



EUROPEAN
COMMISSION

Brussels, 10.2.2022
COM(2022) 39 final

2022/0027 (CNS)

Proposal for a

COUNCIL DIRECTIVE

amending Directive 2006/112/EC as regards the extension of the application period of the optional reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud and of the Quick Reaction Mechanism against VAT fraud

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

The purpose of the current proposal for a Directive amending Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹ (hereafter the ‘VAT Directive’) is to prolong: 1) the possibility for Member States to apply the reverse charge mechanism to combat existing fraud in supplies of goods and services included in Article 199a(1) of the VAT Directive and 2) the possibility to use the Quick Reaction Mechanism (QRM), as set out in Article 199b of the VAT Directive, to combat fraud via the application of the reverse charge mechanism in very specific cases.

As a general rule, Article 193 of the VAT Directive stipulates that the taxable person supplying goods or services is liable to pay VAT. As a derogation, the reverse charge mechanism allows to designate the recipient of the supply as the person liable for the payment of VAT. Under this reverse charge mechanism, VAT is not charged by the supplier but accounted for by the customer (a taxable person) in his VAT return. This VAT is then deducted in that same VAT return and, therefore, insofar this person has a full right of deduction, the result is nil.

The reverse charge mechanism is used to combat fraud and in particular Missing Trader Intra-Community (MTIC) fraud. This type of fraud occurs when a trader acquires goods, transported or dispatched from another Member State, by means of a supply exempt from VAT, and sells them on including VAT on the invoice to the customer. After having received the VAT amount from the customer such trader disappears before paying the VAT due to the tax authorities. At the same time, the customer acting in good faith can normally deduct the VAT he paid to the supplier through his VAT return. Hence, under the reverse charge mechanism VAT is not effectively paid to the supplier.

The reverse charge mechanism based on Article 199a of the VAT Directive is optional for Member States to apply. It allows them to fight this type of fraud in the pre-defined sensitive areas where it typically occurs² on their territory. Once suppliers are obliged to use the reverse charge mechanism for such domestic supplies, they cannot charge VAT on their invoice. They will subsequently not receive the VAT amount from their customer and, as a result, such traders cannot disappear with the amount of VAT received. The QRM of Article 199b is an exceptional measure allowing Member States to quickly introduce, in cases of imperative urgency, a temporary reverse charge mechanism for supplies of goods and services in sectors where sudden and massive fraud occurred and which are not listed in Article 199a of the VAT Directive. This procedure is exceptional and extremely quick as the Commission has to react within one month, either with a negative opinion or to confirm in writing to the Member State concerned that it does not object the measure. The Member State may adopt the QRM special measure from the date of receipt of that confirmation. By using this mechanism, Member States can bridge the period required for obtaining a ‘normal’ derogation under Article 395 of the VAT Directive, which can take up to six months. Such a derogation requires a proposal from the Commission and unanimous adoption by Council.

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p.1).

² For instance, the transfer of allowances to emit greenhouse gases, supplies of mobile telephones, gas and electricity certificates, telecommunication services, and cereal and other industrial crops.

Article 199a of the VAT Directive was introduced³ for the period 2010 until 30 June 2015 and was a first time extended⁴, with amendments, until 31 December 2018. Article 199b of the VAT Directive was introduced⁵ for the period 2013 until 31 December 2018. Both Articles 199a and 199b of the VAT Directive were subsequently extended⁶ until 30 June 2022 in order to coincide with the initially foreseen date on which the VAT definitive system would enter into force (see more details below).

At the time the application period of Articles 199a and 199b of the VAT Directive would be extended until 30 June 2022, the Commission presented a report on the effects of the mechanisms included in these articles⁷ and concluded, on the basis of contributions of tax administrations and business stakeholders, that the measures in these articles were useful in the fight against fraud.

In order to deal with the issue of (MTIC) fraud in a more structural manner, the Commission made a proposal for the introduction of the so-called definitive VAT system, a simpler and fraud-proof system for intra-Union trade of goods⁸. These arrangements, which the Commission proposed to enter into force on 1 July 2022, provide a fundamental response to MTIC fraud.

