European Commission publishes VAT Action Plan to modernise the EU VAT system

Indirect Tax

01 June 2016

The European Commission publishes its action plan for the creation of a single EU VAT area but acknowledges political will and agreement is needed to take it forward.

Considering the current VAT system to be too complex and vulnerable to fraud, the European Commission published its VAT Action Plan on 7 April. This proposes to 'reboot' the transitional arrangements and create a simpler, more robust and business-friendly framework. Aimed at promoting cross-border trade and recognising developments in technology, business models and a growing digital economy, the key features are:

- A single European VAT system based on the 'destination principle' that VAT on goods and services will be paid to the country where they are consumed;
- Short-term measures to tackle VAT fraud: The VAT gap was estimated to be 170bn euros in 2013;
- Options to modernise VAT rates: two are proposed;
- Plans to simplify VAT rules for e-commerce in the context of the digital single market strategy; and
- A VAT simplification package for small and medium-sized enterprises (SMEs) to support the growth of cross-border trade.

The Commission plans to present legislative proposals on each of the issues raised in the action plan to trigger a debate with EU member states and with the European Parliament to secure political agreement. Measures scheduled for 2016 include adapting the VAT system to the digital economy, removing VAT obstacles to cross-border e-commerce and specific measures for e-publications. A VAT package for

SMEs will be proposed in 2017, along with a proposal for the definitive VAT system for EU cross-border trade, together with a reform of the VAT rates.

The CIOT will scrutinise the ‘destination system’ proposal because this will convert what is today an intra-EU VAT-free, cross-border, business-to-business (B2B) sale of goods into one subject to VAT. Whether this will create a substantial cash flow burden on business will depend on how it is implemented and how quickly any VAT is refunded.

The proposals follow discussions in the European Commission’s VAT Expert Group, on which the CIOT has been represented for more than three years. The proposals have a long way to go before being adopted so there will be an opportunity to comment to the Commission on the detail of the proposals.

The CIOT is also represented on HM Treasury’s SME VAT forum, which has recently discussed the impact of these measures on SMEs and micro-businesses. This forum will give a voice to SMEs (in themselves forming a wide range of business types) and we would encourage members to feed back thoughts and concerns to the ITX technical officers as more details emerge.

The reform of VAT rates has been of great media interest since the UK government’s announcement in Budget 2016 that the tax is to be abolished on women’s sanitary products. The action plan now gives us further information on how this could happen if agreement is found on either of the Commission’s options for VAT rates.

- Option 1 proposes a list of reduced rate goods and services that would be regularly reviewed. All current reduced rates, including derogations (for example zero rates) would be maintained and could be adopted by all member states to ensure equal treatment. The minimum standard VAT rate of 15% would also be maintained. However, member states would not be able to introduce zero rates for additional goods and services.
- Option 2 would permit member states to adopt the rates they want on their choice of goods and services as long as they do not create distortion of competition or unduly complicate the VAT system. There would be no minimum standard rate of VAT.

It is worth noting that many countries, including the UK, have reduced rates and any changes would require unanimous agreement among all 27 member states and therefore cannot be imposed on the UK without its agreement.

In conclusion, the new system aims to both simplify the treatment of sales of goods from a VAT perspective and reduce the ever-increasing criminal activity aimed at exploiting the VAT system. They are excellent motivations. Although we endorse simplification, we believe it must not be at the expense of imposing extra burdens on compliant businesses.