

THE COMMISSION'S WORK PROGRAMME FOR THE GRADUAL INTRODUCTION OF THE NEW COMMON VAT SYSTEM

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Introduction

On the 10th July 1996, the Commission made public its approach for the new common system of VAT set out in the form of a work programme accompanied by a timetable for progress in stages, the last one being envisaged for 1999 (COM 96/328 final). The choice of a staged approach was made in view of the scope and the technical complexity of the various and very different problems to be solved.

This article summarises the state of play regarding the development of the programme since its adoption one year ago; describes where the Commission stands with its work in implementing the programme and what the priorities are for the future.

What has Happened since the Adoption of the Programme

- The Commission received the reaction of a very broad business environment. The consultation process currently organised on an ad-hoc basis consisting of the Commission's conference last November, written contributions from trade associations, participation of EC officials in private sector organised conferences made clear that the general thrust of the programme was welcomed, that simplification of the VAT system was top priority and that harmonisation through legislation and a more uniform application of the tax were both essential. Work has started on how to set up a more formal consultation process to ensure continuous access to the opinion of the business community and to involve them in the technical

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work on drawing up the different proposals laid down in the programme. The Commission is fully aware that it will need the support of the business community of the Union in the, no doubt difficult, discussions with the Member States and Parliament ahead.

- With its resolution (A4-0164/97 - June 10, 1997) the European Parliament confirms the shortcomings of the current VAT arrangements and subscribes to the move to an origin based system, which is simpler, more transparent, more uniform and better capable of being monitored. However, the resolution is also indicative of a considerable scepticism with regard to a rapid transition to the final régime and the will to maintain national autonomy in the field of VAT, especially in setting the level of VAT rates.
- The Economic and Social Committee welcomes the Commission's initiative and agrees in principle with the broad concept of its work programme. The ESC's opinion (ESC 37/97 - July 9, 1997) highlights some technical doubts over the possibility of establishing accurate statistical data for the redistribution of VAT receipts among Member States and the concept of a single place of registration and political problems regarding convergence of VAT rates and Member States fiscal autonomy.
- In the absence of fully worked solutions and because of the staged approach, political and formal discussion with Member States, at this time, about the general concept of the Commission's ideas for a new origin based VAT system is seen as premature. Discussing the basic approach of the programme could mean rushing into binding statements on questions of principle instead of finding a pragmatic approach to "real" problems and thus harm the common interest of all parties involved. The Commission needs to proceed with its work of considering the concepts and developing techniques for implementing new VAT legislation in order to make the necessary proposals to the Council of Members. The Council will at that stage have the opportunity to consider each proposal on its merits.

The Way Forward

Further to our programme and following the discussions in the European Parliament and the Economic and Social Committee and from what we know from informal contacts with some Member States, it is clear that top priority is to be given to the elimination of some of the shortcomings of the present VAT system. In parallel with our work to improve the current system and to set conditions favourable for the changeover to the origin-based taxation scheme, the services of the Commission have to pursue their work to find solutions to the outstanding technical problems of the new system.

Improvements to the current VAT system

Pending the changeover to the origin system, the actual system is to be modernised, more uniformly applied and made simpler where possible. At the same time the capacity of national tax administrations to collect tax and to prevent tax fraud or tax evasion is to be strengthened.

The Commission will, as announced in the programme, prepare the necessary proposals to meet these first priorities.

In implementing its programme, the Commission has already presented its proposals on:

1. the change of the legal status of the VAT Committee (COM(97)325 - 25.06.97). The VAT Committee is a key instrument to ensure more uniformity in the practical application of the tax. The transformation of the VAT Committee from an advisory to a regulatory body should ensure a more unified approach to interpreting existing legislation and remove an important source of unhealthy competition and complexity for traders. Also, more uniformly applied rules should counteract the legal exploitation of the system's loopholes and lead to better enforcement and control of the tax. The role of a regulatory VAT Committee would be very similar to what happens within Member States in that administrative circulars would contain interpretation of primary legislation.
2. the FISCALS programme (COM(97)175 - 23.04.97), a significant new initiative at Community level aiming at establishing a new spirit of administrative co-operation in the fight against fraud. The Commission has long been convinced of the vulnerability of the transitional VAT system to fraud and has explicitly expressed its concern, particularly in the VAT programme. The Commission has therefore taken several steps to analyse the problem and proposed long term solutions (the new VAT system) and some immediate steps. The key factor in all these solutions is the need for more administrative co-operation and mutual assistance both to improve the operation of the present system and to prepare the ground for the new system. In a world offering new technological opportunities which reinforce the trend towards globalisation, administrative co-operation becomes an increasingly vital link in the VAT control chain.

In the near future, the Commission will present its proposals:

- to improve the arrangements on mutual assistance on recovery;
- to modernise the actual VAT system.

The modernisation exercise will take into account economic and technical developments like:

- the increase in services supplied via Internet
- the growing tendency to privatisation.

The approach will be to increase the scope of the tax, to enforce the system's neutrality and simplicity and to counteract the erosion of the tax base resulting from the Court's case law (which is becoming more and more the *de facto* legislator) on the definition of the concept of economic activity.

