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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL  
COMMITTEE**

**on an action plan on VAT**

**Towards a single EU VAT area - Time to decide**

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## 1 INTRODUCTION: THE CASE FOR A SINGLE EU VAT AREA

This action plan sets out the pathway to the creation of a single EU VAT<sup>1</sup> area. A VAT area that can support a deeper and fairer single market, and help to boost jobs, growth, investment and competitiveness. A VAT area that is fit for purpose in the 21<sup>st</sup> century.

The common VAT system is a core element of Europe's single market. By removing obstacles that distorted competition and prevented the free movement of goods, it has facilitated trade within the single market. It is a major and growing source of revenue in the EU, raising almost EUR 1 trillion in 2014, which corresponds to 7% of EU GDP.<sup>2</sup> One of the EU's own resources is also based on VAT. As a broad-based consumption tax, it is one of the most growth-friendly forms of taxation.

But the VAT system has been unable to keep pace with the challenges of today's global, digital and mobile economy. The current VAT system, which was intended to be a transitional system, is fragmented, complex for the growing number of businesses operating cross-border and leaves the door open to fraud: domestic and cross-border transactions are treated differently and goods or services can be bought free of VAT within the single market.

It now urgently needs reform:

- It needs to be simpler for businesses to use. Compliance costs are significantly higher in single market trade than in domestic trade<sup>3</sup>, while complexity is stifling business, especially small and medium-sized businesses (SMEs);<sup>4</sup>
- It must combat the growing risk of fraud. The "VAT gap" between expected revenue and revenue actually collected is estimated at EUR 170 billion<sup>5</sup>, while cross-border fraud alone accounts for EUR 50 billion of revenue loss each year;<sup>6</sup>
- It needs to be more efficient, in particular at exploiting the opportunities of digital technology and reducing the costs of revenue collection;
- It must be based on greater trust: trust between business and tax administrations, and between EU tax administrations.

To sum up, VAT needs to be modernised and rebooted. Reaching this goal will not be easy. The current system has proved difficult to reform and the requirement for unanimity between all Member States to change anything presents a serious challenge. Yet increasingly business as usual is not an option. Simply adding new layers of obligations and checks in order to

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<sup>1</sup> Value Added Tax.

<sup>2</sup> 17.5 % of national tax revenues, including social contributions (Eurostat).

<sup>3</sup> Ernst & Young, *Implementing the 'destination principle' to intra-EU B2B supplies of goods – Feasibility and economic evaluation study*, 2015.

<sup>4</sup> Compliance costs for business are estimated between 2 and 8 % of the VAT collection (Institute for Fiscal Studies, *A retrospective evaluation of elements of the EU VAT system*, 2011).

<sup>5</sup> The difference between the VAT revenue expected and the VAT actually collected by national authorities. The VAT gap provides an estimate of revenue lost due to fraud and evasion, tax avoidance, bankruptcies, financial insolvencies and miscalculations (CASE, *Study to quantify and analyse the VAT Gap in the EU Member States*, 2015).

<sup>6</sup> Ernst & Young, 2015.

tackle fraud will add even more compliance costs and legal uncertainty for all businesses, including the trusted ones, and further hamper the functioning of the single market. Piecemeal simplification is also unlikely to work.

Action is now needed. It is time for the creation of a genuine single EU VAT area for the single market.

To this end, the Commission now plans to present a legislative proposal to put in place a definitive VAT system<sup>7</sup>. This definitive system will rest upon the agreement of EU legislators that the VAT system should be based on the principle of taxation in the country of destination of the goods. This means that the taxation rules according to which the supplier of goods collects VAT from his customer will be extended to cross-border transactions. This change alone should help reduce cross-border VAT fraud by EUR 40 billion per year.<sup>8</sup>

Since preparing and adopting such a major change in the way VAT works will take some time, the Commission will in parallel take forward a number of other linked initiatives to help resolve the challenges presented by the VAT system. Some of these initiatives have already been announced, and they will be completed with other measures to help immediately address the fraud issue.

