

A Hybrid VAT System in the European Union

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ABSTRACT

The principle of the common system of Value Added Tax (VAT) in the European Union involves the application of a general tax on consumption to goods and services exactly proportional to the price of the goods and services. The tax is applied irrespective of the number of transactions which take place in the production and distribution process before the stage at which tax is charged. Under the current system, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, is chargeable on each transaction after deduction of the amount of input value added tax borne directly by the various cost components. In order to combat certain forms of VAT fraud Germany and Austria recently submitted a proposal for the implementation of a reverse charge mechanism for business-to-business transactions above a certain threshold value occurring within the territory of a single Member State of the EU.

With the reverse charge mechanism, the customer rather than the supplier would be liable to pay VAT. However, the customer is still entitled to deduct the input VAT under the general conditions. Applying the reverse charge mechanism for business-to-business transactions, the VAT would take on the characteristics of a mere retail sales tax. Since the VAT system would formally be maintained and would still apply in the conventional way for sales below a certain threshold value, implementation of reverse charge mechanisms within the framework of the VAT Directive would lead to a hybrid system of consumption taxation.

The paper identifies criteria for successful implementation of such a reform and explains how a reverse charge mechanism would resolve the problems of existing VAT rules. It makes a balanced proposal for a system of taxation of sales of goods and services within a Common Market such as the European Union that would combat VAT fraud effectively.

I. Introduction

Value Added Tax (VAT), including Goods and Services Tax (GST), has become a major source of revenue in more than 130 countries¹. Twenty-nine of 30 OECD member countries have implemented a VAT/GST system. Only the United States does not employ a VAT/GST system, although the U.S. states impose Sales and Use Taxes which are also consumption taxes that differ in many respects from a VAT/GST system. Implementation of a federal VAT in the US has been recommended for various reasons².

VAT yields on average about 20% of the total tax revenue and represents on average about 7.6 % of GDP in European OECD countries³. This is why a systematic VAT revenue loss has dramatic budgetary consequences for European countries. During the last decade, the tax authorities of the EU Member States have observed increasing VAT tax fraud. Although the exact amount involved in VAT fraud is difficult to quantify, some Member States have estimated their losses at up to 10% of the net VAT receipts⁴. Revenue losses are resulting, for example, from the “black market”, the filing of false returns, and unauthorized deductions of VAT⁵. In recent years, so-called carousel fraud has been identified as a key factor in revenue loss⁶, which is estimated to amount to 2-4.4% of total VAT receipts⁷. Another source of lost tax revenue is the bankruptcy of traders in the chain of production and distribution.

The EU and the Member States seek strategies to close the tax gap since VAT fraud affects not only the tax revenue of the Member States but also the financial interests of the EU. For this reason, combating VAT fraud is a legal obligation according to Art 280 EC Treaty⁸. The EU Commission pinned its hopes on the administrative cooperation between the Member States, but it had to accept that the level of administrative cooperation is not commensurate with the size of intra-Community trade⁹. That is why administrative cooperation between the Member States could not prevent an increase VAT fraud.

¹ OECD, Consumption Tax Trends – VAT/GST and Excise Rates, Trends and Administration Issues (2006) 10.

² President’s Advisory Panel on Federal Tax Reform views a partial replacement VAT as an option worthy of further discussion, Report of the President’s Advisory Panel on Federal Tax Reform (2005) 192; For a history of VAT proposals in the United States see Richardson, Efforts to Introduce a Value Added Tax in the United States, 5 Fla. Int’l L.J. 29 (1989-1990) 29, 34-37.

³ OECD, Consumption Tax Trends – VAT/GST and Excise Rates, Trends and Administration Issues (2006) 27 - 28.

⁴ Commission report to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud, IP/04/523.

⁵ See an overview of different forms of VAT evasion: Tait, Value Added Tax (1988) 306-315.

⁶ Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee concerning the need to develop a co-ordinated strategy to improve the fight against fiscal fraud, COM(2006) 254 final, 4; also see Amand/De Rick, Intra-Community VAT Carousels, International VAT Monitor 2005, 8 subsequ.

⁷ COM(2006) 404 final, 4.

⁸ Art 280 (1) EC Treaty: “The Community and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the Community through measures to be taken in accordance with this Article, which shall act as a deterrent and be such as to afford effective protection in the Member States.”

⁹ COM(2006) 254 final, 4.

Some Member States have requested and received authorization from the Council to derogate from the provisions of the VAT Directive in order to prevent certain forms of tax evasion or avoidance¹⁰. Some Member States tightened the national measures to combat fraud, implementing additional obligations of taxpayers in the chain of production and distribution to submit information to the tax authorities and to be jointly and severally liable for the payment of VAT.

Although many of these measures have been successful and can be further improved to safeguard tax revenue, some Member States—Austria and Germany—consider that the VAT system should be amended in order to combat VAT fraud more efficiently, in particular to target carousel fraud. They call for the extension of the reverse charge mechanism to domestic transactions in a Member State, thus combating carousel fraud effectively, since the reverse charge mechanism has proved its effectiveness in specific sectors of business. The EU Commission has so far been reluctant to authorize those Member States to extend the reverse charge mechanism either by a measure of derogation from the directive according to Art 27 6th Directive (now Art 395 VAT Directive) or by implementing an option to deviate from the provisions of the VAT Directive in order to provide that the person liable for payment of VAT is the taxable person to whom supplies are made.

According to a recently published Communication¹¹ the EU Commission supports the objective of combating fraud and is examining the need for steps “with an open mind at this stage. However, according to the Commission, the preconditions for any change to the current VAT system are that it must:

- reduce considerably the possibilities for fraud and exclude new important fraud risks;
- generate no disproportionate administrative burden for traders and the authorities;
- ensure tax neutrality;
- ensure non-discriminatory treatment in a Member State of both national operators and operators established elsewhere.”

These preconditions for any adaptation of the VAT system must be taken seriously, not only because they are political requirements but also because they constitute reasonable prerequisites for amendments to the VAT system. Therefore, the fulfillment of these requirements is an appropriate benchmark for the hybrid VAT system. Furthermore, with regard to the businesses which are most affected by any change of the VAT system, the EU Commission considers that two important questions must be answered:

¹⁰ Art 27 6th Directive (now Art 395 VAT Directive).

¹¹ COM(2006) 254 final, 9.

- the level of legal certainty for businesses applying the reverse charge system in good faith;
- the advantages and the costs of implementation.

Although every kind of tax evasion causes losses of revenue and possibly leads to distortions of competition, the discussion focuses on “carousel fraud”¹², which is also referred to as “VAT missing trader intra-Community fraud”¹³. Carousel fraud consists of chains of supplies of goods in which a defaulting trader is involved. The defaulting trader is liable to VAT, but and “goes missing” without accounting for that VAT.

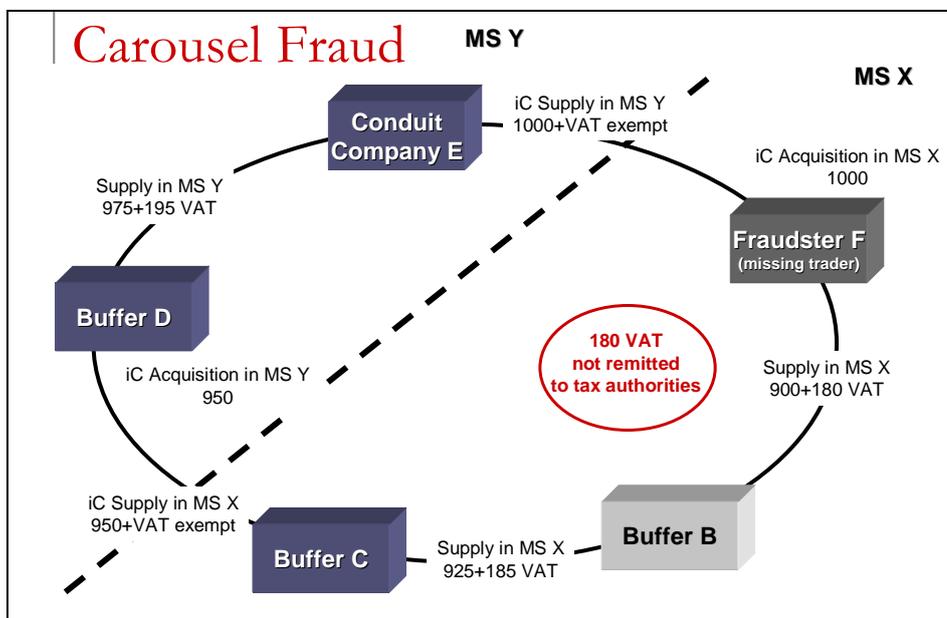
Intra-Community VAT carousel fraud comes in different forms. A typical example of carousel fraud involves B (Buffer) –usually ignorant of the fraud– who purchases goods from F, a company established by the fraudster. Thus F supplies goods to the local customer B in Member State X for, say, 900. In accordance with EU common VAT rules F charges its customer VAT of Member State X (20%), i.e. 180. Payment of the 180 in VAT is fully deductible by B from his own VAT liability, but the fraud occurs when F fails to remit the tax of 180 to the tax authorities of Member State X. For the purposes of its VAT return, F pretends that the transaction was an exempt intra-Community supply of goods, located in another Member State. In order to reduce the chances of discovery, F may pretend that the goods were supplied, in smaller quantities, to various customers outside the Member State X.

