Oiling the cracks

Indirect Tax



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Richard Asquith considers the challenges posed by the upcoming VAT reforms, especially in light of COVID-19

Key Points

What is the issue?

The 27 EU member states are mid-way through a hugely ambitious programme of VAT reforms, implementing over ten major measures being rolled out between 2018 and 2025.

What does it mean for me?

Tough negotiations on the major elements – 2021 e-commerce and the 2022 Definitive VAT System – have still to be completed.

What can I take away?

The cornerstone reform, the Definitive VAT System, has yet to be confirmed for a 2022 planned launch, and faces immovable objections. Many states are unwilling to trust each other with revenue collections.

The EU VAT regime is creaking badly. The 27 member states are mid-way through a hugely ambitious programme of VAT reforms, designed to reboot the indirect tax regime for the challenges of billion Euro frauds and ballooning e-commerce. We are now almost half-way through implementing over ten major measures being rolled out between 2018 and 2025. But tough negotiations on the major elements – 2021 e-commerce and the 2022 Definitive VAT System – have still to be completed.

Both of them may now fall victim to the global COVID-19 crisis.

EU VAT: time for change

Since the inception of the EU single market in 1993, the EU VAT regime has remained largely unchanged. Since then, two major forces have exposed the need for radical change:

1. Fraud and lost tax revenues caused by criminal gangs exploiting the current zero VAT rating of intra-community supplies between businesses. This ‘missing trader’ or ‘carousel’ fraud is estimated to cost EU member states €50 billion a year.

2. The explosive growth of e-commerce, which has reached over €550 billion a year in the EU, of which almost €100 billion is cross-border. These new digital businesses models expose loopholes and a lack of flexibility.

To adapt the regime for the 21st century, in 2016 the European Commission launched a hugely ambitious range of reforms – the ‘Action Plan on VAT’.

Action plan on VAT faces challenges

The EU Commission has proposed a range of more than ten reforms to the EU VAT Directive. These reforms seek to close the VAT fraud loopholes and simplify e-commerce VAT. The ‘Four Quick Fixes’, clarifying B2B VAT rules, came into force in January 2020, following other simplifications to the digital VAT compliance rules.

The big changes start next year with the VAT e-commerce package, introducing a single pan-EU VAT return for online sellers of goods. In addition, marketplaces such as Amazon, eBay and Etsy will become responsible for the VAT on goods sold by online retailers from China, the US and other EU countries.

But the cornerstone reform, the Definitive VAT System, has yet to be confirmed for a 2022 planned launch, and faces immovable objections. Many states are unwilling to trust each other with revenue collections. It would replace the existing origin-based regime with the obligation to collect VAT in the country of the customer – a destination-based tax. One element of the reform, the ‘certified taxable person’, is now effectively dead.

Furthermore, with the COVID-19 crisis demanding emergency measures and intervention from global authorities, there is a chance that progress on the Action Plan beyond 2020 may be even further delayed.

The EU has already successfully passed a number of reforms as part of the Action Plan:

- 2018 Generalised reverse charge;
- 2018 Harmonising VAT rates for electronic publications;
- 2018 Simplification of e-services compliance;
- 2020 Co-operation between tax authorities on fraud; and
- 2020 Quick fixes for B2B supply chains to reduce compliance and fraud.

Below, we set out the years ahead, and some of the issues that remain unresolved. To start, 2021 brings in notable simplifications for e-commerce compliance, and a role for online marketplaces in tax collections.

These may need further adjustment to tackle substantial elements of VAT evasion.

2021: Simplification for e-commerce compliance

Building on the success of the mini one-stop-shop (MOSS) single EU VAT return for pan-EU B2C sales of e-services, the extended one-stop-shop (OSS) reform will further simplify VAT compliance for hundreds of thousands of online sellers.

Rather than having to register in all the states of their consumers, OSS will mean that online merchants selling cross-border can opt to complete a single OSS return, declaring all their pan-EU sales.

OSS returns are to be filed on a quarterly basis, with the business's domestic VAT office, with the VAT for each transaction charged as per the customer's country of residence.

The OSS reform also benefits non-EU sellers, who will be required to register for VAT in one EU country of their choice (typically, the country they are importing goods into). Their OSS returns filed in that country will then cover their distance sales across the rest of the EU.

Simultaneously, the EU will withdraw the distance selling VAT threshold regime. Rather than immediately registering in other EU states where they have consumers, businesses will be able to charge their own country's VAT rate, declaring it to their national tax authorities.

Only once they pass the country of their customers' thresholds, will they have to locally register and charge the VAT rate of the consumer's state. The distance selling thresholds are set by the member states at either €35,000 or €100,000 per annum.

The current low-value consignment stock relief provides an exemption on import VAT for goods at or below €22 being sold from outside the EU to EU consumers, and provides an advantage to sellers from the US, China and elsewhere.

From 1 January 2021, the playing field will be levelled, bringing EU sellers (who currently must charge VAT on all EU sales) in line with the rest of the world. This happens through two new measures:

1. A new import VAT declaration scheme will be launched for goods at or below €150. For import sales at or below this amount, sellers will have to declare the VAT charged on imported packages in a new VAT declaration, the import one-stop-shop (IOSS). Imported goods above this value will have to be reported

through a regular VAT return if the seller wishes to declare and recover the import VAT, which will be collected at customs, as is the current process.

