



The road towards a definitive European VAT system

**What you need to know about the EU VAT changes
in 2019, 2021, 2022 and beyond**

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The biggest reform of the European VAT rules in over 25 years is on our doorstep. Over the coming years, the EU VAT landscape will gradually change with the implementation of a definitive EU VAT system. The system should be less complex, more fraud-proof, more business-friendly and ready for the challenges of the 21st century, starting with the booming digital economy.

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1. Background

The common VAT system plays an important role in the European Single Market. It was initially introduced with the commitment to (ultimately) establish a definitive VAT system whereby operating within the European Community would feel like operating within a single country. Despite many reforms, the EU VAT system we know today is still a fraud-sensitive transitional regime which is way too complex and unable to keep pace with the challenges of today's increasingly globalized and digitized economy.

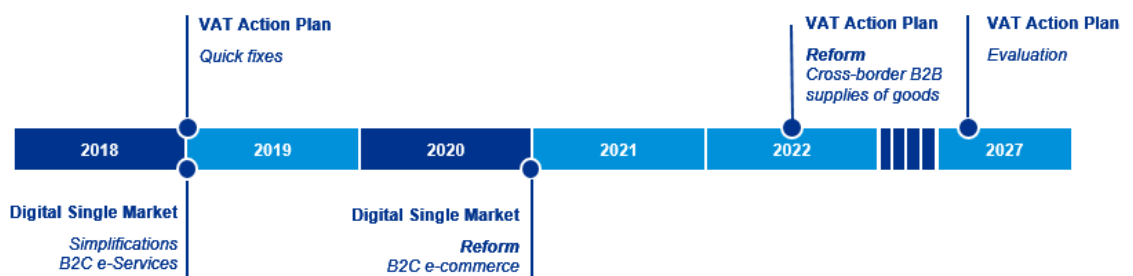
The difference between the expected VAT revenues and the amount actually collected in the EU (i.e. the "VAT gap") is estimated at around EUR 150 billion per year. According to estimates of the European Commission, around EUR 50 billion – or EUR 100 per EU citizen each year – of this amount results from cross-border VAT fraud. These euros are not available for governments but go to criminal individuals and criminal organizations.

As part of its Digital Single Market Strategy, the European Commission agreed on a series of measures to eliminate the VAT obstacles concerning cross-border e-commerce that will be gradually implemented by the EU member states by 1 January 2021.

Furthermore, as part of its VAT Action Plan, the European Commission wants to abolish the transitional is being called the biggest EU VAT reform in 25 years in order to establish a definitive VAT system that helps companies reap all the benefits of the Single Market and compete in global markets. The plan sets out the progressive steps required to effectuate a single EU VAT area and should result in an 80% decrease of the VAT gap. Furthermore, it should save businesses an estimated EUR 1 billion by reducing the red tape which currently complicates cross-border trade in the EU.

The main principle of the definitive VAT system will make the supplier liable to collect the VAT and settle it in the member state of residence. This tax is however to be collected following the rules (and tax rates) of the destination country, i.e. the presumed state of consumption. The member states will then pay the VAT to each other directly, as is already the case for e-services, which are declared under the Mini One Stop Shop (MOSS) regime.

The anticipated timeline for the implementation of the aforementioned Digital Single Market and VAT Action Plan is as follows:





“Twenty-five years after the creation of the Single Market, companies and consumers still face 28 different VAT regimes when operating cross-border. Criminals and possibly terrorists have been exploiting these loopholes for too long, organising a €50bn fraud per year. This anachronistic system based on national borders must end! Member states should consider cross-border VAT transactions as domestic operations in our internal market by 2022. Today's proposal is expected to reduce cross-border VAT fraud by around 80%. At the same time, it will make life easier for EU companies trading across borders, slashing red tape and simplifying VAT-related procedures. In short: good news for business, consumers and national budgets, bad news for fraudsters.”

Pierre Moscovici, Commissioner for Economic and Financial Affairs,
Taxation and Customs

2. Digital Single Market (B2C)

2.1 B2C e-services

Additional simplification rules will be implemented for small and mid-sized enterprises (SMEs) to facilitate them in broadening their offering of telecommunication, broadcasting (radio, and television) or electronically supplied services (e.g. provision or processing of data or licensing for software) to B2C consumers in other member states.