The current system is also struggling to address innovative business models and technological progress in today's digital environment. Different VAT rates between physical and digital goods and services do not fully reflect today's realities. Moreover Member States feel unduly constrained in their rates-setting policy. The paradigm shift in the last few years towards the destination principle requires a broader reflection about the consequences to be drawn for the VAT system and EU rules governing VAT rates.

Overall, this action plan sets out the progressive steps required toward a single EU VAT area. It sets out immediate and urgent actions to tackle the VAT gap and adapt the VAT system to the digital economy and the needs of SMEs. And it provides clear longer-term orientations on the definitive VAT system and VAT rates. Decisions on all of these issues are now needed. Above all, political leadership is needed, to overcome the deep-rooted obstacles that have blocked progress in the past and finally adopt the reforms needed to combat fraud, remove administrative barriers and reduce regulatory costs to simplify life for Europe's businesses.

## **2 RECENT AND ONGOING POLICY INITIATIVES**

The Commission has consistently pressed for the reform of the VAT system. Recently, after a broad and fruitful public debate launched by the *Green Paper on the future of VAT* in December 2010<sup>9</sup>, the Commission presented its conclusions in a *Communication on the future of VAT* in December 2011<sup>10</sup> and set out the priority actions for the coming years.

On this occasion, after many years of unsuccessful attempts, the Commission abandoned the objective of implementing definitive VAT arrangements based on the principle of taxing all

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<sup>7</sup> As part of the Regulatory Fitness and Performance Program (REFIT).

<sup>8</sup> Ernst & Young, 2015.

<sup>9</sup> COM(2010) 695, Commission Staff Working Document SEC(2010) 1455, 1.12.2010.

<sup>10</sup> COM(2011) 851, 6.12.2011.

cross-border supplies of goods in the Member State of their origin, under the same conditions that apply to domestic trade including VAT rates. The European Parliament<sup>11</sup> and the Council<sup>12</sup> agreed that the definitive system should be based on the principle of taxation in the Member State of the destination of the goods.

The initiatives that were then achieved included:

- the Quick Reaction Mechanism to combat sudden and massive VAT fraud;<sup>13</sup>
- implementation of the new place of supply rules, in line with the general principles, at the place of destination, for telecommunications, broadcasting and electronic services provided to final consumers with a One Stop Shop to facilitate tax compliance;<sup>14</sup>
- a new, more transparent governance system for EU VAT system, in which all stakeholders were more closely involved.<sup>15</sup>

Following this, other initiatives have been initiated to remove VAT obstacles to digital and SMEs development in the single market and review the VAT rules in the public sector<sup>16</sup>.

## 2.1 Removing VAT obstacles to e-commerce in the single market

The current VAT system for cross-border e-commerce is complex and costly for Member States and business alike. The average annual costs of supplying goods to another EU country are estimated at EUR 8 000<sup>17</sup>. Moreover, EU businesses are at a competitive disadvantage, as non-EU suppliers can supply VAT-free goods to consumers in the EU under the exemption for imports of small consignments (nearly 150 million VAT-free consignments were imported in 2015<sup>18</sup>). The complexity of the system also makes it difficult for Member States to ensure compliance, with losses estimated at around EUR 3 billion annually<sup>19</sup>.

As announced in May 2015 in the Digital Single Market strategy,<sup>20</sup> the Commission will present a legislative proposal by the end of 2016 to modernise and simplify VAT for cross-border e-commerce, in particular for SMEs. This will include:

- extending the One Stop Shop mechanism to EU and non-EU countries online sales of tangible goods to final consumers;

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<sup>11</sup> <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2011-0436>

<sup>12</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/130257.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130257.pdf).

<sup>13</sup> [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/138239.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/138239.pdf)

<sup>14</sup> [http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/telecom/index\\_en.htm#new\\_rules](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm#new_rules)

<sup>15</sup> The VAT Expert Group and the EU VAT Forum were set up, and explanatory notes and VAT Committee guidelines were published.

