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# THE CCIP REACTION TO THE GREEN PAPER ON THE FUTURE OF VAT

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# SUMMARY NOTE

## BACKGROUND

As part of its ongoing effort to boost the single market, the European Commission has decided to launch a broad-based consultation on how to optimise the functioning of VAT, which currently has a number of weaknesses.

For Member States, which have to tackle the depletion of public finances, VAT is a tax that should be more neutral economically and should provide a more efficient revenue stream. According to the report by the French “Cour des Comptes” on Franco-German fiscal convergence, putting the French reduced rate in line with the German reduced rate would bring in 15 billion euros in tax revenue in France. From a business perspective, the system has become extremely complex, is a source of tax fraud and generates compliance and administrative costs that are a disincentive for investors on the European single market as confirmed in the 2010 survey of the “Observatoire Européen de la Fiscalité des Entreprises” (OEFE – <http://www.oefe.ccip.fr/>). According to the majority of company directors interviewed the tax difficulties met in intra-EU transactions primarily concern VAT.

The reflexion in the Green Paper is organised around general principles of simplification and economic neutrality, which could act as a guide for reforming EU VAT, together with more specific proposals on the dysfunctional aspects of the present system.

## THE CCIP AGREES WITH THE GENERAL PRINCIPLES OF A LONG-TERM REFORM

The CCIP supports the determination of the European Commission to simplify and modernise the common VAT system on the basis of the following general principles.

### Principle 1: Broadening the VAT base

If the objective of a simpler, more efficient common VAT system is to build up a solid base for sound public financial resources that are economically neutral while reducing compliance costs as much as possible, no exemptions from VAT should be maintained. This principle should lead Member States to limit VAT exemptions to activities that are in the public interest and financed by public or charitable funds (health, education, social services, etc) and possibly, to the residential property sector.

### Principle 2: Harmonising the VAT rate structure

Because of the variations in VAT rates from one EU Member State to another, the system is extremely complex and lacks consistency across the European Union. In particular, the proliferation of reduced VAT rates weighs on both the administrative costs borne by businesses and the public finances of Member States. Furthermore, reduced VAT rates are not the most suitable instrument for all public policies and their extension undermines the VAT system. In principle, it would be better to eliminate the majority of reduced rates or at least limit them to a very short list and to apply a significantly lower standard rate of VAT. It should be possible to fund a reduction in the standard rate by broadening the tax base and removing almost all reduced rates.

### Principle 3: Improving VAT administration and collection

The new VAT collection methods studied by the European Commission are innovative and ambitious, and will help to thwart attempted fraud. Clearly, at this stage, the Commission must continue to study their feasibility with special attention to not overburden businesses with costs by passing on a greater administrative load to them.

## THE CCIP'S REACTION TO THE GREEN PAPER'S PROPOSALS FOR TECHNICAL IMPROVEMENTS

In addition to the main lines of a long-term reform, the European Commission makes proposals that will immediately affect all businesses. The CCIP holds the view that priority should be given to the six following points.

### **1– Reducing the compliance costs for businesses: limiting the use of reduced VAT rates**

The EC's Green Paper highlights the unequal treatment of VAT rates applicable to products on the basis of whether the medium used is digital or physical (books), whereas this could be eliminated by applying a single standard rate. These differences in treatment are illogical, but in sectors undergoing technological change, where historical components of national legislation are being called into question (e.g. book prices in France), it would perhaps be more realistic, at least for the immediate future, simply to prohibit all extension of reduced rates.

### **2 – Simplifying the administrative rules: settling VAT when purchases are paid for**

For improved VAT administration and security, liability for the tax should be incurred when goods or services are paid for and not when delivered or performed. This solution would have the advantage of doing away with a number of special rules in this area and of strengthening neutrality and fairness in the deduction of VAT.

### **3 – Simplifying the reporting obligations of businesses: encouraging the reverse charge mechanism and creating a single VAT return form**

To ensure consistent treatment in the B2B sector between national and intra-EU transactions, the most appropriate VAT arrangement would be to apply reverse charging of the customer to all intra-EU purchases. This would need to be accompanied by an information campaign to improve understanding of this mechanism.

