Opinion Statement FC 1/2020 on the harmonisation of VAT penalties in the EU

Prepared by the CFE Fiscal Committee
Submitted to the EU institutions on 6 March 2020

This Opinion Statement discusses issues surrounding the justification for harmonisation of VAT penalties in the EU.
The movement to the destination principle in VAT and in particular the abolition of current distance sales rules in 2021 by Council Directive 2017/2455 mean that businesses are going to increasingly have to account for VAT in accordance with the rules of the country where their customer is established. Because they will understandably be less familiar with the rules and procedures in other states, there is also a greater risk that traders based in other states may by accident make mistakes. Small businesses in particular may be apprehensive about undertaking cross-border transactions if this potentially results in them being subject to relatively draconian penalties in other Member States. Such businesses are also likely to have particular difficulties in disputing any claims for penalties.

The logistical and financial burdens of instructing advisers in other states for advice and then in disputing any penalties are likely to be especially onerous for them. If correspondence is sent to them in a language that they do not understand, they may have difficulties in knowing that penalties are being sought and the basis and time limits for disputing the penalties. If demands are sent by post, delays in sending post between Member States may also cause them problems in disputing demands in time.

Although principles of European Union law require penalties to be proportionate, courts are likely to be reluctant to brand penalties as disproportionate. Member States currently therefore have considerable discretion when setting penalties. Given the changes being made to the VAT system and the burdens that these will place on businesses established in other states, CFE Tax Advisers Europe considers that both the Commission and the Member States should seek to harmonise or increasingly harmonise the basis upon which penalties are imposed. This applies both to the level of penalties imposed but also in relation to the procedures for disputing penalties. This is particularly the position when the penalties relate to cross-border sales. There is also a need for Member States to provide literature that is easily accessible to traders in other Member States which explains the basis upon which penalties are calculated and imposed and how penalties can be mitigated and disputed and relevant national time limits. This guidance should ideally be in all the national languages of the Union. It certainly needs to be available in English and other major languages of the Union.

In this regard CFE Tax Advisers Europe observes that:

1. A number of Member States have sought to charge interest on unpaid VAT at penal rates. For example, we understand Slovakia and the Czech Republic impose rates of 15%+ and Poland has just reduced its rate to a still very high 8%. Such interest rates effectively become a no-fault penalty for making an error. Over a period of time such interest liabilities can become very significant. Because they may only be making very occasional supplies in the Member State in question, there is also a danger that tax authorities may take longer to notice errors made by traders who are established in other states. As such, there are particular dangers that they may be penalised by these heavy charges. We consider that it would be good practice if interest rates were aligned to those in the commercial markets and should not act as a disguised no-fault penalty. On this basis it must also be doubtful if it is appropriate to have significantly higher rates of interest charged on underpaid VAT than is paid on repayments of overpaid VAT and no interest should be charged if the taxpayer has a valid claim for overpaid tax during a period that matches any claims by the tax authority;
2. We do not consider that it is appropriate for any or any material penalties to be imposed on traders who have made careless errors if they make a voluntary disclosure of the error. The imposition of material penalties clearly will discourage traders from correcting the position;

3. We do not consider that it is appropriate for any penalties to be imposed on a trader who has a reasonable excuse for an error and in particular for traders who have made an error as a result of taking legal advice on an issue of uncertainty. For example we understand that penalties may be imposed in Austria in these circumstances unless the error arises from a judicial decision which is subsequently overturned. This defence is in our view unduly restrictive;

4. We are concerned that the level of penalties imposed by some countries are disproportionate. For example, we understand that in Italy 90-180% penalties can be imposed for failures to account for output tax liabilities. In Belgium 200% penalties can be imposed. In Italy, this is also the position even though there has been no loss of tax because the person subject to the output tax liability has a corresponding claim to recover input tax, for example when there is a reverse charge on the receipt of supplies with a corresponding right to recover input tax. Indeed, the tax authority will more generally suffer no loss in cases where the sale is to a business customer whose right of deduction is correspondingly impacted. Especially for non-deliberate errors, we, in any event, consider that this rate of penalty is disproportionate even in cases where tax is overall due. It is clearly even more disproportionate in cases where there is no overall liability because there is a corresponding claim to recover input tax. We consider that no penalties and certainly no material penalties should be due in a case where a corresponding right to deduct input tax means that there is no overall loss of tax;

5. We are also concerned that some states allow penalties to be set at a far lower rate if the trader reaches a negotiated settlement with the tax administration. For example, we understand that in Italy such settlements can result in a taxpayer paying a penalty which is just 10-20% of the minimum penalty that would otherwise apply. Although less extreme, similar rules also apply in Spain. Such a regime is a matter of concern because it effectively makes it commercially very difficult for a trader to dispute whether any penalties are due if the consequence of doing this is a penalty over ten times larger, especially given the time and costs involved in disputing the penalties. We consider such regimes are difficult to reconcile with the rule of law. Going forward, in the cross-border context, particularly with small traders, we are also concerned that traders may be subjected to disproportionate penalties because they are not aware of the facility to negotiate a much lower penalty. This is particularly true if there are time limits that have to be complied with if a trader is to take advantage of any mitigated penalties. We are also concerned that having a very high level of penalties for all errors, such as in Belgium of 200%, in practice has a similar effect;

6. We note that minimum fixed penalties are likely to impose disproportionate burdens on small traders established in other Member states who are only likely to make relatively low value supplies in another country;
7. Most penalties are likely to be regarded as criminal for the purposes of the European Convention on Human Rights. Article 6(3) of the European Convention of Human Rights recognises that in criminal matters a person has a right to translation if they do not understand the language of the court. Article 41 of the Charter of Fundamental Rights of the European Union also gives a right to correspond in all the national languages of the Union. Article 52(5) of the Charter also envisages that the Charter applies to Member States when they are implementing European Union law. Recognising these facts, the Netherlands provides guidance on penalties in other languages. Other states should follow this practice. Indeed, it would clearly be desirable if this practice could be extended to any demands for tax, and not just to penalties;

8. Consideration should be given to having extended and harmonised time limits for disputing demands on cross-border supplies and claims for refunds, or possibly having harmonised time limits more generally. This reflects the fact that:

(i) a trader who pays tax in one Member State in error and fails to pay tax in another Member State may find that they have to pay the tax and penalties in the State where they failed to pay any tax but could find that they are out of time to make a claim to recover the tax that they have overpaid in the other State. The trader will effectively be subject to a double penalty in the situation;

(ii) there are clearly greater risks of delays in the postal system when correspondence is sent by post between Member States. It also reflects the fact that there will inevitably also be additional logistical issues in seeking cross-border advice, especially if the correspondence is not sent in the national language of the trader;

(iii) having well-advertised harmonised time limits will also assist taxpayers in knowing what time limits they have for disputing demands. It would clearly be desirable if this could also be extended to appeals against demands for tax;

9. Since it acts as a de facto penalty, we also have concerns about tax authorities disputing claims to deduct input tax because of minor defects which cases such as C-332/15 [https://eur-lex.europa.eu/eli/case/c-332/15/en establish are not consistent with European Union law. Similarly, in Case C-533/16 [https://eur-lex.europa.eu/eli/case/c-533/16/en the Court considered that national time limits could not be relied upon to prevent an input tax claim when the claimant had previously not been provided with a VAT invoice. We consider that it would be helpful if the Commission could provide guidance on this issue.

Given the abolition of the distance sales rules in January 2021, the CFE Tax Advisers Europe considers that these issues should receive urgent attention by the Commission and the Member States.