

EUR Research Information Portal

VAT and International Trade's Crossroads: Right, Left or Straight On?

Published in:
EC Tax Review

Publication status and date:
Published: 01/01/2019

Document Version
Publisher's PDF, also known as Version of record

Citation for the published version (APA):
Merkx, M., Verbaan, N., & Starckenburg, R. (2019). VAT and International Trade's Crossroads: Right, Left or Straight On? *EC Tax Review*, 28(5), 233-244. <http://hdl.handle.net/1765/124355>

[Link to publication on the EUR Research Information Portal](#)

Terms and Conditions of Use

Except as permitted by the applicable copyright law, you may not reproduce or make this material available to any third party without the prior written permission from the copyright holder(s). Copyright law allows the following uses of this material without prior permission:

- you may download, save and print a copy of this material for your personal use only;
- you may share the EUR portal link to this material.

In case the material is published with an open access license (e.g. a Creative Commons (CC) license), other uses may be allowed. Please check the terms and conditions of the specific license.

Take-down policy

If you believe that this material infringes your copyright and/or any other intellectual property rights, you may request its removal by contacting us at the following email address: openaccess.library@eur.nl. Please provide us with all the relevant information, including the reasons why you believe any of your rights have been infringed. In case of a legitimate complaint, we will make the material inaccessible and/or remove it from the website.

The current VAT system for intra EU B2B is susceptible to fraud. This is one of the main reasons why the European Commission has tabled a proposal for a definitive VAT system based on the destination principle. On the other hand, there are Member States that want to introduce a general reverse charge mechanism in the fight against VAT fraud. While the definitive VAT system proposed by the European Commission taxes all supplies in the supply chain, the general reverse charge mechanism has the opposite effect. Under this mechanism effective collection of VAT is postponed to the last link in the supply chain. In this article, the authors evaluate both systems as well as the current system to assess which system is best.

1 INTRODUCTION

Since the transitional system came into force in 1993, several attempts have been made to design a definitive system for cross-border transactions. Initially, the objective was to introduce a definitive system based on the principle of taxation in the country of origin.¹ However, in 2011 the conclusion was drawn that this was politically unachievable and the origin principle was abandoned in favour of the principle of taxation in the country of destination.² Several ways to implement the destination principle have been identified and evaluated.³ This research solely focused on the business to business (B2B) supplies of goods, as the place of supply rules for the B2B supply of services were brought in line with the destination principle in 2010.⁴ The European Commission presented the outcome of this research in its VAT action plan.⁵ In October 2017 the

European Commission presented the main aspects of the new rules for B2B supplies⁶ followed by detailed rules in May 2018.⁷ The main feature of this system is that all transactions will eventually⁸ result in a VAT amount to be paid to the tax authorities. The proposed destination based system has already been criticized in literature.⁹ In this article we compare the proposed definitive system with the current system and the general reverse charge mechanism. This general reverse charge mechanism can be temporarily implemented by some Member States.¹⁰ The option was introduced upon request of some EU Member States, in particular the Czech Republic that has already requested to apply this temporary general reverse charge mechanism. The main result of this system is that no VAT will be received by the tax authorities until the last link in the supply chain. So we are indeed at a VAT cross roads:

* Professor of indirect taxes at Erasmus University Rotterdam and a partner of the Tax Research Center of BDO Accountants & Belastingadviseurs B.V. in Tilburg. Email: merkx@law.eur.nl.

** Working as a tax talent trainee at the Dutch tax authorities.

*** Works for PwC in Amsterdam and as a lecturer and researcher at the tax department of Leiden University.

¹ First Council Directive 67/227/EEC and Second Council Directive 67/228/EEC of 11 Apr. 1967. This objective is still included in Art. 402 of the Council Directive 2006/112/EC of 28 Nov. 2006.

² Communication on the Future of VAT COM (2011) 851 final, at 5.

³ European Commission, Green Paper On the future of VAT Towards a simpler, more robust and efficient VAT system, Brussels, 1 Dec. 2010, COM(2010) 695 final; VAT Expert Group, VEG No. 004, First meeting – 24 Oct. 2012, taxud.c.1(2012)1329567; European Commission, Implementing the 'destination principle' to intra-EU B2B supplies of goods, Feasibility and economic evaluation study, Final Report, 30 June 2015; European Commission, Commission staff working document impact assessment accompanying the document Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, Brussels, 4 Oct. 2017, SWD(2017) 325 final.

⁴ VAT Expert Group, VEG No. 004, first meeting – 24 Oct. 2012, taxud.c.1(2012)1329567, at 4.

⁵ European Commission, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT, Towards a single EU vat area - Time to decide, Brussels, 7 Apr. 2016, COM(2016) 148 final.

⁶ Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, 4 Oct. 2017, COM (2017) 569 final.

⁷ Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, 25 May 2018, COM (2018) 329 final.

⁸ As a temporary measure the VAT will be reverse charged to Certified Taxable Persons (CTPs), see s. 3.2.

⁹ Madeleine Merkx, John Gruson, Naomie Verbaan & Bart van der Doef, *Definitive VAT Regime: Stairway to Heaven or Highway to Hell?*, 27(2) EC Tax Rev. 74–82 and Gorka Echevarria Zubeldia, *Definitive VAT Regime ... Really?*, 29(4) Int'l VAT Monitor (2018).

¹⁰ Council Directive (EU) 2018/2057 of 20 Dec. 2018 amending Directive 2006/112/EC on the common system of value added tax as regards the temporary application of a generalized reverse charge mechanism in relation to supplies of goods and services above a certain threshold, OJ 2018, L 329/3.

complete taxation of domestic and cross-border supplies as the European Commission proposes or effectively only taxation in the last link of the supply chain as some EU Member States propose. Or should we continue the current system? In this article we address all these options. We test the systems in sections 3 and 4 using the following principles: taxation in the country of consumption, neutrality, simplicity, cash flow neutrality, easy to audit and fraud proof (described in section 2). Most of these principles are important when adopting new tax legislation, some especially for VAT. VAT fraud in particular is a big problem within intra EU B2B trade.¹¹ A new system should therefore contribute to limiting this VAT fraud. We will end the article with a summarized comparison and a conclusion in section 5.

2 PRINCIPLES

2.1 Taxation in the Country of Consumption

VAT is a general tax on consumption (Article 1 (2) VAT Directive). As such, its objective is to tax all private consumption. The tax should accrue to the country where the consumption takes place. This principle can be found in the legislative history of the VAT Directive¹² as well as the guidance from international organizations.¹³ The place of supply rules are the provisions that are responsible for achieving the goal of taxation in the country of consumption. Proxies are used to achieve that goal. With the exception of the rule that allows Member States to tax certain services at the place of their use and enjoyment (Article 59a VAT Directive), place of supply rules use proxies such as, the place where the transport of the goods ends, the place where the customer is established. But also the place where the supplier is established and the place where the transport of the goods starts or the goods are located at the time of supply can be proxies to achieve the objective of taxation in the country of destination, when it is common knowledge that consumption regularly takes place at that place (e.g. when an immovable property is supplied it will be used at the place it is located).