As of 1 January 2019, EU-established businesses supplying such services across the EU can charge local VAT in their member state of residence if their annual turnover of such cross-border services does not exceed EUR 10,000.

Once the threshold is reached, VAT needs to be accounted for in the member state of the B2C consumer. This is also the principle for non-EU-based companies and EU-based companies with an establishment in multiple member states, as these are excluded from the aforementioned simplification rule. The VAT compliance burden for these companies was already drastically reduced in 2015 with the introduction of the “Mini One-Stop-Shop” (MOSS) regime, allowing companies to report and pay VAT on their EU-wide turnover via a single online portal in their home member state (or a member state of their choosing if the company does not have any physical presence in Europe). The member states will then pay the respective VAT to each other directly.

Taxable persons without an EU establishment but having an EU VAT ID number will also be able to apply the MOSS regime as of 1 January 2019. They had slipped through the legislative cracks upon initial implementation, leaving them at an administrative disadvantage as they were required to VAT register in every single member state in which they had customers. This anomaly in the VAT legislation will thus be resolved as of 1 January 2019.

As of 1 January 2021, the application of the MOSS regime will be extended to cover all services offered to B2C consumers, and will therefore no longer be limited to telecommunication, broadcasting and electronically supplied services. This change is likely to ease the administrative burden of many B2C service providers, based in or outside the EU, that were reluctant to offer their services cross-border within the EU (including cross-border passenger transport and cultural/educational events). Lawyers, consultants, translators, accountants etc. will however not be affected by this change. Their services remain taxable in the country of their residence. A re-evaluation of the service place-of-supply rules is planned for 2027.

2.2 Supplies of goods via online shops (B2C e-commerce)

Building on the success of MOSS for telecommunication, broadcasting and electronic services, the concept will be extended and the “One Stop Shop” (OSS) – as the extended version is called – will become one of the cornerstones of the definitive VAT system.

As of 1 January 2021, the OSS regime will also cover the cross-border sale of goods to B2C consumers in the EU. These are usually sales that are made via a webshop to residents of other member states.

In principle, such supplies are subject to VAT in the country of the consumer. As for the collection of the VAT via the OSS regime, a distinction will be made depending on whether the goods are supplied from within the EU (“intra-EU distance sales”) or are supplied from a third country and imported into the EU (“distance sales of imported goods”).

2.2.1 Electronic marketplaces

Before going into detail on the implications of the One Stop Shop extension, it is important to note that a new commissionaire fiction will be introduced, making electronic interfaces (such as marketplaces and platforms) liable to pay VAT for certain distance sales they facilitate. This will be the case in two instances, i.e. when:

- they facilitate intra-EU distance sales by businesses not established in the EU; *and when*
- they facilitate distance sales of goods imported into the EU whereby the goods have a value under EUR 150.

As for the second case, it is noteworthy that no condition is included as to whether the vendor itself has an establishment in the EU.

In these two instances, the marketplace will be deemed to have purchased those goods from the supplier itself and sold them on to the final consumer.

Already today, a significant share of the e-commerce business is handled via such marketplaces. Today, vendors need to take care of taxation of their supplies in the country of their B2C consumers. Under the new rules, however, they will only be deemed to have supplied goods to the marketplaces (B2B), whereby either a VAT exemption will be applicable or VAT needs to be accounted for in the country of shipment of the goods. As the taxation in the country of destination is shifted to the deemed onward supply by the marketplaces, the vendors will no longer require a VAT registration in the countries of the end-consumers¹. Therefore, the new rules will entail a major shift of administrative burden from the vendors to the marketplaces. Fortunately for these marketplaces, they will (as deemed sellers) be able to benefit from the special OSS regimes that will be introduced.

It is not yet entirely clear what exact types of marketplaces will be affected. Further guidelines from the European Commission are required and expected in this respect.

