



CENTRE
FOR ECONOMIC
STRATEGY



Funded by the European Union

TAX POLICY HARMONISATION WITH THE EU. FRAMEWORK AND OPPORTUNITIES FOR UKRAINE

Research presentation

Date: 15/06/2023

Author: Yuriy Gaidai, Senior Economist at CES

The key objective of EU tax policy is to ensure the functioning of the European single market – an area without internal borders, where the free movement of goods, persons, services, and capital is ensured.

Direct tax policy remains the responsibility of EU member states. The EU sets only certain **harmonised standards** for corporate and personal taxation, taking into account the principles of the EU single market.

Indirect taxation policy is determined by the EU authorities with the aim of harmonisation.

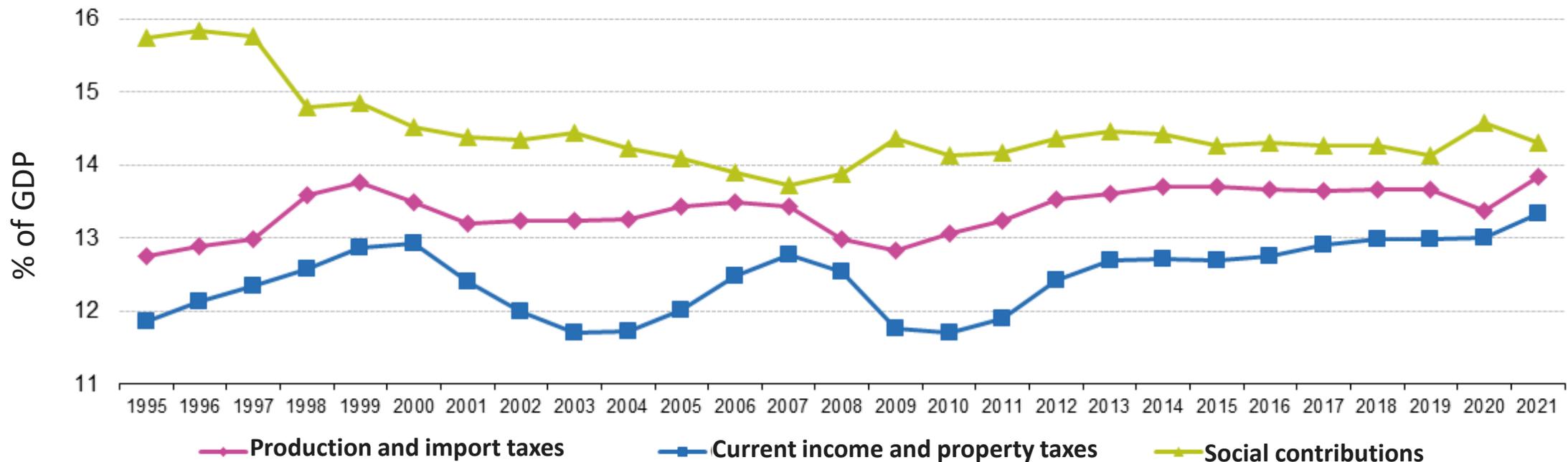
The main instrument is the European Directives, which set out the general principles and framework for the application of indirect taxes, as well as the derogation mechanisms available to member states.

The practical implementation of indirect taxation within the harmonised framework also remains **the responsibility of EU member states**.

INDIRECT TAXES

Indirect taxes, such as VAT and excise duties, are the main tax source of revenue for EU countries (13.8% of GDP in 2021).

Main components of tax revenues in the EU, % of GDP, 1995-2021



VALUE ADDED TAX

The national legislation of the Member States is based on **the European Directive 2006/112/EC on the common VAT system**, which establishes, inter alia:

- rates
- VAT exemptions
- derogations
- special schemes (small businesses, farmers, second-hand goods, OSS...)

The EU has a transitional VAT system, as opposed to a definitive system. For most transactions, the destination country principle is already in place, but some transactions are still taxed in the country of origin.

VALUE ADDED TAX

Rates

Member States are obliged to apply the standard rate, but may determine its amount themselves, subject to the following conditions:

- the rate cannot be less than 15% of the taxable amount
- the rate must be the same for all transactions for the supply of goods and services

You can apply a maximum of two reduced rates under such conditions:

- the rate is not less than 5%;
- reduced rates are applicable only to goods and services listed in Annex III of the Directive;
- reduced rates may be applied to goods and services listed in no more than 24 points of Annex III (mainly goods and services considered to be basic needs - food, water, medicines, pharmaceuticals, health and hygiene products, transportation of persons and some cultural goods (books and periodicals);

Also, with the adoption of Directive 2022/542 of 05.04.2022, Member States were given the opportunity **to set a rate below 5%** or apply VAT exemption with the possibility of crediting input tax credit to goods and services from certain points of Annex III (no more than 7 points in total)

VALUE ADDED TAX

Rates (derogations)

Many EU countries have been granted temporary derogations from the general rules for a transitional period in order to gradually bring their national tax legislation into line with the requirements of the VAT Directive. Some of the derogations are geographically based and are driven by socio-economic factors.

