

October 2007

ETNO Reflection Document on the Consultation Paper “Possible introduction of an optional reverse charge mechanism for VAT – Impact on businesses”

Executive Summary

- These new rules constitute a further step away from the “definitive VAT-system” without making progress towards the “definitive system”.
- It is the responsibility of fiscal and law enforcement authorities to tackle VAT fraud: the responsibility should not be placed on businesses.
- The proposals will create unforeseeable but substantial administrative costs for businesses (running into many millions of Euros). This runs counter to the overall objective of reducing burdens on businesses as established in the Lisbon Strategy.
- ETNO does not consider that the proposals will effectively tackle VAT fraud, and in fact believes that they may make the situation worse.
- Any possible pilot project in a Member State must have specific identified and measurable goals at the outset which are communicated to all interested parties. The success of any project should be measured against fraud identified and prevented and the results fully published.

The European Telecommunications Network Operators Association (hereafter “ETNO”) welcomes the opportunity to present its comments on the Consultation Paper entitled “*Possible introduction of an optional reverse charge mechanism for VAT – Impact on businesses*” recently issued by the European Commission.

ETNO represents 41 major telecommunication operators throughout Europe and in all EU Member States providing a number of different services including traditional fixed line telecommunications, mobile telecommunications, content provision and internet services.

ETNO is generally committed to support the appropriate national and international authorities fight against fiscal fraud, especially VAT fraud.

Background in brief

Some Member States are of the opinion that the best way to fight VAT fraud is to shift the VAT liability and accounting responsibility from the supplier to the (business) customer. This marks a fundamental shift in the VAT system and will in fact create two parallel VAT systems with wide-ranging and significant unforeseeable burdens for businesses.

ETNO's comments

Study of Price Waterhouse Coopers (PwC)

ETNO considers that the PwC paper is unrepresentative because of the relatively small number of businesses involved in the study. Throughout the EU, millions of business transactions take place, with VAT revenues amounting to billions of EUR, but PwC derived its opinion from a moderate sample of 20 companies! ETNO strongly believes that such a tiny sample - at least from a rational statistical point of view - lacks the validity and reliability for a representative view of business within Europe.

ETNO finds that the method of computing the cost impact on administration is unclear. Our companies - mainly large scale companies - will face additional millions of EUR per year as a result of these proposals. ETNO understands that there are three further studies being undertaken by the Commission this year which may impact the reverse charge proposals. It may therefore be premature to focus too much on the PwC study. ETNO and its members are available to input into these studies.

Reverse charge mechanism and the principles of VAT

The introduction of the general reverse charge mechanism for domestic supplies is alien to the general system of VAT which has been based on the twin principles of simplicity and neutrality. The beginning of this process goes back to the year 1993 when the transitional VAT system was introduced. This "transitional system" has in fact become a permanent system and it seems that there is no will to achieve the "definitive system" any more. The root of problems relating to fraud is found in the transitional system. ETNO believes that going towards the "definitive system" would solve a lot of the problems under discussion.

The VAT Fraud risk

The proposals for introducing the general reverse charge mechanism have one very important point in common, which is that the VAT fraud risk is partly shifted from the fiscal authorities to businesses. In the retail sector this is compounded because businesses will have to account for VAT on the full value of their sales but will not get relief for VAT on their purchases. As a result, fraud may actually increase because there will be greater incentives to suppress the tax. It is ETNO's belief that in all European countries it is the responsibility of governments to counteract tax evasion and fraud (for direct and indirect taxes) without imposing undue burdens on businesses.

Administrative costs of implementing the proposals

ETNO believes that the impact on administrative costs is much higher than assumed at the moment, although it recognises that it is extremely difficult to accurately compute these. Furthermore, we believe there will also be more hidden costs which have not yet been recognised. The costs of penalties (or disallowance of input tax deduction) for non-compliance have also not been taken into account.

As an example, one of our member companies (Deutsche Telekom) has used rational assumptions to compute the on-going administrative costs of the proposals at nearly €75m per annum. These calculations are contained at Annex1.

With regards to cash flow effects, some companies may gain but others will lose, so it is not possible to make a general statement about this. However, it could be foreseen that tax authorities will lose the cash flow benefits of VAT because manufacturers and wholesalers will not be passing VAT to them.

It is ETNO's view that these new proposals contradict the European Commission's intent to tackle bureaucracy as well, in that the administrative burden will not be reduced but increased.

New types of fraud

ETNO believes that with the introduction of the reverse charge for domestic supplies new opportunities for VAT fraud schemes will arise. At the moment, to commit a missing trader fraud a tax free intra-community supply is necessary. Under these proposals, any domestic supply can be 'free' of tax and so have the same effect. It seems that combating the carousel fraud will produce this new type of fraud.

It is difficult to say whether the amount of fraud prevented by the proposed measures will be greater or lesser than the increase in fraud made possible by these proposals. ETNO believes it is necessary to carefully consider these issues and to find appropriate answers before introducing the new rules.

Pilot Project

If it is thought to be reasonable to test the general reverse concept in one Member State (for instance Austria), ETNO believes that it will be necessary to make very clear at the outset what the objective criteria for success should be and ensure that the test is independently audited and that the results are widely published.

Deutsche Telekom AG

Costs of introducing Reverse Charge for sales exceeding

5,000.00 €

	<u>Facts</u>	<u>Assumptions</u> (estimated)	<u>Calculated</u>	<u>Comments</u>
Invoices issued per month	38,000,000			fixed line and mobile phone customers
Invoices issued per year			456,000,000	
Share of invoices exceeding 5,000.00 €		1%		can be managed automatically by the system if prepared for it (one time costs)
Share of B2B		95%		can be managed automatically by the system if the master file of the customers is revised (one time costs)
Number of Reverse Charge cases per year			4,332,000	
Share of controversial cases		20%	866,400	for instance, if customer wants one invoice exceeding 5000 € instead of several invoices all included
Processing time per case		1 hour		
Personnel costs per hour		40.00 €		
Costs of delayed payment	0.50% per month	21,660,000.00 €		assumed the payment is one month delayed in each controversial case
Costs of settling controversial cases per year			56,316,000.00 €	
Processing time for checking and documentation per case		0.1 hour		
Costs of checking and documentation per year			17,328,000.00 €	
Costs of reporting per case for cross check		0.05 €		depends on the kind of interface to the authorities
Costs of reporting per year			216,600.00 €	
Current costs per year all together			73,860,600.00 €	not included are the costs for purchases exceeding 5000 € Costs of settling controversial cases Costs of reporting