However, the state of play of the ongoing negotiations in the Council indicates that it will not be possible for the definitive VAT system to enter into force on 1 July 2022. In order to allow the negotiations on the definitive system to continue, without putting at risk the available tools in order to combat VAT fraud, it is appropriate to prolong the anti-fraud measures contained in the said articles for another limited period.

To extend the application period of Articles 199a and 199b would also allow developing further tools to fight tax evasion. To that end, and in accordance with the Tax Package⁹, the Commission is preparing a proposal in order to modernise the current VAT rules, taking into

³ Council Directive 2010/23/EU of 16 March 2010 amending Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain services susceptible to fraud (OJ L 72, 20.3.2010, p. 1–2)

⁴ Council Directive 2013/43/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud (OJ L 201, 26.7.2013, p. 4–6)

⁵ Council Directive 2013/42/EU of 22 July 2013 amending Directive 2006/112/EC on the common system of value added tax, as regards a quick Reaction Mechanism against VAT fraud (OJ L 201, 26.7.2013, p.1).

⁶ Council Directive (EU) 2018/1695 of 6 November 2018 amending Directive 2006/112/EC on the common system of value added tax as regards the period of application of the optional reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud and of the Quick Reaction Mechanism against VAT fraud (OJ L 282, 12.11.2018, p. 5–7).

⁷ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118/2.

⁸ The proposed introduction of the definitive VAT system is based on two different proposals for Council Directives: one setting out the principles of the system and one detailing the technical measures to ensure the effective operation of the system. These proposals are respectively: Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final.

Proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final.

⁹ Communication from the Commission to the European Parliament and the Council - An action plan for fair and simple taxation supporting the recovery strategy, COM(2020) 312 final

account the opportunities offered by digital technologies. Under the heading ‘VAT in the digital age’, the Commission will assess VAT reporting obligations, possibly including on Transaction-Based Reporting (TBR) and an enhanced system of e-invoicing. This should provide quicker and more detailed information on individual transactions to tax administrations and therefore lower the risk of fraud. Based on such legislative developments, the need to further extend Articles 199a and 199b should be reassessed in the future.

- **Consistency with existing policy provisions in the policy area**

The current proposal prolongs the measures, laid down in Articles 199a and 199b of the VAT Directive, for a limited period while the negotiations at the Council on the proposal for a definitive VAT system, which includes amendments to Articles 199a and 199b of the VAT Directive as to align them to the functioning of that definitive system, are continued. As the definitive VAT system is related to goods, Articles 199a and 199b would be restricted to services.

The prolongation is also consistent with the timing of the Commission’s preparations for new reporting rules as an anti-fraud measure, which could result in the application of the reverse charge mechanism no longer being required. However, even if these new reporting rules would be adopted rather soon, a period of time would be needed for taxable persons to adapt to the new rules; an extension until the end of 2025 seems therefore adequate.

- **Consistency with other Union policies**

Article 199a of the VAT Directive covers under the reverse charge mechanism, among others, the EU trading in greenhouse gas emission allowances (EU Emission Trading System (ETS)). In order to support the goals of the Green Deal, in particular as regards the reduction of emissions of greenhouse gases by 55% by 2030, it is essential that the ETS is further protected from (carousel) fraud as to avoid that, apart from the financial losses, the credibility of the system would be undermined.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The Directive amends the VAT Directive on the basis of Article 113 of the Treaty on the Functioning of the European Union.

As the proposal prolongs the application of certain provisions of the Directive, an amendment of the VAT Directive is necessary.

- **Subsidiarity (for non-exclusive competence)**

According to the principle of subsidiarity, as set out in Article 5(3) of the Treaty on European Union, action at Union level may only be taken if the envisaged aims cannot be achieved sufficiently by the Member States alone and can therefore, by reason of the scale or effects of the proposed actions, be better achieved by the Union.

The objective of fighting fraud via the application of the reverse charge mechanism and the possibility to use the Quick Reaction Mechanism to fight sudden and massive fraud is best achieved at Union level and finds its specific legal basis in the VAT Directive. Therefore, the prolongation of these measures requires an amendment to the VAT Directive.