2.2 Neutrality

The principle of fiscal neutrality is one of the pillars of the VAT system.¹⁴ Therefore, this principle is mentioned

several times in the Preamble of the VAT Directive.¹⁵ However, it is not a rule of primary law, but more a principle of interpretation, to be applied concurrently with other VAT principles.¹⁶

There are different types of neutrality. In international trade, the so-called external neutrality is particularly important. External neutrality entails that the tax levied on importation should be equal to the amount of tax levied on the same supplies in a domestic situation. Also, the refund on exportation should be equal to the amount of tax that has been levied domestically.¹⁷ In the international context it is also of great importance that, with respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due or paid. A neutral VAT system has to ensure there is no unfair competitive advantage afforded to domestic businesses which may otherwise discourage international trade and limit consumer choices. Goods have to be subject to the same VAT legislation regardless of their origin. This is achieved by the application of the destination principle.¹⁸

2.3 Simplicity

When levying VAT, the practical feasibility must also be taken into account. VAT collection should not be more complicated than necessary for the entrepreneur who is obliged to pay the VAT to the tax authorities. However, (administrative) simplicity is not an objective in itself. It does not stand alone, so it must always be seen in relation to other principles.¹⁹

A recent study conducted by Ernst & Young for the European Commission concludes that the costs associated with complying with cross-border VAT obligations are 11% higher than the VAT compliance costs associated with domestic trade. This is likely to be due to the more complicated nature of cross-border VAT compliance compared to domestic VAT compliance. High costs and obligations associated with cross-border VAT compliance can deter businesses from engaging in intra-EU trade, which can have significant implications for levels of trade across the EU as a whole.²⁰ It also turns out that VAT obligations are particularly burdensome for businesses that are small given that they operate with more limited resources than large enterprises,

¹¹ Press release 28 Sept. 2017, http://europa.eu/rapid/press-release_IP-17-3441_en.htm (accessed 27 Feb. 2019), and the full Report: 'Study and Reports on the VAT Gap in the EU-28 Member States: 2017 Final report', TAXUD/2015/CC/131.

¹² Explanatory memorandum on the Proposal for a Council Directive amending Directive 77/388/EEC as regards the place of supply of services. COM (2003), 822 final, at 3 and 4.

¹³ OECD International VAT/GST Guidelines 2017, https://read.oecd-ilibrary.org/taxation/international-vat-gst-guidelines_9789264271401-en#page4 (accessed 27 Feb. 2019), at 16.

¹⁴ See e.g. CJEU Apr. 10, C-309/06 (Mark & Spencer III), ECLI:EU:C:2008:211; CJEU Sept. 19 2000, C-454/98, ECLI:EU:C:2000:469.

¹⁵ See points 5, 13, 30 and 34 of Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax.

¹⁶ CJEU 19 July 2012, C-44/11 (Deutsche Bank AG), ECLI:EU:C:2012:484; see also Giorgio Beretta, *VAT and the Sharing Economy*, World Tax J. 395 (Aug. 2018).

¹⁷ M. M. W. D. Merckx, *De woon- en vestigingsplaats in de btw*, Deventer: Kluwer 2011 Merckx 31–33 (2011).

¹⁸ OECD international VAT/GST guidelines on neutrality, Committee on Fiscal Affairs 2011, at 8.

¹⁹ See Merckx, *supra* n. 17, at 82–83.

²⁰ Ernst & Young LLP, *Implementing the 'destination principle' to intra-EU B2B supplies of goods. Feasibility and economic evaluation study*, 30 June 2015, TAXUD/2013/DE/319, at 13 and 80.

which leads to small businesses bearing proportionally higher VAT compliance costs than larger businesses.²¹ Therefore, it is not surprising that the European Commission has been aiming for a long time to simplify the VAT system (also specifically for Small and Medium Enterprises (SME's)²²).

Clear rules ensure clarity for the entrepreneur. Taxation in the Member State of residence would be the best option for entrepreneurs in the context of simplicity as they speak the language of this country and they know the rules.²³ Further harmonization is also a measure that increases the administrative simplicity for entrepreneurs. When for example VAT rates and exemptions are the same in every country, it is less complicated for taxpayers to apply the taxation rules of a different country as they are identical to the rules in their own country.²⁴ Problems that foreign entrepreneurs have in a Member State where they are not established and do not have a fixed establishment can also be solved by the One-Stop-Shop system. Only one VAT registration will be required in the Member State of residence. It enables taxpayers to comply with all VAT requirements in their own country. Reverse charge schemes contribute to the prevention of VAT registrations in other countries as well.²⁵ Limitation on reporting obligations will decrease the administrative burden for taxpayers.

A report from the OECD²⁶ points out that the highest feasible levels of compliance by foreign suppliers are likely to be achieved if compliance obligations in the jurisdiction of taxation are limited to what is strictly necessary for the effective VAT collection. Too complex registration and compliance procedures may lead to non-compliance.²⁷ Non-compliant behaviour makes tax auditing more difficult for tax authorities.²⁸

2.4 Cash Flow Neutral

VAT is a tax on consumption paid, ultimately, by final consumers and collected by businesses. This implies that, in principle, businesses should not bear the burden of the VAT itself. Therefore, there are mechanisms in place that allow for a refund or credit of the VAT levied on transactions between businesses (except for

businesses that make exempt supplies or are involved in non-business activities). In the staged process of VAT collection successive businesses are, in principle entitled to deduct input VAT on purchases and account for output VAT on sales.²⁹ As a result, the VAT passes through the supply chain and should, in theory, not be a cost to businesses. However, due to timing differences, the incoming and outgoing amounts of VAT can lead to a surplus or a deficit for businesses. Or, as a cash flow is the amount of money that moves in and out of a business, a cash flow advantage or disadvantage. That's why businesses often try to manage their cash flow position (particularly cross-border VAT refunds and domestic VAT credits).³⁰ Of course, tax authorities are also faced with cash flow impacts in reversed order.

2.5 Easy to Audit

Tax authorities should be able to check the correct application of the VAT rules. Auditing should not be too difficult and the costs should not be too high. The costs must also be in proportion to the revenues. Auditing is easiest in the Member State where the taxable event takes place. However, due to the ever increasing cross-border trade within the European Union, audits must also take place across borders. Exchange of information and cooperation between Member States are helpful in order to audit cross-border trade and VAT collection.³¹ The European Commission is aware of this and is therefore increasingly focusing on improving the cooperation between the Member States.³² Recapitulative statements are currently already mandatory in the case of cross-border transactions in the European Union. These statements allow tax authorities to follow the goods that are being traded and to identify mismatches. As such, reporting obligations can make it easier for tax authorities to audit.

The OECD pays a lot of attention to tax audits as well. At the end of 2017 it published a report on the effective collection of VAT on cross-border sales. In this report it advises tax authorities to facilitate international administrative cooperation.³³ Furthermore, the OECD advocates the destination principle as the basic rule for the application of the VAT to international trade.³⁴ According to the OECD, depending on developments in technology, automated systems may play a central role in facilitating tax collection in the future. Currently, it sees technology as a tool to support the

²¹ European Commission, Commission staff working document impact assessment accompanying the document Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises, Brussels, 18 Jan. 2018, SWD(2018) 9 final, at 15.