In many cases, the fraudster arranges for a customer in the same Member State or in another Member States who can be directly involved in the fraudulent activity or just another buffer. So B supplies C with the goods purchased from F and charges the purchase price including a small margin assume 925 plus VAT of Member State X (20%), i.e. 185. B remits the VAT of 185 to the tax authorities of X. C pays 1010 to B and deducts the input VAT of 185. Subsequently the goods are dispatched or transported to D in Member State Y. C effects an exempt intra-Community supply of goods and invoices 950 without VAT. D effects an intra-Community acquisition of goods for consideration which is subject to VAT in Member State Y (VAT tax rate 20%) and is therefore liable to VAT of 190, which can be deducted in the same period as input VAT. When D supplies the goods to E, who acts as Conduit Company for F in Member State Y, a price of 975 plus VAT (20%) of 195 is invoiced. If the Conduit Company E effects an exempt intra-Community supply to F dispatching or transporting the goods from Member State Y to Member State X, an intra-Community acquisition is subject to VAT. However, F can deduct the input VAT to balance it with the VAT due to the intra-Community acquisition and sell the goods again to the same or another

¹² See e.g. Vandenberghe/Sharkett, Rights of Taxable Persons Involved in VAT Carousel Fraud from an EU, Belgian and UK Point of View Today and Tomorrow, *International VAT Monitor* 2006, 254 et. seq.

¹³ Ruffles/Tily/Caplan/Tudor, VAT missing trader intra-Community fraud: the effect on Balance of Payments statistics and UK National Accounts, ‘Economic Trends’ No. 597 August 2003, 58.

buffer. As shown in the graph below, this last step closes the circle and the carousel has generated a “fraud” profit of 180 (minus the margin of the participating unrelated Buffers, in this example 100, i.e., 80 net profits) that derives from the gaps in the VAT system.



In this scenario, F can use the system of exempt intra-Community supplies to cover up taxable domestic transactions. Its VAT returns would not show excess input VAT since it purchases the goods from another Member State and is therefore subject to VAT due to an intra-Community acquisition of goods. For this reason, it is not very likely that F will be audited. However, the fraud may be discovered when the tax authorities in Member State X audit B and find out that the supplier F has not remitted the VAT which B has deducted as input tax. In most cases, the fraudster F has already disappeared or the company which performed the fraudulent activity has become insolvent. If the tax authorities are not able to either hold other businesses in the chain jointly and severally liable, so that they may collect the outstanding VAT from them, or to deny B the deduction of input VAT, the public exchequer of Member State X has to bear the default.

Although VAT carousel fraud is often committed involving intra-Community transactions, carousel fraud does not necessarily depend on the presence of a cross-border transaction in the chain of supplies. Carousel fraud may also be committed by the supplier in domestic transactions if he collects VAT on sales from the purchaser and simply does not remit the VAT to the tax authorities. In addition to fully domestic carousel fraud, the EU has seen a rise in cross-border carousel frauds where the cross-border supply comes from a non-

EU country¹⁴. It may be harder to get a carousel moving if the goods have to be imported from a third country because of the border control by customs. Nevertheless, many cases of fraud involving third countries have been reported.

In the past, several measures have been taken by the Member States to combat carousel fraud. Member States have conditioned right buffers to deduct input VAT upon their supplier's remittance of VAT. Some Member States have also held buffers jointly and severally liable for VAT. However, the European Court of Justice (ECJ) ruled in *Optigen*¹⁵ that the right to deduct input VAT cannot be affected by the fact that VAT fraud was committed somewhere in the chain of supply as long as the taxable person did not know or have any means of knowing of such fraud. In its judgment in *Kittel*¹⁶, the ECJ pointed out that, by contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is possible to refuse that taxable person entitlement to the right to deduct. In the light of these judgments of the ECJ, the national tax authorities can refuse a taxable person entitlement to the right to deduct only on the basis of objective evidence "where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT"¹⁷.

The ECJ also decided in *Federation of Technological Industries*¹⁸ that a taxable person involved in a carousel fraud can be made jointly and severally liable to pay the VAT with the person who is in principle liable as supplier of goods or services if, at the time of the supply to him, the former knew or had reasonable grounds to suspect that some or all of the VAT payable in respect of that supply, or of any previous or subsequent supply of those goods, would go unpaid. Reasonable grounds can be presumed if the price payable by that person was less than the lowest price that might reasonably be expected to be payable for those goods on the market if there were no circumstances for such a low price unconnected with failure to pay VAT. With regard to the principle of proportionality, the ECJ pointed out that, while it is legitimate for Member States to seek to preserve the rights of the public exchequer as effectively as possible, such measures must not go further than is necessary for that purpose. Overall, due to the jurisprudence of the ECJ, the Member States have only a

¹⁴ COM(2006) 254 final, 4.

¹⁵ ECJ judgment of 12 January 2006 in *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v. Commissioners of Customs & Excise*, Joined Cases C-354/03, C-355/03 and C-484/03, not yet officially published.

¹⁶ ECJ judgment of 6 July 2006 in *Axel Kittel and Recolta Recycling SPRL*, Joined Cases C-439/04 and C-440/04, not yet officially published.

¹⁷ ECJ judgment of 6 July 2006 in *Axel Kittel and Recolta Recycling SPRL*, Joined Cases C-439/04 and C-440/04, not yet officially published.

¹⁸ ECJ judgment of 11 May 2006 in *Federation of Technological Industries and Others*, Case C-384/04, not yet officially published.

little leeway to deny the deduction of input VAT or to hold someone not directly involved in the fraudulent activity jointly and severally liable for VAT debts of a fraudster.

In contrast to this, Member States have found a successful way to combat different forms of fraudulent activities and ensure their tax revenue in cases of bankruptcy by applying the reverse charge mechanism. The reverse charge mechanism has proved its effectiveness in specific business sectors, such as construction¹⁹.

Under Art 27 (1) 6th Directive, the Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce special measures for derogation from the provisions of the VAT Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. The Council has authorized some Member States to hold the customer in lieu of the supplier liable for VAT due on the supply of goods and services in specific cases, in order to prevent certain types of tax evasion.

Those derogations applying the reverse charge mechanism, which were granted under varying terms to individual Member States by the Council pursuant to Art 27 (1) 6th Directive, have now been made available to all Member States through incorporation into the VAT Directive²⁰. Under Art 199 VAT Directive, Member States may provide that the person liable for payment of VAT is the taxable person to whom certain supplies are made, including construction work, used material or immovable property, are made. However, a more generalized application has yet not been approved.

Although the Commission acknowledges that the extension of the reverse charge mechanism could reduce certain types of fraud, the Commission and some Member States²¹ fear that it entails other problems, such as the risk of new types of fraud. A hybrid VAT system addresses these considerations and therefore limits the application of the reverse charge mechanism to supplies above a certain threshold value.

What makes this proposal a hybrid VAT system? For domestic sales up to a certain threshold value, the standard rules of the present VAT system would continue to apply, retaining the VAT liability on the supplier. Above a certain threshold value, the rules of the VAT system would still apply for domestic sales. However, the customer would be held liable for VAT due for the supply of goods and services he or she receives if the customer runs a business. If the purchaser of goods or services is a consumer, the supplier would still

¹⁹ COM(2006) 254 final, 9.

²⁰ Council Directive 2006/69/EC of 24 July 2006 amending Directive 77/388/EEC as regards certain measures to simplify the procedure for charging value added tax and to assist in countering tax evasion or avoidance, and repealing certain Decisions granting derogations, OJ L 221, 12.8.2006, p. 9–14.

²¹ See the press release “Outcomes of the Informal ECOFIN Meeting in Berlin on 20/21 April 2007”, http://www.eu2007.de/en/News/Press_Releases/April/0421ECOFIN.html; Finance Ministers discussed the extension of the reverse charge mechanism. The discussion focused on whether this mechanism may have an impact on the internal market or not.

be liable to remit the tax to the tax authorities.

The basic idea of the hybrid VAT system is to combine the advantages of a “cashless VAT system” with the benefits of the classical VAT system. The extension of the reverse charge mechanism would eliminate carousel and missing trader fraud effectively because the fraudster would not receive VAT included in the price of the sales. The hybrid VAT also addresses a major concern associated with a shift to a reverse charge mechanism for all transactions: that it would encourage new type of fraud where consumers pretend to purchase goods or services for business purposes free of VAT. This new type of fraud would be prevented because the classical VAT system would still be applicable in the majority of cases where the invoice value is below a certain threshold.

Austria and Germany have already developed proposals for a hybrid VAT system based on the basic principles outlined above²². The EU Commission has invited the Member States and experts²³ to an open discussion about the effects of such a change in the VAT system for all parties concerned. This article aims at providing an in-depth analysis of the hybrid VAT and thus contributes to this discussion²⁴. It considers whether the hybrid VAT system fulfils the preconditions formulated by the EU Commission, focusing primarily on its compatibility with the principles of VAT and its effectiveness in combating tax fraud. A change towards a hybrid VAT system seems feasible only if it is the best possible way of eliminating carousel fraud and if it is more effective in preventing, detecting and tackling this fraud than other methods and politically realizable. Hence, the hybrid VAT system shall be contrasted with other possible solutions of combating tax fraud including the sales taxes applied by the U.S. states.

