and IT costs are significant.

For multinational businesses that manage their businesses through a single ERP system, the diversity of legal requirements — whether in the Member States' transposition of VAT Directives into domestic law or in the derogations — present significant challenges since every rule, exception, rate, and mode of delivery (whether domestic or cross-border, digital or physical) must be addressed. Standardised rules with streamlined reporting obligations would simplify the programming and compliance challenges considerably. TEI would also welcome elimination of redundant reporting requirements, such as the requirement to file annual VAT declarations in addition to monthly (or quarterly) VAT returns. The goal of streamlined reporting should be to report individual pieces of information only once.

Moreover, TEI welcomes further standardisation and streamlining of the rules governing electronic invoicing and archiving. Even after the proposed changes in the regulations take effect on 1 January 2013, Member States will have considerable latitude to adopt different interpretations of the rules. We believe the guiding principle should be the equal treatment of paper and electronic invoices while encouraging enterprises to use electronic invoicing. Thus, TEI encourages the Commission to develop a proposal to eliminate requirements imposed on electronic invoicing and archiving that hinder the implementation of these technologies and

prevent the realisation of significant cost savings by business taxpayers. In every case, the equal treatment of paper and e-invoices should not lead to requirements for paper invoices that are more burdensome than the current rules.

Companies engaged in intra-EU trade are required to file myriad reports with Member States. In some Member States, businesses must, in addition to their VAT returns, file European Sales and Purchase Listings and Statistical filings relating to Intrastat. Providing documentation of proof of export or proof for zero rating intra-community supplies is extremely burdensome in some Member States. As noted in the discussion of recommendation 8 in paragraph 9.2 of the Commission Staff document, export documentation could be reduced to the export document drawn up for customs purposes. TEI encourages the Commission to propose legislation to adopt that recommendation.

Businesses understand that documentation and reporting obligations are necessary to permit the Member States to administer the tax system. Reporting obligations, however, should be minimised to require only the information necessary to administer the regime effectively. Where a Member State believes that a derogation is necessary to combat fraud and the derogation imposes additional reporting obligations on taxable persons, TEI believes the Member State should bear the burden of establishing that the benefits outweigh the costs.

Finally, many Member States require businesses to reconcile all sales reported on the Intrastat, EC Sales and Purchase listings, and VAT returns. Given the variation in the transactions included for each report, the reconciliation is extremely time-consuming. TEI would welcome elimination of the requirement to reconcile the various declarations and reports.

Q22. What should be done at EU level to overcome these problems?

Paragraph 5.3.1 of the GREEN PAPER states

> The VAT Directive includes a common set of obligations and Member States have some freedom in deciding how to meet them. This leads to a patchwork of national VAT obligations and, in particular, VAT returns which require different types and volume of information. Devising a standard EU VAT return available in all languages, which businesses could opt to use but which all Member States would have to accept, could be a way forward to reduce compliance costs.

As noted in response to Question 5, TEI supports the standardisation and streamlining of compliance obligations across the EU as possible based on the best practices of Member States. As important, the rules should not be based on the most stringent requirements that Member States might impose. For example, a single, common VAT return form (or template) could be employed by all Member States as long as the reporting requirements for that return were proportionate, requiring only what is needed to ensure that the proper amount of tax is collected and remitted at the proper time.

In addition, invoice requirements should be harmonised and additional local invoicing requirements should not be permitted. Similarly, electronic invoicing and archiving regulations should be updated and standardised to take advantage of the efficiency of such technology. Again the requirements should be proportionate — required information should be limited to that necessary for ensuring compliance and should be based on the best practices among the Member States.

Redundant filings should also be eliminated in order to decrease compliance costs. For example, an annual VAT return merely recapitulates information reported on monthly (or quarterly) VAT returns and should not be required.

Finally, we encourage the EU to consider adopting "trusted taxpayer" arrangements such as the horizontal monitoring technique employed in the Netherlands. Such arrangements afford businesses an exemption from the considerable administrative burdens that have been imposed on compliant businesses by legislation aimed at curbing abuses and fraud.