²² See Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises, Brussels, 18 Jan. 2018, COM(2018) 21 final.

²³ Merkx, *supra* n. 17, at 92.

²⁴ Merkx, *supra* n. 17, at 96.

²⁵ Merkx, *supra* n. 17, at 91 and 94.

²⁶ OECD, *Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located in the Jurisdiction of Taxation* (Paris: OECD Publishing 2017a).

²⁷ OECD 2017a, at 20 and 34.

²⁸ OECD 2017a, at 20–21 and 39–43.

²⁹ OECD international VAT/GST guidelines on neutrality, Committee on Fiscal Affairs 2011, at 3.

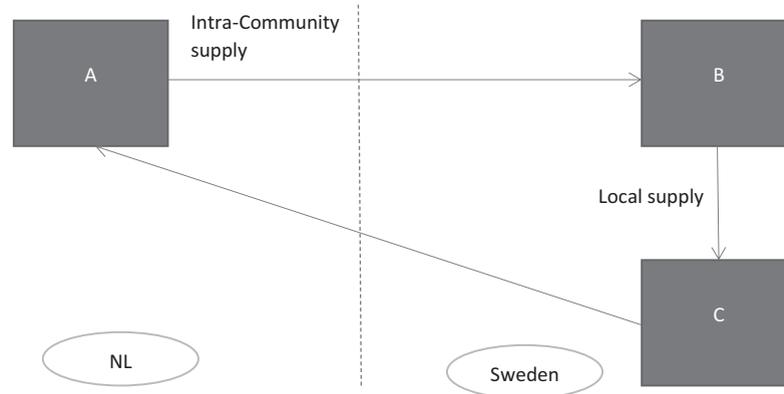
³⁰ See Ernst & Young, Managing indirect tax refunds, [https://www.ey.com/Publication/vwLUAssets/ey-new-value-new-vision/\\$FILE/ey-new-value-new-vision.pdf](https://www.ey.com/Publication/vwLUAssets/ey-new-value-new-vision/$FILE/ey-new-value-new-vision.pdf) (accessed 27 Feb. 2019).

³¹ Merkx, *supra* n. 17, at 102 and 104.

³² See e.g. European Commission, Towards a single EU VAT area - Time to act, Brussels, 30 Nov. 2017, COM(2017) 706 final.

³³ OECD 2017a, at 3, 17 and 35.

³⁴ OECD 2017a, at 12–13.



operation of the existing collection regimes.³⁵ The OECD encourages tax authorities to allow the use of electronic record keeping systems as business processes have become increasingly automated. Tax authorities can make use of reliable business records and accounting systems in order to acquire the information needed (e.g. type, date and place of supply and VAT payable).³⁶ Systems-based audits by means of business analytics could also be used to read and validate the supplier's business information (e.g. IP address, billing address and credit card) and to cross-match these data.³⁷

2.6 Fraud Proof

VAT fraud is a big problem in the EU. With an estimated VAT gap of EUR 152 billion a year within the EU, EUR 50 billion is ascribed to VAT fraud.³⁸ The CJEU describes what VAT fraud is in a number of cases.³⁹ Technically VAT fraud is no more than the non-payment of VAT where it should have been paid. Important is that this is done with intent (in other words in case VAT is not paid by accident or because the taxable person does not have sufficient funds we won't speak of VAT fraud). The most persistent VAT fraud is carousel fraud. Because the EU proposals for a definitive VAT system target this type of fraud directly it is important to discuss the way carousel fraud works here. We however do note that other types of fraud are possible within the VAT system and if one type of fraud is not possible anymore fraud shifts to another type. It goes beyond the scope of this article to discuss them all and we might even not be aware of all types of VAT fraud going on.⁴⁰

VAT carousel fraud, also known as Missing Trading Intra-Community Fraud or simply MTIC fraud, in its simplest form requires three parties (A, B and C) and most likely high value goods with a compact volume or services. To conceal the VAT fraud from the tax authorities often more parties are used in the fraud supply chain, including innocent businesses. However, irrespective of the length or complexity of the supply chain the principle of the fraud is always the same.

In our example party A is established in the Netherlands and supplies goods to party B established in Sweden. In relation to the supply the goods are transported from the Netherlands to Sweden. A's supply therefore qualifies as an intra-Community supply, meaning that A applies an exemption with right the to deduct VAT. B is required to report an intra-Community acquisition in Sweden where he receives the goods. Party B can deduct the VAT due because of the intra-Community acquisition in the same VAT return. Party B then subsequently sells the goods to party C, also established in Sweden, which qualifies as a local supply in Sweden. B charges C Swedish VAT and C will deduct this VAT in its VAT return. However in our example party B is the fraudster. He will therefore not report the intra-Community acquisition (and not deduct the VAT due to intra-Community acquisition as well) and not report the local Swedish supply. Instead he will disappear with the VAT paid by party C in hand. To make it a carousel fraud party C must supply the goods to party A and then the fraud can start again.

Our example is a case where the fraud takes place with actual goods or services. It is also possible that empty boxes are used or that no transport of goods takes place at all, but there is a paper carousel fraud (i.e. invoices are issued for goods that have never been supplied).

The fraud is lucrative because of the exemption applying in the A-B transaction followed by a local supply that is subject to the general VAT rate. In its

³⁵ OECD 2017a, at 17 and 27.

³⁶ OECD 2017a, at 46–47.

³⁷ OECD 2017a, at 34.

³⁸ See Press release 28 Sept. 2017, http://europa.eu/rapid/press-release_IP-17-3441_en.htm (accessed 27 Feb. 2019), and the full report Study and Reports on the VAT Gap in the EU-28 Member States:2017 Final Report, TAXUD/2015/CC/131.

³⁹ For example in CJEU 7 Dec. 2010, C-285/09 (R.), ECLI:EU:C:2010:742, para. 49.

⁴⁰ The authors refer to Marie Lamensch & Emanuele Ceci, *VAT Fraud. Economic Impact, Challenges and Policy Issues*, Study requested by the TAX3 Committee, Oct. 2018, in particular Ch. 2.

objective to address the VAT fraud the EU therefore has two options: to effectively tax the intra-Community supply by removing the exemption (as is envisaged in the proposals for the definitive VAT system) or by removing the VAT of the local supply (as is envisaged in the temporary general reverse charge rule). To address the VAT fraud now tax authorities also have the power to refuse the entitlement to the exemption or to the right to deduct VAT to the fraudster and the persons involved in the supply chain who knew or should have known of the VAT fraud.⁴¹ Some Member States also have rules for joint and several liability in place. The CJEU however ruled that taxable persons can only be held liable if they knew or should have known of the VAT fraud.⁴²

2.7 Relationship Between the Principles

It is important to take note of the relationship between the principles described above. Sometimes these principles will go hand in hand. For example taxation in the country of consumption ensures neutrality too, because when taxing in the country of consumption it doesn't matter to the consumer if he buys a product from a local or foreign supplier. Sometimes these principles may collide. For example taxation in the country of the supplier provides for simplicity and is easy to audit, but infringes the principle of taxation in the Member State of consumption and the neutrality principle. Consequently, when evaluating a system the principles must be weighed taking into account the importance of each principle.