To limit the number of returns that businesses have to fill in, an effort of simplification and harmonisation should be undertaken by combining, for example, the EC Services List (Déclaration européenne de services - DES) and the EC Sales List (Déclaration d'échange de biens - DEB) into a single European form.

### **4 – Promoting good practice: incorporating the customs Approved Economic Operator scheme into the VAT system**

The Approved Economic Operator scheme is a good system from which to draw inspiration. A common VAT trader and customs trader status should be promoted, with simplified obligations and a presumption of no fraud once approval has been obtained.

### **5 – Improving and modernising the administration of the VAT system: adjusting delays to incorporate tax reforms into national law; better integration of IT systems**

To improve incorporation of new rules into national law, which currently are too short for businesses to adapt to new rules, an improvement would be to set an obligatory delay of one year before a directive becomes effective in Member States. This delay would allow the Commission to check for manifest errors by Member States and would give businesses and tax authorities enough time to adopt the new rules and keep their administrative and IT upgrading costs down. Finally, to improve collection and reduce the charges for businesses, it is essential to give more consideration to new technology in the process of implementing VAT rules.

### **6 – Combating VAT fraud: the risks of an optional “split payment” system**

The CCIP supports the EC in its fight against tax fraud, but doubts the effect of one of its short term proposals.

To avoid high costs being incurred by businesses in monitoring their suppliers, the EC proposes that the customer should be able to opt to pay VAT directly to the tax authority and not to their provider. The CCIP is not in favour of this option as it could adversely affect trade and business as well as foster a climate of suspicion between businesses and between the tax authorities and businesses. Its optional nature would introduce a new element of complexity that contradicts the aim of simplifying the formalities for businesses.

## The CCIP reaction to the green paper on the future of VAT: towards a simpler, more robust and efficient VAT system

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

Among the obstacles to the single market, it is hard to determine the influence of cultural practices or national regulations in areas other than VAT. However, quite clearly, the very existence of “borders” and of local particularities within the common VAT system is not ideal from the single market viewpoint.

In such conditions and short of politically unrealistic large-scale and over-ambitious projects (such as generalizing the reverse charge mechanism, a one-stop shop system, “super administration”, etc.), only marginal improvements to the common VAT system are possible in the short term.

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

The most appropriate and realistic VAT system would be one that moves towards the generalisation and uniformisation of VAT reverse charging for B2B buyers of goods and services within the EU. This move might be accompanied by an information campaign to increase understanding of how the reverse-charge mechanism works.

It should be supplemented by simplification and harmonisation through:

- standardisation of reporting obligations, for example, by merging the European Services Declaration (DES) and Trade of Goods Declaration (DEB) into a single European form along the lines of the British European Sales List;
- this same approach could be introduced for national VAT returns by the adoption of a standardised EU VAT return acceptable to all national administrations.

A limitation on exceptions to community rules, on the granting of options to Member States and the stabilisation of European rules would facilitate this process and maximise its potential positive impacts.

The existence of territoriality rules that differ depending on whether trading is B2B or B2C, and within B2B trading depending on whether the service is provided electronically or via other media, is a complex obstacle when different clients are involved (e.g. in the training sector in which, moreover, the scope of exemptions differs from one Member State to another).

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

The application of VAT rules to public authorities is hardly acceptable, particularly with regard to tax neutrality (outsourcing of activities to private persons doesn't allow deduction of VAT invoiced).

The situation has arisen from the wide range of bodies forms, organisations and activities of public entities in different Member States. As a result, the applicable scope of VAT in the public domain, particularly for subsidised activities, public/public or public/private partnerships and groupings of entities not liable to VAT or only partially liable thereto (cooperation between public entities) remains uncertain.

This leads to distortions, great instability and legal uncertainty: the rules that have been drawn up for situations loosely described as coming under “non-competitive public services” or “competitive economic activity” become subjective and open to interpretation.

Reflexions should probably focus on a single and relatively straightforward adjustment criterion based on the method by which the activity is financed - mainly through taxation, or direct or indirect subsidies - rather than based on the legal status of the persons concerned.

