The need for a unified, uniform VAT in a unified, uniform EU

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Value Added Tax (VAT) is that elusive little percentage that creeps up and settles at the bottom of invoices or requests for payment, many times over and above the final price that has been agreed.

It sneaks up and spooks consumers and businesses alike every time a transaction is completed, whether it is a purchase of a bottle of fine wine, a new office building, or the intellectual property rights to a consumer brand.

Even though there is little the end consumer can do about VAT, the same does not apply to businesses.

I am still perplexed by how little attention businesses sometimes pay to the subject of VAT in the European Union (EU). Especially when this lack of attention allows for the necessity of a unified, uniform VAT to be grossly undermined and ignored by the ultimate preachers of unification and uniformity, the EU.

EU and VAT: History in the making

VAT lies at the heart of the internal market concept. France first adopted a VAT system in 1954, with the other five founding Member States of the EU, Belgium, Germany, Italy, Luxembourg and the Netherlands, all following suit.

Abolishing border controls, including fiscal controls, has always been at the forefront of the arguments for establishing the internal market, a feat achieved officially on 1 January 1993.

As for VAT within the internal market, the Commission's original proposal was to have VAT charged in the Member State of origin, and abolishing tax remittance on inter-Member State supplies, a system which became known as the VAT definitive system.

However, getting Member States to agree, given the tendency to protect vested national interests, led to a transitional system that was meant to be in place for only four years, that is until the end of 1996.

The concept of the transitional system was to have the functions that were previously performed by border controls, to be performed within the Member State where the taxable person was established. For persons who already possess a working knowledge of VAT, this system will be familiar. This is because the VAT transitional system is still in place today, with no evidence that the VAT definitive system will ever be approved.

The only real developments in VAT legislation comes either from the European Court of Justice (ECJ), which interprets specific articles of the VAT Directive, and of course from the amendments to the VAT Directive itself, which arise from time to time on specific matters in an attempt to deal with non-uniform practises of Member States and attain some level of harmonization of the functioning of the internal market.

Unfortunately, no serious effort has been made to introduce the fundamental and utilitarian legislative amendments, which are required to deal effectively with the issues surrounding this VAT transitional system. At the same time, implementing a VAT system has become a requirement for any new country aspiring to EU membership.

Yet the more one delves into, and absorbs the philosophy of the VAT Directive, the more emphatic becomes the problem of non-harmonization.

Looking at the big picture
Imagine the following: You stand at the bottom of a skyscraper and look up. You will no doubt witness the large building. But if you then start walking backwards, away from the building, you will slowly observe the building rise higher, grow bigger, and eventually impose its true magnitude on the skyline.

In a very similar way, when examining how the VAT Directive is enforced across the Member States, a significant disparity appears in many areas of interpretation and practical implementation. To complete the analogy, the skyline in which the skyscraper stands, is the environment in which the VAT Directive is implemented. The EU Commission, in shaping the skyline and in an attempt to fix this disparity, frequently proposes amendments to the VAT Directive whilst the EU Council also adopts regulations, which are legally binding in the Member States. Yet the disparity gap remains unaltered.

The problem
The options provided in the VAT Directive are the primary cause of non-uniformity. Arguably, these choices exist because the economies of the various Member States are not the same. Practically, such choices exist because a Directive requires unanimous approval from all Member States, and thus all Member States always seek to protect their national interests.

Let's talk numbers
Let's take the example of the standard rate of VAT in the EU.

As per the VAT Directive, a Member State must have a standard VAT rate that cannot be lower than 15%. Today this ranges from Hungary's 27% to Luxembourg's 15%.

In addition, Member States can have up to two reduced rates the lowest of which cannot be less than 5%, to a restricted list of goods and services.

Yet the Directive provides for a series of derogations even here. For example it allows the use of certain super-reduced rates, i.e. below the 5% minimum, if these had existed in that country before 1 January 1991 and had originally been adopted for clearly defined social reasons and for the benefit of the final consumer. Such derogations are meant to be abolished when the definitive system is put in place. In practice, however, there is no sign that the non-uniformity of the VAT rates across the Member States will ever be bridged.

Bridging the gap: Recent amendments
Amendments proposed to the VAT Directive are frequent. Recently, Member States adopted an amendment to their VAT legislation so as to pave the way for electronic invoicing. The same amendment allowed Member States to introduce a cash accounting scheme in order to alleviate the problem of bad debts for businesses.

Cyprus adopted a cash accounting scheme but only for businesses with a gross 12-month turnover below €25.000, which effectively rendered the scheme ineffective as this excluded almost all businesses that could in theory benefit from such a scheme.

In May 2012, the EU Commission also launched its proposal to amend the VAT Directive with regards to the VAT treatment of vouchers, resulting from a lack of common rules on this topic, resulting in dissimilar practices across the Member States. The draft Directive is still pending.

Bridging the gap: What the future holds
From 1 January 2015, a change in the place of supply rules for telecommunications, broadcasting and electronic services will mean that such services will always be taxed in the country where the customer belongs. There is however also the option that if the supplier is based in the EU, the EU country where the supplier resides can opt to levy VAT if the service is effectively used and enjoyed in that country. The *use and enjoyment* rule can apply to other services as well at the discretion of the Member States, which again leads to non-uniformity.

Explanatory notes were issued on the 3 April 2014 by the EU Commission, as food-for-thought, in order to provide a better understanding of the EU legislation relating to the place of supply changes, although these notes are not legally binding. Once again, there is ample scope for different interpretations by the Member States.

Moreover, the Mini One Stop Shop (MOSS) comes into force on 1 January 2015 and will allow taxable persons supplying telecommunication services, television and radio broadcasting services and electronically supplied services to non-taxable persons in Member States in which they do not have an establishment, to account for the VAT due on those supplies via a web-portal of their Member State. The scheme constitutes yet another optional element of the VAT legislation.

Due to the vast difference in interpretation across the Member States over the place of supply rules, which determine where VAT is due, the Council of the EU adopted a legally binding Regulation on 15 March 2011 which became effective on 1 July 2011. The Regulation clarified certain concepts, mainly relating to place-of-supply rules, thus laying down guidelines for the Member States that are necessary to implement the VAT Directive. Then, second guessing its own decision, the Council decided that the Member States would require further clarifications and issued a proposal in December 2012 to amend the Regulation.

This proposal is currently being discussed across the EU, with each Member State no doubt preparing to defend its national economic interests.

The ECJ has been more consistent in providing clarifications on the VAT Directive through its judgments. If the decisions of the Cyprus Courts of Justice are anything to judge by, this is not the case at a national level. Moreover, the interpretation of VAT legislation by the VAT Authorities of each Member State varies so widely that it poses a real challenge to undertake VAT planning on cross-border transactions.

Is this how the founders of the EU envisaged unification?

Do not undermine VAT
This may be good news for the VAT professional advisor, whose services are increasingly in demand, but businesses of all sizes must take a closer look at the VAT element of their commercial undertakings and finally give it the due attention it demands and deserves.

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Chelco VAT Ltd is perhaps the only VAT-dedicated service provider in Cyprus and specialises in strategic VAT planning and VAT compliance.