In that respect we note that neutrality and taxation in the country of consumption are two main objectives of the VAT system. Cash flow neutrality supports the neutrality principle, but is not an objective in itself.⁴³ Simplicity and easy to audit are not objectives in itself either. They can be dealt with in different ways, for example the Mini One Stop Shop (MOSS) to deal with VAT obligations in other Member States and administrative cooperation to deal with audits of taxable persons established abroad. However the importance of these two principles must not be underestimated. If mistakes are made because the system is too complex and fraud is easy because audits are too difficult to carry out taxation in the country of consumption and neutrality will not be achieved. Considering the yearly estimated lost amount due to VAT fraud the level a system is susceptible to VAT fraud is of importance as well.

⁴¹ CJEU 6 July 2006, C-439/04 and C-440/04 (Kittel and Recolta), ECLI:EU:C:2006:446, CJEU 7 Dec. 2010, C-285/09 (R.), ECLI:EU:C:2010:742 and CJEU 18 Dec. 2014, C-131/13, C-163/13 and C-164/13 (Italmoda), ECLI:EU:C:2014:2455.

⁴² CJEU 11 May 2006, C-384/04 (Federation of Technological Industries), ECLI:EU:C:2006:309.

⁴³ In the end the supplier does not carry the burden of VAT, but he might need to prefinance the VAT.

3. THE CURRENT AND THE PROPOSED DEFINITIVE VAT SYSTEM

3.1 How the Current System Works

The current European VAT system treats domestic and cross-border transactions differently.⁴⁴ Generally, VAT is charged on goods and services supplied domestically,⁴⁵ whereas goods and services supplied cross-border are free of VAT.

In case of domestic supplies of goods and services, the supplier charges local VAT to his customer. Depending on the nature of his activities (economic/non-economic, taxable/exempt), the supplier has the right to recover input VAT incurred. As a result, each individual supplier in the supply chain effectively only pays the VAT due on the value he added to the good/service (mechanism of fractioned payment).⁴⁶

In case of cross-border B2B supplies of goods under the 'transitional' arrangement the transaction is split into two taxable events: the exempt or zero-rated intra-Community supply performed by the supplier from the Member State of departure of the goods, followed by an intra-Community acquisition by the recipient in the Member State of arrival of the goods. The recipient is liable to report and pay local VAT in the Member State of arrival of the goods. However, as the payment is shifted to the VAT return and this payable VAT amount can be fully recovered in the same VAT return (if the recipient has a full right to recover VAT), the recipient acquired goods free of VAT. This opportunity to acquire goods free of VAT makes VAT fraud within international trade lucrative, as described in section 2.6.

3.2 How the Proposed System Works

Under the proposed definitive VAT system cross-border B2B supplies of goods within the EU will be treated the same as domestic supplies of goods. Whereas under the current system the cross-border B2B supplies of goods is split up in two taxable events, under the definitive system there will only be one taxable event, the intra-Union supply performed by the supplier. This intra-Union supply is subject to VAT in the Member State of arrival of the goods. As the one-stop-shop mechanism is extended to include these intra-Union supplies, the supplier reports and pays the VAT due in the country of arrival of the goods via its VAT return in its country of establishment. After the evaluation of the definitive VAT system for the

⁴⁴ See Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee, On the follow-up to the Action Plan on VAT, Towards a single EU VAT area – Time to act, Brussels, 4 Oct. 2017, COM (2017) 566 final, at 3.

⁴⁵ Except when the supply of the good or service is subject to an exemption, is zero-rated or a domestic reverse charge mechanism applies.

⁴⁶ M. E. van Hilten & H. W. M van Kesteren, *Omzetbelasting 14* (Deventer: Wolters Kluwer 2017) and R. A. Wolf, *Carrouselfraude*, para. 1.2 (Den Haag: SDU uitgevers 2010, online).

B2B cross-border supplies of goods, the European Commission has the intention to extend this system to the B2B supplies of services.⁴⁷

The definitive system is complicated with different rules for cross-border supplies of goods to so-called 'certified taxable persons' ('CTPs').⁴⁸ In case the supplier is not established in the Member State of arrival of the goods and the customer is a CTP, no VAT is charged on the supply. Instead, the CTP has to account for reverse charge VAT. We refer to previous articles written by some of the authors of this article for a more detailed explanation of the proposed system.⁴⁹

3.3 Testing the Current and Proposed System

3.3.1 Taxation in the Country of Consumption

In the current VAT system, taxation in the Member State of destination (where the goods will most likely be consumed) of the B2B cross-border supply of goods is achieved by exempting the intra-Community supply and taxing the intra-Community acquisition in the Member State of arrival of the goods.

Although the mechanism is different, the cross-border B2B supply of goods continues to be taxed in the country of destination of the goods under the proposed system. Under the proposed system it will be the supplier who charges VAT of the Member State of destination. In case the goods are supplied to a CTP, the CTP has to account for reverse charge VAT in the Member State of destination of the goods.

3.3.2 Neutrality

A neutral VAT system requires goods to be subject to the same VAT legislation regardless of their origin. This is true under the current as well as the proposed system. As described under (a) both the current and the proposed system guarantee that VAT on the acquired goods is due in the Member State of destination of those goods. What's more, compared to the current system the proposed system is more neutral. Currently if a supplier purchases goods domestically it needs to pay VAT to the supplier and recover that VAT through the periodic VAT returns. If the supplier purchases goods from a supplier in another Member State the supply will be

exempt and the supplier can report and deduct the VAT on the intra-Community acquisition in the same VAT return. This means that by purchasing goods abroad there is no cash flow effect. Intra-Community purchases can therefore be preferred to domestic purchases. Under the proposed system it doesn't matter whether goods are purchased domestically or coming from another EU Member State. In each case local VAT is charged and needs to be paid to the supplier by the customer. The customer must recover this VAT through its periodic VAT return. However if the supplier is not established in the Member State where VAT is due and the customer is a CTP VAT will still be reverse charged, making it more interesting to purchase goods from suppliers established abroad.

3.3.3 As Simple as Possible

With the completion of the internal market on 1 January 1993 the European Commission aimed to create 'a more favourable environment for stimulating enterprise, competition and trade'.⁵⁰ It was envisaged that the abolition of customs procedures would reduce compliance costs associated with intra-EU trade.⁵¹ However, the transitional system replacing the customs procedures resulted in an additional (compliance) burden, risks and legal uncertainty for businesses involved in EU trade, thus leading to higher costs. This transitional system is even said to have led businesses to avoid EU trade.⁵²

With the disappearance of the border controls, administrative obligations were devised in order for Member States to still be able to follow the goods circulating through the EU. In this respect, businesses involved in EU trade have to fulfil additional compliance obligations (such as filing recapitulative statements for the intra-Community supplies and/or acquisition of goods). Furthermore, in order to be allowed to apply the exemption for the intra-Community supply of goods, the supplier is required to collect and retain proof that the goods have left the Member State of dispatch and check the status of its customer by verifying the customer's VAT number.