Q23. What are your views particularly on the feasibility and relevance of the suggested measures including those set out in the reduction plan for VAT (N° 6 to 15) and in the opinion of the High Level Group?

To improve the competitiveness of EU businesses in global markets, the Commission established a High Level Group of Independent Stakeholders (hereinafter the HLG) to advise the Commission on ways to make the EU's regulatory environment simpler, more understandable, effective, and enforceable. The HLG made 16 recommendations in the VAT area, with recommendations 1 to 5 and 16 already adopted or proposed for adoption.

TEI welcomes the proposed regulatory changes for electronic invoicing, but they regrettably fall short of (i) standardising invoicing requirements across the EU and (ii) reflecting current business practices. To reduce costs, many companies employ a shared service centre where all invoicing, accounts receivable, cash, and often tax reporting are managed. Hence, the business records for all or a significant portion of a company's European business are often stored in one location rather than in all the jurisdictions where it does business. Greater standardisation of electronic invoicing requirements would be welcomed by pan-European businesses.

The HLG recommends adopting a number of simplification measures including a one stop shop for tax administration and increasing the threshold amounts relating to the special schemes for Small and Medium Enterprises (SMEs) and distance sellers. Raising the thresholds for SMEs engaged in distance selling would significantly reduce burdens on start-up enterprises. Currently the threshold in some countries is as low as 30,000 Euro, which does not afford new ventures room to grow. TEI encourages the Commission to review the distance selling thresholds. By coupling an increase in the thresholds with an easy to operate one stop shop for administration, the burdens on SMEs would be significantly reduced.

The HLG made several recommendations to improve the recovery of VAT where taxable persons incur VAT in connection with their business activities in a Member State in which they do not make supplies of goods or services. A new fully electronic procedure was implemented 1 January 2010, with the goal of providing EU businesses with quicker and more efficient processing of refund claims. Regrettably, the changes are not delivering the anticipated results. Hence, TEI urges the Commission to revisit this legislation with a view to further simplification. Concededly, a transition period in the implementation of the refund procedure is to be expected, but anecdotal evidence from businesses suggests that Member States are still not issuing refunds expeditiously. In a recent example, a claim for refund of overseas VAT was rejected, but the taxpayer was not informed of the reason for the delay on a timely basis.[10] Where a business hears nothing in respect of a refund claim within four months, it must file an appeal. TEI urges the Commission to explore the possibility of revising the procedures to place the onus on the Member States to reject a refund claim within four months of its receipt; if the claim is not rejected in a timely fashion, it should be deemed accepted. Alternatively, the Commission should consider establishing a procedure (or a moderator) to handle complaints about untimely processing of refund claims.

Next, the changes to the rules on place of supply of services recommended by the HLG are broadly welcome, as is the agreement by the Member States to an interpreting implementing regulation. It would have been helpful, however, had the regulation been agreed in time to permit effective operation of the rules from the date they came into force rather than 18 months later. Although businesses understand the Member States' need to audit effectively, the information on the European Sales Listing declaration is costly to produce and it is unclear how the tax authorities will make use of the information to control the tax.

The VAT Directive permits Member States to require that taxable persons submit a list of acquisitions of goods or transactions from sellers established in other Member States. In recommendation 9, the HLG proposes abolishing the intra-EU acquisition list. TEI agrees that the requirement for reporting intra-community acquisition listings is redundant because tax authorities can obtain the information through other means such as the VAT Information Exchange System. Eliminating this burden in the countries that require it would be a welcome improvement.

The Directive also requires taxable persons to file lists of all supplies made to taxable persons in other Member States. Member States may require taxable persons to submit such reports even in periods where no sales take place. The HLG recommends (recommendation 10) abolishing the requirement to submit nil intra EU listings. TEI concurs with the recommendation. Nil sales activity can easily be confirmed by taxing authorities during VAT inspections.