As well as the telecom directive already adopted by the Commission (COM (97) 4 final - 29.01.97), at least 5 concrete proposals were scheduled to be presented by mid-1997 on fundamental provisions of the 6th VAT Directive such as the scope of VAT, taxable person, taxable amount, exemptions and the right of deduction.

Although preparatory work is currently done within DG21, this timetable appears to be over-optimistic. Also it might prove impossible to change immediately from non-harmonisation to full harmonisation. Some intermediary phases providing for a step-by-step approximation of Member States' legislation might be necessary. This is particularly true where full harmonisation will have major budgetary implications, such as the right of deduction.

As we cannot tackle all the subjects at the same time some choices of priority have to be made.

First priorities would be:

- extension of the scope of the tax to respond to the Court's case law on definition of the concept of economic activity (*Polysar, Satam, Wellcome Trust...*);
- extension of the scope of the tax to include some public bodies. However, the fiscal treatment of public bodies cannot be seen as an isolated topic as it has major links with other fundamental provisions of the 6th VAT Directive like exemptions, taxable basis (e.g. subsidies) and the right to deduct input VAT;
- harmonisation of the right to deduct input VAT (especially the limitation of this right on car expenses) in combination with the revision of the Eighth Refund Directive.

It is obvious that any gradual shift towards the approximations needed has to be fully in tune with the objectives which have been set. In a way the intermediate

steps are to pave the way for the complete revision of the subjects in question. The global modernisation package would be presented in late 1998.

A major contribution to improving the operation of the current VAT system could be provided by the SLIM II (Simpler Legislation for the Internal Market) exercise. The main objective will be to make proposals or to suggest actions for simplifying certain aspects of VAT legislation in order to eliminate excessive formalities and burdens. Attention will focus on the principal obligations imposed on traders under the Sixth VAT Directive and the corresponding national implementing measures, particularly in cases of use of a tax representative as the person liable for payment in place of a non-established taxable person.

It should be stressed that the modernisation exercise is not restricted solely to the transitional VAT arrangements. It also touches upon the basic provisions of the 6th VAT Directive, into which the transitional arrangements have been integrated. The same applies to the simplification exercise. A genuine simplification of the present VAT system is unthinkable if we are not prepared to change the 25 complex place of supply rules. As a consequence, the Commission sees the improvements to the current VAT system only as a preparation for the move to a new VAT system, providing for a single place of taxation, which is the sole guarantee of bringing drastic simplification to the VAT system and to redress budgetary losses by providing for long term revenue security for Member States.

Outstanding work to solve technical problems of the new origin-based system

Much remains to be done in order to introduce all the measures necessary for changing over to the new common VAT system as envisaged by the Commission. For the time being, the programme only sums up the broad lines and the format of the origin-based taxation scheme without providing for technical solutions to all its outstanding questions.

Although concrete proposals for the changeover to the origin system are not scheduled before late 1998/mid 1999, preliminary work has started within DG 21, in parallel with the work to improve the current system, to fill in some technical gaps in the envisaged system.

The items for which thorough preliminary studies are needed (probably with the help of external consultants), are tackled first.

These items are:

- the determination of the single place of taxation/deduction.

Currently the concept of the single place of taxation i.e. the place where taxable persons would be registered for VAT purposes and where all the transactions for

the entire Community would be taxed, is not yet defined. The following criteria will need to be considered; the place where the company is incorporated or legally established, its headquarters, the place where the company is effectively managed and the genuine centre of activity. Another outstanding question is how to place third country operators not established in the Community within the scope of the tax.

- the definition of the territorial scope of the tax, especially the place of consumption.

The scope of VAT is to be clearly established by means of a definition of the concept of the consumption of goods or services in Community territory in order to ensure that, as is the case at present, only sales giving rise to consumption within the Community are subject to VAT.

- the concrete development of the proposed re-allocation system and the accuracy of the statistics to be used;

The re-allocation system must ensure that Member States will not lose in VAT revenue terms compared to the present system. A lot of analysis remains to be done and one of the key aspects for the proper functioning of the envisaged re-allocation system is the quantification of the "underground" economy (included in the final consumption figures) which is to be excluded from the calculations.

- setting up a legal framework for a Community wide organisation of control systems.

Administrative co-operation and mutual assistance will become more important in the operation of the new system. In short, a level of co-operation between the Member States equivalent to that currently achieved within each Member State will be required. The existing legal framework for mutual assistance and administrative co-operation requires extensive reform.

Conclusion

As you may have realised from the above, with the limited resources available, an enormous amount of work is still to be carried out in different areas like:

- finding solutions for immediate problems;
- improving the operation of the current system;
- filling in technical gaps of the new system;
- modelling the revenue consequences of the new VAT system;

On top of our programme, we have to face additional work like the SLIM II exercise and the issue of electronic commerce.

Also, and in parallel, a large and formal consultation process with trade and, in respect of the modernisation exercise with Member States, has to be set up with regard to the specific proposals to be made.

The Commission is well aware of the difficulties which will have to be overcome before its ideas for a new common VAT system can be realised, but these should not deter it from undertaking the task. The reward for success in simplifying and modernising the tax are considerable in terms of promoting free trade and strengthening the European economy.