

# Indirect tax alert

## The EU Commission issues its comments on the future of EU VAT

On 1 December 2010, the EU Commission issued its *Green Paper on the future of the VAT system in the European Union*, launching a wide-ranging consultation process on the current VAT system, studying its major flaws and the possible ways of moving toward a simpler, more robust and more efficient VAT system. The text of the Green Paper and contributions to the consultation are via the EU website, by [clicking here](#).

On 5 December 2011, the EU Commission published the results of the public consultation on its *Green Paper on the future of VAT*, launched in 2010. The Commission reported that it received more than 1,700 responses to the Green Paper from businesses, academics, citizens, tax authorities and professional service providers, including Ernst & Young; the size of the response indicates just how profoundly today's economy is affected by VAT issues.

Following this consultation, the Commission has now presented its conclusions on how the EU VAT system should evolve in the coming years and outlined its planned next steps. The short-term proposals include a move to taxing transactions using the "destination principle" in the country of consumption, a simplification of the rules and a broadening of the tax base to boost revenues. These proposals will have an impact on all businesses that are established in, or trade with, the EU.



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## The Green Paper on the future of VAT

VAT in the EU dates back to the late 1960s, and the time for a deeper reflection on its functioning seems to be justified not only by the complexity of the current system but also by the rapid changes that have taken place in the economic environment, the advent of new technologies and the growth of complex financial instruments. Few commentators would deny that the European VAT system has come of age and needs profound reforms, improvement and simplification to meet the challenges of today's global economy.

However, when it comes to suggesting concrete changes, opinions differ and it is no surprise that when the Commission presented its *Green Paper on the future of VAT* in December 2010, the authors chose a broad approach, raising over 30 questions addressing various VAT issues. In response,

the Commission received more than 1,700 comments from businesses, academics, professional advisers and tax authorities, representing a wide range of interests and views.

With so many issues and so many diverging interests on the table, how the Commission would deal with the results of the consultation and what changes would be announced were anticipated with interest. But, in the event, there are no big surprises.

In its communication dated 5 December 2011, the Commission clearly sets out its understanding of a future EU VAT system and identifies 26 priority areas for further action. Among these are several action points that are surprisingly detailed and capable of being implemented in the very near future.

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## Future-proofing EU VAT

According to the Commission's report, a future-proofed European VAT system will be based on the "destination principle." This implies that all supplies are taxed for VAT according to the rules of the country where the supply to the final consumer occurs. As a consequence, the "origin principle," which is the underlying principle of the current EU VAT Directive, would be completely abandoned.

It is anticipated that the reshaped VAT system will result in a single set of clear

and simple VAT rules – the EU VAT code – and taxpayers will only have to deal with the tax authorities of a single Member State. The national tax authorities will set up an intensified, automated and rapid exchange of information and ultimately collectively act as a European VAT authority.

Finally, in order to generate more revenue at less cost, the future system will have a broader tax base and follow the principle of taxation at the standard rate.

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## First-step measures

To move the current VAT to the future system, the Commission wants to implement the following short-term measures as a first step:

- ▶ Setting up an EU VAT web portal that provides information in several languages on basic issues such as registration, invoicing, VAT returns, VAT rates, special obligations and limitations to the right of deduction
- ▶ In 2012, publishing the Guidelines agreed by the VAT Committee on EU legislation and explanatory notes on the new legislation before its entry into force, in order to inform businesses
- ▶ Setting up a tripartite EU VAT forum (involving the Commission, Member states, and stakeholders) in the course of 2012
- ▶ Proposing a standardized VAT declaration (VAT Return) to be available in all languages and optional for businesses across the EU by 2013
- ▶ Ensuring the smooth introduction of the mini one-stop shop scheme (registration in a single EU Member State) in 2015 and envisaging a managed broadening of the concept from 2015 onward

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## Other measures

In addition, the Commission announced that it will work towards proposals for the following issues:

- ▶ Proposing a quick reaction mechanism in 2012 to deal with massive, organized and sudden VAT fraud
- ▶ Establishing a more neutral and simpler VAT framework for passenger transport activities
- ▶ Restricting the use of reduced VAT rates in order to increase the efficiency of the VAT system by 2013
- ▶ Proposing legislation to lay down the definitive regime of taxation of intra-EU trade by 2014

Furthermore, the Commission intends to explore the possibility of setting up an EU cross-border audit team to facilitate and improve multilateral controls and

strengthened cooperation with third countries (i.e., non-EU countries) with a view to exchanging information in the field of indirect taxation. The Commission will also further analyze new ways for VAT to be collected. Not surprisingly, the suggested “split payment model”<sup>1</sup> prompted negative reactions from business and tax practitioners; they feel it is likely to have a negative impact on cash flow and compliance costs. Nevertheless, the Commission does not want to discard this model, as some Member States expressed an interest in exploring it further.

Other aspects of EU VAT such as the small business scheme and the VAT grouping provisions or the complex and divergent rules on the right of deduction and double taxation issues, will be addressed only in the medium-term.

1. In this model, the purchaser pays the VAT on the purchase price to a blocked VAT bank account, which can only be used by the supplier for paying VAT to his suppliers' blocked VAT bank accounts.

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## Issues that are not addressed in the report

Interestingly, some other issues that were part of the Green Paper are no longer mentioned by the Commission in its report. This is the case for the still unclear VAT treatment of holding companies' transactions notably those related to management of shares or treasury

functions, for the handling of a large number of exemptions and for the question of how the EU VAT system could be further harmonized, e.g., by using Council regulations or by allowing the Commission to adopt implementing decisions.

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## Ernst & Young's response

Ernst & Young's response to the Green Paper – which was based on feedback from our clients and our professional experience – recommended that the Commission should concentrate in the short- to medium-term on making proposals to improve and modernize the administrative and technical framework within which businesses are required to collect and account for VAT. In particular, we recommended:

- ▶ Further efforts to simplify and harmonize invoicing requirements
- ▶ Harmonizing the frequency and content of VAT returns and listings using modern computerized technology
- ▶ Extended use of the one-stop shop mechanism for registering and fulfilling VAT obligations with a view, in particular, to incorporating the possibility of deducting input tax

In addition, we recommended that, in the longer term, priority should be given to harmonizing the rules regarding restrictions on the right to deduct input tax, and to disassociating formal requirements in this area from the actual right to deduct input tax, to increase the neutrality of the VAT system.

It is good to see that the Commission also considers most of these recommendations to be priorities. There is hope that the reform and modernization of the European VAT system has now finally taken off and will gather speed. It should, however, be kept in mind that it could be a long time before even the short-term proposals are implemented. Surprising twists are still possible along the way! We believe that stakeholders should follow further developments attentively and not hesitate to contribute their opinions as the discussions progress.

## Contacts

If you would like more information about the EU VAT proposals and how they may affect your business, please contact one of the following VAT professionals, or your usual Ernst & Young indirect tax advisor.

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