The proposed rules have their own problems. Under the proposed rules VAT is due in the Member State of arrival of the goods, where it has to be paid by the supplier. This means that suppliers must have

⁴⁷ See Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT, Towards a single EU VAT area – Time to decide, Brussels 7 Apr. 2016, COM(2016) 148 final, at 10 and COM (2017) 566 final, at 7. For some critical comments on the scope of the extension of the system to B2B supplies of services (not all exceptions to the main place of supply rule should be abolished) see M. Merckx, J. Gruson, N. Verbaan & B. van der Doef, *Definitive VAT Regime: Stairway to Heaven or Highway to Hell?*, 27(2) EC Tax Rev. 77 (2018).

⁴⁸ COM (2017) 566 final, at 7.

⁴⁹ Merckx, Gruson, Verbaan & van der Doef, *supra* n. 47, at 74–82 and M. Merckx & J. Gruson, *Definitive VAT regime: Ready for the Next Step?*, 28(3) EC Tax Rev. 136–49 (2019).

⁵⁰ Completing the internal market, White paper from the Commission to the European Council, Brussels 14 June 1985, COM(85), 310 final, at 4.

⁵¹ Commission Staff Working Document, Impact Assessment, Accompanying the document Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, Brussels 4 Oct. 2017, SWD(2017) 325 final, at 27.

⁵² VAT expert group, VEG No 003, B2B supplies of goods – Taxation at destination, Shortcomings of the current VAT system identified by stakeholders, Brussels 27 Sept. 2012, taxud.c.1(2012)1325533 – EN, at 6. VEG No 003, taxud.c.1(2012)1325533 – EN, at 3.

knowledge of applicable rates, exemptions etc. in Member States where they have customers. Considering the European Commission's proposal to give Member States more freedom to determine for which goods and services the reduced rate applies,⁵³ this will become a difficult task for businesses in the proposed system. According to the European Commission the proposed system will decrease compliance burdens with one billion euros. We however have doubts. The system seems rather complicated to us and more complicated than the current system for businesses to apply due to the fact that they must apply the EU VAT rules of possibly twenty-eight Member States. This will be mitigated to some extent, because customers may have the CTP status and will report the VAT due. However this is presented as a temporary solution and requires taxable persons to apply two different set of rules depending on their customer's status.

3.3.4 Cash Flow Neutral

Under the transitional system, the intra-Community cross border B2B supplies of goods is cash flow neutral for both businesses and the tax authorities when the customer has a full right to recover input VAT. Since the intra-Community supply is VAT exempt and the VAT reported on the intra-Community acquisition by the customer can be recovered in the same VAT return, the intra-Community transaction does not involve a payment of VAT. In case the customer does not have a full right to recover input VAT, there is a cash flow advantage. The customer is not required to pay the acquisition VAT at the moment he receives the goods, the VAT payment only needs to be made within a certain timeframe after the filing period.

Under the proposed system, VAT is charged on the intra-Union supply of goods against the applicable VAT rate in the Member State of arrival of the goods. This involves considerable amounts of additional cash flow among entrepreneurs, among tax authorities and between entrepreneurs and tax authorities compared to the current VAT system.⁵⁴ Depending on their trade profile, businesses will either have a cash flow advantage or a cash flow disadvantage.⁵⁵

3.3.5 Easy to Audit

Under the current system tax authorities audit local business to check whether they paid VAT in their

Member State. In case of a suspected fraud they will need to consult the tax authorities of the Member State of destination or origin of the goods.

Under the proposed system, the tax authorities of the Member State of dispatch of the goods have to collect the VAT charged on the intra-Union supply, accruing to the Member State of arrival of the goods. The main issue for the tax authorities of the Member State of dispatch of the goods is that they have to assess whether businesses have applied the correct VAT rate on supplies to other Member States. The tax authorities of the Member State of dispatch practically have to enforce (and have knowledge of) VAT rates of all Member States, posing them for serious delimitation problems. The VAT rates proposal makes matters even more complicated, as it provides Member States with more freedom to set their VAT rates, leading to more rates diversification.⁵⁶

The main issue for the tax authorities of the Member State of arrival of the goods is that they have to rely completely on the remittance of the VAT on the intra-Union supply by businesses established in other Member States (whom they cannot audit without the involvement of the Member State of dispatch) and the assessment of the tax authorities of those Member States of the correctness thereof.⁵⁷ As the administrative obligations for businesses relating to the cross border B2B supply of goods in the EU are removed (i.e. filing recapitulative statements for the intra-Community supplies and/or acquisition of goods), the Member State of arrival also cannot monitor the goods shipped to its country and the VAT due on these goods. What's more it must allow the deduction of input VAT even though it may not yet have received the VAT on the supply from the Member State of dispatch.

Consequently, the tax authorities have to work together more closely under the proposed system and assist each other with collecting VAT. The recently approved measures to strengthen administrative cooperation in the field of VAT aim to provide tax authorities with more instruments to do so (e.g. joint audit, exchange of information without prior request).⁵⁸ It remains to be seen whether this is enough, since, as Lamensch puts it 'states naturally have little appetite to mobilize resources to ensure the collection of taxes in other states'.⁵⁹ Furthermore, working together is not

⁵³ Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax COM/2018/020 final.

⁵⁴ Letter of the State Secretary of Finance of 10 Nov. 2017, BZDOC-1015490419-119, Fiche 5: Mededeling, richtlijn en verordening betreffende een definitief BTW-systeem, at 7, Merckx, Gruson, Verbaan & van der Doef, *supra* n. 47, at 82.

⁵⁵ SWD(2017) 325 final, p. 61.

⁵⁶ Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, Brussels 18 Jan. 2018, COM (2018) 20 final and R. De La Feria, *The Definitive VAT System: Breaking with Transition*, 3 EC Tax Rev. 125 (2018).

⁵⁷ Compare: Marie Lamensch & Emanuele Ceci, *VAT Fraud. Economic Impact, Challenges and Policy Issues*, Study requested by the TAX3 Committee, Oct. 2018, at 49.

⁵⁸ Council regulation (EU) 2018/1541 of 2 Oct. 2018 amending Regulations (EU) No 904/2010 and (EU) 2017/2454 as regards measures to strengthen administrative cooperation in the field of value added tax, OJ L 259, 16 Oct. 2018, at 1–11.

⁵⁹ M. Lamensch, *Is There Any Future for the Vendor Collection Model in the 21st Century Economy?*, Int'l VAT Monitor 183 (May/June 2016).

only a matter of having the right instruments, but education, knowledge, language and culture also play a role.⁶⁰

Although the above does not apply to supplies to CTP's, the CTP concept brings its own difficulties. The tax authorities require structural additional capacity for processing requests for the CTP status and monitoring the status after it has been granted.⁶¹

3.3.6 Fraud Proof

The mechanism of fractioned payment ensures that, to a certain level, VAT is self-enforcing and mitigates the effects of fraud.⁶² It is self-enforcing in the sense that there is an incentive for businesses to comply. Gains of fraud/evasion are minimized to the VAT on the value added by that business. Purchasers' interests are opposed to that of sellers, in the sense that there is no benefit for businesses to purchase goods free of VAT (as they can (fully) reclaim the input VAT charged). Should a business decide not to remit the VAT due on their supplies the tax loss is minimized to the value added in that last production phase.