- **Proportionality**

Because of the optional and temporary character of the prolonged measures, the proposal is proportionate to the aim pursued which is to combat fraud in certain supplies of goods and services and help Member States to tackle sudden and massive VAT fraud.

- **Choice of the instrument**

A Directive is proposed in view of amending the VAT Directive.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Ex-post evaluations/fitness checks of existing legislation**

The Commission presented a report, at the time of the prolongation, on the functioning and effects of the reverse charge mechanism in relation to Articles 199a and 199b of the VAT Directive¹⁰ and concluded that the measures in these Articles were useful in the fight against fraud.

This in-depth analysis was carried out rather recently and the VAT Directive has not been altered as regards the legal conditions or practicalities for the application of the reverse charge mechanism since then. Moreover, the VAT Directive has not been significantly amended in order to tackle the issue of MTIC fraud in a more structural manner. Finally, the Commission services have no information on new sectors which would be prone to MTIC fraud and for which the reverse charge mechanism would be the right tool. Therefore, it is reasonable to conclude that the above-mentioned findings are still valid.

- **Stakeholder consultations**

For the above-mentioned report, Member States were invited to provide their experience and assessment of the measures. Stakeholders were consulted via the VAT Expert Group.

Member States generally considered the reverse charge mechanism included in Article 199a of the VAT Directive an effective and efficient tool in fighting VAT fraud. Due to the introduction of the reverse charge mechanism, the fraud decreased significantly or disappeared in the defined sectors. This view was also shared in the replies received from the consulted business stakeholders who consider the reverse charge mechanism as an efficient, temporary measure for combatting fraud.

Regarding the Quick Reaction Mechanism in Article 199b of the VAT Directive, although it was never used, most Member States considered that it remained a useful tool and a precautionary measure against exceptional cases of sudden VAT fraud.

- **Collection and use of expertise**

In the framework of the above-mentioned report, the VAT Expert Group has been consulted regarding the functioning and the effects of the measure included in Article 199a of the VAT Directive. The feedback indicated that the reverse charge mechanism for given supplies was considered an efficient, temporary tool for fighting fraud.

¹⁰ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118/2.

In general, the optional reverse charge mechanism has been assessed in earlier studies¹¹. An assessment of a general reverse charge mechanism (also comparing to the sectorial reverse charge) on the internal market has been carried out in the impact assessment accompanying the proposal on the temporary application of a generalised reverse charge mechanism¹².

- **Impact assessment**

The initiative prolongs for another limited period the measures included in Articles 199a and 199b of the VAT Directive to support Member States in tackling VAT fraud while a more comprehensive reform of the VAT system is being discussed by Member States in Council.

Given the Commission's on-going work on the definitive VAT system and modernisation of reporting obligations, and its expected impact on the fight against fraud, it would not be useful for the moment to re-evaluate or revise the measures as any conclusions would be transitional and would need to be reassessed in the light of these possible new rules.

4. BUDGETARY IMPLICATIONS

The proposal will have no negative implications for the Union's budget.

5. OTHER ELEMENTS

- **Detailed explanation of the specific provisions of the proposal**

As regards the optional reverse charge mechanism in Article 199a of the VAT Directive, two changes are proposed.

First, the application period is extended until the end of 2025. This seems to be a reasonable period in order to allow Council negotiations on the definitive VAT system to continue. If the definitive VAT system does not enter into force before that date, the arrangements in Article 199a of the VAT Directive might, because of the sunset clause, come to an end in 2025. If the definitive VAT system would enter into force before 2025, Articles 199a and 199b will be amended and therefore replace the current rules which are being extended.

Similarly, this extension is also linked to the development and adoption of a Commission proposal concerning VAT in the digital age, for which a date of entry into force cannot be provided at this stage. The adoption of the proposal itself by the Commission is scheduled for 2022. The end of 2025 is therefore also in this context a reasonable period for the Council to adopt the proposal.

In case by the end of 2025 neither the definitive system nor the VAT in the digital age rules would be in place, a further extension of Articles 199a and 199b of the VAT Directive would be considered.

Secondly, a small technical amendment is made as regards the deletion of outdated reporting obligations on which the above-mentioned report of the Commission was based.