<sup>16</sup> Under special rules dating from the 1970s certain activities of public sector bodies or deemed to be in the public interest are not subject to VAT. Since then they have increasingly been deregulated or opened up to the private sector, heightening concerns about the possible distortive effect of these rules on competition and their complexity. The Commission has investigated possible remedies.

<sup>17</sup> Preliminary figures from the ongoing Commission' study on VAT obstacles to cross-border e-commerce.

<sup>18</sup> *Idem.*

<sup>19</sup> *Idem.*

<sup>20</sup> COM(2015) 192, 6.5.2015.

- introducing a common EU-wide simplification measure (VAT threshold<sup>21</sup>) to help small start-up e-commerce businesses;
- allowing for home country checks, including a single audit of cross-border businesses;
- removing the VAT exemption for imports of small consignments from non-EU suppliers.

## **2.2 Towards an SME VAT Package**

More generally, SMEs bear proportionally higher VAT compliance costs than large businesses due to the complexity and fragmentation of the EU VAT system.<sup>22</sup> Further to the new Single Market Strategy,<sup>23</sup> the Commission is therefore preparing a comprehensive simplification package for SMEs that will seek to create an environment that is conducive to their growth and favourable to cross-border trade. In particular, the special scheme for small enterprises will be subject to review. This package will be presented in 2017.

The Commission will also draw lessons from the withdrawal of the proposal for a standard VAT return<sup>24</sup> which remains an important area for simplification, and continue to reflect on how to alleviate compliance costs for SMEs in this regard.

## **3 URGENT MEASURES TO TACKLE THE VAT GAP**

The current levels of VAT gap call for urgent action on three fronts: achieving better administrative cooperation, improving voluntary compliance and collectively improving the performance of European tax administrations. In addition, the boom in e-commerce requires a new approach to tax collection.

### **3.1 Improving cooperation within the EU and with non-EU countries**

As recognised by the European Court of Auditors,<sup>25</sup> the tools of administrative cooperation between tax administrations are not being sufficiently exploited. Moreover, the implementation of the Eurofisc<sup>26</sup> was not ambitious enough. We therefore need to move from the existing cooperation models based on Member States exchanging information to new models of sharing and jointly analysing information and acting together. Member States should benefit from a risk management capacity at EU level, enabling them to rapidly and more effectively identify and dismantle fraudulent networks.

This involves looking at ways of strengthening the role and impact of Eurofisc with a view to making a qualitative leap forward towards a more advanced structure. With the support of the Commission, competent officials working in Eurofisc should have direct access to relevant information held in different Member States, enabling them to exchange, share and analyse

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<sup>21</sup> Under which no registration in other Member States or to the One Stop Shop is required for cross-border supplies.

<sup>22</sup> Institute for Fiscal Studies, see above.

<sup>23</sup> COM(2015) 550, 28.10.2015.

<sup>24</sup> COM(2013) 721, 23.10.2013.

<sup>25</sup> Special report No 24/2015: Tackling intra-Community VAT fraud: More action needed, 3 March 2016.

<sup>26</sup> Eurofisc is a network of national civil servants set up for the rapid exchange of targeted information on VAT fraud.

key information and launch joint audits. A legislative proposal to implement such improvements will be tabled in 2017.

There is also a need to strengthen mutual assistance for the recovery of tax debts.

Fighting organised crime networks and VAT fraud on imports also requires removing the obstacles to effective cooperation between tax administrations and customs, and with law enforcement bodies and financial institutions at national and EU level. In this context, adoption of the Commission proposals on the protection of the EU financial interests<sup>27</sup> to cover EU wide VAT fraud and the proposal to create a European Public Prosecutor's Office<sup>28</sup> could play a significant role.

Finally, better cooperation with international organisations and non-EU countries over VAT should make it possible to extend the EU system of administrative cooperation to non-EU countries, particularly to ensure effective taxation of e-commerce.