II. Principles of VAT

A. *Main Characteristics of a Value Added Tax*

Despite its name, VAT is not intended to be a tax on value added as such but rather a tax on consumption²⁵. More precisely, VAT is a tax on the expenditure of income or capital to acquire goods or service for consumption or use²⁶ for other than business purposes. The key features²⁷ of the VAT are that: (1) it is ultimately paid by end consumers for their

²² See Communication from the Commission to the Council in accordance with Article 27(3) of Directive 77/388/EEC, COM(2006) 404 final.

²³ Conference of the EU Commission "Tackling VAT fraud: possible ways forward" Brussels - 29 March 2007.

²⁴ In his Opening speech Commissioner Kovács at the conference "Tackling VAT fraud: possible ways forward" Brussels - 29 March 2007 stated regarding the extension reverse charge system which would be a crucial of a hybrid VAT system: "Commission has been examining this issue carefully in order to prepare the political orientation debate, which will take place at the Informal ECOFIN meeting of April." The results of the Commission's examinations have not been made public yet.

²⁵ OECD, Consumption Tax Trends 11.

²⁶ Ruppe, Umsatzsteuergesetz – Kommentar (2005) Einf Tz 35.

²⁷ Bodin/Ebrill/Keen/Summers, The Modern VAT (2001) 1; OECD, Consumption Tax Trends 11; Terra/Kajus, A

consumption expenditures, (2) levied on a broad base²⁸, and (3) charged and collected on all transactions by businesses throughout the production and distribution process, with (4) provision for deduction of VAT covering all business inputs. As the end consumer cannot recover the tax, the amount of tax actually collected is equal to the amount of VAT charged by the last vendor in the supply chain to the consumer. The following example illustrates the principle mechanism of the VAT system applied in the EU.

A domestic sale of goods by manufacturer M at a price of 1000 to a Reseller R who sells the same goods with a margin of 500 to a Consumer C applying the standard rules of the EU VAT system (at the average normal tax rate of 20%) has the following results:

Sale M to R

<i>net price</i>	<i>1000</i>
<i>plus VAT (20%)</i>	<i>200</i>
	<hr/>
<i>gross price</i>	<i>1200</i>

M receives 1200 from the R and remits the VAT of 200 to the tax authorities. Therefore, the balance on the first stage is 200.

R is entitled to deduct 200 of input VAT. Hence, R's net purchase price is 1000, adding a profit margin of 500 results in a net price of 1500.

Sale R to C

<i>net price</i>	<i>1500</i>
<i>plus VAT (20%)</i>	<i>300</i>
	<hr/>
<i>gross price</i>	<i>1800</i>

R receives 1800 from C and remits the VAT of 300 less deduction of input VAT of 200 thus 100 to the tax authorities. The total tax burden borne by the consumer is 300 remitted partly by M (200) and R (100) to the tax authorities.

VAT is collected in a staged process, with successive taxpayers (businesses) entitled to deduct input VAT on purchases and obliged to account for output tax on their supplies of goods and services. The EU Member States apply the invoice credit method²⁹, under which each supplier charges VAT at the specified rate on each sale and passes to the purchaser an invoice showing the amount of tax thus charged. In theory, this method allows the tax authorities to cross-check the VAT paid by the supplier and the input VAT deducted by the purchaser. In practice, an immediate deduction of input VAT is allowed; therefore, the tax authorities can only check ex post whether the deducted input VAT has been duly remitted by the supplier. On the one hand, the fractionated levying of VAT avoids total default of VAT if a supplier in the chain does not pay VAT for which he is liable. On the other hand, it is the

Guide to European VAT Directives, Part 2.2 Chapter 7.6.3.1.

²⁸ In contrast to excises, VAT is a general turnover tax, not limited to specific goods or services.

²⁹ OECD, Consumption Tax Trends 11.

reason for many types of fraud described above, especially carousel fraud.

The deduction of input VAT on every stage of production or distribution, with the exception of the end consumer, the person who purchases the goods or services for final consumption, ensures competitive neutrality. The total tax burden is always proportional to the sales price. By contrast, the total tax burden of cumulative cascading turnover taxes is dependent on the number of stages of production or distribution.

Pursuit of international trade neutrality with regard to the place where the goods or service are supplied to the end consumer has led to the implementation of the destination principle³⁰. The VAT system provides for neutrality because exports are exempt with a prior deduction of input VAT, which results in total tax relief from VAT in the state of origin. The destination principle is achieved because imports are subject to VAT in the destination state on the same basis and at the same rate as local goods or services.

VAT is an indirect tax, because the vendors are liable to pay the tax, though the economic burden is shifted to the end consumer. However, as VAT increases the price of every product supplied to end consumers, the elasticity of demand is decisive for answering the question of whether the tax can successfully be shifted to the consumer in economic reality.

B. History of VAT in the EU

Although the Americans³¹ and the French often claim that they invented the VAT system, the German Carl Friedrich von Siemens³² must actually be given credit for the first VAT concept in the year 1919³³. However, the French tax à la valeur ajoutée, which was drafted by Maurice Lauré³⁴ and first introduced in 1954, was the predecessor of the modern EU VAT system. In the former European Economic Community, the First VAT Directive³⁵ and the Second VAT Directive³⁶, which were simultaneously enacted by the Council on 11 April 1967, instructed the Member States to replace their existing turnover tax systems by a common VAT system. This common VAT system was described in Art 2 1st VAT Directive as follows:

“The principle of the common system of value added tax involves the application to

³⁰ OECD, Consumption Tax Trends 12.

³¹ Adams, Fundamental Problems of Federal Income Taxation, Quarterly Journal of Economics, Vol. 35, no. 4, 1921, 527, 553.

³² von Siemens, Veredelte Umsatzsteuer, Siemensstadt 1919 (2nd edition 1921).

³³ Lindholm, The Value Added Tax: A Short Review of the Literature, Journal of Economic Literature, Vol. 8, No. 4 1970, 1178.

³⁴ Lauré, La taxe sur la valeur ajoutée (1952) ; Lauré, Au secours de la T. V. A. (1957).

³⁵ First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes, OJ 71, 14. April 1967, p. 1301–1303.

³⁶ Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax, OJ 71, 14 April 1967, p. 1303 et seq.

goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.

On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components.

The common system of value added tax shall be applied up to and including the retail trade stage.”

The former Member States of the EEC (later European Community) implemented the 1st and 2nd VAT Directives in the years 1968 to 1973. Every acceding Member State is obliged to implement VAT in line with the VAT Directives by its date of accession. In 1977, the 2nd VAT Directive was replaced by the Sixth Directive³⁷, which further harmonized the national laws of the Member States. Most of the subsequent changes of Community VAT law have been effected by amending the 6th VAT Directive.

Although Art 4 1st VAT Directive called on the Commission to submit, before the end of 1968, proposals on how to achieve the aim of abolishing the imposition of tax on importation and the remission of tax on exportation in trade between Member States, border tax adjustments remained necessary even after the adoption of the 6th VAT Directive.

However, 1993 was the deadline for the establishment of the internal market as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured. The completion of the internal market required the elimination of fiscal frontiers between Member States and therefore required the elimination of tax on imports and the remission of tax on exports between Member States. Art 4 1st VAT Directive would have required the taxation of trade between Member States to be based on the origin principle, that is taxation by the Member State of origin of goods and services supplied. The origin principle would have implied a harmonization of tax rates and exemptions to avoid distortions of competition, as well as a revenue clearing system to maintain the principle that revenue from the imposition of tax at the final consumption stage belongs to the Member State in which that final consumption takes place. Although the Commission drafted a proposal that provided such a system, the Member States could neither agree on harmonization of tax rates and exemptions nor on revenue sharing.

³⁷ Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, OJ L 145, 13. June 1977, p. 1 et seq.

This is why a Directive³⁸ on the abolition of fiscal frontiers introducing transitional arrangements for the taxation of trade between Member States was adopted by the Council in 1991 and came into force in 1993. The tax system for intra-Community trade implemented with this directive is largely blamed for facilitating carousel fraud. With regard to intra-Community trade, the concepts of importation and exportation monitored by customs have been abolished. In lieu thereof, intra-Community supplies of goods purchased by businesses are exempt, resulting in intra-Community acquisitions which are subject to VAT in the Member State where the customers acquire the goods. No effective burden generally accrues since input VAT of the intra-Community acquisition can be deducted from such VAT liability in the same period as the tax is due. Intra-Community supplies and intra-Community acquisitions must be reported on domestic VAT returns rather than to customs officials at the borders. The tax authorities of the Member States exchange information gathered from their businesses to monitor intra-Community trade. This exchange of information is evidently insufficient, since the EU Commission is calling for more efficient methods of exchanging information³⁹ and modernisation of the VIES (computerised VAT Information Exchange System).

The text of the 6th VAT Directive, which had previously been amended several times, has recently been remodelled and, together with the 1st VAT Directive, integrated into the new VAT Directive⁴⁰ which came into force on 1 January 2007. Although the overhaul affected the structure and the wording of the Directive, it will not, in principle, materially change in the existing legislation⁴¹.

C. *Neutrality*

Neutrality is considered the crucial advantage of VAT compared with other turnover and sales taxes. The meaning of the term “neutrality” is opaque and viewed in relation to different phenomena. Internal neutrality is usually distinguished from external neutrality. Levying the tax in a general manner, covering all goods as well as the supply of services and the full right to deduction of input tax through the supply chain, with the exception of the end consumer, ensures the internal neutrality⁴². External neutrality provides for equal tax treatment regarding international trade.