2.2.2 Intra-EU distance sales (EU-EU B2C)

The country-specific thresholds (between EUR 35,000 and EUR 100,000) which are the basis of the current distance sales regime, as well as the threshold for B2C e-services (as introduced in 2019) will be abolished as of 1 January 2021. They will be replaced by one EU-wide threshold of EUR 10,000 which will cover all intra-EU supplies (i.e. both goods and services) to B2C recipients in a member state other than the supplier’s country of residence. Companies that exceed this threshold will need to charge VAT on these supplies according to the VAT rate in the country of the consumer or in the country where the goods are delivered. Only companies with an EU-wide turnover of such supplies below EUR 10,000 will be able to charge VAT according to the country of origin (i.e. their member state of residence or the member state from which the goods are being shipped).

This lowered threshold will without doubt significantly increase the number of companies required to charge VAT outside their home state. To limit their administrative burden, such businesses will be able to report and pay the VAT due on their EU-wide distance sales via the OSS in their home member state (or the state of registration for companies without an EU establishment). Therefore, a local VAT registration in the various countries of their customers might no longer be required. Furthermore, companies will no longer be required to consider the local thresholds in each individual member state. As an additional advantage, companies applying this OSS will no longer be obliged to issue an invoice for these sales.

Strangely, the OSS return will not cover supplies to B2C consumers in the supplier’s home state itself. These supplies will still (as today) need to be reported via the local VAT return.

¹ At least not for the supplies who will fall under this new commissionaire fiction.

2.2.3 Distance sales of imported goods (Non-EU-EU B2C)

Distance sales of goods from outside the EU with importation of goods into the EU will also be subject to VAT in the member state of the consumer.

In order to avoid distortion of competition between suppliers within and outside the EU², as well as for fiscal reasons, the Low Value Consignment Relief will be abolished, implying that importation of consignments with a value below EUR 22 will no longer be VAT-exempt. According to the European Commission this would resolve around EUR 4 billion of VAT fraud caused by imported goods being undervalued in order to benefit from this exemption.

Similar measures will be implemented in Switzerland as of 1 January 2019. We refer to our blog for more details in this respect.

From 2021, a full customs declaration will only be required for the importation of consignments which are subject to excise duties or have a value exceeding EUR 150. All other consignments can benefit from an "Import One Stop Shop" (IOSS) or a special import procedure, involving a fast-tracked customs mechanism.

It is important to note that, unlike for intra-EU distance sales, the requirement to issue invoices for distance sales with importation will not be waived.

2.2.3.1 Import One Stop Shop

The IOSS will operate in a similar way to the OSS, despite the fact that the use of the IOSS will require a separate and special VAT ID number.

This IOSS ID number must be quoted on all consignments in order for the customs authorities to distinguish these consignments (which can benefit from the IOSS regime) from all other consignments, as they will not be required to collect import VAT for the IOSS consignments. The IOSS consignments will be exempt from import VAT at customs, as VAT will be paid through the IOSS return. The EU is to provide an online database to enable the customs authorities to check the validity of the indicated IOSS ID numbers in real time.

Sellers without an establishment in the EU will be required to appoint an EU-based intermediary to make use of the IOSS scheme. An exception is made if these sellers are established in a country that concluded an agreement on mutual assistance with the EU. A list of these countries will be published at a later stage, but it seems that Norway is currently the only country to fulfill this criterion (since February 2018).

If an intermediary is used, the sellers will not require an individual IOSS ID number. The IOSS ID number of the intermediary will be used for all importations into the EU and the intermediary will be deemed liable for paying the VAT and fulfilling the obligations related to IOSS in the name and on behalf of the sellers. The concept of the intermediary therefore exceeds the concept of a fiscal representative as applicable in various member states (although some countries already provide for joint and several liability in the hands of fiscal representatives). On the other hand, the concept is more limited than the commissionaire principal that is implemented for electronic marketplaces.

It is not yet determined how the member states will deal with a new type of fraud, whereby dubious sellers indicate the IOSS ID number of a (well-known) platform on their consignments in order to avoid paying import VAT, without actually using that platform for their sales.

2.2.3.2 Special import procedure

In case the seller/platform opts not to use the IOSS, a second simplification mechanism will be available for goods which are directly imported into the customer's member state. It is expected that this procedure will mainly be applied if transport is arranged via postal or express courier logistic operators.