However, under the current system this mechanism of fractioned payments is broken when the goods are supplied to a business in another Member State. As the intra-Community supply is exempt with full recovery of the input VAT incurred in respect of these goods, the goods leave the country free of VAT. Unfortunately, this happens 'at a particularly vulnerable spot: the interface of domestic and foreign tax administrations',⁶³ making it more difficult to detect the fraud. Another element of the VAT system that is utilized, in amongst others the carousel fraud, is the fact that recovery of input VAT is not linked to VAT actually being paid.⁶⁴ In our example mentioned in section 2.6, party C can in principle reclaim the input VAT charged, but not remitted by party B.

Under the proposed system this break in the mechanism of fractioned payments is repaired, as the intra-Union supply is subject to VAT. This removes the lucrateness of the carousel fraud as goods cannot be purchased VAT free any longer, but it does not prevent exploitation of the credit and refund system of VAT. Different types of fraud may arise. For example a fraudster can buy goods in a Member State that applies a low VAT rate on certain goods (i.e. a Member State may apply a reduced rate while another applies a general VAT rate or the Member State has a low general VAT rate) and sell them to a

customer in a Member State that has a high rate on these goods. When it does not report the supply it can also not deduct the input VAT. However because the input VAT is much lower than the output VAT, this may still be lucrative. Especially in case of a high volume of transactions. Hence, under the proposed system the seller instead of the acquirer will become the missing trader. What's more, the chances to get away with the fraud will increase, because the reaction by the tax authorities in the Member State of consumption will be slower and the latter's means of action will be more limited, because most of the relevant data and auditing powers will be with the Member State of Identification.⁶⁵ Under the special regime for CTP's, it is also still possible to purchase goods VAT free, as the reverse charge mechanism applies in that case. A CTP is supposed to be a trustworthy taxpayer, but fraudsters will surely find their way to use this concept to their benefit.⁶⁶

4 GENERAL REVERSE CHARGE

4.1 How the System Works

Under the general reverse charge mechanism, the liability for the payment of VAT on B2B transactions is shifted from the supplier to the recipient in case of domestic supplies.⁶⁷ This implies that the supplier is no longer responsible for the reporting and payment of VAT in case the recipient is a taxable person for VAT purposes. In the event the recipient has a full right to deduct input VAT, he accounts for the VAT on the purchase in his VAT return as output VAT and deducts the same amount as input VAT. As a result, no actual payment would be made to the tax authorities for the supply. Only retailers (i.e. companies conducting business to consumer (B2C) transactions) would actually collect the VAT and are obliged to pay it to the tax authorities.⁶⁸ This approach is very different from the current VAT system, in particular with respect to the fractionated payment of VAT at the level of each economic transaction.⁶⁹ The VAT treatment of intra-Community transactions remains the same.

⁶⁰ J. Sanders jr., *Een nieuwe start voor de btw*, 46 BTW-bulletin (2016).

⁶¹ Letter of the State Secretary of Finance of 10 Nov. 2017, BZDOC-1015490419-119, Fiche 5: Mededeling, richtlijn en verordening betreffende een definitief BTW-systeem, at 8.

⁶² M. Keen & S. Smith, *VAT Fraud and Evasion: What Do We Know, and What Can be Done?*, IMF Working Paper WP/07/31, at 6, 7 and Wolf, *supra* n. 46, para. 2.5.

⁶³ R. T. Ainsworth, *Carousel Fraud in the EU: A digital VAT Solution*, Tax Notes Int'l 445 (1 May 2006).

⁶⁴ Wolf, *supra* n. 46, para. 1.2.

⁶⁵ Marie Lamensch & Emanuele Ceci, *VAT Fraud. Economic Impact, Challenges and Policy Issues*, Study requested by the TAX3 Committee, Oct. 2018, at 49 and 50.

⁶⁶ G. J. van Norden, *Voorstellen voor ingrijpende Europese btw-hervormingen*, NTFR 2017/2908, J. Gruson & N. Verbaan, *Voorstellen voor het definitieve btw-stelsel: definitief een nieuw begin?*, BTW-bulletin 2018/11, Merckx, Gruson, Verbaan & van der Doef, *supra* n. 47, at 82.

⁶⁷ See also 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 generalized reverse charge mechanism in relation to supplies of goods and services above a certain threshold, Brussels, 21 Dec. 2016, COM(2016) 811 final.

⁶⁸ Robert F. van Brederode & Sebastian Pfeiffer, *Combating Carousel Fraud: The General Reverse Charge VAT*, Int'l VAT Monitor 151 (May/June 2015).

⁶⁹ Commission of the European Communities, Communication from the Commission to the Council and the European Parliament. A

Currently the VAT Directive already gives the possibility to Member States to apply a reverse charge mechanism to a limited number of transactions under specific conditions (e.g. articles 199 and 199a VAT Directive).

On 21 December 2016, the European Commission proposed an optional and temporary general reverse charge on domestic B2B supplies of goods and services when Member States meets certain conditions and when the invoice exceeds the amount of EUR 10,000.⁷⁰ It was adopted by the EU Member States on 2 October 2018. In the adopted proposal the monetary threshold has been increased to EUR 17,500.⁷¹ Member States can only request to apply the generalized reverse mechanism if they meet strict conditions: e.g. they must have a VAT gap of at least 5% above the EU median VAT gap, a level of carousel fraud of 25% within that VAT gap and the Member State in question establishes that other control measures are not sufficient to combat carousel fraud as well as the reasons why VAT administrative cooperation has proven insufficient.

4.2 Testing the General Reverse Charge

4.2.1 Taxation in the Country of Consumption

Under the general reverse charge mechanism, the liability to pay VAT is shifted from the supplier to the recipient in the event of domestic B2B transactions. As a result, taxation still takes place in the Member State of residence of the buyer, where the goods will also be consumed most of the time. Therefore, there is no effect on taxation in the country of consumption compared to the current system. Under the proposed system, the VAT treatment of domestic supplies doesn't change. Hence, the VAT collection in the country of consumption remains the same. As described in section 3.2 both the exempt intra-Community supply in the Member State of departure in combination with the intra-Community acquisition taxed in the Member State of destination (this will be maintained under the general reverse charge mechanism) and the proposed intra-Union supply of goods leads to taxation in the Member State of destination. As a result, there is no difference with regard to the place of taxation compared to the current and proposed system.

strategy to improve the operation of the vat system within the context of the internal market, Brussels, 7 June 2000, COM (2000) 348 final, at 13; International VAT Association, *Combating VAT Fraud in the EU – The Way Forward* 22–23 (Mar. 2007).

⁷⁰ 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 generalized reverse charge mechanism in relation to supplies of goods and services above a certain threshold, Brussels, 21 Dec. 2016, COM(2016) 811 final, at 3 and 7–10.