As regards the Quick Reaction Mechanism in Article 199b of the VAT Directive, the application period is also extended until the end of 2025.

¹¹ See: https://ec.europa.eu/taxation_customs/system/files/2016-09/kp_07_14_060_en.pdf

¹² Impact assessment for the proposal as regards the temporary application of a generalised reverse charge mechanism in relation to supplies of goods and services above a certain threshold, SWD/2016/457.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 113 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Parliament¹,

Having regard to the opinion of the European Economic and Social Committee²,

Acting in accordance with a special legislative procedure,

Whereas:

- (1) Tax fraud in the field of value added tax (VAT) leads to considerable budget losses and has an impact on the operation of the internal market.
- (2) Article 199a of Council Directive 2006/112/EC³ provides for Member States to use, on an optional basis, the reverse charge mechanism for the payment of VAT on supplies of pre-defined goods and services that are susceptible to fraud, and in particular, Missing Trader Intra-Community (MTIC) fraud. The Quick Reaction Mechanism (QRM) special measure set out in Article 199b of that Directive offers Member States, under certain strict conditions, a faster procedure that allows for the introduction of the reverse charge mechanism, resulting in a more adequate and effective response to sudden and massive fraud. Both Articles expire on 30 June 2022.
- (3) The Commission adopted two legislative proposals⁴ for the introduction of the definitive VAT system, which should provide a comprehensive response to MTIC fraud. These proposals, initially foreseen to enter into force on 1 July 2022, are still being negotiated at the Council and it is foreseeable that they will not be adopted before, and enter into force on, that date.

¹ OJ C , , p. .

² OJ C , , p. .

³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p.1).

⁴ Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final and proposal for a Council Directive amending Directive 2006/112/EC as regards the introduction of the detailed technical measures for the operation of the definitive VAT system for the taxation of trade between Member States, COM(2018) 329 final.

- (4) Following the Tax Package,⁵ and under the heading of VAT in the digital age, the Commission is also working on a proposal for modernising reporting rules, a system that would, possibly in real-time, provide detailed information about individual transactions to tax administrations and which could make the application of the reverse charge mechanism obsolete.
- (5) In 2018, the Commission reported its findings on the effects of the mechanisms included in Articles 199a and 199b of Directive 2006/112/EC on combatting fraud⁶. In the report, Member States and stakeholders generally considered the reverse charge mechanism set out in Article 199a of that Directive as an effective, temporary tool in fighting VAT fraud. Further, Member States considered in that report the QRM a useful tool and a precautionary measure against exceptional cases of VAT fraud. Since then, the legal conditions or practicalities for the application of the reverse charge mechanism within the EU VAT system have not been altered. Also, the VAT Directive has not significantly been amended in order to tackle the issue of the MTIC fraud in a more structural manner. It is therefore reasonable to assume that these findings and considerations are still largely valid.
- (6) In light of the above, it appears that the measures included in Articles 199a and 199b of Directive 2006/112/EC have been useful as temporary and targeted measures. Their expiration would deprive Member States of an efficient tool to fight fraud; it is, therefore, appropriate to prolong those measures for another limited period of time as to allow negotiations in the Council to take place on the definitive VAT system, and to allow for the continued development of modernised reporting rules, to be adopted in the meantime.
- (7) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 2006/112/EC is amended as follows:

- (1) Article 199a is amended as follows:
- (a) in paragraph 1, the introductory wording is replaced by the following:
‘Until 31 December 2025, Member States may provide that the person liable for the payment of VAT is the taxable person to whom any of the following supplies are made.’;
 - (b) paragraphs 3, 4 and 5 are deleted;
- (2) in Article 199b, paragraph 6 is replaced by the following:
‘6. The QRM special measure as provided for in paragraph 1 shall apply until 31 December 2025.’.

⁵ Communication from the Commission to the European Parliament and the Council - An action plan for fair and simple taxation supporting the recovery strategy, COM(2020) 312 final

⁶ Report from the Commission to the Council and the European Parliament on the effects of Articles 199a and 199b of Council Directive 2006/112/EC on combatting fraud, COM(2018) 118/2.

Article 2

This Directive shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Article 3

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President