In recommendation 13, the HLG encourages tax authorities to increase the use of "e-government solutions," including electronic filing of returns. For many large businesses, e-filing and other forms of electronic interaction would facilitate communication and compliance, but the

[10] Upon inquiry, the claimant determined that the claimant's tax authorities had rejected the claim rather than the Member State responsible for paying the claim.

option for paper returns should be retained for SMEs. Indeed, before the Commission or Member States mandate e-filing, the costs and benefits should be studied. Eliminating the option to file paper returns before businesses have readily available, low-cost e-filing solutions would be counterproductive.

The HLG recommends (recommendation 7) reducing the frequency of periodic VAT returns. Although we neither oppose nor support the recommendation, we question whether setting out in the VAT Directive the frequency with which VAT returns must be made is a significant improvement. The requirement imposed in some countries to resubmit a VAT return in its entirety where mistakes are made, however, should be revised. Specifically, TEI would welcome EU-level rules that would permit taxable persons to submit amendments to their returns rather than resubmitting the entire return. In a recent example, the effect of a ruling was to require a business to resubmit every VAT return for the last five years (or 60 returns).

Q27. Do you see the one stop shop concept as a relevant simplification measure? If so, what features should it have?

As explained in paragraph 11.1 of the Commission Staff document, a one stop shop would permit taxable persons with activities and transactions in multiple Member States to satisfy all VAT obligations for those transactions in a single Member State. All administrative obligations could thus be addressed with and through one Member State, but the transactions would be taxed according to the rules (*e.g.*, rates, exemptions, and deductions) of the Member State where the transaction is taxable for VAT purposes.

As a preliminary matter, the one stop shop concept is consistent with principles introduced by the Modernized Customs Code (MCC), such as the introduction of the Single European Authorization and Centralized Clearance process. The Commission should review the public consultations on the MCC to ascertain the VAT changes that were recommended in connection with the implementation of the MCC.

TEI believes a one stop shop could offer an important simplification and reduction of current burdens and complexity. A well-functioning one stop shop is also an essential element of an effective destination-based VAT system. The system must to be easy to use to ensure that the burden on business (suppliers) is not increased significantly. Moreover, a one stop shop should cover both output VAT and input VAT and businesses should have the option to register to comply with their VAT obligations under the one stop shop or through traditional country-by-country registration.

To be effective, a one stop shop should be based on a standardised IT platform with standardised, streamlined returns that can be filed electronically by business. A centrally managed online database containing information on rates and other relevant information (*e.g.*, exemptions and input VAT deduction rules) of all Member States would also be necessary and should published in all official languages. In addition, VAT registered businesses should be permitted to make a single payment of VAT to the Member State with which the business is registered (*i.e.*, the administering Member State). The administering Member State would then

have to share that payment with other Member States based on the reported taxable transactions in each of the respective Member States. Similarly, refunds of excess VAT should be paid in a timely fashion by the administering Member State, with the other Member States reimbursing the administering Member State as appropriate. Consequently, cooperation between Member States is key to ensuring that a one stop shop works efficiently.

Under a one stop shop, some of the most burdensome statistical reporting requirements (*e.g.*, EU sales and purchase listings, and possibly Intrastat reporting) could be eliminated. A one stop shop might also permit intra-EU transactions between affiliated parties to be addressed under a reverse charge system. Consequently, only B2C transactions and B2B transactions between third parties would need to be reported.

Q28. Do you think that the current VAT rules create difficulties for intra-company or intra-group cross-border transactions? How can these difficulties be solved?

A significant amount of VAT flowing through the system (both domestic and cross border) is attributable to intra-company and intra-group trading. Removing such transactions from the scope of VAT would greatly simplify the process, reduce the number of transactions that must be reported (and inspected), and reduce the VAT compliance and cash-flow burdens on business. In most such cases, the transactions are VAT-neutral. In other words, there are significant sums of money flowing through the system, passing from purchaser to seller to tax authority and then back to the purchaser.

TEI urges the Commission to explore treating transactions between related companies or supplies of goods between branches as outside the scope of VAT. Since most pan-European businesses are subject to high levels of scrutiny by tax authorities, such a step would enable minimal, if any, noncompliance.