For example, **Greece** has the right to apply rates that are 30% lower than the standard mainland rates on a number of islands and archipelagos (4, 9 and 17% vs. 6, 13 and 24%)

Greece first received the right to lower rates in 2018, based on the migration crisis, provided that these islands continue to receive refugees from third countries.



VALUE ADDED TAX

Exemptions

Section IX of the Directive provides a broad list of transactions in respect of which Member States:

- (i) are obliged to apply VAT exemptions (goods and services in the public interest - public postal services, education, healthcare, public cultural events, etc.)
- (ii) may exempt from VAT at their discretion, subject to certain conditions
- (iii) may leave the choice of VAT exemption to entrepreneurs

States may also exempt from VAT on a case-by-case basis transactions of non-state entities in respect of similar transactions if the following conditions are met:

- non-profitability and reinvestment of profits in improving services;
- prices for goods/services are set or limited by the state or are lower than similar prices of commercial institutions;
- the exemption does not create market distortions that worsen the position of commercial institutions.

VALUE ADDED TAX

Derogations

Member States may seek authorisation from the European Council **to derogate from the common VAT rules** under Article 395 of the VAT Directive **in order to simplify the VAT collection procedure or to prevent tax evasion and avoidance.**

For this purpose, Member States submit an application to the European Commission, which may either reject the requested derogation or submit a proposal for approval by the European Council.

Derogations aimed at simplifying the VAT collection procedure **should not reduce the tax revenues of a Member State.**

Examples: DRR, enhanced schemes for small businesses, reduced rates for certain services with a significant labour input (hairdressing, restaurants, home care).

VALUE ADDED TAX

Special schemes for small businesses

Currently, there are actually three special schemes for small businesses in the EU:

(i) Simplified VAT charging and collection

Member States may, after consultation with the VAT Committee of the Council of Europe, introduce simplified procedures for the calculation and collection of VAT for small businesses, such as applying a flat tax rate to their turnover with the loss of the right to a VAT credit (flat-rate scheme)

(ii) VAT exemptions

Member States may exempt from VAT businesses with annual turnover below a certain amount. The VAT exemption is voluntary, and small businesses may instead opt for a simplified or regular VAT system with partial/graduated tax relief, if applicable in their respective countries..

(iii) Graduated/partial tax relief

Member States may introduce partial tax exemptions for small businesses that do not meet the criteria for full VAT exemption. Such businesses must register as VAT payers and receive a partial exemption for their turnover. As the turnover increases, the exemption gradually decreases until a set limit is reached.

Currently, only a few countries apply such exemptions.

