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NOTE

from: Presidency
to: Council

Subject: VAT fraud: Quick Reaction Mechanism - Reverse Charge Mechanism
- Political Guidelines

Following discussions in Coreper on 28 February 2013, the Council will find attached a Presidency Introductory Note (Annex I) and draft Political Guidelines (Annex II).

This will serve as a basis for an exchange of views among Ministers, who will be asked to take a view on the further work, at technical level, on a comprehensive package fighting VAT fraud, as set out in the draft Political Guidelines.

Presidency Introductory Note on an anti-Fraud Package encompassing the Quick Reaction Mechanism (QRM) and Reverse Charge Mechanism (RCM)

1. The Presidency is of the view that in the context of the recent discussions on VAT fraud, and specifically the proposal concerning a quick reaction mechanism (QRM) and the separate but complementary proposal on the reverse charge mechanism (RCM), that the coincidence of these two proposals presents a unique opportunity to deliver a comprehensive package of measures against VAT fraud. This paper sets out the rationale and the key measures underpinning such a package which the Presidency believes can deliver the agility and flexibility required by Member States in the face of fraud. The intention is to achieve the support of the Council on the principles underpinning the package, and thereby paving the way for the necessary technical work and subsequent adoption by Council of the QRM and RCM legislative proposals.
2. Inherent weaknesses in the VAT system and particularly in respect of cross-border transactions leave Member States vulnerable to fraud, often with serious consequences for National Exchequers. While the Council has noted the Commission's Communication of December 2011 on the Future of VAT including the key objective of developing a "Robust, Resilient and Fraud Proof VAT system", the capacity of Member States to respond effectively to fraudulent activity continues in the interim to depend on the ready availability of derogatory measures. It is clear that rapid access to the potential offered by the existing reverse charge mechanism in the case of known fraud, and to the proposed QRM framework in the case of unknown, sudden and massive fraud, is crucial for Member States in protecting tax revenues.

3. The proposed QRM framework, complemented by a reverse charge facility suitably updated to reflect identified fraudulent behaviours, form the backbone of the Presidency's anti-fraud package. The other elements featured under the package are a response to issues which have emerged during discussions at the Working Party and which the Presidency considers key to building a comprehensive response to fraud.
4. Regarding the QRM, and in response to the request from the Council on 4 December 2012 that the Working party "*continue its work on the QRM, while exploring both alternatives concerning the conferral of implementing powers to the Commission or the Council with a view to reaching an agreement as soon as possible*", the Working Party discussed these alternatives at its meeting of 24 January 2013. The meeting served to confirm that all Member States strongly support the principle of a QRM, with the majority of Member States supporting the procedure proposed by the Commission based on the conferral of powers to the Commission to grant temporary derogations under the QRM framework. However, concerns were raised by some Member States about the possible effect on the principle of unanimity in tax matters. The alternative proposal based on maintaining such powers within the Council received limited support, with many Member States expressing concerns that this alternative could not deliver the requisite speed to address sudden and massive VAT fraud.
5. Regarding the reverse charge mechanism, while the Presidency appreciates the concerns of some Member States regarding the potential undermining of the VAT system, the impact on business and the potential for the fraud to move to other Member States and sectors, the mechanism has proven its worth in targeted situations in minimising revenue losses. The Presidency would also note the value of the mechanism in ensuring that compliant businesses are protected against those that choose to engage in fraudulent activity.

6. The Presidency presented its compromise solution, consisting of an anti-fraud package, to the Working Party of 15 February 2013 and the Fiscal Attachés meeting of 22 February 2013. A large majority of Member States were strongly in favour of the package. However, some Member States reiterated their strong concerns regarding unanimity despite the time-limiting of the proposals to 2018 while others had concerns regarding any extension of the scope of the RCM proposal, and therefore could not accept the package. Nevertheless, a number of these Member States did agree with the Presidency objective of delivering a comprehensive anti-fraud package.

The Anti-Fraud Package

The Presidency anti-fraud package comprises six main elements which are now described:

1. Quick Reaction Mechanism (QRM)

The Presidency proposes a QRM framework based on the procedure proposed by the EU Commission, but strengthened in respect of unanimity and scope. The QRM is an exceptional measure designed to facilitate rapid access by Member States to derogations in cases of unknown, sudden and massive fraud.

Regarding the question of unanimity, which remains a matter of concern for some Member States, the Presidency proposes that the QRM be time-limited, say to end of 2018, with any renewal of the framework being the subject of a proposal from the Commission to the Council to be agreed by unanimity, essentially enabling a “unanimity envelope” to be wrapped around the QRM. The proposed time limit should enable the parallel work of the Commission in developing a fraud-proof VAT system to be put in place.

Regarding the scope of the QRM framework which has been raised by a number of Member States, the Presidency proposes that consideration be given to the inclusion of a second measure beyond the single reverse charge mechanism envisaged under the Commission's proposal. In this regard, rapid access to derogations providing for the blocking of VAT deductibility should also be explored as a candidate for inclusion under the QRM framework.