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

In principle, if a simpler and more efficient common VAT system is to form the basis of sound and economically neutral public financing, no exemption should be maintained. In particular, Member States should be banned from using VAT to support a broad range of their economic and social public

policies. VAT is intrinsically ill-suited to this goal and far from ideal: “manipulating” VAT for too broad a range of public policy ends reduces and weakens its potential efficiency (complexity, administration costs, distortions, risks of fraud, etc.).

That being said, it is politically unrealistic to expect this principle to be implemented in the short term. However, it could lead to VAT exemptions being limited to two specific areas:

- the contracting out of certain activities deemed to be in the public interest, which would have to be specified, financed from public or not-for-profit sources (healthcare, education, community social services, etc.);
- residential housing (no VAT levied on rents, etc.).

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

For budgetary reasons and reasons based on the presumption of fraud, France applies a range of limitations on the right to deduct VAT. This raises many problems under internal EU and intra-state law:

- exclusions of the right of deduction (e.g. passenger-carrying vehicles) and the case of persons only partially liable to VAT (public entities, banks and insurance companies);
- the problem of the right to deduct VAT across borders that the 8<sup>th</sup> Directive fails to adequately resolve (purchases in a Member State where the business has no taxable operations and cannot therefore deduct its VAT).

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

In order to administer the VAT system more efficiently and securely, we should consider generalising the principle whereby VAT is chargeable **upon payment** of the goods or services and not at the time of delivery or of provision. The benefit of this solution would be to eliminate many special rules in this area and the cost of switching to this new regime would only impact tax revenues collected by Member States during the switchover year.

In general, if all national VAT systems within the EU were identical, simplified and standardised, the problems relating to the right to deduct VAT would be more manageable.

Fixed and harmonised deduction rates might then be proposed for goods and services partially supplied for private use, with the option to deduct VAT on an ad hoc basis (i.e. not fixed in advance) where it can be justified that the goods or services are used for economic activities taxable beyond the fixed rate.

Finally, the EC proposes to establish a “one-stop shop” to avoid delays for businesses in the single market in obtaining the reimbursement of their VAT credits. The idea is appealing in theory, but in practice the difficulties encountered with the 8<sup>th</sup> Directive reimbursement portal does not encourage the adoption of this system of administration. Preference should be given to searching for the ways and means to simplify and standardise tax representation in its current form.

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

The main VAT problems in international services concern “B2C” activities, transnational groups and, more generally, the difficulty of interpreting common definitions of various services (services relating to a building, trade events and fairs, advertising services, education services, etc.), which may lead to double or no taxation.

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

Regardless of national borders, VAT should be processed in the same way whether the businesses concerned are transnational groups within the EU or purely national groups. This would simplify the rules and would result in fewer exceptions.

To resolve the VAT problem for electronic services provided by an operator outside the EU in the B2C sector, the EC has proposed a VAT system based on payment by the end customer. This is a radical position regarding the principles behind the VAT system, but its practical implementation could run into major difficulties.

To overcome this, can we not envisage an intermediate system based on joint VAT liability between the client and his supplier outside the UE, which would be easier to set up, rather than always charge the customer.

This legal mechanism would act as a sufficient deterrent to international operators, who would be forced to comply with European VAT standards if they want to enter the European market: they would not run the risk of seeing their initial customers being prosecuted for non-payment of VAT that they (the operators) had illegally abstained from invoicing ...

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

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

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

While the intention underlying these proposals is sound, the proposals themselves are not necessarily politically realistic. Moreover, if these proposals result in trade-offs that are too subtle and case-sensitive, they may complicate the decision-making processes.

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

In light of recent French experience in incorporating the VAT package into the 2010 Finance Act passed at the end of December 2009 with a view to its enforcement from 1<sup>st</sup> January 2010, this leaves too little time for businesses to adjust to the new rules.

One possible improvement would be set a compulsory deadline, e.g. of one year, between the incorporation of a new European law and its effective enforcement date within Member States. This deadline would enable the EC to check that no obvious incorporation errors have been made by the Member States and would allow businesses and public authorities concerned to familiarise themselves with the new rules and reduce their management and IT upgrading costs thanks to such a proactive approach. .

