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Mr. Frits Bolkestein
European Commission
DG Taxation and Customs Union
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Rue de la Loi 200
B-1049 Brussels

Dear Mr Bolkestein,

Re: Proposal for a Directive amending Directive 77/388/EEC as regards the rules governing the right to deduct Value Added Tax

FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments to the Commission on the recent proposals regarding the above-indicated subject.

These proposals which take many of the points developed by the Commission in the document 98/C 219/11 of 17 June 1998 are, if our understanding is correct, attempting at the same time to abolish the 8th VAT Directive 79/1072 and to modify to a significant extent the deduction rights of taxable persons in proposing to modify article 17 et seq. of the 6th VAT Directive 77/388.

In this document we will address separately our comments on the modifications to article 17 et seq. and on the proposals to abolish the 8th Directive.

Amendments to article 17 et seq. of Directive 77/388:

1. The modifications proposed are completely contrary to all of the Commission's stated objectives in its programme of March 2000, where the Commission indicated that the VAT system within the 15 and soon to be 25 EU Member States, should be simplified, modernised and harmonised. In the proposals now being put forward which have been reviewed and, as we understand it agreed, in VAT Committee 1, they go completely against the Commission's clearly stated positions in the matter.

2. The VAT system, as stated in the preamble to the First VAT Directive 67/227, should be simple and neutral with VAT being charged at all points along the supply chain, be neutral towards businesses and borne by the ultimate consumer only. Any restriction in the rights of deduction is contrary to the principle of neutrality of the tax, to the extent that the expenses are incurred for the purposes of making taxable transactions or any of those set out in article 17,3.

3. The proposals in the draft directive do not simplify the application of the tax by taxable persons. The Directive allows Member States to decide what is or is not deductible. The impact on business will vary from country to country as it is also left to Member States to decide, how much VAT is recoverable, on an actual basis, on a forfait basis, on a percentage basis, etc. For businesses operating both within and outside their own country this proposal is clearly going to increase rather than diminish burdens.

4. There should be harmonisation of the rules, if any VAT incurred in the making of taxable supplies is deemed not to be deductible, between VAT and direct taxes, if an expense is deductible for direct tax purposes then there can be no argument to sustain the view that the same type of expense is not deductible for VAT purposes – see in this regard the cases of Sanofi and Ampafrance at the ECJ (cases

181/99 and 177/99). In addition there should clearly be harmonisation of the definitions of such vague terms as “luxury” and “entertainment” services.

5. In any event FEE believes that the VAT system should not be used to raise taxation. Any non-deductible VAT clearly is a form of hidden taxation, as this increases distortions between businesses depending upon how they are organised, and between similar businesses operating in different Member States.

Abolition of the 8th VAT Directive 79/1072 and amending regulation to Council Regulation 218/92:

As far as the abolition of the 8th Directive is concerned, FEE believes that the existing system could and should be improved, rather than be abolished.

We understand that the Spanish administration has, amongst others, significantly simplified the procedures for making reclaims, reducing the delays in effecting refunds to non-established businesses and uses technology to a large extent.

This system called ‘IVAN’ enables businesses to make claims via the Internet, without requiring the presentation of all original invoices and where the checks carried out by the Spanish authorities are based on determined risk criteria to speed up the refund process.

We are not aware if a study has been carried out in this area to determine how and whether the existing system could be improved rather than substantially increasing business burdens by requiring businesses to comply with extra reporting requirements

Specific comments on the proposals:

The right of deduction will be granted in the Member State of the establishment of the taxpayer. This will mean that, for the same type of expense incurred in the same Member State, the amount of the actual tax recoverable will vary depending upon where the taxpayer is established. This proposal, in the new article 17,3 bis of the draft Directive will mean that where a taxpayer uses the expense for the purposes of operations carried out in more than one Member State that there will “shopping” between Member States to determine which one allows the highest level of recovery.

An example might help illustrate the point.

Supposing that France decides, after adoption of these proposals, to again limit the deduction rights on restaurant costs at say 25% of the VAT incurred – this seems to be possible under the revised article 17bis.

A business only established in France would only recover 25% of the VAT incurred. If the same expense were incurred by a business established in say Germany (where the deduction percentage is say fixed at 50%) and the Netherlands (where the deduction percentage is fixed at say 100%) and where the expenses were incurred in the negotiation of a contract which would generate taxable turnover for both the German and the Dutch establishments, the business would claim the deduction in the Netherlands and not in Germany. Compared to the French business the Dutch business has a four times greater deduction right for the same expense!

We are concerned that this type of “shopping” possibility will give rise to significant disputes as to which, where there are many establishments, is the establishment using the services. Further, what would happen where no taxable supplies are made, i.e. the expense is incurred to develop an activity which never materialises, which establishment then has the deduction right?

Similarly the notion of “principal establishment”, in the last but one paragraph of article 17,3 bis, is going to be difficult to determine without a more precise definition, i.e. number of staff, turnover etc.

1. The list of extra information to be added to the VAT declaration to obtain a refund (ex Art. 22.4) creates an additional burden for business and for administrations. The definitions are not sufficiently precise to avoid ambiguity. Code 1 " Fuel", under this category could relate to both fuel giving rise to a full deduction, eg. diesel fuel for the carriage of goods and a partial deduction – the same fuel but used in a passenger vehicle – the same remark can be made in relation to "leasing of vehicles". Code 3 refers to "short leasing of means of transport" – what does "short" mean in this context?

2. Clearly to avoid confusion, to help businesses operating in more than one country the definitions must be precise and harmonised.

3. The system of compensation between Member States as set out in the amending Council Regulation appears to us to be cumbersome – subject to significant risks of error and without the benefit of a full review to determine how the existing system might be improved – using technology – and is difficult to evaluate in terms of the impacts on business. How will national tax auditors be able to validate whether an invoice in a foreign language is a valid document, that the amount of VAT shown is correct, that the tax point rules have been correctly applied, in particular where the option in article 10,2 of Directive 77/388 has been exercised for supplies of services.

We have set out a number of comments and initial remarks in relation to the Commission's proposals and we would be pleased to discuss any aspect of this letter you may wish to raise with us in a meeting at your convenience.

Yours sincerely,

David Devlin
President