



Brussels, 8.3.2018
COM(2018) 118 final

**REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN
PARLIAMENT**

**on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting
fraud**

1 BACKGROUND

Article 199a (1) of Directive 2006/112/EC ('VAT Directive') allows Member States to provide that the person liable for payment of VAT on supplies listed in this Article is the taxable person to whom the supply is made (the reverse charge mechanism). This mechanism is limited in time and may be applied until 31 December 2018.

Based on Article 199a (3) of the VAT Directive, Member States applying the mechanism shall submit a report to the Commission no later than 30 June 2017 based on criteria defined in paragraph 2 point (c) of Article 199a.

Subsequently, before 1 January 2018, the Commission shall present an overall assessment report on the effects of the mechanism provided for in Article 199a (1) of the VAT Directive on combatting fraud.

Article 199b (1) of the VAT Directive allows Member States to designate the recipient as the person liable for payment of VAT on specific supplies of goods and services as a Quick Reaction Mechanism ('QRM') measure to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses. This measure shall apply until 31 December 2018¹.

Following Article 2 of Directive 2013/42/EU amending the VAT Directive, the Commission shall present an overall assessment report on the impact of the QRM measure and this before 1 January 2018.

Consequently this report focuses on the effects of the measures provided for in Article 199a of the VAT Directive on combatting fraud and on the impacts of the mechanism provided for in Article 199b of the VAT Directive.

2 SCOPE OF THE REPORT

The purpose of the measures foreseen in Articles 199a and 199b is to allow Member States to quickly tackle problems of the missing trader fraud in intra-Community trade (MTIC): in Article 199a by an option of applying the reverse charge mechanism for listed supplies and in Article 199b by offering a faster procedure for the introduction of the reverse charge mechanism in case of sudden and massive fraud.

The MTIC fraud occurs when a trader acquires goods from another Member State exempt from VAT and sells them on including VAT on the invoice to the customer. After having received the VAT amount from the customer such trader disappears before paying the VAT due to the tax authorities. At the same time the customer, acting in good faith or not, can deduct the VAT he paid to the supplier through his VAT return. The optional reverse charge mechanism based on Article 199a of the VAT Directive appears to be a useful tool for Member States to fight this type of fraud in the pre-defined sensitive areas when it occurs on

¹ Article 3 of Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC.

their territory. Once the trader is obliged to use reverse charge for such domestic supplies, he cannot charge VAT on its invoice and he will not receive the VAT amount from his customer, and as a result he cannot disappear with the amount of VAT received.

The QRM of Article 199b is a procedural measure allowing Member States to quickly introduce a temporary reverse charge mechanism on supplies in which sudden and massive fraud occurred including for supplies which are not listed in Article 199a. By using this mechanism Member States can bridge the period required for obtaining the normal derogation under Article 395 of the VAT Directive, which should be submitted simultaneously.

The Commission presented lately two legislative proposals which should help Member States in the fight against VAT fraud. The first is a proposal for administrative cooperation in the field of VAT², which would strengthen cooperation between Member States to efficiently combat cross-border fraud. The second is the proposal for a definitive VAT regime³ that would ultimately limit the risk of MTIC, as it would introduce taxation at the place where transport of goods ends, thus abolishing exempted intra-Community supplies and acquisitions of goods.

This report is based on Member States' and stakeholders' feedback as regards the effectiveness of the sectoral reverse charge in fighting fraud, as required by the VAT Directive.

In preparing the report, Member States were invited to provide their experience and assessment of the measures. To ensure that the feedback from business is taken into account, business stakeholders were requested, via the VAT Expert Group⁴, to provide their views.

3 THE ASSESSMENT OF THE MEASURES

3.1 The use of the measure included in Article 199a (1) of the VAT Directive

Article 199a (1) of the VAT Directive has an optional character and allows Member States to apply the reverse charge mechanism to a series of supplies of goods and services. Depending on the Member State, some have made extensive use of the options and apply the reverse charge mechanism to a large number of supplies, while others do not make use of the options at all.

An overview of the use by the Member States of the reverse charge mechanism based on Article 199a (1) of the VAT Directive is included in Annex I (as provided by Member States or stakeholders).

² COM(2017) 706 final.