### **3.2 Towards more efficient tax administrations**

It is the responsibility of Member States' tax administrations to enforce tax legislation. Collecting VAT and fighting fraud in a global economic environment requires strong tax administrations that are well-equipped to assist each other. Many European Semester recommendations call on Member States to improve tax compliance and their tax administration capacity. More should therefore be done to exchange and implement best practices in this area.

Modernising VAT collection could also have significant benefits. eGovernance and digital tax accounts would simplify the procedures for the tax authorities and reduce burdens for business, both within Member States and across borders. In addition, it could help building trust and combat fraud.

The time has come to develop a common agenda for tax administrations in order to build trust and to strengthen tax administrations' capacity to tackle fraud and adapt to economic developments while working together. The Commission will:

- provide for a strategic discussion between the heads of the 28 tax administrations, and with customs, in order to build such an agenda;
- facilitate agreements on minimum quality standards for core tax administration functions and evaluation;
- provide platforms for knowledge and experience sharing and technical assistance to support reforms.<sup>29</sup>

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<sup>27</sup> COM(2012) 363, 11.07.2012, Proposal for a Directive of the European Parliament and of the Council on the fight against fraud to the Union's financial interests by means of criminal law.

<sup>28</sup> COM(2013) 534, 17.07.2013, Proposal for a Council Regulation on the establishment of the European Public Prosecutor's Office.

<sup>29</sup> The Structural Reform Support Service (SRSS) of the Commission could play a role.

### **3.3 Improving voluntary compliance**

It is also important to improve voluntary compliance and cooperation between businesses and tax authorities. The Commission will facilitate this process by running or sponsoring concrete projects such as effective dispute prevention and resolution mechanisms under the EU VAT Forum and will facilitate agreements between tax administrations and business sectors.

### **3.4 Tax collection**

E-commerce, the collaborative economy and other new forms of business are both a challenge and an opportunity in terms of tax collection. This is true domestically as well as cross-border. Member States have to work together and with the Commission support, to define and exchange best practices in addressing these challenges. New approaches to tax collection may include, among others: new reporting tools, new auditing tools, defining new roles for certain market intermediaries.

### **3.5 Temporary derogation for Member States to tackle national and structural fraud**

VAT fraud does not affect all EU countries equally; indeed, the VAT gap varies from less than 5% to more than 40%. Some Member States more heavily affected have asked to be allowed to implement a temporary generalised reverse charge system which would derogate from the general principles of the VAT Directive<sup>30</sup>. These requests would aim at addressing an endemic VAT fraud, taking into account the specificities of the Member States in question.

The Commission recognises the need to find practical and short-term solutions to tackle VAT fraud. While going beyond the possibilities of the current VAT Directive<sup>31</sup> and requiring therefore a legislative change, the Commission takes these requests very seriously and will thoroughly assess their political, legal and economic implications before presenting its conclusions. Such derogations should not disproportionately hamper the proper functioning of the single market and would require unanimity in the Council. This assessment will involve detailed analysis so as to ensure a thorough and accurate understanding of the situation and the possible implications of the temporary derogations. The possible impact on business and tax administrations in particular in terms of adjustment costs as well as fraud shifting to neighbouring countries and retail level will be a critical element to be taken into account.

In any case, credible administrative measures exist and have proved their effectiveness for containing fraud in many Member States. Therefore, the Commission also stands ready to help the Member States concerned to improve their tax collection and inspection capacity. Comprehensive reform programmes based on thorough analysis of the VAT gap and fraud schemes in these Member States and building on best practice could be implemented quickly. This could involve Commission financial support and the expertise of national tax administrations with a good record in this field. In addition Eurofisc could help carry out risk analysis, and joint audits could be launched, for which national tax administrations could volunteer.

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<sup>30</sup> Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

<sup>31</sup> Article 395 of the VAT Directive.



The assessment of these derogations will be done without prejudice to the proposals for the implementation of the definitive VAT system to be presented by the Commission. The Commission will report on the state of play of this matter by June of this year.