In its judgments, the ECJ often refers to internal neutrality in the sense laid down in

³⁸ Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, OJ 1991, L 376, 31. December 1991, p. 1.

³⁹ Van Dyne, VAT Fraud and the Policy of Global Ignorance, European Journal of Law Reform, Vol 1, No. 4 (1999) 425, 440 proposes the establishment of ‘knowledge centre’ to combat carousel fraud.

⁴⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11. December 2006, p. 1–118.

⁴¹ See the third recital of the VAT Directive.

⁴² See US Supreme Court, *Trinova Corp. v. Michigan Dept. of Treasury*, 498 U.S. 358 (1991).

Art 2 1st Directive and at present in Art 1 (2) VAT Directive as a fundamental principle of the EU VAT system. Thereby, the ECJ focuses on the rules governing deduction introduced by the VAT Directive. These rules aim at relieving the trader entirely of the burden of the VAT payable or paid in the course of all his/her economic activities and states: “The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT”⁴³. The principle of fiscal neutrality of the common system of VAT involves the application, in the Community, to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged⁴⁴.

Fiscal neutrality became a dominant principle of interpretation in the ECJ’s case law. Under the court's settled interpretation, the principle of fiscal neutrality precludes any general distinction between lawful and unlawful transactions for purposes of levying VAT, except where, because of the special characteristics, all competition between a lawful economic sector and an unlawful sector is precluded⁴⁵. The principle of neutrality of the tax also precludes treating similar, and therefore competing, supplies differently for VAT purposes⁴⁶. Consequently, exemptions⁴⁷, tax rates and special schemes⁴⁸ have to be applied equally within a Member State.

External neutrality⁴⁹ means that it should not make any difference whether goods are produced in the country of consumption or imported, nor should it make any difference from where a service is rendered. This leads to the principle of destination. VAT on importation must not exceed the tax on like domestic goods and the refund on exportation must be the amount that was actually levied. Even if rates and exemptions are not fully harmonized, external neutrality is achieved. Similar goods and services bear the same tax

⁴³ ECJ judgment of 8 February 2007 in *Investrand BV versus Staatssecretaris van Financiën v. Commissioners of Customs & Excise*, Case C-435/05, not yet officially published.

⁴⁴ ECJ judgment of 7 December 2006 in *Administration de l’enregistrement et des domaines versus Eurodental Sàrl*, Case C-240/05, not yet officially published.

⁴⁵ ECJ judgment of 12 January 2006 in *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v. Commissioners of Customs & Excise*, Joined Cases C-354/03, C-355/03 and C-484/03, not yet officially published; ECJ judgment of 6 July 2006 in *Axel Kittel and Recolta Recycling SPRL*, Joined Cases C-439/04 and C-440/04, not yet officially published. In the case of the supply of products such as narcotic drugs which have special characteristics, because of their specific nature, they are subject to a total prohibition on marketing in all the Member States, where all competition between a lawful economic sector and an unlawful sector is precluded, the ECJ decided that the supply of such products is not subject to VAT (see inter alia ECJ judgment of 5 July 1988 in *Mol v. Inspecteur der Invoerrechten en Accijnzen*, Case 269/86 [1988] ECR 3627 and in *Happy Family v Inspecteur der Omzetbelasting*, Case 289/86 [1988] ECR 3655).

⁴⁶ ECJ judgment of 6 June 2006 in *Finanzamt Eisleben versus Feuerbestattungsverein Halle eV*, Case C-430/04, not yet officially published.

⁴⁷ ECJ judgment of 12 January 2006 in *Turn- und Sportunion Waldburg versus Finanzlandesdirektion für Oberösterreich*, Case C-246/04, not yet officially published; ECJ judgment of 27 April 2006 in *H.A. Solleveld and J.E. van den Hout-van Eijnsbergen versus Staatssecretaris van Financiën*, Joined Cases C-443/04 and C-444/04, not yet officially published.

⁴⁸ ECJ judgment of 26 May 2005 in *Finanzamt Arnsberg versus Stadt Sundern*, Case C-43/04, ECR [2005] I-4491.

⁴⁹ Terra/Kajus, *A Guide to European VAT Directives*, Part 2.2 Chapter 7.3.2.

burden within the territory of each Member State⁵⁰.

Whereas the EU strictly applies the destination principle with regard to trade with third countries and intra-Community supply of goods to businesses, supplies of services overall and goods to end consumers are treated differently. Services are taxed at the place where they are deemed to be supplied. This is usually the place where services are rendered or intangible goods are used. However, the general provision deviates from this principle and deems the place of services to be the place where the supplier conducts his or her business. In case of distance sales⁵¹, intra-Community supplies of goods to end consumers are taxed at the place where the transport ends, when the supplier dispatches or transports the goods. If a private customer purchases goods in another Member State and takes them home, the supply is only subject to VAT in the Member State where the goods are supplied. Intra-Community supplies of new means of transport, such as new cars, to end consumers are always taxed in the Member State where the transport ends regardless of whether the supplier or the customer provides for the transport.

This results in distortion of competition, especially where Member States with highly diverse tax rates (e.g. Denmark 25% and Germany 19%) share a common border, since similar goods bear a different tax burdens.

D. Fractionated Levying of VAT

VAT is classified as an all-stages non-cumulative tax⁵². Art 1 (2) VAT Directive expresses this characteristic: “On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. The common system of VAT shall be applied up to and including the retail trade stage.” In the view of the EU Commission, fractionated payment belongs to the principles of VAT and eliminating the fractionated payment would result in a fundamental change to the VAT system⁵³. As a matter of fact, one of the main characteristics of VAT is that each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the portion of tax corresponding to the difference between the VAT paid out to suppliers and the VAT charged to customers⁵⁴. The principle of fractionated levying of VAT obviously conflicts with a reverse charge system where VAT payment in the chain of business-to-business supplies is deferred.

⁵⁰ See 7th Recital of the VAT Directive.

⁵¹ If all supplies of the seller to end consumer exceed a threshold in the calendar year (in most cases 100,000 euros) or exceeded the same amount in the last calendar year, the supply is taxed where the transport of goods ends. Otherwise the supply is subject to VAT in the Member State where the transport begins.

⁵² Terra/Kajus, A Guide to European VAT Directives, Part 2.2 Chapter 7.5.1.

⁵³ COM(2006) 404 final, 5.

⁵⁴ OECD, Consumption Tax Trends 11.

However, EU Member States have previously been authorized to apply the reverse charge mechanism by Art 199 VAT Directive to specific sectors (construction, waste, wood etc) of domestic business, so that instead of having risky small and ephemeral businesses did not charge VAT, VAT was charged by the larger, easier to control businesses⁵⁵. Furthermore, in order to prevent tax evasion concerning the selling of gold, it seems to be justifiable to allow Member States to designate the customer as the person liable for payment of VAT by 198 VAT Directive.

Concerning international trade and internationally provided services, the reverse charge mechanism is also applicable. According to Art 194 VAT Directive, Member States may provide that the person liable for payment of VAT is the person to whom the goods or services are supplied, where the taxable supply of goods or services is carried out by a business which is not established in the Member State in which the VAT is due. Moreover, according to Art 200 VAT Directive, VAT shall be payable by any person making a taxable intra-Community acquisition of goods. This means that no payment is due if the purchaser is entitled to deduction of VAT. One could argue that these are only cases concerning international trade and hence are not comparable to domestic supplies. However, in small Member States, most of the goods are imported and many services are rendered by foreign businesses. Deviating from fractionated payment of VAT seems to be in line with the principles of VAT where it is appropriate to simplify the tax assessment or combat tax evasion.

III. Proposals for a Hybrid VAT system

A. *German Proposal*

In 2006, Germany requested authorization, pursuant to Art 27 6th VAT Directive, to introduce measures derogating from Art 21 6th VAT Directive, which provides that the business carrying out a taxable supply of goods or services is liable for tax. Germany wanted to implement the reverse charge mechanism in respect of all business-to-business supplies of goods or services where the invoice value exceeds 5,000 euros.

In addition, the German proposal included an obligation for businesses making the supply to confirm electronically and on-line the validity of the special VAT identification number of the customer before making a reverse charge supply. If the customer number was verified as being valid, the supplier would not account for VAT on the supply, but the purchaser would be liable for tax which is deductible input VAT. The purchaser would have to declare the tax liability for all reverse charge supplies received separately as well as the

⁵⁵ COM(2006) 404 final, 6.

deductible input VAT. Additionally, the supplier would have to notify the tax authorities electronically each time that he/she is making a non-taxed supply and declare the value of the supply. The tax administration could thus cross-check the information received electronically from the supplier with the information declared by the purchaser. In this way, Germany thinks it can protect itself against new fraud opportunities created by the reverse charge system.

The EU Commission has correctly criticized the additional compliance burdens (verifying the nature of customers and reporting transactions) which would be imposed on honest traders operating in areas where fraud is not prevalent. Also, the tax authorities would have to expand their capacities significantly to cope with the additional verification system, along with the exchange of information for intra-Community trade.

In sum, the German proposal for a hybrid VAT seems inappropriate because it creates additional compliance burdens for businesses and costs to control VAT for the tax authorities instead of extending the intra-Community tax status verification system and information exchange system to domestic supplies. If there are concerns regarding the functioning of these systems, it would be appropriate to consider improvements also for intra-Community trade.