³ COM(2017) 569 final, COM(2017) 568 final, COM(2017) 567 final.

⁴ The VAT Expert Group assists and advises the European Commission on VAT matters. The group is composed of individuals appointed in a personal capacity with the requisite expertise in the area of VAT and organisations representing in particular businesses and tax practitioners which can assist in the development and implementation of VAT policies.

3.2 The measure included in Article 199a of the VAT Directive

The assessment of the measure included in Article 199a centred mainly around the following five questions: 1) Do you consider that the applied measure is/was effective and efficient in combatting fraud? 2) Do you consider that the measure was necessary for fighting fraud? What would have been the consequences as regards VAT fraud if your Member State had not introduced the measure? 3) Was there a shift of fraudulent activities to other supplies of goods or services following the introduction of the measure? 4) Did you identify a shift of the VAT fraud to other countries following the introduction of the measure domestically? 5) Was there an increase of compliance costs for taxable persons resulting from the introduction of the measure and if so, do you consider these costs proportionate compared to the benefits resulting from the measure?

Almost all Member States responded to the questionnaire and provided their assessment of the measure. Also stakeholders, such as a number of large enterprises, consulting companies, smaller accountancies and a few academics, provided their views.

3.2.1 The effectiveness of the measure in fighting fraud

3.2.1.1 Assessment by Member States

Member States generally consider the measure as a very effective and efficient tool in fighting VAT fraud in the given sectors or in preventing the fraud from appearing.

A number of Member States pointed out that due to the introduction of the reverse charge mechanism the missing trader fraud (MTIC) decreased significantly or disappeared completely in the defined sectors. The introduction of the reverse charge mechanism in the specified sectors helped Member States to significantly reduce revenue losses caused by the MTIC fraud and led to improved VAT collection. Next to the elimination of missing traders the measure also contributed to the decrease of the number of traders on the 'black' market and reinstalled fair competition in the sector.

Some Member States pointed out that the reverse charge mechanism is not entirely fraud proof, as it is open to other methods of VAT avoidance. At the same time, however, they indicated that it can be effective to minimise fraud in certain areas.

All Member States applying the domestic reverse charge mechanism in emission allowances indicated that it was very efficient for stopping the particularly aggressive fraud. It was pointed out that the market of greenhouse emissions allowances is particularly susceptible to fraud given the high mobility of the allowances and the high amounts at stake whereby the measure enables Member States to prevent such VAT fraud from occurring. It is also considered effective in limiting the forthcoming losses in VAT revenues and therefore, some Member States introduced it as a preventive measure, as there were enough signals indicating fraud risks in the given sector.

3.2.1.2 Assessment by stakeholders

Stakeholders consider that the measure is effective in fighting VAT fraud, especially carousel fraud and MTIC fraud.

The measure appears to have eliminated fraud in a number of cases, to have decreased the risk of companies becoming part of VAT carousel fraud and to have cleaned the sector from inexplicably low prices, recreating a level playing field for honest businesses.

A few stakeholders stressed that the reverse charge is effective only as a short term measure but not as a long term solution. It is a general anti-fraud measure applying to all businesses in the sector having to deal with complex compliance rules. Furthermore, as the implementation is not uniform at EU level, an additional burden is created for traders working across different Member States, since the rules for invoicing differ depending on whether or not the Member State concerned has opted to introduce a domestic reverse charge for the commodities or services the business is trading in. These stakeholders insist on a standardised and harmonised implementation of the EU VAT Directive into national legislation and on the necessity of a more robust and fraud proof EU VAT system.

A few stakeholders underlined that the measure was very effective in combatting fraud in greenhouse emission allowances.

3.2.2 The necessity of the measure for fighting fraud

3.2.2.1 Assessment by Member States

Member States generally consider that the introduction of the reverse charge in the given sectors was necessary and essential to fight fraud. If the measure had not been introduced in the specific cases, there would have been a big risk of fraud and large scale losses to the public budgets.

A number of Member States indicated that since standard audit measures were insufficient in the majority of cases, the reverse charge was necessary to allow them to fight against fraud in the specific sectors. Some Member States pointed out that without the reverse charge mechanism one would need to rely on significant operational resources, whereby the outcome is often retrospective and does not guarantee the success.