#### **4 MEDIUM TERM MEASURE TO TACKLE THE VAT GAP: TOWARDS A ROBUST SINGLE EUROPEAN VAT AREA**

The present system, which has been in place since 1993 and was supposed to be transitional, splits every cross-border transaction into an exempted cross-border supply and a taxable cross-border acquisition. It is like a customs system, but lacks equivalent controls and is therefore the root of cross-border fraud.

Such fraud occurs when a supplier pretends to have transported the goods to another Member State but the goods are in fact consumed VAT-free locally or especially when a client of a cross-border transaction purchases goods or services VAT-free and charges VAT without remitting it to tax authorities while his/her customer can deduct it.<sup>32</sup>

It is now high time to adopt a unified approach to tackling such fraud that is fully compatible with the requirements of the single market. Even the ambitious administrative actions set out above to tackle the VAT gap, while useful, would not be sufficient on their own to put an end to cross-border fraud.

A robust single European VAT area would treat cross-border transactions in the same way as domestic transactions, putting an end to the endemic weakness of the system, and would integrate the management and enforcement of VAT through closer cooperation between tax administrations.

Following the Council conclusions of May 2012, the Commission engaged in transparent dialogue with Member States and other stakeholders<sup>33</sup> with the aim of examining in detail the possible options for implementing the ‘destination principle’ in B2B<sup>34</sup> cross-border trade<sup>35</sup> including the implementation of a generalised reverse charge system.

Under a generalised reverse charge system, VAT is ‘suspended’ along the whole economic chain and is charged only to consumers. This means that total VAT collection is shifted to the retail stage. Such a system does not have the self-policing nature of the current VAT system (i.e. under the principle of fractionated payment), which ensures that a small number of fairly large, reliable taxable persons in the economic chain account for most of VAT.

In addition, other types of fraud can arise, e.g. fraudsters claiming to be taxable persons to obtain goods intended for final consumption VAT-free. There is therefore a high built-in risk that fraud and untaxed private consumption would soar, particularly in view of EU countries’ high VAT rates (up to 27 %).

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<sup>32</sup> ‘Missing Trader Intra-Community’ and ‘carousel’ fraud.

<sup>33</sup> Business and tax practitioners’ representatives and academics from the VAT Expert Group.

<sup>34</sup> Business to Business.

<sup>35</sup> SWD(2014) 338, 29.10.2014 on the implementation of the definitive VAT regime for cross-border trade.

The Commission's conclusion from this work is therefore that the best option for the EU as a whole would be to tax B2B supplies of goods within the EU in the same way as domestic supplies, thus fixing the great flaw of the transitional arrangements while keeping the underlying features of the VAT system intact.

Such a system of taxation of cross-border supplies will ensure consistent treatment of domestic and cross-border supplies along the entire chain of a production and distribution, and re-establish the basic features of the VAT in cross-border trade i.e. the fractionated payments system with its self-policing character.

Therefore, this change should reduce cross-border fraud by about EUR 40 billion (80%) a year in the EU.<sup>36</sup> The intermediate and final consumption of the goods will continue to be taxed where the goods are transported to, which is a reliable proxy of the place of consumption. Such an objective criterion would make it difficult for taxable persons to engage in tax planning or commit fraud. This will enable tax administrations to concentrate resources on other challenges.

Some significant simplification measures will be taken to accompany this change. For instance, the One Stop Shop that already exists for telecommunication, broadcasting and electronic services and which is due to be extended to all e-commerce transactions<sup>37</sup>, will be even more widely implemented and rebooted, so as to fully exploit the opportunities presented by digital technology to simplify, standardise and modernise processes. Businesses will need to register for VAT purposes in the Member States where they were established only. Collectively, businesses should save an average of around EUR 1 billion.<sup>38</sup>

Such a system would require more trust and cooperation between tax administrations as the Member State where the goods arrive would have to rely on the Member State of departure to collect the VAT due on the cross-border supply. The efficiency in collecting VAT and fighting fraud between tax administrations would therefore need to be aligned to the highest level. Such a system would also involve significant change for business. Any implementation should therefore be gradual to ensure a smooth transition for business and allow all Member States to reach higher levels of cooperation and administrative capacity. It should also be user friendly and be built on the latest digital technologies available.