B. Austrian Proposal

Austria sought to introduce the reverse charge mechanism in respect of all business-to-business supplies of goods or services where the invoice value exceeds 10,000 euros. Additionally, where the value of an individual invoice does not exceed 10,000 euros, the reverse charge mechanism would also be applicable when the supplies to a specific business customer exceed 40,000 euros in a month. In order to counter possible new fraud patterns, Austria wanted to impose an obligation on business to provide monthly global turnover figures for individual business customers.

The Austrian proposal deviates from the German primarily in proposing a second threshold of 40,000 euros and renouncing an additional verification procedure. The second threshold should obviously prevent circumventions of the reverse charge mechanism by issuing multiple invoices below the threshold. It appears very complicated and inconvenient for sellers to observe for every accounting period whether total sales to a specific customer exceed the threshold. In case of large customers with decentralized procurement and suppliers with decentralized order taking offices, only a very sophisticated just-in-time ordering system would be able to comply with this provision.

Providing statements about monthly global turnover figures for individual business customers does not exceed what businesses effecting intra-Community supplies of goods are

required to file for tax purposes. An obligation for the acquirer to provide similar figures is just as adequate as it is for the supplier and within the scope of Art 273 VAT Directive. According to Art 273 VAT Directive, Member States may impose other obligations other than those required by the provisions of the VAT Directive which they deem necessary to ensure the correct collection of VAT and to prevent evasion. The permission to impose other reporting obligations is subject to the requirement of equal treatment between domestic transactions and transactions carried out between Member States by taxable persons and the requirement that such obligations will not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

C. *Own Proposal for a Hybrid VAT in the EU*

The following proposal of a hybrid VAT system refers to the specific conditions and requirements in the EU and makes reference to the provisions of the VAT Directive. It complies with the principle of neutrality. Moreover, levying of VAT in the EU must be seen as influenced by intra-Community and international trade which makes it easier for fraudsters to exploit tax loopholes. A proposal of any amendment of the existing VAT system of the EU must fit within the existing framework rather than duplicating compliance burdens. As a result, the following proposal is considered as a possible solution for the Member States of the EU, although it may not be appropriate for other jurisdictions:

Art 194 (1) VAT Directive should be amended to allow Member States to provide that the person liable for payment of VAT is the person to whom the goods or services are supplied, in cases where the taxable supply of goods or services is by a taxable person who established within the same Member State in which the VAT is due. Currently, pursuant to Art 194 (2) VAT Directive, Member States shall lay down the conditions for implementation of paragraph 1. Applying this provision of the VAT Directive to domestic supplies would leave the determination of the threshold value where the liability for payment reverses to the discretion of the Member States. In order to obtain a harmonization of the rules in the internal market, a certain threshold for applying the reverse charge mechanism to domestic supplies value should be determined.

According to Art 207 VAT Directive Member States shall take the measures necessary to ensure that persons who are regarded as liable for payment of VAT in the stead of a taxable person not established in their respective territory comply with the payment obligations set out in the VAT Directive. If this provision is retained unchanged, it would give Member States leeway to enforce the useful provisions to ensure compliance with the rules. However, it appears sensible to apply the rules of identification of taxable persons (Art 213-216) and recapitulative statements (Art 262-271) provided for intra-Community

supplies analogously.

Domestic business-to-business supplies would be treated like intra-Community supplies of goods if the invoice value exceeds the threshold value. Suppliers' invoices would be issued without VAT. Persons to whom the goods or services are supplied would be liable to tax payment. If purchasers are entitled to deduct input VAT, they would be able to offset it against their VAT liability. Whether the customers are businesses and the reverse charge mechanism is applicable or the supplier is liable for the payment of VAT should be contingent upon the presentation of a VAT identification number, such as in the case of the exemption of intra-Community supplies of goods. If the purchaser does not present a VAT identification number, suppliers should remain liable for payment of VAT. In this case, purchasers can recover the input VAT only with applications to the tax authorities if suppliers have actually paid the VAT. All other domestic purchases, including sales to businesses with invoice values below the threshold, should be handled according to the present VAT system. If suppliers are not positive about the status of the purchaser, they will invoice VAT. In case of sales below the threshold, purchasers who know or should know that the supplier splits invoices with fraudulent intention in order to charge VAT in accordance with the jurisprudence of the ECJ would not be entitled to deduct input VAT. Perhaps it will be necessary to establish special schemes for pricy goods to prevent fraud by end consumers. In case of new means of transport, a special check prior to their registration could ensure correct taxation.

IV. Justification of a Hybrid VAT System

A. *Implementation of the Intra-Community Concept on Domestic Sales*

The basic idea for implementing a cashless VAT system is to impede carousel fraud, "missing trader" and other forms of fraud. These aims could be achieved by applying the reverse charge mechanism to supplies within a Member State. It would have the effect of nullifying the fraud insofar as the potential "missing trader" would not have a VAT liability and therefore would not be able to charge the purchaser with VAT that can be evaded. The consequences are illustrated by returning to the example given above:

A domestic sale of goods by Manufacturer M at a price of 1000 to a Reseller R who sells the same goods with a margin of 500 to a Consumer C has the following results when applying the standard rules of the EU VAT system (at the average normal tax rate of 20%):

<i>Sale M to R</i>	
<i>net price</i>	<i>1000</i>
<i>plus VAT (20%)</i>	<i>200</i>
	<hr/>

gross price 1200

M receives 1200 from the M. If M acts fraudulently or goes bankrupt, failing to remit the VAT of 200 to the tax authorities, the balance on the first stage would be 0.

If R is entitled to deduct 200 input VAT, his/her net purchase price is 1000; adding a profit margin of 500 results in a net price of 1500.

Sale R to C

net price 1500

plus VAT (20%) 300

gross price 1800

R receives 1800 from C and remits the VAT of 300 less deduction of input VAT of 200 thus 100 to the tax authorities. The total tax burden borne by the consumer remains 300 but only 100 has been remitted to the tax authorities, who sustain a loss of revenue of 200.

Although the fraudster receives the payment from the customer, the loss originates from not remitting the VAT due on the taxable sale. In contrast, if the supply of goods or services was exempt or, under a reverse charge mechanism, the customer is liable to tax would be paid to the fraudster, and his unwillingness to remit VAT to the tax authorities would be of no consequence. The reverse charge mechanism is illustrated below:

A domestic sale of goods by manufacturer M at a price of 1000 to a Reseller R who sells the same goods with a margin of 500 to a Consumer C applying the reverse charge system has the following results:

Sale M to R

net price 1000

no VAT 0

gross price 1000

M receives 1000 from the R. M has to remit no tax to the tax authorities. Therefore, the balance on the first stage is 0.

R is liable for the tax of 200 and, in the same tax period, is entitled to deduct 200 of input VAT. Hence, R's net purchase price is 1000, adding a profit margin of 500 results in a net price of 1500.

Sale R to C

net price 1500

plus VAT (20%) 300

gross price 1800

R receives 1800 from C and remits the VAT due on R's own acquisition (200) and the VAT due on R's sale to the end consumer (300) less the deduction of R's input VAT (200). Thus R remits a net of 300 to the tax authorities; the total tax burden borne by the consumer

is 300 remitted entirely by R to the tax authorities.

As explained above, the reverse charge mechanism works perfectly in the case of services rendered by foreign suppliers and in specific sectors (e.g. construction). De facto, it is also presently applied in case of intra-Community sales of goods to businesses because the intra-Community supply is exempt, but the purchaser is liable for VAT caused by an intra-Community acquisition which can be deducted as input VAT. Nevertheless, the strengths and weaknesses of an extension of the reverse charge mechanism to domestic supplies have to be considered. In particular, the proposal must be considered in light of preconditions for any change to the current VAT system set forth by the EU Commission⁵⁶.

As shown on the basis of the example above, the reverse charge mechanism systematically eliminates any possibility of carousel fraud and missing trader fraud. Admittedly, it does create other fraud risks. End consumers could try to purchase goods or services VAT-free by pretending to acquire for business purposes. This is not a new risk, because the VAT rules for intra-Community trade of goods and services create the same problem. However, the risk definitely increases with a surge of possibilities to purchase tax free domestically.

To respond to these increased opportunities for fraud when the reverse charge mechanism applies to domestic supplies, the idea of a hybrid system evolved. Limiting the reverse charge mechanism to sales exceeding a certain threshold removes the risk of fraud from most goods and services purchased for day-to-day. However, special schemes to prevent fraud in cases of high-priced goods, such as new cars, boats, and construction of houses, must be found. The VAT Directive already contains special rules for the intra-Community acquisition of new means of transport by end consumers. Since new means of transport usually require a public registration, registration can easily be made contingent on the submission of a certificate of taxation. Usually high-priced goods such as jewelry should only be sold without VAT to special businesses (e.g. jewelers) that have obtained an authorization by entering into a partnership with the tax administration, as is currently the case in the customs field⁵⁷.

Many Member States hold the vendor jointly and severally liable in case of reverse charge sales. It seems appropriate to protect tax revenue. If the supplier does not want to be liable, he or she can remit tax to the authorities. The purchaser, however, would not be entitled to deduct VAT under general conditions. Either a special recovery procedure, depending on an application to the tax authorities and verification of payment by the supplier, or payment of VAT by the purchaser to the tax authorities could be considered as methods

⁵⁶ See above and COM(2006) 254 final, 9.

⁵⁷ COM(2006) 254 final, 8.

for escaping the vicious circle.