Specifically regarding the supplies of greenhouse emission allowances, Member States pointed out that the reverse charge was necessary to fight the VAT fraud and to avoid that more losses would have been incurred by the state budgets. It is probable that without the domestic reverse charge fraud would have continued since conventional control resources and measures would have not been sufficient to deal with the fraud.

Some Member States pointed out that counteracting international fraud in the greenhouse emission allowances was only possible by introducing common rules on a wider level, introducing the reverse charge in one or a few Member States would not have had the same effect.

3.2.2.2 Assessment by stakeholders

All stakeholders, who provided feedback on this element, consider that the measure was necessary to fight VAT fraud.

Without the measure, fraudulent activities involving these goods and services would most probably continue. Many companies would have been forced to stop contracting with businesses without sufficient assurance regarding their honesty, which would have had an impact on business activities in general. Business would also be impacted from the commercial perspective, not only in that the commercial teams would have to go through long processes to get the counter-party approved, but also in terms of the time spent by the tax team auditing their activities.

3.2.3 Shift of fraud to other sectors

3.2.3.1 Assessment by Member States

Member States are rather divided on the issue of the shift of fraud to other sectors. Whereas some Member States applying the measure consider that no shift of fraud to other goods or services took place, an equal number of Member States claim that a shift of fraud to other goods or services did take place.

Member States which identified the shift of fraud to other sectors indicated that fraudsters adapt and indeed move to other goods which are not covered by the reverse charge mechanism.

One Member State established that in connection with the introduction of the reverse charge it is often observed that companies involved in the MTIC fraud shift place in the fraudulent chain of transactions (e.g. from broker to conduit company). One Member State underlined that fraudsters change their way of operating following the introduction of the reverse charge mechanism. For instance, they start using more than one commodity (product) within the fraudulent chain in order to make it difficult to assess the commodity impacted and the financial effect of the fraud.

In case of the reverse charge for greenhouse emission allowances, one Member State pointed to a shift of the VAT fraud to the electricity sector.

Some Member States identified a shift of fraudulent activities in case of electronic goods which are easily replaced by goods that are just outside the description of the products included in the provision. A few Member States indicated that after the introduction of the reverse charge in the sectors of mobile phones, microprocessors, tablets, PCs and laptops there was a shift of fraudulent activities to the range of similar products like cameras, play stations, monitors, printer cartridges or consumer electronic equipment and consumer electrical appliances.

One Member State discovered fraud in the sector of flour, forage crops and vegetable oils which might be the effect of a shift due to the introduction of the reverse charge in the grains sector.

Finally, a few Member States mentioned that no information on the shift to other sectors was available.

3.2.3.2 Assessment by stakeholders

Stakeholders' feedback on this element was rather limited, as the majority of stakeholders appear not to have information in this area. According to a few stakeholders it seems natural that after the introduction of the reverse charge mechanism in one sector, fraudsters turn their attention elsewhere.

3.2.4 Shift of fraud to other Member States

3.2.4.1 Assessment by Member States

The same number of Member States identified the shift of fraud to other Member States after the introduction of the measure as the number of Member States who did not identify such shift.

According to a few Member States, it is likely that a shift of fraud occurs to a Member State that did not introduce the reverse charge mechanism, as fraudsters search for new fraud opportunities. Some Member States pointed out that fraud risks occurred in their territory after the introduction of the reverse charge in the neighbouring Member State.

In case of greenhouse emission allowances, a few Member States pointed to the shift of fraud to other Member States. A few Member States indicated that a reason for fraud not shifting to other Member States may partly be attributed to the fact that when fraud was observed in a specific sector other Member States responded to the VAT fraud by preventively introducing the reverse charge to the respective sector thereby limiting the opportunities for the fraud to move to their territory.

3.2.4.2 Assessment by stakeholders

Stakeholders' feedback on this element was limited, as the majority of stakeholders appear not to have information in this area. A few stakeholders informed the Commission that no shift of fraud to other Member States was observed.

3.2.5 Impact on compliance costs and proportionality of the measure

3.2.5.1 Assessment by Member States

The majority of Member States consider that there was some increase of compliance costs resulting from the introduction of the measure. The additional costs are associated with modifications in accounting systems, cash-registers, invoicing, staff training etc.