² As EU businesses have to charge VAT regardless of the value of the goods sold where imported goods can currently benefit from this VAT exemption

Under this special arrangement, the declarant presenting the goods at customs will collect the import VAT from the final customer (i.e. the recipient of the goods). Once collected, the declarant will report and pay the VAT amount via a monthly declaration. This eliminates the need for the declarant to pre-finance VAT.

On the other hand, the member states will have the option to reject the application of reduced VAT rates under this special arrangement. Therefore, it remains to be seen if (and how) consumers will be able to avail themselves of a potential reduced VAT rate (e.g. when buying books) by opting for the standard import procedure.

3. VAT Action Plan (B2B)

As the definitive VAT system for intra-Union B2B trade will only be implemented at a later stage (planned for 1 July 2022), it was proposed to implement some “quick fixes” from 1 January 2019 to improve the day-to-day functioning of the current VAT system. Considering that the European Commission has not yet reached a final agreement on the implementation thereof, it remains unclear whether and when these legislative changes will come into force.

3.1 Introduction of the notion “certified taxable person”

The current VAT system does not allow for whether or not a taxable person is deemed reliable. Therefore all tax payers are subject to the same VAT rules. It was proposed to introduce the notion of the certified taxable person (CTP) as of 1 January 2019. With the CTP system in place, some new fraud-sensitive simplification rules can be implemented; these will only be available to taxable persons deemed reliable and thus in possession of CTP status.

Besides benefiting from the significant cash-flow advantage upon implementation of the definitive VAT system for cross-border B2B trade (see below), CTPs will enjoy the following simplifications:

(1) A simplification for call-off stock

Where both the supplier and customer of cross-border call-off stock³ have CTP status, the call-off stock arrangements will be considered as a single cross-border supply of goods, disregarding the timing difference between the cross-border movement of the goods and the onward local call-off supply. As a result, suppliers can avoid VAT registration obligations in the member states in which they have such call-off stock arrangements.

(2) A simplification for chain transactions

Currently, a frequent subject of dispute is deciding which relationship in the chain should be determined as the “moved supply” and can therefore benefit from VAT exemption.⁴ A new article in the VAT Directive will provide legal certainty in this respect. The article will be applicable if the transport is made by or on behalf of an intermediate supplier in the chain⁵, and provided that both the intermediate supplier and the taxable person who supplied the goods have CTP status. In such a scenario, the supply made for that intermediate supplier will be the moved supply, if that entity (i) is VAT registered in a member state other than the member state of dispatch of the goods and (ii) has communicated the name of the member state of arrival of the goods to the supplier. If either of these two conditions are not met, the supply made by the intermediate supplier to the next operator in the chain would be deemed the “moved supply”.

³ To this effect, “call-off stock” refers to the situation where a supplier transfers goods to a known acquirer without transferring the ownership of the goods yet. The acquirer has the right to take the goods from a stock of the supplier at his own discretion at which point a supply of goods takes place and the acquirer becomes the owner of the goods.

⁴ In case of successive supplies of the same goods whereby the goods are only subject to one single intracommunity transport (often from the initial supplier directly to the customer further up the supply chain), only one of the supplies within the chain can be determined as the “moved supply” which can benefit from the VAT exemption for intracommunity supplies of goods. The other supplies are then to be treated as local supplies of goods (without transport), either in the member state of dispatch or in the member state of arrival of the goods.

⁵ No rule of this kind is needed where the transport is made on behalf of the first supplier in the chain (in which case the transport should be assigned to the first supply) or on behalf of the last taxable person in the chain (in which case the transport should be assigned to the supply made for that taxable person).

(3) A simplification for the proof of exemption for intracommunity supplies

CTPs will also benefit from a reduced burden of proof for VAT-exempt intracommunity supplies.

A distinction should be made between the following situations:

1. The CTP-status holder is the supplier of the goods and arranges the transport itself

In such case, the cross-border transport is sufficiently evidenced when the supplier is in possession of two non-contradictory documents (e.g. invoice from transport firm, purchase order or contract containing the destination of the goods, or correspondence between supplier and recipient referencing the destination).

2. The CTP-status holder is the customer who arranges the transport of the goods (i.e. usually purchases subject to Ex Works or FCA incoterms).