VALUE ADDED TAX

Special schemes for small businesses

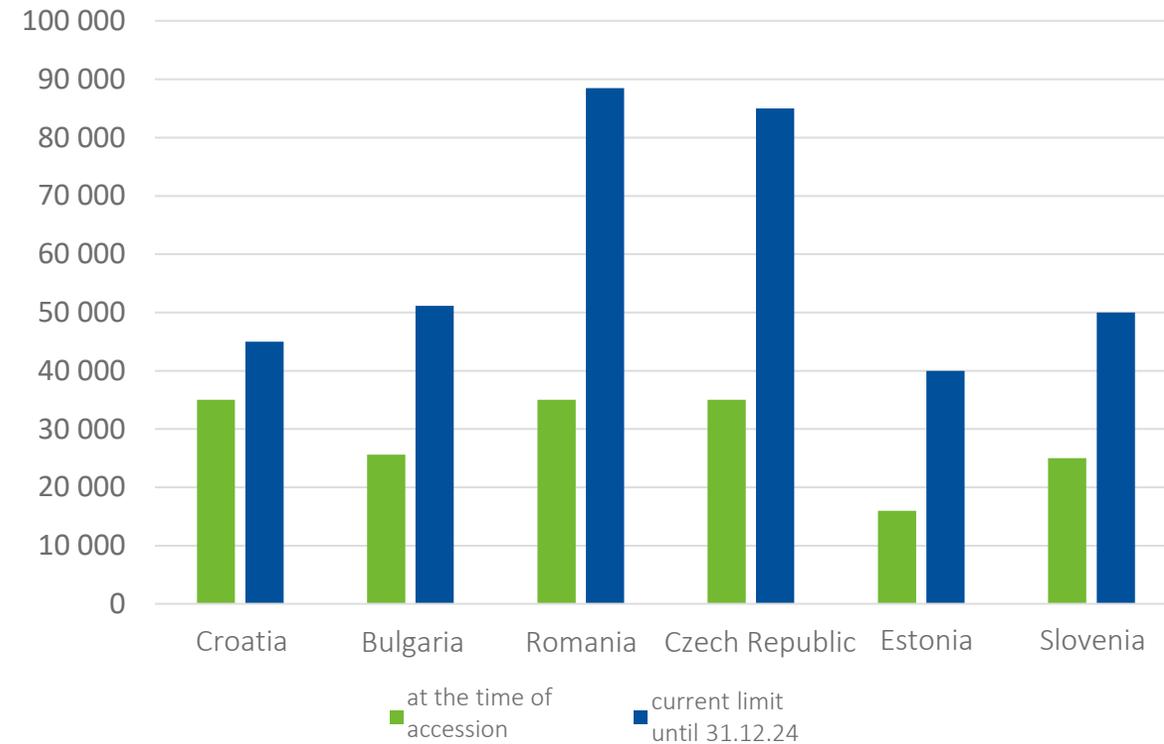
The current VAT Directive provisions, which set the annual turnover limit for the application of VAT exempt transactions, were established in 1977.

These rules allowed EEC member states that, as of 17 May 1977, exempted small businesses with an annual turnover of more than 5,000 ECU from VAT to retain this limit and increase it to maintain real value, while the rest of the then member states set the limit at 5,000 ECU (now EUR).

These rules allowed EEC member states that, as of 17 May 1977, exempted small businesses with an annual turnover of more than 5,000 ECU from VAT to retain this limit and increase it to maintain real value, while the rest of the then member states set the limit at 5,000 ECU (now EUR).

Given the insufficiency of such restrictions, **most countries subsequently applied to the European Commission for permission to raise the annual turnover limit for small businesses. As a result, the highest annual turnover limits as of 1 April 2023 were in the Czech Republic, Hungary, Italy and Poland - EUR 85,000, and in Romania - EUR 88,500. All relevant permits approved by the Council of Europe are temporary, for a period of 2-3 years, and are subject to extension by separate decisions.**

Annual turnover threshold for VAT registration for new Member States, EUR



VALUE ADDED TAX

Special schemes for farmers (flat rate)

The VAT Directive recommends allowing a flat-rate scheme for small farmers in cases where the application of standard VAT or special schemes for small businesses may "cause difficulties" and excluding certain categories of farmers and agricultural service providers from the scheme, for whom standard VAT or special schemes for small businesses do not create significant administrative difficulties. At the same time, farmers can choose the scheme at their discretion.

Farmers who choose to switch to the flat rate scheme are exempt from VAT. To compensate for the loss of the input tax credit, a flat rate calculated for the agricultural sector based on national statistical accounts for the previous three years is applied to their transactions. The rate is based on sectoral input-output tables showing the VAT-eligible expenditures of farm enterprises.

The flat rate is added by farmers to their sales, in which case their buyers include the rate in their VAT credit based on invoices issued by farmers, and farmers retain the proceeds as compensation for input VAT paid. Alternatively, buyers of farm products issue invoices to farmers, which then form the basis for VAT refunds from the state.

Farmers are entitled to a flat-rate VAT refund. Similarly, importers from EU countries that apply a flat rate can claim VAT refunds from the exporting Member State.

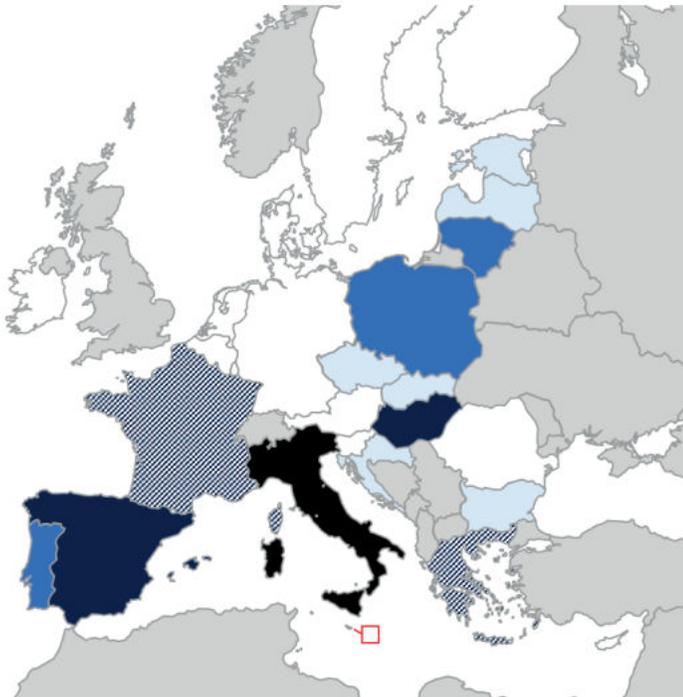
Flat-rate VAT refunds cannot exceed the amount of input VAT paid by farmers.

