Tax Policy Alert

VAT in the Digital Age proposals published by the European Commission

16 December 2022

In brief

On 8 December 2022, the European Commission (EC) published significant, and much anticipated, proposals to amend the VAT directive and Implementing Regulation with respect to the VAT in the Digital Age (ViDA) initiative. According to the EC, the 30 year-old VAT rules for cross-border trade are not fully adapted to deal with the digital age and need to be amended using technology to reduce administrative burdens and related costs for business and at the same time combat tax fraud.

The ViDA package has three main objectives:

1. Introducing Digital Reporting Requirements (DRR), which will standardize the information submitted by taxable persons on each transaction to the tax authorities in an electronic format almost in real time. At the same time, more freedom is given to Member States to introduce e-invoicing for local transactions while the use of e-invoicing for cross-border transactions becomes mandatory;
2. Updating the VAT rules applicable to platform economy operators when they facilitate the supply of short-term accommodation rental or passenger transport services, as well as for the supply of goods in almost all cases;
3. Introducing a Single VAT Registration by improving and expanding the One-Stop Shop (OSS) and Import One-Stop Shop (IOSS) regimes and reverse charge in order to minimize the instances for which a taxable person is required to register in another Member State.

The timeline of the entry into force is spread from 2023 until 2028. However, it must be stressed that unanimous approval of all EU Member States is required for the proposals to enter in force.

From the expected implementation date of the first proposals being 31 December 2023, there is a prospect that the EC may strive to have a decision on the proposals in the second quarter of 2023. However, in our view, it's not possible to exclude the possibility that the proposals will not be approved fully or will be implemented with a delay.

In detail

VAT reporting and DRR

E-invoicing

The EC announced a two-phase approach for modernizing the VAT reporting obligations.

From **1 January 2024**, the VAT Directive allows for Member States to impose e-invoicing obligations and should mandatorily be based upon an EU wide minimum standard of both the content and syntax based format (the currently already known B2G invoice standard). It’s important to note that as of 1 January 2024, the e-invoice can no longer be subject to prior validation by the local tax authorities in order to be sent to the recipient, which is contrary to common practice in most Member States currently applying e-invoicing.

From **1 January 2028**, e-invoicing will become the default for issuing invoices with exceptions allowed to be introduced by Member States (i.e. allowing also paper invoices) except for B2B intra-EU supplies of goods and services (and certain other services) for which e-invoicing will become mandatory in all circumstances and should be issued within 2 working days after the supply (almost real time).

Digital reporting system for intra-Union transactions

From **1 January 2028**, the current recapitulative statements (EC sales listings) will be replaced with DRRs for B2B intra-EU transactions and they will also include the reverse charge on supplies made by non-established businesses to VAT identified traders based on article 194 VAT Directive and must exclude call-off stocks as these rules will be abolished starting 1 January 2025.

There are several differences from the current EC Sales listings. Under DRRs the reportable data must be detailed for each transaction instead of aggregated by the customer and several new data points were added to improve the detection of VAT fraud. In addition, the data must only be submitted electronically, within 2 working days after the invoice was issued (or should have been issued).

The information provided under the DRR will be published in a new central VAT Information Exchange System (VIES) database which can be used for analytics by the EU Member States. Member States will be obliged to develop, maintain, host and technically manage a local database to easily transmit data to the central VIES. The Member States will need to ensure that the data is up-to-date. All information in the central VIES database will remain available for 5 years.

***Observation*:** This measure will lead to an estimated €11 billion per annum (€111 billion over ten years) in additional VAT revenues for the EU. There should be further gains of €4bn per annum (€41.4 billion over 10 years) in savings for businesses from pre-filled VAT returns, ending EC sales listings and general e-invoicing savings. Importantly, the estimated costs of implementation will be significant: €11.3bn and €2.2bn for businesses and the tax authorities, respectively.

VAT treatment of the platform economy

The ViDA proposals include an extension of the deemed supplier regulations to other platform services (discussed below) and for almost all supplies of goods facilitated by a platform, and an extension of the data retention obligations for platforms. The ViDA proposals indicate that the platform economy has created new problems and created VAT inequality. For example, a hotel in Europe could be competing with accommodation listings which do not charge VAT on their services. There is also a lack of clarity on VAT rules that apply to services rendered by the platforms. The solution will be to introduce a deemed supplier model for the services covered.

Observation: This is a significant development and is in keeping with other global developments in this area in countries such as Canada, India and New Zealand, which have introduced a full VAT model for certain services (Canada and India) or have tabled draft law (New Zealand). By making this VAT policy choice, the EC is adopting a "fast follower" approach in relation to full VAT liability for platforms and is choosing to not proceed down the path of requiring platforms to collect and report information as is the case in countries like Australia.

Deemed supply of goods for electronic interfaces

In order to level the playing field between EU and Non-EU businesses, for all supplies of goods within the EU that are facilitated by the use of an electronic interface (such as marketplaces and platforms) the taxable person facilitating the supply shall be regarded as the deemed supplier, irrespective of the VAT status of the purchaser and irrespective of the place of departure of the good and the place of establishment of the supplier. This is also the case for margin goods. The (deemed) supply from the underlying supplier to the platform will be exempt from VAT without credit.

