EUROPEAN
COMMISSION

Brussels, 22.4.2014
COM(2014) 229 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 395 of Council Directive 2006/112/EC

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1. BACKGROUND

Pursuant to Article 395 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the VAT Directive), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. As this procedure provides for derogations from the general principles of VAT, in accordance with the consistent rulings from the European Court of Justice, such derogations should be proportionate and limited in scope.

By notification registered at the Commission on 27 November 2013, Hungary requested, on the basis of Article 199b[1] of Directive 2006/112/EC (hereafter 'the VAT Directive'), authorisation to introduce a Quick Reaction Mechanism (QRM) special measure derogating from Article 193 of the VAT Directive in order to apply the reverse charge mechanism to supplies of sugar. However, the Commission was not in a position to accept the proposed measure as the basic legal conditions were not fulfilled[2].

When a notification within the framework of the QRM is sent, an application for a 'normal' derogation within the meaning of Article 395 of the VAT Directive has to be filed as well in accordance with the last paragraph of Article 199b(2) of the VAT Directive. Hungary, via the same letter sent for the QRM notification, requested to be authorised to apply, as mentioned, the reverse charge mechanism to supplies of sugar.

In accordance with the second paragraph of Article 395 of that Directive, the Commission informed the other Member States by letter dated 19 March 2014 of the request made by Hungary. By letter dated 20 March 2014, the Commission notified Hungary that it had all the information it considered necessary for appraisal of the request.

2. REVERSE CHARGE

The person liable for the payment of VAT pursuant to Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the reverse charge mechanism is to shift that liability onto the taxable person to whom the supplies are made.

Missing trader fraud occurs when traders evade paying VAT to the tax authorities after selling their products. Their customers, however, are entitled to a tax deduction

[1] Introduced by Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a Quick Reaction Mechanism against VAT fraud (OJ L 201, 26.7.2013, p. 1)

[2] Commission implementing Decision of 11 December 2013 refusing the request by Hungary to introduce a Quick Reaction Mechanism special measure derogating from Article 193 of Council Directive 2006/112/EC on the common system of value added tax (OJ L 341, 18.12.2013, p. 68)

as they are in possession of a valid invoice. In the most aggressive cases of such tax evasion the same goods or services are, via a "carousel" scheme (which involves the goods or services being traded between Member States) supplied several times without payment of VAT to the tax authorities. By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT in such cases, the reverse charge mechanism has been found to eliminate the opportunity to engage in that form of tax evasion.

3. THE REQUEST

Hungary requests, under Article 395 of the VAT Directive and following a QRM notification, that the Council, acting upon a proposal of the Commission, authorises Hungary to apply a special measure derogating from Article 193 of the VAT Directive as regards the application of the reverse charge mechanism in relation to supplies of quantities of sugar in excess of 200 kg.

On the basis of information provided by Hungary, it appears that fraud problems in the sector already started to occur in 2007. A steep increase of non-paid VAT was however noted during 2013 (on the basis of the then available figures for the first three quarters of that year). Anti-fraud measures which have been put in place in this context would, according to Hungary, not be sufficient to counter the increasing fraud.

4. THE COMMISSION'S VIEW

When the Commission receives requests in accordance with Article 395, these are examined to ensure that the basic conditions for their granting are fulfilled i.e. whether the proposed specific measure simplifies procedures for taxable persons and/or the tax administration or whether the proposal prevents certain types of tax evasion or avoidance. In this context, the Commission has always taken a limited, cautious approach to ensure that derogations do not undermine the operation of the general VAT system, are limited in scope, necessary and proportionate.

In the first place, the Commission notes that it is the third time in one year that a request is filed by Hungary in relation to agricultural products (cereals and oilseeds; pigs; and now sugar).

In the same way as for the pig-farming and animal fodder industry ((COM)2013 148final), it is the Commission’s view that the type of good in question (sugar) is of a nature which should make auditing possible through conventional control means without the need to implement the reverse charge mechanism.

In addition, applying the reverse charge mechanism in relation to goods destined for final consumption, such as sugar, always entails the risk that the fraud is shifted further down the supply chain which could become even more difficult to control, despite the proposed application of a threshold. That is also the reason why Member States have deliberately excluded agricultural products destined for final consumption from the ‘Reverse Charge Directive’[3]. This approach is also justified by the risk of fraud moving to other Member States in a sector whose economic

[3] Council Directive 2013/43/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud (OJ L 201, 26.7.2013, p. 4)

importance is quite considerable in several Member States. Previous experiences with cereals and oilseeds confirm that this risk is more than hypothetical.

A derogation is in any case not a long-term solution, nor does it compensate for inadequate surveillance of taxable persons in this market. The various requests seem to indicate that there are structural problems in the control of the agricultural sector in Hungary and which therefore require a different approach.

In this context, the Commission has been made aware through publicly available information in the Hungarian press of allegations of possible mismanagement which would hamper the correct tax collection in the sector. It should be noted that they have led to a difficult situation. Therefore, it would appear that a solution at political, administrative or even judicial level has to be found as to clarify the situation and as to ensure that the normal functioning of the tax administration is guaranteed and, where needed, improved or restored.

As regards the fraud figures, the VAT losses in the sector are considerable but in relation to the total estimated VAT gap in Hungary, they corresponded to only 0,291% (figures of 2011)[4], indicating the need for a more comprehensive solution to address VAT control and collection issues.

Hungary indicates in its request that certain measures to fight fraud in this sector have been taken (such as, inter alia, a better registration procedure, more efficient inspections, increased fines, integration of tax and customs authorities). However, it has not implemented yet all recommendations already produced by the EU in this context.

Measures should in the Commission's view rely more on improving the efficiency of tax control than on imposing new obligations on taxable persons. The Commission indeed notes that tax obligations in Hungary are already relatively heavy and that this country has a low ranking – according to the World Bank – in terms of easiness of paying taxes[5].

On the basis of all these elements, the Commission has come to the conclusion that a derogation allowing the reverse charge mechanism to be applied is not the appropriate solution in order to deal with the fraud situation in the sugar sector and would have adverse impacts on fraud at the retail level and on other Member States. A solution would have to be found at a wider level involving structural reforms of tax control and collection. The Commission remains willing to provide, where possible, the necessary assistance to Hungary as to counter the problems regarding VAT fraud. The Commission also suggests that Hungary should strengthen the cooperation in the context of Eurofisc with other Member States that are confronted, or likely to be confronted, with similar problems in the agricultural sector.

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4 *Study to quantify and analyse the VAT Gap in the EU-27 Member States.* Report commissioned by the European Commission and prepared by a consortium led by CPB (Netherlands Bureau for Economic Policy Analysis): http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf

5 See: Assessment of the 2013 national reform programme and convergence programme for Hungary - Accompanying the document Recommendation for a Council recommendation on Hungary's 2013 national reform programme and delivering a Council Opinion on Hungary's convergence programme for 2012-2016 (Commission staff working document - SWD(2013) 367 final; p. 21-22); see also: http://www.doingbusiness.org

5. CONCLUSION

On the basis of above-mentioned elements, the Commission objects to the request made by Hungary.