VAT grouping rules also provide a means of simplification by eliminating VAT charged between members of the same corporate group. Thus, it would be helpful to have the option to group all related companies within the EU. Indeed, the Commission should review whether to permit non-EU entities with EU VAT identification numbers to be included in pan-EU VAT groups. Requiring Member States to adopt grouping rules and expanding the eligibility rules to permit VAT grouping across national borders would significantly reduce compliance burdens by reducing the number of returns filed and offsetting VAT refund claims of one member of the group against the liabilities of other group members. To the extent cross-border grouping is permitted, a significant part of the VAT "throughput" would be eliminated.

Another option to consider would be adopting an EU-wide simplification measure or mandatory reverse charge for all intra-group transactions for goods and services.

Q29. In which areas of VAT legislation do synergies with other tax or customs legislation need to be promoted?

Paragraph 5.3.3.3 of the GREEN PAPER (synergies with other legislation) notes that "[e]fforts made to make customs procedures on importation easier must take account of VAT to maximise the benefits. Consistency between VAT law and other tax legislation, notably excise duties, could . . . simplify compliance for businesses." TEI concurs. In addition to aligning VAT with the Modernized Customs Code, VAT should be aligned with the reporting and payment of excise duties. For example, the trigger point for excise duty and VAT liability should be the same. As another example, the customs legislation affords businesses the opportunity to apply for rulings that have pan-European effect (*i.e.*, binding tariff information). A similar process should be considered for VAT purposes. Another potential improvement would be to align the reporting for VAT on imports with the centralised customs reporting process.

Q30. Which of these models looks most promising in your view and why, or would you suggest other alternatives?

As part of the debate about devising a strategy to combat VAT fraud the Commission launched a study on ways of improving the collection of VAT by means of modern technologies or via financial intermediaries.[11] The study explored the costs and benefits of four different models for revising the methods through which VAT is collected and remitted. Three models are based primarily on technological changes, including a split payment option, a real-time central VAT monitoring database managed by the tax authorities, and a VAT database warehousing scheme maintained by taxable persons but accessible by taxing authorities. The fourth model involves certification of taxpayer internal control processes by taxing authorities.

Regrettably, the solutions posed in the first three options are based on flawed or untested assumptions. Before implementing any of the models, TEI recommends undertaking additional study to accumulate commercial data on the costs and benefits of each approach.[12] The fourth model, the taxpayer certification process, holds promise, but would require significant investment in human resources by tax authorities (and potentially by businesses) so the costs deserve further study.

Q31. What are your views on the feasibility and relevance of an optional split payment?

Under a split-payment system envisioned as one of four models for improving the simplification of VAT collection, a customer would instruct its bank to pay for taxable goods or services, with the bank splitting the payment into the taxable amount paid to the supplier and the

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[11] TAXUD/2009/AO-05, *Study on the feasibility of alternative methods for improving and simplifying the collection of VAT through the means of modern technologies and/or financial intermediaries,* Final Report (20 September 2010).

[12] Paragraph 171 of the study acknowledges the data limitations: "We attempt to estimate all costs as accurately as possible. However, due to a lack of data and due to data quality issues, some of the costs are not quantifiable at this time and assumptions have needed to be made."

VAT amount transferred directly to the tax authority. TEI opposes adopting a split-payment system because of the substantially increased costs it would impose on business. Banks (or other financial intermediaries) would likely impose substantial charges for the payment services, but there would be little or no benefit to business in the way of decreased compliance or administrative burdens. Moreover, we are not convinced that such a system would effectively curb fraudulent activities.

Q32. Would you support these suggestions to improve the relationship between traders and tax authorities? Do you have other suggestions?

Taxpayers play a crucial role in making the VAT system work and the strength of the relationship with tax authorities greatly influences the cost of administering the system for both. In a recent study,[13] the Commission pointed to the need to devise a new approach to VAT administration based on voluntary compliance, risk assessment, and monitoring, with the aim of reducing both the involvement of tax authorities and the administrative burden on businesses. Some measures that might be considered include:

- Enhancing the dialogue between tax authorities and other stakeholders, *e.g.*, by setting up a permanent discussion forum to permit tax authorities and business representatives to exchange views at an EU level.

