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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

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

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 of the Court of Justice of the European Union, such derogations should be proportionate and limited in scope.

By letter registered with the Commission on 8 August, Latvia requested an authorisation to apply a measure derogating from Article 193 of the VAT Directive. In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 3 November 2017 (Portugal by letter dated 6 November 2017) of the request made by Latvia. By letter dated 7 November 2017, the Commission notified Latvia that it had all the information it considered necessary for appraisal of the request.

As a general rule, the person liable for the payment of VAT to the tax authorities under Article 193 of the VAT Directive is the taxable person supplying the goods. The purpose of the derogation requested by Latvia is to place that liability on the taxable person to whom the supplies are made (the so-called reverse charge mechanism), in the case of particular products, notably as regards construction goods. The aim of the requested derogation is the fight against fraud.

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 sell goods or provide services, collect the VAT from their customers and subsequently disappear without remitting the VAT they collected from their customers to the tax authorities. 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, whereas at the same time the customer will deduct the VAT it paid to its supplier. 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 domestic reverse charge mechanism has been found to eliminate the opportunity to engage in that form of tax evasion.

3. THE REQUEST

Latvia requests, under Article 395 of the VAT Directive, that the Council, acting upon a proposal of the Commission, authorises Latvia 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 domestic supplies of construction products.

In light of occurring fraud, Latvia introduced the reverse charge mechanism in the sector of construction services pursuant to Article 199(1)(a) of the VAT Directive which according to Latvia, reduced the VAT fraud in the sector of construction services. However, Latvia submits that an increase of VAT refunds to taxpayers has been observed after the introduction of the reverse charge mechanism in the sector of construction services and this can be partially explained by the increase of fraud in the supply of constructions goods. Latvia claims that there are grounds to believe that part of the registered VAT payers in the construction sector are acting in bad faith, not disclosing the actual volumes of construction products used when providing construction services.

Following the information submitted by Latvia, similarly to other sectors, taxpayers operating in the construction sector apply the same methods for VAT evasion, namely: a) input tax is unjustly increased b) suppliers of construction goods are doubtful ("missing trader") companies making it impossible to determine the origin of the products c) products are acquired from "buffer companies" and input tax is declared.

Latvia also submits that the construction sector has the highest proportion of shadow economy consisting of not reporting the business income and of envelope wages.

By designating the person to whom the construction goods or services are supplied as the person liable for the payment of VAT, Latvia would like to combat the above fraud which occurs in the sector of construction products. It appears from the request and is confirmed by a letter sent to the Commission on 12 October 2017 that Latvia envisages the application of the reverse charge mechanism to supplies of these goods as from 1 January 2018.

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 restrictive, cautious approach to ensure that derogations do not undermine the operation of the general VAT system, are limited in scope, necessary and proportionate.

Any derogation from the system of fractionated payment can, therefore, not be more than a last resort and an emergency measure and must offer guarantees as to the necessity and exceptional nature of the derogation granted.

Against this background, it should be recalled that it has been the Commission's policy to consider derogations on the reverse charge mechanism only when, at the same time, the goods at stake cannot reach the final consumption, a weak taxpayer is replaced by a more reliable one and there is no risk of fraud to the retail level or to other Member States that do not use the mechanism.

In the first place, it should be noted that the products concerned can be intended for private consumption entailing thus the risk that the fraud is shifted further down the supply chain which could become even more difficult to control. Transferring the whole VAT liability to the last link of the chain would, therefore, increase the risks. There is also a risk of fraud shift to other Member States.

Furthermore, a derogation is in any case not a long-term solution, nor does it replace adequate control measures for the sector and for taxable persons. Although Latvia indicated in its request that a comprehensive range of control measures is currently in place to tackle VAT fraudsters, it did not demonstrate why such control measures would not be sufficient to fight fraud in construction products. Nor did Latvia indicate concretely which measures have been taken or will be taken to fight fraud in the sector of construction goods.

Based on the information provided by Latvia, various forms of fraud appear in the sector of construction products. While the domestic reverse charge mechanism has been found effective to combat the missing trader fraud (MTIC), it does not seem to be an appropriate instrument to fight other forms of fraud, such as for instance non-declaring of volumes of purchased products. Consequently, the requested measure would not provide an optimal solution for the fraud situation in the sector of construction goods.

Finally, the Commission refused a number of requests for derogation to apply the reverse charge mechanism based on the above elements. In this respect reference is made to Commission's communications concerning pig-farming and animal fodder industry (COM(2013)148 of 19.3.2013 - in response to a request from Hungary), sugar sector (COM(2014)229 of 22.4.2014 – in response to the request by Hungary), precious stones (COM(2014) 623 of 10.10.2014 - request by Estonia), meat sector (COM(2017) 24 final of 19.1.2017 – request by Slovakia).

Taking into account the above, the Commission has come to the conclusion that a derogation allowing the reverse charge mechanism to be applied in the sector of construction products could have adverse impacts on fraud at the retail level and on other Member States. The requested measure would also not seem to be an optimal measure able to deal with the complex fraud situation in this sector.

A solution would have to be found at a wider level involving appropriate control measures. The Commission remains available to provide Latvia with necessary assistance to counter the problems of VAT fraud.

5. CONCLUSION

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