Quite correctly, the Commission argues that the reverse charge mechanism is not an answer to “black market sales” (i.e. off the record sales⁵⁸). Nevertheless, it should be kept in mind that the present system does not impede black market sales either. Admittedly, the loss of VAT in case of black market sales in a fractionated tax system only occurs at the final stage. In contrast, if applying the reverse charge mechanism, the loss affects the entire amount of VAT accumulated in the chain. The same can even happen under the present system if goods are bought under the intra-Community supply exemption in another Member State or if input VAT is deducted when the goods or services are acquired and thus are discharged from VAT. The hybrid VAT system should dilute this problem, since, up to a certain threshold, sales would be still taxed.

An additional advantage of a cashless VAT system, as far as business-to-business sales are concerned, is that in case of bankruptcy of the supplier in the chain, tax authorities do not suffer any losses. However, the amount of possible losses in case of insolvency of the supplier of end consumers increases, because the whole amount of VAT is paid on the final level of sale. The EU Commission⁵⁹ estimates, without indicating empirical evidence, that currently, a large proportion of the VAT collected by each Member State is paid by a very small group of large, compliant taxable persons. The Commission argues that applying a generalized reverse charge would mean that the tax would be collected from a far larger group of taxpayers, making control comparatively more difficult than today. This assumption is questionable because the bulk of sales to end consumers are conducted by big retailers in most of the Member States which can easily be monitored by the tax authorities.

If the reverse charge mechanism is applied to domestic supplies in the exact same manner and under the same rules, as provided for intra-Community trade by the VAT Directive, no additional administrative burden for traders and the authorities will be generated. However, the administrative burden would be increased if additional requirements have to be fulfilled prior to the supply. For example, the German proposal for an extension of the reverse charge mechanism to domestic supplies includes a provision that suppliers should be obliged to confirm the validity of the special VAT identification number of the customer before making a reverse charge supply, which creates an extra burden for suppliers, customers, and tax authorities. Also issuing of a certificate, when the purchaser claims to acquire for business purposes, comparable to the sales tax exemption certificate required in most U.S. states to absolve the seller of liability⁶⁰, would increase the administrative burden.

⁵⁸ COM(2006) 404, final 4.

⁵⁹ COM(2006) 404 final, 5.

⁶⁰ Hellerstein/Hellerstein, *State Taxation*, 3rd Ed., II 19A.07[6][a].

Applying the reverse charge mechanism to domestic supplies ensures the neutrality of the VAT system. It relieves the trader entirely of VAT, so that within the supply chain no VAT liability of the supplier is created. The liability for VAT due to acquisition can be deducted if the business is entitled to deduction of VAT. Not only is internal neutrality ensured by the reverse charge mechanism but also external neutrality. If goods are exported after they have been acquired in a Member State, they are completely relieved of any tax burden, because input VAT can be deducted, although intra-Community supplies or exports to a third state are exempted from VAT.

If the reverse charge mechanism is applied under the same rules which are provided for intra-Community supplies of goods and cross-border services, a non-discriminatory treatment in a Member State of both national operators and operators established elsewhere is ensured. Equal treatment will be assured where the existing EU VAT system treats domestic and international trade differently.

One major problem of the application of the reverse charge mechanism is that it requires the supplier to check on the status of the customer to establish whether or not he or she carries on a business and therefore whether or not VAT should be charged. Suppliers must continue to collect tax from customers who do not carry on a business. Special requirements to ensure the correct identification of businesses for domestic supplies represent an extra burden for businesses and the tax authorities. However, the identification of businesses (taxpayers who effect intra-Community acquisitions) is also critical in case of exempt intra-Community supplies pursuant to Art 138 VAT Directive and this has been solved by establishing a system of VAT identification numbers that can be checked with the help of VIES⁶¹. If this system is applied uniformly to intra-Community and domestic supplies, there should not be any additional burden for the traders or the tax authorities.

Moreover, according to Art 131 VAT Directive, the Member States have discretion to lay down additional conditions for the purposes of ensuring the correct and straightforward application of those exemptions and of preventing any possible evasion, avoidance or abuse. Member States may define more closely the formal evidential requirements as regards the circumstances in which exemption from VAT will apply. In adopting such measures, Member States must also adhere to the principle of proportionality⁶². Pursuant to Art 263 (2) VAT Directive, Member States may provide that recapitulative statements of the acquirers identified for VAT purposes to whom goods have been supplied –which are required to be drawn up for each calendar quarter under Art 263 (1) VAT Directive – are to be submitted on a monthly basis. Thus, the requirement to provide

⁶¹ VAT Information Exchange System see above.

⁶² See Opinion of Advocate General Kokott delivered on 11 January 2007 in *Albert Collée versus Finanzamt Limburg an der Lahn*, Case C-146/05, not yet officially published.

monthly global turnover figures for individual business customers, including also domestic sales as proposed by Austria, is by no means disproportionate.

According to Art 194 (1) VAT Directive, where the taxable supply of goods or services is carried out by a taxable person who is not established in the Member State in which VAT is due, Member States may provide that the person liable for payment of VAT is the person to whom the goods or services are supplied. Since the Member States shall lay down the conditions for implementation pursuant to Art 194 (2) VAT Directive, it is appropriate to apply the system of verification of the status and recording of turnover figures not only for supplies of goods, but also for rendering of services.

Hence, if the reverse charge mechanism were extended to domestic supplies of goods and services, no additional layer of accounting and compliance burdens would be imposed on honest traders, as long as harmonized provisions are applied. Only those businesses currently not participating in intra-Community trade would suffer additional burdens. If those are the same accounting and compliance burdens that businesses engaged in intra-Community trade must already bear, it seems perfectly justified from an internal market perspective that they also apply for domestic transactions.

The downside of the extension of the reverse charge mechanism to domestic supplies certainly is the increased possibility for end consumer fraud, in which end consumers pretend to acquire the good or service for business purposes and thereby manage to avoid imposition of VAT. Although end consumers can already acquire goods and services tax exempt in another Member State if they make suppliers believe that they are acting as businesses (by presenting a VAT identification number from a business, which they can easily obtain from any invoice) there is a higher potential of this form of tax evasion once goods and services can also be purchased VAT-free domestically. The consequences of this kind of tax fraud can be demonstrated by the following example:

A domestic sale of goods by manufacturer M at a price of 1000 to a Reseller R who sells the same goods with a margin of 500 to a Consumer C who pretends to acquire for business purposes, applying the reverse charge system has the following results:

<i>Sale M to R</i>	
<i>net price</i>	<i>1000</i>
<i>no VAT</i>	<i>0</i>
<hr/>	
<i>gross price</i>	<i>1000</i>

M receives 1000 from R and has no tax to remit to the tax authorities. Therefore the balance on the first stage is 0.

R is liable for the tax of 200 and in the same tax period entitled to deduct 200 of

input VAT. Hence, R's net purchase price is 1000, adding a profit margin of 500 results in a net price of 1500.

<i>Sale R to C</i>	
<i>net price</i>	<i>1500</i>
<i>no VAT</i>	<i>0</i>
<hr/>	
<i>gross price</i>	<i>1500</i>

R receives 1500 from C and remits the VAT of R's acquisition of 200 less deduction of input VAT of 200 thus 0 to the tax authorities. The total tax burden borne by the consumer is 300; however, nothing is remitted to the tax authorities because no VAT has been levied in the supply chain.

In order to prevent such cases of fraud and to relieve the supplier of the burden of checking the status of the customer (a burden that would apply even in cases of small supplies), the hybrid VAT system applies the standard rules holding the supplier liable for tax up to a certain invoice value. Austria proposed a threshold of 10,000 euros, Germany a threshold of 5000 euros. Germany estimates that the reverse charge system according to their proposal would affect only 0.5% of all invoices. Therefore 99.5% of the total invoices would be issued subject to VAT as hitherto. As far as the Austrian proposal is concerned, even more invoices continue to impose VAT. All sales exceeding the threshold would be conducted according to the standard VAT system of fractionated levying.

To determine the optimal threshold value, more empirical analysis and practical experience is needed. However, it can be assumed that usual over-the-counter business would be excluded from the application of the reverse charge mechanism if the 5,000 euro threshold is applied. A higher threshold would exclude even more sales from the application of the reverse charge mechanism on but may reduce the anti-fraud benefits of the reverse charge system for domestic supplies. One has to bear in mind that every sale below the threshold is still vulnerable to carousel fraud. A higher threshold value gives fraudsters the opportunity to continue the fraud scheme issuing invoices just below the threshold. A lower threshold reduces the VAT margin of the fraudster and makes the pursuit of the fraud scheme less attractive as a consequence. Issuing numerous invoices below the threshold amount will arouse the suspicion of the customer. Pursuant to the ECJ judgments, that could be a reason to refuse the customer's entitlement to the right to deduct⁶³, or to hold him jointly and severally liable for payment of value added tax⁶⁴, thus providing security for the payment of that tax due.

⁶³ ECJ judgment of 6 July 2006 in Axel Kittel and Recolta Recycling SPRL, Joined Cases C-439/04 and C-440/04, not yet officially published.

⁶⁴ ECJ judgment of 11 May 2006 in Federation of Technological Industries and Others, Case C-384/04, not yet officially published.