The Presidency recognises the importance of informing all Member States and of course the relevant business sectors regarding decisions to authorise derogations under the QRM.

2. Reverse Charge Mechanism (RCM)

The complementary but related proposal on the reverse charge mechanism, which has been the subject of a number of discussions under the Cyprus Presidency, represents the second main element of the anti-fraud package. Recognised as the proven response to known frauds, and particularly carousel fraud, it is important that the reverse charge mechanism remains relevant in the light of significant fraud extending to new sectors.

In achieving this objective, the Presidency proposes that the scope of the reverse charge mechanism be extended to encompass trading in those sectors which are already the subject of derogation requests, including mobile phones, integrated circuit devices, game consoles, tablet PCs and laptops, telecommunications services, gas and electricity, and agricultural products. It is also proposed to include transactions in copper on the basis that EUROFISC has recently identified significant fraud in this area. It is proposed that the RCM will also apply until end-2018.

3. Speed up existing Derogation Procedure

The existing Article 395 procedure for seeking derogations is considered slow and any improvement in the 8 month timeline for granting derogations in general would make this procedure more practical. The possibility of speeding up this procedure emerged during recent discussions of the Working Party and there is general support for such a development among Member States and also the EU Commission.

4. Transition from QRM to normal VAT Derogation

A number of Member States have sought clarity regarding the transition of temporary derogations granted under the QRM framework to more permanent arrangements under normal (Article 395) procedures and the criteria to be met in achieving this transition. In the interest of maintaining continuity and consistency in the fight against fraud, the Presidency considers it important that Member States are made aware of such criteria and are assured of the possibility of access to the normal procedure.

5. Delivering a Robust and Resilient VAT System

The Presidency considers that a longer term solution is required to address inherent weakness in the VAT system i.e. address the root cause rather than addressing the symptoms. The Commission's Communication of December 2011 on the Future of VAT included the key objective of developing a "Robust, Resilient and Fraud Proof VAT system". While discussions have already taken place at the Group on the Future of VAT, the Presidency considers that addressing the weaknesses in the VAT system should be prioritised by the Commission. The expiration period of end-2018 being proposed for the QRM and the RCM represents an ideal opportunity for the Commission to progress this work.

6. Sharing Best Administrative Practice in the Fight against Fraud

The Presidency is aware that a number of Member States have faced sudden and massive fraud and have introduced administrative practices and tools which enable them to identify and address fraud. These measures include real-time risk analysis, utilising CJEU rulings and specialised training for tax auditors, etc. The Presidency considers that the sharing of best administrative practice in this area will assist tax administrations in protecting Exchequer finances from fraud and thereby complement the work of EUROFISC which is tasked with sharing intelligence on emerging fraud areas. An examination of the means by which the sharing of best practice can be enhanced would, in the Presidency's view, assist in ensuring that Member States are more fully equipped to address fraud. The Fiscalis programme may provide an ideal opportunity to support this work.

Draft Political Guidelines

1. A Quick Reaction Mechanism (QRM) based on the procedure proposed by the EU Commission should be considered to facilitate the rapid response necessary for Member States faced with unknown, sudden and massive fraud. The lifetime of the QRM framework will be limited to five years to end-2018 and any renewal of the framework will require a new legislative proposal from the Commission to the Council to be adopted by unanimity.
2. Regarding known fraud, the scope of the existing Reverse Charge Mechanism (RCM) under Article 199a of the VAT Directive should be extended in order to provide the option to Member States to apply this mechanism to transactions in sectors which are already the subject of derogation requests, including mobile phones, integrated circuit devices, game consoles, tablet PCs and laptops, telecommunications services, gas and electricity, and agricultural products; and also to recently identified transactions in the copper sector.
3. The timeframe for the RCM should be aligned with that of the QRM to apply until end-2018 and the necessary technical work in respect of the QRM and the RCM should be concluded with a view to enabling the Council to adopt these legislative proposals by May 2013 at the latest.
4. All Member States should inform the relevant business sectors of decisions granting derogations under the QRM framework in a timely manner.

5. The Commission should clarify the criteria under which a temporary derogation already granted under the QRM framework may qualify for extension as required under the normal (Article 395) procedures. It is important that Member States are not denied the possibility of accessing that derogation under Article 395.

6. The desire of Member States and the Commission to speed-up the existing procedures under Article 395 of the VAT Directive with a view to reducing the timescale involved in granting derogations in general should be taken into account. The Presidency notes the Commission's commitment in this regard.

7. The Presidency also welcomes the commitment from the Commission to progress the delivery of a "Robust, Resilient and Fraud Proof VAT system" as outlined in its Communication on the Future of VAT with a view to facilitating the prevention of VAT fraud rather than having to rely on derogatory arrangements to deal with its often serious consequences.

8. Greater co-operation in the sharing of best administrative practice among Member States in enhancing the effectiveness of measures against the risk of VAT fraud should be encouraged.