As a first legislative step, the principle of taxation of cross-border supplies will be re-established and the One Stop Shop extended to cover cross-border B2B supplies of goods. However, compliant businesses, certified by their tax administrations, including SMEs, would continue to be liable for VAT on goods purchased from other EU countries. As compliant businesses represent the vast majority of taxable persons involved in cross-border transactions, this would significantly reduce the amounts of VAT channelled through the One Stop Shop and would make it easier for businesses to adapt.

As a second legislative step, taxation would cover all cross-border supplies so all supplies in goods and services within the single market, either domestic or cross-border, would be treated

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<sup>36</sup> In France, for instance, fraud would be reduced by about EUR 10 billion. Other figures include: Italy: EUR 7 billion, UK: EUR 4 billion, Romania: about 17% of current VAT revenue, Greece: 12%, Ernst & Young (2015).

<sup>37</sup> See the upcoming legislative proposal set out above.

<sup>38</sup> Ernst & Young, see above.

the same way. To this end a significant qualitative leap in cooperation and joint enforcement tools would be needed to ensure mutual trust between tax administrations. Stepping up cooperation through Eurofisc and improving tax administrations' capacities will be the first stage in meeting this objective. Only when Member States consider that the qualitative leap has been achieved could the definitive system be fully implemented.

## 5 TOWARDS A MODERNISED RATES POLICY

The VAT Directive sets out general rules framing Member States' freedom to set VAT rates. These rules were intended to guarantee, above all, the neutrality, simplicity and workability of the VAT system. The legislator chose to apply – as the default rule – a standard VAT rate to all taxable supplies of goods and services and to set a minimum rate of 15%. It permitted two reduced rates, set at 5% or more, which were confined to certain goods and services listed in the VAT Directive<sup>39</sup>. In addition a number of reduced rates, including lower than 5% are allowed in certain Member States according to 'standstill derogations'.<sup>40</sup>

But current rules do not fully take into account technological and economic developments. This is for example the case for e-books and electronic newspapers, which cannot benefit from reduced rates available for physical publications. This issue will be addressed in the context of the Digital Single Market strategy.

Moreover, these rules were designed over two decades ago with the aim of arriving at a definitive VAT system based on the origin principle. Since then, VAT has increasingly developed into a system based on the destination principle. The rules on rates, however, have never been adjusted to reflect this logic, which allows for greater diversity in VAT rates. Differences in VAT rates may still affect the functioning of the single market in a system where consumers cross the border to buy goods and services. But apart from these cases, in contrast to what happens under an origin system, suppliers derive no significant benefit from being established in a lower-rate Member State, so VAT rate differences have less potential to disrupt the functioning of the single market.

The rules of the VAT Directive aim to preserve the functioning of the single market and avoid distortions of competition. In accordance with the subsidiarity principle, the Commission recalls that the EU can act only if and in so far as certain objectives cannot be sufficiently achieved by the Member States, and can be better achieved at Union level. The current rules make it slow and difficult for them to extend reduced-rate treatment to new areas, as all decisions have to be taken unanimously. As a result, the VAT Directive is becoming obsolete, for example as regards products subject to technological progress.

Worse, given the long time-lags for adopting changes in EU legislation, Member States find themselves in breach of the rules. To date, the Commission has had to open more than 40 infringement proceedings against over two thirds of Member States. A reform giving more freedom to Member States would enable them to take the tax policy decisions they want more rapidly, while relieving the EU of unnecessary litigation.

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<sup>39</sup> In Annex III to the VAT Directive

<sup>40</sup> Articles 109-122 of the VAT Directive.