⁷¹ 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 generalized reverse charge mechanism in relation to supplies of goods and services above a certain threshold, Interinstitutional File: 2016/0406(CNS).

4.2.2 Neutrality

As described the general reverse charge mechanism does not affect the place of taxation and hence the neutrality of the system compared to the current system is not affected. Under the general reverse charge mechanism both domestic and cross-border supplies are effectively freed from VAT. Like under the proposed system where both domestic and cross-border supplies are subject to VAT, business will therefore not prefer purchases from foreign suppliers over domestic purchases.

4.2.3 As Simple as Possible

In order to determine whether or not the reverse charge mechanism has to be applied in domestic situations, the supplier must verify the VAT status of all recipients. This results in an increased burden compared to the current situation and will therefore increase compliance costs. Currently the status only has to be verified in case of intra-Community supplies. Under the proposed system both the VAT status and the CTP status have to be validated in case of intra-Union transactions. In addition, under the general reverse charge mechanism, the supplier must be informed of the consumer's purpose with the goods (i.e. private or business use). This information collection will likewise increase administrative burden compared to the current system. Not to mention who bears the risk of the correctness of this information.

The different VAT treatment of B2B and B2C transaction will also lead to different invoices. As a result, suppliers should have an administrative system that is able to make this distinction. This will increase the compliance costs as well. The retail sector (mostly SMEs) will be confronted with the biggest burden as they will in most cases be responsible for the collection of the VAT due on the B2C transactions. A monetary threshold, as mentioned in section 4.1 would be beneficial for SMEs, but will also make the system more complex as the current system will remain applicable to invoices with a value below the monetary threshold and the reverse charge system will apply to invoices with a value that exceeds the threshold.

Besides, to overcome the disappearance of the fractioned payments, compensatory reporting obligations (e.g. periodic customer list, value of the supplies and VAT identification numbers) could be introduced that allow for basic crosschecking of the information stemming from suppliers and acquirers. This would enable the tax authorities to monitor the transactions and to identify mismatches. These reporting obligations alone would represent some significant one-off costs for introduction as well as recurrent costs for businesses.⁷²

⁷² Commission of the European Communities, Communication from the Commission to the Council and the European Parliament on measures to change the VAT system to fight fraud, Brussels 22 Feb. 2008, COM(2008) 109 final, at 8.

Recapitulative statements are already mandatory in the case of cross-border transactions in the European Union. A general reverse charge VAT system will possibly apply them in purely domestic situations as well.⁷³ Intra-Union supplies of goods should no longer be included in the recapitulative statements under the proposed system.

In addition, currently the supplier is responsible for VAT payment. This VAT responsibility is limited 'only' to the correct VAT payment for the portfolio of provided services or supplied goods. This is usually a limited group of similar types of products. However, under the reverse mechanism this might change considerably. The recipient can become liable for the VAT payment of a significantly larger and more diverse range of different types of goods and services, depending on the number of different types of goods that are purchased. In case the recipient has a full right to deduct input VAT the impact would only be an accounting one. The real increase in burden will arise for businesses which do not have a full right to deduct VAT as some of them may be liable for VAT payment for the first time. For these entities there would be a significant increase of administrative and compliance costs compared to the current system.⁷⁴ Under the proposed system the recipient will only be liable for the VAT payment in case of cross-border supplies of goods within the European Union provided that he is a CTP and the supplier is not established in the Member State of destination.

4.2.4 Cash Flow Neutral

Under the current VAT system the supplier is liable for the payment of VAT. In a domestic situation, he will charge the recipient VAT. When the recipient has a (full) right to deduct input VAT, he can (partly) deduct the input VAT in its periodic VAT return. It is offset against the (possible) output VAT. Under the general reverse charge system, taxpayers no longer have to pre-finance the VAT as there would be no disparities anymore between the moment of payment and recovery of VAT. In case of B2B transactions there is no need to pay VAT at all when the taxpayer has a full right to deduct VAT. This is comparable with the current system of intra-Community acquisitions in cross-border situations. However, in B2C situations, the introduction of a general reverse mechanism may have a substantial impact on the cash flow position of retailers when using an invoice based accounting system. Since (almost) the entire remittance takes place in this part of the chain, it is possible that enormous amounts have to be pre-financed or are already received (in case the recipient pays earlier than the moment the VAT has to be paid to the tax

authorities). The proposed system is based on the principle that the supplier is liable for charging and collecting the VAT of the Member State of destination. This entails that the recipient may have to pre-finance the input VAT since he can no longer directly deduct the VAT due as input tax, as is possible with the intra-Community acquisition. There is also a cash flow impact for the supplier as intra-Community supplies are currently exempt from VAT. This is not the case when the customer is a CTP and the supplier is not established in the Member State of the customer. In that case the VAT is reverse charged to the buyer. Altogether, the general reverse charge system is more cash flow neutral than the current and the proposed system, except for the last link in the supply chain. The flip side, of course, is that tax authorities will receive less fractionated VAT payments through the production chain. Conversely, they will receive higher amounts at the end of it.

4.2.5 Easy to Audit

The rule of thumb in all Member States is that 80% of the VAT is paid by less than 10% of the taxable persons. This means that very little control effort has to be invested by Member States' tax authorities to be guaranteed the bulk of their VAT revenue.⁷⁵ However, under reverse charge, the bulk of the VAT would be payable by retailers who in many countries may be small and may have less knowledge and resources than the small number of large businesses that currently pay a large proportion of the VAT in most Member States. This increases the chance of making mistakes. Besides that, larger companies are most of the time more willing to be compliant. Moreover, the identification of taxable persons would be even more crucial than under the current system as no VAT will be levied in domestic B2B situations. This would require additional efforts and resources. Finally, general control of all businesses needs to be maintained in order to avoid diversion of goods and services to the black economy.⁷⁶

As mentioned under (c), recapitulative statements in both domestic and cross-border situations might be needed in order to monitor the transactions and to identify mismatches. As a result, tax authorities have to audit more statements.

The above leads to the conclusion that the general reverse charge system is less easy to audit than the current system. The proposed system intends to benefit from reliable taxable persons, hence it has introduced the CTP status with additional simplifications. However, these persons can still be fraudsters and they should therefore continue to be monitored in our opinion.

⁷³ van Brederode & Pfeiffer, *supra* n. 68, at 154.

⁷⁴ Petr Toman, *Reverse Charge in VAT – Possibilities and Limitations*, in Ministry of Finance of the Czech Republic, *Closing VAT GAP Through Reverse Charge Mechanism* 47–48 (Prague, Dec. 2015).

⁷⁵ Commission of the European Communities, Communication from the Commission to the Council in accordance with Art. 27(3) of Directive 77/388/EEC, Brussels, 19 July 2006 COM(2006) 404 final, at 4.

⁷⁶ Commission of the European Communities 2008, at 8–9.

Nevertheless, this would in the authors' opinion be easier than auditing all the retailers under the general reverse charge system.