Then the cross-border transport is sufficiently evidenced when the supplier possesses two non-contradictory documents and a written statement from the customer indicating that the goods were transported to a certain member state of destination.

3.1.1 Requirements to become a CTP

According to the proposed Council Directive, CTP status can only be obtained by taxable persons with an establishment in the EU (either domicile or via a permanent establishment). Furthermore, some taxable persons (those applying the special farmers or SME scheme) will not be eligible for CTP status.

In order to be granted CTP status, companies will also have to demonstrate (i) their financial solvency, (ii) a high level of control of their operations and (iii) the absence of serious or repeated infringements of taxation and customs legislation. As these conditions are similar to those needed to obtain the certification of an authorized economic operator (AEO) as defined in the Union Customs Code, taxable persons with AEO-certification will automatically meet these three conditions.

Based on the current proposal, Swiss companies without any establishment in the EU will thus not be able to obtain CTP status, even if they have Swiss AEO status (which is also partly recognized by the EU).

As all advantages of the CTP status are connected to cross-border intra-EU trade, it is of utmost importance that the concept is introduced with harmonized criteria at EU level. To date, only limited implementation guidance is provided on the interpretation of the conditions (e.g. what is deemed as a sufficient level of control of operations?) and on the procedure to obtain a CTP status (timeline?). Additional guidelines are thus required to avoid 28 different regimes, which might lead companies to arrange CTP certification wherever the conditions are easiest.

Furthermore, it is essential that the CTP status can be verified in real time. To this end, the existing VIES system⁶ (which is currently applied to verify the validity of EU VAT ID numbers) will be adapted to also provide information on the CTP status of a company. In addition, member states should be prepared to process all the CTP applications they will receive.

With 2019 rapidly approaching, the introduction of the CTP status and other “quick fixes” could well be postponed until adequate harmonized guidelines are in place and significant (time-consuming) IT and process adjustments can be made.

⁶ VAT Information Exchange System (VIES)

3.2 Conditions to apply the exemption for intracommunity supply of goods

Upon demand of the EU member states, and in addition to having proof of the cross-border transport of the goods, both (i) having a valid VAT ID number of the acquirer in a member state other than that in which transport of the goods begins and (ii) duly reporting said VAT ID number in the recapitulative statement (the "European sales listing"), will become a substantive condition for the application of the VAT exemption for intracommunity supplies of goods. Under current practice, the Court of Justice of the EU treats these conditions as merely formal (and not substantive) conditions. Therefore, member states are currently not allowed to deny application of the exemption if these conditions are not met (they can only impose fines or administrative sanctions). By making these conditions substantive, member states will be able to deny application on the exemption.

In practice, companies' internal processes are often limited to e.g. a one-off verification of the VAT ID number of new customers when creating the relevant customer master data. Companies now might want to revise such limited processes considering that non-compliance will – from 2019 – not only lead to fines or administrative sanctions, but also to the reassessment of VAT and late payment interest (following rejection of the applied exemption).

3.3 B2B "intra-Union supply"

The new definitive VAT system with respect to cross-border B2B trade within Europe is expected to be implemented as of 1 July 2022. Although changes to the proposed technical provisions are expected during the discussion phase at European level, the overall objective is clear: treating intra-EU supplies as one taxable supply subject to VAT in the destination country.

The current system that splits an intra-EU cross-border supply of goods into two separate taxable events (i.e. an exempt intracommunity supply in the member state of departure and a taxable intracommunity acquisition in the member state of destination) will be replaced by a system of a single supply which is taxed in the member state of destination ("intra-Union supply").

As a general rule, the supplier will be responsible for charging, collecting and forwarding the VAT of the member state of destination. In order to eliminate any additional administrative burden where suppliers are not established in the member state of destination, they will be able to report and pay the VAT via the OSS regime. As of 1 July 2022, the OSS should also allow companies to deduct the incurred foreign input VAT from the reported output VAT. The member states will then settle the respective VAT balances with each other directly.