Although a few Member States consider that the increase of costs is considerable, all Member States consider that the increase of costs was proportionate and largely outweighed by the benefits resulting from the introduction of the measure such as for instance gain of VAT revenues, decrease in unfair competition, reduced assessment costs of potential VAT risks of transactions, reduced costs of tax disputes, improved cash flow.

Some Member States consider that there was no increase of compliance costs resulting from the introduction of the measure.

3.2.5.2 Assessment by stakeholders

The majority of stakeholders identified some increase in costs connected with the implementation of the reverse charge mechanism in the defined sectors.

In general, one of the main costs for the business was the change in the VAT cash flow and a one-off cost of implementation (e.g. including analysis of products falling under the reverse charge). The implementation of the reverse charge mechanism is also deemed to increase complexity connected to the correct VAT determination, the invoicing and the review of input invoices received from other suppliers. It also generates new risks for suppliers and customers such as for instance when the supplier erroneously applies the reverse charge, whereby no VAT is charged on the invoice or cases whereby the customer accepts the invoice that was erroneously issued with VAT instead indicating that the reverse charge needs to apply and as a consequence pays VAT to his supplier.

At the same time, stakeholders definitely consider the costs proportional to the obtained benefits. It was pointed out that legitimate businesses clearly consider the introduction of the reverse charge resulting in the creation of a level playing field justifying the increased compliance costs. For some businesses the incurred costs were necessary in order to stabilise the market.

A number of stakeholders identified no increase of compliance costs. Some claim that the reverse charge procedure simplifies internal procedures and reduces unnecessary cash flow for tax payers and tax administrations.

3.2.6 Other issues and comments by the Commission

Although no major problem what concerns the shift of fraud to other Member States was identified, a number of Member States pointed out that the risk of such a shift increases and that the reverse charge mechanism is also introduced as a preventive measure, in particular when the neighbouring Member State introduced the measure. Thus the fact that no shift of fraud to other Member States was observed may be attributed in part to the fact that by introducing the reverse charge mechanism preventively Member States limit the opportunities for fraud to move.

As regards the shift of fraud to other sectors, the Commission did receive a number of requests from Member States wishing to apply a reverse charge to domestic supplies of

certain commodities not listed under Article 199a but often closely related to goods covered by that Article. The motivation for such request quite often stated is that there was a shift in the fraudulent transaction chain from goods for which the country concerned had opted to apply a reverse charge, to similar goods not covered by the list. This indicates that the domestic reverse charge is a measure that can solve at short notice a specific problem of fraud with the supply of certain goods or services, but that it does lead to the fraud shifting to other goods, often involving the same traders. This confirms what certain Member States indicated in their replies. Therefore, when assessing such requests for derogations the Commission always insists that Member States should indicate at the same time which other measures they take or intend to take to solve the VAT fraud problem in the sector concerned.

Finally, a number of business stakeholders made comments of a general nature on the sectoral reverse charge mechanism. They generally consider that the optional reverse charge increases the complexity of doing business, reduces legal certainty and accentuated a need for a standardised and harmonised implementation of the VAT Directive. Some pointed out that the optional reverse charge is a quick measure only and not effective as a long term solution, as globally the VAT fraud has not reduced over the years. A more robust and fraud proof system is, therefore, necessary according to them.

3.3 The period of minimum two years for the application of the measure included in Article 199a of the VAT Directive

According to Article 199a(1) of the VAT Directive, Member States may apply the reverse charge mechanism until 31 December 2018 and for a minimum period of two years.

The requirement of a minimum of two years for the application of the measure proved to be an impediment to a few Member States wishing to introduce the reverse charge mechanism in the course of 2017 to fight newly discovered cases of VAT fraud in the supplies of goods and/or services included in the list of Article 199a. The Member States concerned ultimately had to file the request for a derogation based on Article 395 of the VAT Directive and according to the procedure included in this Article resulting in delaying the reaction of the Member States to the fraud problem. In this context the question arises to which extent the limitation to two-years is useful.