4.2.6 *Fraud Proof*

We believe that the general reverse charge system will significantly reduce carousel fraud or missing trader fraud as no actual payments of VAT take place in the supply chain. Payment and reclaim of VAT are made by the same person and the 'missing trader' has no VAT liability. Only the B2C transaction results in an actual payment of VAT. Besides that, the fraud cannot shift to other types of goods as can happen with the current reverse charges for specific goods or services (e.g. article 199a VAT Directive). This is because the general reverse charge system applies to all domestic B2B supplies of goods. A monetary threshold, as mentioned in section 4.1 would not be beneficial for the prevention of fraud as it will weaken the general reverse charge system.

However, there is also a risk of new types of fraud. For example, consumers may try to pose as taxable persons in order to be granted access to supplies without VAT. However, this problem is not new and not caused by the general reverse charge system per se. It also happens under the current system.⁷⁷ Business owners may also be tempted to purchase goods for private use through their business in order to save VAT. This problem is not new either and exists already under the current system also.⁷⁸ A possible solution may be the formulation of a definition of consumer products whose nature is highly indicative of private use, enumerating particular characteristics. When the definition is met, the supplier would not be able to make tax-free or reverse charge supplies on the basis of only the VAT identification number, but should also acquire other information sufficient to demonstrate business use.⁷⁹ However, this will increase administrative burden.

Further, the general reverse charge mechanism is not an answer to black sales and may generate other types of consumption fraud, like false statements about the customer's VAT status and the hijacking of VAT identification numbers at the retail level (in order to avoid the supplier having to charge VAT and to allow goods to enter into the black market free of VAT).⁸⁰

Finally, under the reverse charge mechanism VAT is in general always paid by the last entity in the chain (i.e. retailers). When fraud takes place in the last link of the supply chain, the full amount of VAT will be stolen, which tempts to commit the fraud. However, this non-payment of

VAT can also happen unintentionally (e.g. incorrect settings of the supplier's system).⁸¹

Also under the proposed system it is to be expected that fraudsters will find new ways to commit fraud. Moreover, carousel fraud can still take place under this system in CTP situations as no VAT will be paid when the goods cross borders and subsequent domestic taxed supplies can take place. Furthermore, taxable persons can show compliant behaviour at first in order to obtain the CTP status, after which they become fraudulent again.⁸²

5 **COMPARISON AND CONCLUSION**

We summarize our findings from section 3 and 4 in the table below.

	<i>Proposed system</i>	<i>General reverse charge</i>	
	Compared to current system	Compared to current system	Compared to proposed system
Taxation in country of consumption	0	0	0
Neutral	+	+	0
As simple as possible to apply	-	-	0
Cash flow neutral	-	+	+
Easy to audit	-	-	-
Fraud proof	+	+	+

As the table shows both systems have benefits compared to the current system, but also downsides as regards in particular simplicity and audits. The systems also have up and downsides when compared to each other. The comparison in particular paints the general picture that in order to make the system more fraud proof there will be an increase of compliance burdens and audit costs. This stresses in the authors' view the dilemma that we are facing when choosing to implement a new system. The authors therefore conclude that keeping the current system while at the same time addressing VAT fraud within EU trade with the development of technological solutions may be the way forward, not right or left on the VAT crossroads, but straight on!

On a final note the authors' would like to remark that VIVAT is in their opinion an alternative that

⁷⁷ van Brederode & Pfeiffer, *supra* n. 68, at 153.

⁷⁸ van Brederode & Pfeiffer, *supra* n. 68, at 154.

⁷⁹ European Commission, Guidelines resulting from the 93rd meeting, Document B, 1 July 2011, taxud.c.1(2012)389021 – 708; van Brederode & Pfeiffer, *supra* n. 68, at 154.

⁸⁰ Fabrizio Borselli, *Pragmatic Policies to Tackle VAT Fraud in the European Union*, Int'l VAT Monitor 341 (Sept./Oct. 2008).

⁸¹ Toman, *supra* n. 74, at 46–47.

⁸² See also Madeleine Merckx, John Gruson, Naomie Verbaan & Bart van der Doef, *Definitive VAT Regime: Stairway to Heaven or Highway to Hell?*, 27(2) EC Tax Rev. 74–82 (2018).

mitigates the downsides of both the proposed system and the general reverse charge mechanism and further research on this option is of interest. Under Viable Integrated VAT (VIVAT) all B2B supplies of goods are subject to one common VAT rate within the EU. The supplier remits this VAT to the tax authorities in its own Member State and can deduct this VAT as well regardless if this VAT was charged by a local supplier or a foreign supplier. B2C transactions remain under the autonomy of Member States. The local VAT rates apply on these transactions. The VIVAT reduces the opportunity for VAT fraud within B2B-transactions compared to the proposed system. Due to the common rate on B2B-transactions fraudsters can't use rate differences to their advantage as described in section 3.3 (f). Taxation of cross-border transactions instead of applying an exemption, like under the current system, makes VIVAT more fraud proof. It is also simpler to apply than the proposed system, because suppliers don't need to have knowledge of other EU Member States' VAT legislation to apply the correct VAT regime. Audits are also much easier within VIVAT. A taxable person that performs B2B transactions only can be audited on the correct application of the VIVAT by the tax authorities of its own Member State.⁸³

Compared to the reverse charge system, under the VIVAT the fractioned payment of VAT is still maintained. This means that the collection of VAT is already guaranteed in chains of the supply chain preceding the B2C supply and tax authorities can focus on larger suppliers to ensure the collection of VAT too. The impact assessment of the European Commission shows that VIVAT has been considered as an option but was discarded because of the requirement of a clearing mechanism and adjustments in the Member State of destination.⁸⁴ We however do not see a big difference between clearing and the proposed system where Member States have to collect each other's VAT and transfer it to each other. Another issue that the authors note is that special attention must be given to B2B transactions with taxable persons that do not have a full right to deduct VAT or also have non-economic activities. They can be dealt with in two manners: (1) treat them as consumers or (2) require them to pay or refund them the difference between the VAT rate in their Member State and the VIVAT rate. By setting the VIVAT rate 1% higher than the highest VAT rate in the EU one can create an incentive for these taxable persons to remit local VAT and get a refund of the VIVAT.⁸⁵

⁸³ However there can be issues as regards audits. For example, in case an exporter has paid too little VIVAT an upward adjustment of the exporting state will only result in an increasing amount of VAT to be paid to the other Member State. There is therefore a sufficient amount of trust necessary between Member States and coordination to deal with too high refund claims or too low VAT payments. However a similar situation occurs in the proposed system since Member States collect VAT for other Member States. Jan van der Bijl, *The Cockfield Proposals – A European Business and Industry View*, 4 *Intertax* 134 (1989) and Christian Amand, *The 2016 European Commission VAT Action Plan: Weaknesses of a Clearing System and Possible Alternatives*, *Int'l VAT Monitor* 239 (July/Aug. 2016).

⁸⁴ Impact Assessment accompanying the document Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonizing and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, SWD(2017) 325 final, at 133, fn. 317.

⁸⁵ Beate Wohlfahrt, *The Future of the European VAT System*, *Int'l VAT Monitor* (Nov./Dec. 2011).