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

The current VAT rate structure clearly generates compliance costs but it is difficult to measure these since rules on VAT rates are often associated with other national or EU regulations which lay down their own requirements (e.g. VAT on home improvement for private persons that distorts the comparison between supply and assembly work, the legal framework for the definition of pharmaceutical drugs, written media publications, etc.).

It should be noted, in this regard, that the same comments may be made on the proliferation of reduced rates as on the greatly increased number of exemptions: the reduced VAT rate is not ideally suited to all public policies (cf. France's experience of VAT applied to restaurants), and its extension weakens the VAT system.

In such conditions, it is doubtful whether an "eco-friendly" VAT rate system is the most effective environmental policy tool, since it may lead to products that merely meet short-term environmental norms at the expense of a more lasting and structural change in the behaviour patterns of all the stakeholders concerned (in areas such as research, production and consumption).

The EC has also highlighted inequality in the treatment of VAT rates applicable to products depending on whether the media used are digital or physical (books), an anomaly that could be eliminated by applying a standard VAT rate only. Of course, such discrepancies in treatment are not logical, but in these fast-changing sectors of the economy where other historical components of national laws are being called into question (e.g. the price of books in France), it would perhaps be more realistic in the immediate future to merely ban an extension of reduced VAT rates.

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

In absolute terms, it would be preferable to eliminate most of the reduced VAT rates or at least to limit them to a very short list and to apply a significantly lower standard VAT rate.

On the contrary, a list of compulsory reduced rates within the EU does not seem desirable owing to political difficulties and the time needed to negotiate between Member States.

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

Tax forms, required justification of deduction rights for partially liable persons and dematerialisation of procedures.

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

By establishing a minimum set of standards common to all countries and based on a single European Services Declaration Form (DES) and Goods Trading Declaration form (DEB).

In general, the more the basic rules are simplified the easier it will be to harmonise the obligations to be met.

**Q24. Should the current exemption scheme for small businesses be reviewed and what should be the main elements of that reassessment?**

VAT exemption systems are specific to each Member State. The EC’s proposal is to create a single system to encourage a larger number of small businesses to trade on the single market. This proposal aims to simplify the procedures, but it is uncertain as to whether it will attract more entrepreneurs to do business in the EU. If the common European VAT threshold is too low, it will concern a small number of businesses potentially interested in the single market. If, conversely, it is too high, it may distort competition with other businesses.

**Q25. Should additional simplifications be considered and what should be their main elements?**

For small businesses, going over the thresholds has caused blockages and administrative difficulties. One simplification measure would be to modulate the crossing of thresholds by granting businesses a period of, for example, one tax year to adjust and to meet their new obligations.

More generally speaking, European «benchmarking» of declaration obligations could result in a common list of minimum and simplified requirements recognized in all Member States.

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

Yes. In absolute terms, the one-stop shop simplifies matters, but provided that it operates properly. However, the experience of the VAT reimbursement portal has proven that such a measure is complicated and difficult to implement. Before introducing a one-stop shop system, the underlying legislation should be simplified and harmonised first.

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

In principle, VAT should be processed in the same way within national and cross-border groups that operate within the EU.

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

The approved customs operator system is a useful one that could provide inspiration. It is important to promote a common VAT and customs operator status, with simplified obligations and the presumption that no fraud has been committed once approval is obtained.

Here again, simplifying the legislation by limiting exemptions and reduced VAT rates should enable the public authorities to earmark resources to manage such a VAT system.

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

The explored VAT levying methods are innovative and ambitious. Clearly, at this stage, feasibility studies on their impact must continue with the view not to financially overburden businesses by transferring to them more of the administrative cost of the tax.

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

Apart from the fact that this system may weigh on commercial activity generally and generate a climate of widespread suspicion (between businesses and public authorities), the fact that the system is optional adds an significant element of complexity.

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

We are keenly interested in the discussion forum and the inclusion of IT systems in the implementation of VAT rules.