- Pooling best practices in the Member States, *e.g.*, by drafting guidelines for streamlining administrative practices and abolishing unnecessary burdens on businesses.

- Drafting an EU policy on voluntary compliance tailored to the EU VAT system through specific arrangements with stakeholders, *e.g.*, by developing the idea of 'partnerships' between tax administrations and taxpayers and of prior rulings on the tax treatment of certain transactions.

- Paying attention to IT issues when implementing the new VAT rule, including defining a proper timeframe and agreeing on a work process for adapting IT systems, both for businesses and tax authorities, facilitating automated information transfer between taxpayers and the tax authorities through better interoperability, and developing specific software to be supported at EU level and made available to all Member States.

The Institute supports all these suggestions, which implicitly embody the administrative practices being implemented in the United Kingdom (risk assessment) and the Netherlands (horizontal monitoring). These administrative models encourage the parties to work together in close cooperation based on mutual trust and should be commended to other Member States. We especially support establishing a permanent discussion forum between Member States and business at the EU level, with the European Commission acting as facilitator and secretariat.

In addition, we recommend that consideration be given to mandating that Member States comply with certain core substantive legal requirements and procedural rules to ensure that the VAT regime is workable and harmonised across the EU. Two examples of minimum requirements that

[13] *A coordinated strategy to improve the fight against VAT fraud in the EU,* COM (2008) 807 (1.12.2008).

should be prescribed include a voluntary disclosure regime for correction of errors and a scheme for VAT relief for uncollectible bad debts.

We have previously outlined why the VAT Directive should include a requirement for a bad debt relief scheme and prescribe the minimum requirements for the EU. With respect to a voluntary disclosure regime, we note that countries that have adopted a voluntary disclosure regime generally collect taxes more quickly and efficiently (compared to audits) because taxpayers have an incentive — through reduced or avoided penalties and interest — to correct errors and address inadvertent noncompliance. Without a voluntary disclosure regime, taxpayers might be tempted not to correct errors (or correct transactions or processes only prospectively), risking that the error will go undetected on audit. In such cases, the tax collection is delayed if not altogether eliminated.

Q33. Which issues, other than those already mentioned, should be addressed in considering the future of the EU VAT system? What solution would you recommend?

A. Curb Fraud by Certifying Compliant Businesses. There has been considerable discussion in the EU in recent years about the most effective means of curbing VAT carousel fraud. One approach would be to certify *bona fide* businesses, possibly in a fashion similar to that for customs purposes under the guidelines for Authorized Economic Operators. Under such an approach, transactions between certified businesses could be treated as outside the scope of VAT, zero rated, or taxed through a reverse-charge mechanism. Such an approach would reduce the fiscal risks for Member States and also reduce the risk of sticking VAT for business. Tax administrators would thus be able to focus their attention on uncertified businesses, resulting in more effective use of resources by both compliant businesses and tax administrators. We suggest that the Commission and Member States explore such an approach.

B. Proscribe the Use of Penalties as a Revenue Raiser. TEI believes that penalties should be imposed solely to deter misconduct or ensure compliance with minimum standards of behaviour. Member States should not be permitted to use penalty regimes as a means of raising revenue. As important, penalties should always be proportionate to the act or omission. Where the government incurs no actual VAT loss (or there is no risk of loss, as in most B2B supplies), the application of a financial penalty is inappropriate.

Conclusion

TEI welcomes the opportunity to meet with the Commission staff to discuss our comments and responses to the consultation. The comments were prepared by TEI's European Indirect Tax Committee, whose 2011-2012 Chair is Siegert Slagman. If you have any questions about TEI's comments, please contact Mr. Slagman at +41 (58) 242 6513 (or Siegert.Slagman@pmi.com), or Jeffery P. Rasmussen of the Institute's legal staff at +1 202 638 5601 (or jrasmussen@tei.org).

Respectfully submitted,

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