3.4 The assessment of the measure included in Article 199b of the VAT Directive

Article 199b of the VAT Directive allows Member States to designate the recipient as the person liable for payment of VAT on specific supplies of goods and services as a Quick Reaction Mechanism ('QRM') measure to combat sudden and massive fraud liable to lead to considerable and irreparable financial losses.

The QRM was never applied due to the fact that it is difficult for Member States to fulfil the conditions. The questionnaire regarding the measure was sent to the Member States only⁵ and

⁵ As the measure was never applied, businesses have no experience with its application.

focused on the usefulness of the measure and on the conditions for its application. The majority of Member States provided their view on these elements.

3.4.1 Assessment by Member States

The vast majority of Member States, who provided the response, consider that the QRM remains a useful tool for combatting particular cases of sudden and massive fraud. The measure improves Member States' chance of tackling the fraud schemes and of reducing the possibility of irreparable VAT losses. The measure complements and protects the entire VAT system. Member States underlined the extraordinary character of the measure which should serve as a last resort only.

Some Member States consider the measure as not useful claiming that the conditions are extremely strict and it is not possible to fulfil them in practice. One Member State indicated that the conditions 'sudden' and 'massive' are in practice mutually exclusive. If fraud occurs suddenly, it is difficult to prove that it is massive. If it can be proven that the fraud is massive, the criterion sudden cannot be met.

Only one Member State pointed out that the measure is not useful, as other measures provided for by the VAT Directive are sufficient.

4 CONCLUSIONS AND THE WAY FORWARD

Member States generally consider the reverse charge mechanism included in Article 199(1) of the VAT Directive a very effective and efficient tool in fighting VAT fraud. Due to the introduction of the reverse charge mechanism the fraud decreased significantly or disappeared in the defined sectors. This view is also shared in the replies received from the consulted business stakeholders. Regarding the QRM included in Article 199b of the VAT Directive, although it was never used, most Member States consider that it remains a useful tool for exceptional cases of VAT fraud.

The measures included in Articles 199a and 199b of the VAT Directive are limited in time and expire on 31 December 2018. Based on this feedback from Member States and stakeholders it appears that if the measures are not prolonged, Member States would be deprived of an efficient tool to fight VAT fraud.

A sectorial reverse charge mechanism adds some complexity to the VAT system of the participating Member State, leading to increased compliance costs for business and increased administrative burden for tax administrations. According to a recent study on the assessment of the optional reverse charge mechanism⁶, the reverse charge mechanism implies an increase by 43% of compliance costs to businesses. The reverse charge mechanism can be particularly burdensome for SMEs who often do not have high technical resources to handle reverse charge mechanism compliance requirements.

⁶ EY, 2014.

An assessment of a general reverse charge mechanism (also comparing to the sectorial reverse charge) on the internal market has been carried out in the impact assessment accompanying the proposal on the temporary application of a generalised reverse charge mechanism⁷. Sectorial reverse charge mechanism is considered to be an effective temporary measure and it has not come to the attention of the Commission that a targeted reverse charge mechanism would lead to major detrimental consequences given its narrow scope and limitation in time.

Until the definitive regime is in force, the options included in Articles 199a and 199b have been very useful for the Member States as temporary and targeted ad-hoc measures. The expiration of the measures without any alternative solutions provided for could ultimately lead to more VAT fraud, less tax fairness and a loss of state revenues.

Taking into account the above elements and since the definitive VAT regime would solve the problem caused by the VAT exemption linked to the Intra-Community supply of goods, whereby the customer obtains the goods without having to pay the VAT to the supplier, the prolongation of both measures based on Article 199a and the QRM of Article 199b should be limited until the definitive regime enters into force or for another limited period of time. It would reduce Member States' tools to fight VAT fraud in certain sectors if these two measures were to expire at this point. The Commission will therefore issue an appropriate legislative proposal in the second quarter of 2018 prolonging the existing measures.

⁷ Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold. (COM(2016) 811 final) of 21 December 2016.

This proposal provides Member States with a possibility to introduce a general (and not for specific sectors) reverse charge mechanism for domestic supplies of goods and services provided certain conditions are met. The scope and conditions required for the application of the general reverse charge mechanism are different from conditions of Articles 199a and 199b of the VAT Directive, so it would not replace the latter measures.