According to the current proposal, CTPs will have a cash-flow advantage during a transitional phase, as they will not have to pay VAT as recipient of an intra-Union supply. Instead, they will benefit from a reverse charge mechanism on such cross-border purchases of goods. In future therefore, suppliers will, for their intra-Union supplies, not only need to know their customer's VAT ID number but also their CTP status. They will not need to charge VAT to CTPs but supplies to other customers will be taxable at the VAT rate of the member state of destination of the goods.

This reverse charge mechanism mentioned above will also be applicable for domestic deliveries to CTPs provided that the supplier is not established in the member state of taxation.

It should, however, be noted that this rule for CTPs must once again be understood as a transitional provision. After a certain period of time, CTPs should also be subject to the definitive VAT system and pre-finance VAT on their intra-Union purchases.

3.4 More autonomy for member states to choose their own rates policy

As goods and services will generally be taxed in the member state of destination, suppliers no longer derive a significant benefit by establishing themselves in a low-VAT-rate member state. As the diversity of VAT rates under the definitive VAT System will no longer disrupt the functioning of the single market, member states will be given more flexibility to determine their VAT rates. In this respect they will be able to introduce an additional reduced rate (up to 5%).

Furthermore, the current list of goods and services to which reduced rates can be applied will be replaced by a negative list of goods and services to which reduced rates cannot be applied. This will, again, provide the member states with more flexibility in setting their local VAT rates.

In order to limit the risk of increased complexity for companies that need to apply the (increasing number of) VAT rates, an online portal will be created that should provide a clear overview of the applicable VAT rate in each member state based on the statistical classification of the respective goods/services.

3.5 Special scheme for small enterprises

Finally, also in 2022, some simplifications will be put in place to help create an environment that is conducive to SME growth. A unified SME exemption will be enabled for all EU eligible businesses, whether or not established in the respective member state. Furthermore, some simplifications will be put in place lowering the VAT obligations for both exempt and non-exempt small enterprises.

3.6 Evaluation in 2027

Five years after the implementation of the first legislative step of the definitive VAT system (expected to be 2027), an evaluation will be made which should, in principle, lead to the full implementation of the definitive VAT system. In this second legislative step, it is expected that the taxation of cross-border services will be harmonized with the taxation of the cross-border supply of goods, implying that all supplies of goods and services within the single market, either domestic or cross-border, will be treated in a harmonized way.

As the reverse charge concerning cross-border supplies of goods to CTPs was initially announced as a temporary measure, it is not yet clear whether this measure will be abolished with the full implementation of the definitive VAT system. Considering the significant cash-flow impact this would have for reliable tax payers, it seems conceivable that this measure will, at the latest following the evaluation phase, be implemented as a key cornerstone of the definitive VAT system. This would also further encourage businesses to better organize their internal tax functions in order to obtain the CTP status.

4. Conclusion

Numerous changes will affect companies and authorities in the coming years, due in particular to the revisions of the current EU distance sales regime in 2021 (Digital Single Market) and the intra-EU B2B sales regime in 2022 (VAT Action Plan).

Companies often underestimate the time it takes to make complex changes to their accounting, ERP systems and other processes. As the time available before implementation of these regulatory changes is limited, companies would do well to start now with their impact assessments. Especially for Swiss-based companies, the new EU VAT system might require a far-reaching organizational and process adjustment.

E-commerce companies will potentially be able to reduce the number of VAT registrations by enrolling in the OSS regime. However, they will also have to prepare themselves for the systematic taxation of goods in the member state of destination and the structure of their market prices. After all, approximately EUR 5 billion in additional tax revenues will be generated by the e-commerce sales markets. It remains to be seen what proportion will come from higher consumer prices and how much will come from narrower business margins.

Companies in the B2B goods business without a presence in the EU have to check their delivery structure for possible cash-flow disadvantages and might consider changing their organizational set-up. For instance, they may benefit from using a European-based master distributor or establishing a European branch of the Swiss principal, in combination with obtaining CTP status.

Besides businesses, the authorities in the EU and its member states also need to prepare for major adjustments. One of several major tasks will be the provision of real-time databases on CTP status, IOSS ID numbers and EU VAT rates. It is also clear that additional guidelines are needed for member states to be able to fully and harmoniously implement these changes in their local VAT legislation, reducing red tape for both businesses and authorities.

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