Observation: This means that taxable persons who are facilitating the sale of goods via their electronic interface are almost always obliged to collect VAT on all the EU supplies of goods. The only exception is for electronic platforms that are solely facilitating domestic supplies in their country of establishment.

The deemed supplier rule will also be extended to platforms facilitating transfers of their own goods by underlying suppliers. This may be the case, for example, when platforms have a central call-off stock in place for their suppliers.

Deemed supply of accommodation rental and passenger transport services for electronic interfaces

For short-term accommodation rental and passenger transport sectors of the platform economy - where the underlying supplier does not have to charge VAT because it is, for example, a natural person or makes use of the special scheme for small enterprises - the platform will be deemed the supplier of the facilitated service. The supplies shall not affect the right of deduction of the deemed supplier, regardless of whether the supply is one for which VAT is deductible or not.

Observation: One welcome clarification is that the tour operator margin scheme is not applicable to the deemed suppliers of accommodation rental and passenger transport services, partly to prevent abuse.

Mandatory IOSS for deemed supplier platforms of imported consignments for B2C

The use of the existing IOSS scheme will be mandatory for electronic interfaces facilitating as deemed suppliers and carrying out distance sales of imported goods.

Observation: These updated measures will raise in excess of an estimated €6bn per annum, or €66bn in VAT for Member States between 2023-2032. Other areas of the gig and sharing economies may be included in the future. These include professional and manual services, 'click work', crowdfunding and P2P lending. However, the potential VAT difficulties with small entrepreneurs operating in these sectors may mean this will happen at a later date.

Alongside the DAC7 marketplace reporting reforms, there will be improved definition and clarifications of the players and roles in the digital marketplace sphere, and standardisation of information requirements.

Observation: The experience in other countries has been that the new platform rules will require significant systems changes - as well as new reporting and tracking - to manage any new compliance disclosures. The changes will also have a cash flow impact and have typically resulted in changes to product pricing. If the rules do come into effect, a substantial lead in time is required (12 months or more) for businesses to make the relevant systems and contractual changes.

Single VAT registration

Positively, the EC aims to establish a single VAT registration by minimizing the need to register in multiple EU Member States as a result of extending OSS schemes (optional), as follows:

- extension of One Stop Shop to additional B2C supplies of goods leading to VAT payable in a country other than the country of establishment of the supplier (e.g. domestic sales, the supply of goods with installation or assembly, the supply of goods on board ships, aircrafts or trains and the supply of gas, electricity, heating and cooling)
- all supplies under the margin scheme would be taxable in other EU countries
- cross-border movements of own goods (including call-off stock arrangements) to avoid VAT registrations in other countries due to these movements of goods - the call-off stock simplification would be abolished.

The scheme cannot be used for capital goods or if VAT on the acquisition of goods would not be fully recoverable in the country of arrival.

Purely B2B transactions are not included for the time being in this new measure because of the complexities in relation to the right to deduct VAT and fraud risks.

In addition, the reverse charge mechanism provided under article 194 of the Directive will become mandatory and will prevent suppliers performing domestic B2B supplies in a foreign country from being required to register for VAT purposes in that country.

***Observation*:** This will eliminate the need for hundreds of thousands of foreign VAT registrations for e-commerce sellers. The EC estimates that managing each single foreign registration costs €5,000 per annum for businesses. This change in total will cut sellers' cost by €800m per annum or €8.7bn between 2023-32 estimates the EC.

The takeaway

The proposals are both significant and ambitious and will modernize the VAT landscape. Given that the current VAT rules have resulted in sub-optimal VAT collection and control as well as excessive burdens and compliance costs, in our view, it is worthwhile pursuing improvements to the discrepancy between the 30-year old VAT rules and the current digital reality. It has to be recognised that a lot of work has gone into these proposals and many factors have been balanced to achieve the tabled outcomes. This development is highly significant on the global stage - other parts of the world will be looking at the areas covered with interest particularly e-invoicing and the VAT treatment of the platform economy.

Various VAT-policy options were considered. The Impact Assessment discussed the main decisions and the balancing of factors in arriving at the proposals. The *enhanced approach* (combining 1) the introduction of DRRs at EU level, 2) a deemed supplier rule for the accommodation and transport sectors and a combination of a broader OSS extension, 3) a reverse charge and mandatory IOSS) was seen to be better balanced in terms of effectiveness, proportionality and subsidiarity. On the other hand, the *maximal approach* - which additionally includes domestic DRRs, all services supplied via platforms and the removal of the Euro 150 IOSS threshold - has the greatest efficiency. The enhanced approach was seen to be more balanced and the various savings have already been mentioned above.

Though the processes would imply significant investments for implementation, the EC tackles this issue by advancing ambitious saving targets to be achieved in the long term from these measures, to the extent they will be implemented and most importantly, work as expected.

Even though businesses have been accustomed to change and Big Data is no longer just an abstract concept and is a commercial reality unfolding more and more, the big question that still remains is whether the tax authorities will be able to change their own systems within the expected timeline and, if they will be able to return the results sought by the EC after implementation of the comprehensive and, in some cases, potentially burdensome proposals.

Let's talk

For a deeper discussion of how these proposals might affect your business, please contact:

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