The remaining question is whether the differential treatment of business-to-business sales generates a disproportionate administrative burden for traders and the tax authorities. The EU Commission has criticized the Austrian and German proposals of a hybrid VAT system because they present businesses (taxable persons) with the need to deal with three different types of tax regimes: the classical VAT system, the reverse charge system for domestic B2B supplies, and the system for intra-Community supplies. Businesses would not suffer an additional burden if the application of the reverse charge mechanism would be contingent upon the same rules that already apply for intra-Community trade or which are employed in other cases where the reverse charge system is already applicable. Nonetheless, the number of cases in which the reverse charge mechanism applies will increase slightly. However, once accounting and handling is adapted to the reverse charge mechanism, there should not be much additional burden.

B. Implementation of the Hybrid VAT System

The EU Commission issued a Communication⁶⁵ explaining why Art 27 6th VAT Directive cannot serve as legal basis for a generalized reverse charge of the type proposed by Germany and Austria. The Commission believes that these requests fail the tests required by Art 27 6th VAT Directive insofar as they would make the system more complicated for taxable persons and tax administrations, in addition to providing *more* scope for tax evasion. This interpretation of the EU Commission of the scope of Art 27 6th VAT Directive is at least questionable.

In my opinion the implementation of a hybrid VAT system can easily rest on Art 27 6th VAT Directive (now Art 395 VAT Directive). The EU Commission believes that the correct legal basis for Member States to introduce very broad measures intended to counter VAT fraud tax avoidance is Art 93 of the EC Treaty. A hybrid VAT system can therefore be implemented either as an option for the Member States or a general rule. The following part analyzes the legal basis of both possibilities.

According to Art 395 VAT Directive, the Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce special measures for derogation from the provisions of this Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. Measures intended to simplify the procedure for collecting VAT may not, except to a negligible extent, affect the overall amount of the tax revenue of the Member State collected at the stage of final consumption.

This provision has been under scrutiny by the ECJ. In principle, any special measure

⁶⁵ COM(2006) 404 final, 6.

for derogation from the provisions of the VAT Directive can be authorized by the Council. Derogating measures can imply a denial of the right of deduction of input VAT⁶⁶, as well as tax exemptions which lead to a loss of tax revenue⁶⁷, as long as such derogations do not affect the overall amount of the tax revenue collected by the Member State at the stage of final consumption more than marginally.

The original Art 27 6th VAT Directive was adopted without any written legislative history⁶⁸. However, a protocol of Council deliberations exists that indicates the agreement the Commission and Council that measures for derogation from the provisions of the VAT Directive can be taken in different ways. The protocol expressly mentions, as an example for a measure derogating from the Directive, the suspension of fractionated taxation. According to the proposed hybrid VAT system, the extension of the reverse charge mechanism results in a suspension of taxation in cases of business-to-business sales and therefore perfectly matches the exception mentioned in the Council protocol. Furthermore, comparable rules are provided for certain services according to Art 196 VAT Directive and in case of intra-Community acquisitions pursuant to Art 200 VAT Directive.

The introduction of special measures for derogation from the provisions of this Directive is possible either in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. Simplification of the procedure for collecting VAT aims at a reduction of the efforts and costs of taxpayers and tax authorities regarding the collection of VAT. The cancellation of cash flows between businesses and the tax authorities on the one hand and among businesses can be regarded as simplification. Cashless VAT relieves business of strains on liquidity and the costs of handling cash flows. Advantages of the simplification resulting from the expansion of the reverse charge mechanism for the tax authorities are the reduction of the administrative burden connected with the risk of VAT fraud. It must be accepted that a simplification measure implies, by definition, a more general approach than that of the rule which it replaces and thus will not necessarily reflect the exact situation of each taxable person⁶⁹.

The extension of the reverse charge mechanism clearly intends to avoid carousel fraud and other forms of fraud and is therefore a measure to prevent tax evasion according to Art 395 VAT Directive. There is evidence that carousel fraud is booming⁷⁰. Although the Commission continues to believe that the solution to carousel and missing trader fraud can be found in increased VAT control based on risk analysis rather than in extending the reverse charge mechanism, this does not legally preclude an authorization pursuant to Art 395 VAT

⁶⁶ ECJ judgment of 29 April 2004 in Finanzamt Sulingen and Walter Sudholz, Case C-17/01 [2004] ECR I-4243.

⁶⁷ Langer in Reiß/Kraeusel/Langer, UStG Art 27 6. EG-RL Rz 5.

⁶⁸ Terra/Kajus, A Guide to European VAT Directives, Part 1.2. Chapter 15.1.

⁶⁹ ECJ judgment of 29 April 2004 in Finanzamt Sulingen and Walter Sudholz, Case C-17/01 [2004] ECR I-4243.

⁷⁰ Kogels, International VAT Monitor 2006, p. 172.

Directive. The Commission probably has political reasons, for example the fear of uncontrolled proliferation of the reverse charge mechanism with different characteristics, to bar an extension of the reverse charge mechanism, rather than legal grounds.

The Commission considers that Art 27 6th VAT Directive (now Art 395 VAT Directive) is not a correct legal basis for proposing a generalized reverse charge because previous proposals to the Council by the Commission, to authorize the Member States to apply reverse charge in specific situations, were generally dissimilar insofar as they applied to specific sectors (construction) or goods (waste, wood, etc)⁷¹. However, other typical carousel goods exist, such as cell phones, computer parts, cars and even soft drinks⁷². Therefore, the Commission published a proposal to authorize the United Kingdom to extend the reverse charge mechanism to the supply of cell phones and computer parts on the basis of Art 27 6th VAT Directive⁷³. Due to the opposition of France, Germany, and Austria, because of different considerations, the authorization has not yet been adopted. But even if the reverse charge mechanism could be extended to cell phones and computer parts, the variety of possible goods and services is only limited by the creativity of fraudsters.

The Commission considers, without a further explanation, that derogations such as those requested by Germany and Austria do not respect the principle of proportionality as set out by the ECJ in several cases. The ECJ has held on numerous occasions that Community legislation must be certain and its application foreseeable by those subject to it⁷⁴. That requirement of legal certainty must be observed all the more strictly in the case of rules liable to entail financial consequences, in order that those concerned may know precisely the extent of the obligations which are imposed on them⁷⁵. In order for a Community measure concerning the VAT system to be compatible with the principle of proportionality, the provisions which it embodies must be necessary for the attainment of the specific objective it pursues and have the least possible effect on the objectives and principles of the VAT Directive⁷⁶.

In case of the implementation of a hybrid VAT system, the requirement of legal certainty is always observed. The business of the customer is either entitled to deduction of input VAT, so no tax burden accrues, or if no deduction is possible the customer knows his tax liability. However, even if the supplier is held jointly and severally liable, he/she can be

⁷¹ COM(2006) 404 final, 6.

⁷² Kogels, *International VAT Monitor* 2006, p. 172.

⁷³ COM(2006) 555 final.

⁷⁴ ECJ judgment of 22 November 2001 in *Netherlands versus Council*, Case C-301/97 [2001] ECR I-8853.

⁷⁵ ECJ judgment of 29 April 2004 in *Finanzamt Sulingen and Walter Sudholz*, Case C-17/01 [2004] ECR I-4243; ECJ judgment of 21 February 2006 in *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd, versus Commissioners of Customs & Excise*, not yet officially published.

⁷⁶ ECJ judgment of 19 September 2000 in *Ampafrance SA and Directeur des Services Fiscaux de Maine-et-Loire (C-177/99)* and between *Sanofi Synthelabo, formerly Sanofi Winthrop SA, and Directeur des Services Fiscaux du Val-de-Marne (C-181/99)* [2000] ECR I-7013.

certain about the amount of tax when he/she is positive about the tax status of the customer. Proportionality always has to be considered with regard to burdens for taxpayers. ECJ decided in Case C-17/01⁷⁷ that even a measure of the kind which limits the right to deduct VAT to 50% and therefore creates a final burden for the taxpayer does not conflict with the objectives or the principles of the VAT Directive and observes the principle of proportionality. In contrast, a hybrid VAT system that extends the reverse charge mechanism to domestic supplies does not lead to a final tax burden for the taxpayer. It probably increases the compliance cost for those who have not already participated in intra-Community trade. This is why the German proposal would impose a severe burden, because of additional compliance efforts and joint and several liabilities of the persons involved in the sale. However, the reverse charge mechanism could be extended to domestic sales, applying the same compliance rules which already exist for intra-Community sales. It can hardly be argued that compliance rules implemented by the VAT Directive are not proportional. So the application of those rules to domestic sales must be considered in line with the principles of the VAT Directive and the objective of proportionality.

Since the EU Commission objects to the derogations requested by Austria and Germany and believes that the correct legal basis, which would allow Member States to introduce very broad measures intended to counter VAT fraud tax avoidance, would be Art 93 of the EC Treaty⁷⁸, it is much more likely that a hybrid VAT system can be implemented on the latter basis.

Art 93 EC authorizes the Council, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, to adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market. All directives in the field of VAT are based on this provision. So Art 93 EC must be the legal basis for any change of these provisions in order to implement the reverse charge mechanism for domestic sales.

It must be borne in mind that the Community system of VAT is the result of a gradual harmonization of national legislation pursuant to Art 93 EC. This harmonization, as brought about by successive directives, and in particular by the VAT Directive subsequent to the 6th VAT Directive, is still only partial. Thus, the harmonization envisaged has not yet been achieved⁷⁹. However, there is no limitation to creating new options for the Member

⁷⁷ ECJ judgment of 29 April 2004 in Finanzamt Sulingen and Walter Sudholz, Case C-17/01 [2004] ECR I-4243.

⁷⁸ KOM(2006) 404 final, 9.