The flat rate does not apply to sales to VAT-exempt persons or to other farmers applying the scheme.

The respective flat rates are notified by the Member States to the European Commission, which ensures that the scheme is not used to implicitly subsidise the agricultural sector.

VALUE ADDED TAX

VAT in the Digital Age – цифрова звітність



Source: VAT in the Digital Age Executive Summary, European Commission Report

Legend

| | |
|-------------|--|
| Black | Clearance e-invoicing (IT) |
| Dark blue | Real-time reporting (ES, HU) |
| Medium blue | SAF-T listing (LT, PL, PT) |
| Light blue | VAT transfer (BG, CZ, EE, HR, LV, SK) |
| Hatched | Forthcoming reporting requirements (EL, FR) |
| White | No reporting requirements |
| Grey | Non-EU countries |

The VAT Directive does not provide for digital reporting. A number of Member States have received derogations from the European Commission and have introduced a type of digital reporting.

The existing systems are not harmonised, which increases the cost of complying with national transaction reporting requirements for companies doing business in several EU countries (losses of MNCs in the EU - up to EUR 1.6 billion, microbusinesses - EUR 200-500 per year, larger companies - EUR 2-15 thousand per year)

Together with the outdated system of recapitulative statements, this makes it difficult to combat tax fraud, in particular, carousel schemes involving companies from several member states.

Annual losses from such VAT fraud in the EU are estimated at EUR 22-27 billion.

VALUE ADDED TAX

VAT in the Digital Age - digital reporting

The changes proposed by the EC include:

- The first stage is the introduction of standardised requirements for digital reporting of transactions without prior authorisation of transactions by tax authorities, and the introduction of standardised electronic invoices for B2B and B2G transactions between countries within the EU single market (intra-community transactions) without the requirement for acceptance of invoices by recipients;
- The second stage, starting from 2028, will include the mandatory use of standardised electronic invoices, mandatory digital transaction reporting (DDR) with the abandonment of the current system of reporting cross-border transactions between EU member states with aggregation by counterparty (recapitulative statements).

VALUE ADDED TAX

VAT in the Digital Age - Taxation of the Platform Economy

Scale of platform economy operations (2019, billion EUR):

| Sector | Revenue of digital platforms | Revenue of platform providers (net of the facilitation fees) ¹⁰ | Ecosystem value | VAT revenue |
|-------------------------------------|------------------------------|--|-----------------|---------------|
| Accommodation | 6.3 | 36.9 | 43.2 | 3.6 |
| Advertising* | 32.8 | n.a. | 32.8 | n.a. |
| E-Commerce | 16.6 | 93.8 | 110.4 | 15.2 |
| Finance | 0.6 | 6.7 | 7.3 | |
| Household and Professional Services | 1.4 | 7.1 | 8.5 | 3.9 |
| Real Estate | 0.7 | 3.8 | 4.5 | |
| Other | 1.3 | 11.8 | 13.1 | |
| Transportation | 7.2 | 31.0 | 38.2 | 3.1 |
| TOTAL | 66.9 | 191.1** | 258.0 | 25.7** |

Source: VAT in the Digital Age Executive Summary, European Commission Report

Challenges:

Difficulties with determining the place of supply, tax status of suppliers, and violation of tax neutrality, in particular due to the use of platforms by small businesses on special schemes

VALUE ADDED TAX

VAT in the Digital Age - Taxation of the Platform Economy

The changes proposed by the EC include:

- from 2025, **the services of platforms to non-taxpayers will be classified as intermediary services** (rather than electronic services, as currently considered by some Member States). Accordingly, **the place of supply of the intermediary service will be the place of supply of the transaction** between the supplier and the consumer, in accordance with the VAT Directive.
- **a conditional supplier regime will be introduced for the transport and housing segments** of the platform economy. Under this regime, if the service provider is not a VAT payer, the VAT on the relevant transactions will be charged and paid by the intermediary platform.
- In the future, the conditional supplier regime will be extended to all B2B and B2C transactions involving the supply of goods manufactured in the EU.
- the currently optional Import One Stop Shop (IOSS) mode will become mandatory for the supply of certain categories of imports through the platforms.