On the other hand, devolving full rate-setting power to Member States would not come without costs and disadvantages, even if it did not in itself threaten the functioning of the single market. It might generate an erosion of VAT revenues, as individual sectors would claim a more favourable treatment. In the long run, this might shrink the tax base, going against the EU's economic policy recommendations. Indeed, the gap between reduced rates and standard rates has tended to widen in recent years, lowering VAT efficiency and increasing distortions. Furthermore, greater decentralisation might result in an increase in complexity, creating additional costs for businesses and generating legal uncertainty. In a destination based system, under which businesses in each Member State must charge VAT according to the rates applicable in other Member States, it becomes increasingly important that each set of national rules are simple and to the widest extent possible rely on harmonised product categories.

The appraisal of a more decentralised system ultimately depends on political preferences. Therefore the implementation of such a system cannot be decided upon as a pure technical matter, but requires political discussion. There are several possible sub-options at technical level, but first a consensus should be reached on the broad direction of reform. Two main options are outlined below. They are not contradictory. They represent different degrees in the flexibility that could be granted to Member States.

### **5.1 Option 1: Extension and regular review of the list of goods and services eligible for reduced rates**

The minimum standard VAT rate of 15% would be maintained. The list of goods and services that can benefit from the application of a reduced rate would be reviewed in the context of the transition to the definitive system and then at regular intervals, in particular taking account of political priorities. Member States would be able to submit to the Commission their views on the needs for adjustment.

The Commission, with the support of the Member States, would analyse whether such changes would pose any risk to the functioning of the single market or distort competition, and would report its findings before any change.

Under this option all currently existing reduced rates, including derogations, legally applied in Member States would be maintained and could be included in the list of optional reduced rates available to all Member States, ensuring equal treatment.

### **5.2 Option 2: Abolition of the list**

The most ambitious approach in terms of granting Member States greater rate-setting power would be to abolish the list and allow them greater freedom on the number of reduced rates and their level.

While Member States would remain constrained by EU legislation, such as single market or competition rules, and the EU's economic governance framework, this option would require safeguards to be put in place to avoid unfair tax competition within the single market, while also guaranteeing legal certainty and reducing compliance costs. The freedom to set VAT rates should be thus accompanied by a number of basic rules framing the cases in which reduced rates may be applied.

In particular, Member States could be asked to inform the Commission and other Member States about any new measure and to assess any impact it might have on the single market. To prevent unfair tax competition in cross-border shopping, one possible solution could be to prevent application of reduced rates to high-value goods and services, in particular easily transportable items. To ensure the overall consistency and simplicity of the rates system, the total number of reduced rates allowed by Member States could be limited. These elements would limit the possibility of narrowly targeting sectors for unfair tax relief.

Also under this option all currently existing reduced rates, including derogations, legally applied in Member States would be maintained, the possibility to apply them could be made available to all Member States. The minimum standard VAT rate would be removed.

## **6 CONCLUSION**

The action plan has designed a way forward to achieve a single EU VAT Area. The initiatives stemming from this Communication will be developed in accordance with the Commission's Better Regulation guidelines.<sup>41</sup>

The Commission calls on the European Parliament and the Council supported by the European Economic and Social Committee to provide as soon as possible clear political guidance, confirming their willingness to support the actions set out in this Communication.

In order to ensure a continued steering of the overhaul of the EU VAT system initiated in 2011, the Commission will continue reporting regularly on the state of play of this review and set out new actions.

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<sup>41</sup> SWD(2015) 111, 19.5.2015.

## 7 TIMELINE

### Adapting the VAT system to the digital economy and the needs of SMEs

<b>2016</b>	Proposal for removing VAT obstacles to cross-border e-commerce (Digital Single Market - REFIT) - e-publications
<b>2017</b>	SME VAT package

### Towards a robust single European VAT area

<b>2016</b>	Measures to improve cooperation between tax administrations and with customs and law enforcement bodies and to strengthen tax administrations' capacity
<b>2016</b>	Evaluation report of the Directive on the mutual assistance for the recovery of tax debts
<b>2017</b>	Proposal to enhance VAT administrative cooperation and Eurofisc
<b>2017</b>	Proposal for the definitive VAT system for cross-border trade (single European VAT area – first step - REFIT)

### Towards a modernised rates policy

<b>2017</b>	Reform of VAT rates (REFIT)
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