⁷⁹ ECJ judgement of 7. December 2006 in Administration de l'enregistrement et des domaines versus Eurodental Sàrl, Case C-240/05, not yet officially published.

States on the basis of Art 93 EC which provide for exceptions from the Community VAT system.

Consequently, practical or economic reasons will be decisive factors in whether the implementation of a hybrid VAT system should be mandatory or optional for Member States. Optional application of the hybrid VAT system would leave every Member State the choice of implementing the new system or maintaining the old system. A unanimous decision by the Member States necessary for amending the VAT Directive pursuant to Art 93 EC would be easier to achieve. It also makes it possible for some Member States to go ahead and prove the merits and dangers of the hybrid VAT system. Nevertheless, Member States which want to keep the present VAT system might possibly fear that implementing the hybrid VAT in one Member State will see fraud migrate to their territory.

The EU Commission believes that leaving the specific contours to individual Member States could lead to distortion of the Internal Market for VAT purposes, because, depending on the value of the supply, the type of product (or whatever other criteria which could be envisaged), businesses would be confronted with divergent rules and procedures applicable to internal supplies in different Member States⁸⁰. Yet this sounds peculiar as the VAT Directive already contains numerous options and exceptions for the Member States. However, it seems sensible, if a consensus cannot be found, to implement the hybrid as the common VAT system to permit the Member States to apply this system for their domestic purposes within a common framework. In particular, the threshold value could be uniformly determined by the VAT Directive. Regarding checking of the status of businesses and required statements, it should be perfectly sufficient if the rules applicable for intra-Community supplies can be taken over for the purpose of the hybrid VAT system.

C. *Comparison with Alternative Concepts*

A hybrid VAT system implementing a more generalized application of the reverse charge mechanism for domestic supplies is only justified if it can fulfill the aims of the harmonization of turnover taxes as laid down in Art 93 EC better than any other method. The strengths and weaknesses of the hybrid VAT system will now be compared with other systems.

Comparing the hybrid VAT system with the common VAT system applied in the EU, the hybrid system more efficiently combats carousel or missing trader fraud and other forms of fraud utilizing the prepayment of VAT that can be deducted by the purchaser. Using the reverse charge mechanism for every supply, whether goods supplied or sector of commerce, eliminates carousel fraud. Limiting in the reverse charge mechanism to supplies above a

⁸⁰ COM(2006) 404 final, 7.

certain invoice value would mean that carousel fraud would still be possible, but less likely. Extending the reverse charge mechanism to business-to-business sales, which represent a large percentage of all sales value, also reduces the risk of revenue losses due to the bankruptcy of a supplier. In consequence, the amount of possible revenue loss increases if retailers become insolvent. Taking into account that a large proportion of retail sales are made by a few large retailers, increased auditing of these retailers combined with short time limits for remittance of collected VAT should result in an overall positive effect of the hybrid VAT system compared with the present VAT system.

One major advantage of levying VAT on domestic sales is that consumers or businesses without the right to deduct input VAT cannot escape taxation. This advantage of the VAT system would be retained in a hybrid system for sales under the threshold amount. Admittedly, the common VAT system can be considered superior regarding sales above the threshold. Special schemes for pricy goods that are also used for private purposes (e.g., cars) would mitigate this effect. Furthermore, it has to be kept in mind that the possibilities of cheating are already established by exemption of intra-Community sales.

An extension of the reverse charge mechanism does not reduce the risks of tax evasions due to “black market” and false returns. Hence, risks would rise compared with the present VAT system if it is not possible to tax the input of the vendor. This might be a significant disadvantage of expanding the reverse charge mechanism with respect to sales to businesses (especially in the field of construction works) but the problem already exists due to the exemption of intra-Community sales.

Overall it appears that the advantages of the hybrid VAT outweigh its disadvantages and also those created by the current VAT system. A German study performing a simulation came to the same results when comparing the German proposal of a hybrid VAT system with the present VAT system⁸¹.

Alternatively to a hybrid VAT system, a uniform VAT levied by the EU according to the present rules of the VAT Directive on all supplies within the Member States could eliminate intra-Community carousel fraud that exploits the exemption of intra-Community supplies. However, two objections must be raised: First, this method would not combat all “missing trader” fraud schemes, especially with involvement of third country traders. Second, from a political perspective, there seems to be no reasonable chance that the Member States would sacrifice their fiscal sovereignty for such a plan.

Even proposals by the EU Commission failed to introduce a “definitive system” of

⁸¹ Peters Schönberger GmbH, Systembezogene Änderungen bei der Umsatzbesteuerung „Generelle Ist-Versteuerung mit Cross-Check“ und „Reverse-Charge-Verfahren“ (2005) 51-52; see also Matheis/Groß/Vogl, Steuerreformmodelle im Praxistest - Die Erfahrungen der Münchener Steuerplanspiele zur Umsatzsteuer im Lichte der angekündigten „Großen Steuerreform“, DStR 2006, 214 ff.

taxation by which goods and services would be taxed in “the Member State of origin” according to the commitment of the 1st VAT Directive in 1967 and to launch a macro-economic mechanism for redistributing VAT receipts between the Member States. First, the implementation of the plan envisaged would require a uniform application of the VAT system in the Member States, including a harmonization of tax rates and tax exemptions in order to eliminate major distortions of competition. Member States are reluctant to give up their leeway for tax policy. Second, the Member States obviously would not trust a macro-economic mechanism for redistributing VAT receipts based on economic data provided by other Member States.

In Germany, another adaptation of the VAT system in order to combat carousel fraud has been examined but rejected due to administrative difficulties and revenue losses in the year of implementation⁸². According to the proposal, remittance of VAT and deduction of input VAT should become due simultaneously at the time of payment. This would have been combined with a control system checking if VAT had been paid before input VAT could be deducted.

In theory, the sales tax imposed by the U.S. states is a retail tax that should be paid and borne by the end consumer. All states exempt purchases made for resale and materials or parts that are physically incorporated as components or ingredients of items to be resold. Many states also exempt inputs directly used in the production of goods for sale, such as machinery or equipment used in the production process. Services are commonly not taxed at all and⁸³, even when services are taxed, states have avoided taxing many of the common business inputs (e.g. advertising, accounting and legal services)⁸⁴. Sales tax seems to fulfill all principles of VAT as a consumption tax on the one hand and, on the other hand, the tax applies to only the last transaction in the chain of production and distribution, so carousel or missing trader fraud involving business-to-business sales is barred.

But in reality, sales taxes largely deviate from the principle of neutrality. Since services are mostly excluded from taxation, sales taxes are not general consumption taxes, in contrast to VAT. Differential tax treatment of competing goods and services (such as software distributed on CD and downloaded software) violates the principle of neutrality⁸⁵. Due to administrative problems in ensuring that exempt business purchases⁸⁶ are used for personal purposes, no state exempts all business inputs⁸⁷. Taxing business inputs endangers

⁸² BMF, Ergebnis der Modellstudien zu Änderungen bei der Umsatzsteuer zur Verhinderung von Steuerausfällen, Monatsbericht des BMF, Januar 2006, p. 45 subsequ.

⁸³ BNA, Multistate Portfolios, SALES AND USE TAXES, 1310-2nd T.M. 01.C.

⁸⁴ Pomp/Oldman, State and Local Taxation (2005) p. 6-6 and 6-31; BNA, Multistate Portfolios, SALES AND USE TAXES, 1310-2nd T.M. 01.E.

⁸⁵ Pomp/Oldman, State and Local Taxation (2005) p. 6-27.

⁸⁶ Regarding the resale and manufacturing exemptions see NYU Institute on State and Local Taxation (2002) The Basics--Sales/Use Tax § 3.04 and § 3.05.

⁸⁷ Pomp/Oldman, State and Local Taxation (2005) p. 6-31; therefore, business inputs as a share of the sales-tax

multiple taxation, leads to a pyramiding in an economic sense⁸⁸, and interferes with the principle of internal and external neutrality. If low rates are applied, multiple application of sales taxes may be tolerable. With a minimum tax rate of 15% and a maximum rate of 25% in the EU, multiple tax seems unfeasible. Even when exports to other states are usually exempt from sales tax, the principle of external neutrality cannot be satisfied if business inputs are taxed. Like any other cumulative tax, a precise refunding in order to achieve the destination principle is impossible, because the tax burden cannot be calculated exactly. Since the implementation of VAT neutrality appears to be one of the major achievements and also one of the political preconditions for any change in the rules of VAT, the implementation of a sales tax, as is applied by the U.S. states, seems an inappropriate solution.

V. Summary

Recapitulating the analysis, the extension of the reverse charge mechanism to domestic supplies and services has proven to be a viable method to eliminate carousel and missing trader fraud systematically. New forms and patterns of fraud could be expected after the introduction of a more generalized reverse charge system. In order to reduce those risks and facilitate the handling of VAT for suppliers and customers, the application of the classical VAT system appears to be an appropriate scheme if the invoice value does not exceed a threshold. The threshold value must be determined with respect to an appreciation of values, considering the benefits of the extension of the reverse charge mechanism for combating carousel and missing trader fraud, and new forms of tax evasion triggered by tax-exempt acquisitions of goods and services.

base average about 40% for 45 states and the District of Columbia; Ring, Consumers' Share and Producers' Share of the General Sales Tax, 52 Nat'l Tax J. (1999) 79.

⁸⁸ Hellerstein/Hellerstein, State Taxation, 3rd Ed., II 12.04[5].