VAT in the Digital Age – Єдине вікно (OSS)

From 01.07.2021, the One Stop Shop (OSS) and the Single Window for Importers mechanisms were introduced. They allow businesses to declare and pay VAT on a number of sales to end consumers (B2C) without registering in the destination Member States, narrowing the number of scenarios requiring VAT registration in other EU Member States (for B2B transactions, this was previously possible through the reverse charge mechanism, which imposed the obligation to pay VAT on the buyer in the destination country).

However, there are still a number of scenarios that require registration in the country of supply, which are becoming more widespread with the development of e-commerce, in particular for imported goods.

The proposed changes to the VAT in the Digital Age package include :

- **Expansion of the Single Window scheme to include:** supply of goods with subsequent installation or assembly, sales on board aircraft and ships, energy supplies and domestic supply of goods;
- sellers of second-hand goods applying the Margin Scheme will be able to choose to register through the Single Window scheme and declare and pay VAT for cross-border sales;
- mandatory (instead of optional) application of the reverse VAT charge mechanism;
- extension of the single window scheme for cross-border movement of own goods between EU countries and for services provided by non-EU suppliers to all non-VAT payers.

EXCISE DUTIES

The EU has a harmonised system of excise duties for energy products, alcohol and tobacco products.

Specific harmonisation provisions are set out in the Directives for the respective categories of goods:

- 2003/96/EC (**energy products and electricity**);
- 92/83/EEC та 92/84/EEC (**alcohol and alcoholic beverages**);
- 2011/64/EU (**tobacco**).

The general provisions are set out in the Excise Directive 2020/262.

Member States **may introduce non-harmonised excise duties** for other categories of goods, examples of which include:

- sugar tax
- beverage containers tax
- excise duty on passenger cars (Poland)
- excise duty on coffee (Germany).

Simplification for small alcohol producers

Directive 92/83/EEC describes the structure of excise duties on alcohol and alcoholic beverages, the categories of alcohol and beverages, and the basis for calculating excise duties. It also contains special provisions, such as reduced rates for small breweries and distilleries, certain products and geographical regions.

Since its adoption in 1992, the Directive has been amended only three times, twice by acts on the conditions for the admission of new Member States to the EU (2003, 2005) and in 2020 by Directive 2020/1151, which modernised the provisions of the old Directive.

Directive 2020/1151, which modernised the provisions of the old Directive, allowed Member States to:

- **set reduced excise duties for alcohol produced in small volumes by independent small producers.** The status of an independent small producer is confirmed by an annual certificate issued by a Member State, and to reduce the administrative burden, Member States may allow **self-certification** of producers. Member States are also obliged to recognise the following certificates issued by other EU members;
- **set reduced rates for fruit ethyl alcohol produced at distilleries of fruit producers;**
- **exempt from excise duties or set reduced rates for a limited volume of production of traditional/regional alcohol** from fruit ethyl alcohol produced from fruit grown and supplied by individuals from land plots owned by them. The prerequisites for such privileges are proper control of production, consumption and prevention of sales abroad, in particular through registration of such producers and their distillers. Similar rules were previously provided only for fermented beverages such as beer and wine.

In 2021, the European Commission also issued Regulation 2021/2266, which sets out the rules for certification and self-certification of small independent alcohol producers.

EXCISE DUTIES

Energy - fuel

Minimum excise rates for fuels and energy are set by the Directive on Energy Taxation 2003/96/EC. Member States may set higher rates at their discretion.

The minimum rates for motor fuels are currently as follows:

| Fuel | Excise duty unit | Rate |
|-----------------|----------------------|------|
| Leaded petrol | EUR per 1,000 litres | 421 |
| Unleaded petrol | EUR per 1,000 litres | 359 |
| Gas oil | EUR per 1,000 litres | 330 |
| Kerosene | EUR per 1,000 litres | 330 |
| LPG | EUR per 1,000 kg | 125 |
| Natural gas | EUR per gigajoule | 2.6 |

Source: COUNCIL DIRECTIVE 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity

THANK YOU FOR YOUR ATTENTION.



Funded by the European
Union

*The research and the event were organised with the financial support of the European Union.
The contents of the study are the sole responsibility of the Centre for Economic Strategy and do not necessarily reflect the views of the European Union.*