2. Instead of VAT on out-of-EU shipments being collected at the point of import, it will be charged and collected by the seller at the point of sale (typically, online at the checkout process). All imported sales below €150 across the EU may be declared in the single IOSS. The VAT rate applied for each sales transaction should be based on the country of residence of the end consumer.

These two measures combined will mean a more efficient and speedy clearance – 'green lane' – for low value imported goods through customs, providing a better experience for EU consumers and benefiting sellers.

2021: Marketplace changes

From 1 January 2021, the game is set to change for online marketplaces, as they become the 'deemed supplier' on certain imports and cross-border sales to consumers.

Rather than simply 'facilitating' the sale, becoming a deemed supplier will mean that marketplaces must first purchase the goods from the seller, and then make the sale to the consumer. The marketplace will then have to charge and report VAT under its own name. The new rules aim to reduce VAT fraud on cross-border e-commerce transactions, which the EU Commission estimates cost member states over €5bn in 2019, rising to €7bn by 2021.

However, this reform is still far from comprehensive. The main issue is that it will still be optional for marketplaces. While this means that large, well-resourced marketplaces will be unable to gain a compliance advantage, it could also encourage fraudulent sellers to switch platforms, and so may yet be revised. Questions also remain on the liability of marketplaces to any undeclared or missing VAT. Does the responsibility to provide accurate information lie with the marketplace or the seller?

A number of member states, including the Netherlands and Germany, had expressed doubts earlier this year about being ready for these reforms, claiming that adaptions to customs IT regimes were not progressed. However, there is little doubt the near seizure of tax authorities to manage day-to-day activities since the start of the COVID-19 epidemic in March means there is a high likelihood of this reform being pushed into 2022.

2022: Relaxing the rules around reduced rates

Current restrictions around the use of reduced VAT rates prevent distortions in the EU single market and keep the system simple to administer. This is set to change in 2022, when member states have provisionally agreed to loosen rules on the setting of reduced rates across goods and services.

The EU Commission has proposed that states would have more freedom to set their own VAT rates, including:

- the right to set reduced rates at any level for most goods and services;
- a proviso that their weighted rate for all taxable supplies remains at or above 12%; and
- a 'negative list' would restrict reduced rates on certain sensitive goods, such as firearms and alcohol.

Because the above measures are linked to the introduction of the controversial Definitive VAT System (see below), it remains unclear whether the planned 2022 implementation will still go ahead.

2022: EU Definitive VAT System

The EU Definitive VAT System is the ambitious plan to overhaul the existing origin-based EU VAT regime for B2B cross-border sales. The aim is to combat an estimated €50bn a year in VAT fraud.

It is a controversial proposal and has not yet gained unanimous support from the member states. The scheduled January 2022 launch has already been delayed until July 2022. Further deferment is almost certain as fundamental disagreements remain between member states on the potential disproportionate effects and unproven benefits of the plan. It is likely that the COVID-19 crisis will mean any further conversations on this reform will be delayed well into 2022, meaning the reforms will not see the light of day before 2023.

The existing origin-based VAT regime for B2B cross-border transactions was only ever supposed to be a temporary measure, introduced in 1993 as a short-term fix until a destination-based scheme could be agreed upon. However, several attempts over nearly 30 years have failed to achieve this.

The latest plan, the Definitive VAT System, would shift the charging and collecting VAT by the vendor to the country of residence of the customer, rather than that of the vendor. Collected VAT would then be remitted by the seller to its national tax authority and, in turn, distributed to the appropriate member states of its customers.
At a meeting of the EU member state finance ministers, ECOFIN, in December 2019, fundamental blockers to the Definitive VAT System were identified, including:

- the significant upheaval and burden on businesses and tax authorities, which would need to be justified in terms of the amount of VAT fraud reduced;
- the certified taxable person simplification, which would see trusted and certified taxpayers being exempted from charging VAT to reduce their compliance and payments processing burden. The majority of states are opposed;
- the withdrawal of recapitulative statements (e.g. Intrastat and EC Sales Listings; and
- the significant burden on the vendor charging and collecting taxes under the system. Most states feel this would create a major risk to the VAT Gap from new types of fraud and insolvencies.

2024: Payment providers VAT reporting obligations

The EU has agreed requirements for payment providers (credit cards issuers, wire transfer providers, etc.) to make available data on EU e-commerce transactions to help tax authorities identify VAT fraud.

The new obligations will mean that payment providers must report to tax authorities with quarterly data on cross-border e-commerce transactions, and this will apply only to payees receiving more than 25 payments per quarter. The measure also excludes domestic transactions. The data collected will then be provided to the anti-VAT fraud specialists at Eurofisc, the EU tax authorities' network for the multilateral exchange of early warning signals to fight VAT fraud. In turn, non-compliant sellers (both EU and non-EU) will be identifiable via a central electronic database of payment information ('CESOP'), which will be created for this purpose.

2025: VAT registration thresholds equivalence for foreign businesses

Currently, the zero thresholds enjoyed by foreign businesses selling into the EU place them at a competitive advantage and hinder the operation of the single

market. From January 2025, small non-resident businesses will have the same VAT registration thresholds as domestic businesses, bringing them onto the same playing field when it comes to compliance costs.

EU states have agreed on a registration threshold not exceeding €85,000 a year for both foreign and domestic businesses. However, foreign companies can only benefit from this if their total pan-EU sales are €100,000 or below. This will prevent large enterprises benefiting from this new small company threshold.

Businesses will need to keep a watchful eye on the progress of these major VAT reforms, not least to ensure that systems are ready to adapt to changes.