Faculty of Taxation

TAXREP 37/03

VAT: RECAST OF THE SIXTH VAT DIRECTIVE

Text of a letter submitted in October 2003 by The Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in July 2003 by the European Commission

VAT: RECAST OF THE SIXTH VAT DIRECTIVE

1. We welcome the opportunity to comment on the draft recast of the Sixth VAT Directive published by the European Commission on 25 July 2003 on their website at http://europa.eu.int/comm/taxation_customs/taxation/consultations/recast_6th/recast_6th_en.htm.

2. The invitation to comments states that it is important for Community legislation to be accessible and comprehensible to the public and economic operators, and the aim of the work is to have an effective instrument providing a clear overview of existing VAT legislation by having a coherent legal text where the structure of the existing law has been modified but the substance remains unchanged. We note that in order to improve the quality of drafting, some non-substantive amendments have been made to ensure that the text is as clear, simple and precise as possible.

3. We applaud these objectives. It is important to consolidate, in order to codify the effect of case law which has sought to clarify ambiguities and deal with situations which may not have been envisaged when the original version was drafted. In doing such a redraft it is necessary to bear in mind the needs of the users.

4. You will be aware that here in the United Kingdom, the Inland Revenue is rewriting the primary legislation covering taxes on income and capital gains, and the secondary legislation on payroll income taxes (Pay As You Earn and income tax on benefits-in-kind). This exercise, known as the Tax Law Rewrite Project, has been going on at full speed for over five years and I expect that it will take another five years. The project has benefitted from a spirit of openness: the Revenue have consulted at every stage, in some cases more than once on the same clauses, not only by way of public invitations to comment on specific proposals but also by having non-Inland Revenue people, including our own representatives, on the steering committees which are controlling the project and undertaking the detailed work. The high quality of the two Acts that have been issued so far, namely the Capital Allowances Act 2001 and the Income Tax (Earnings and Pensions) Act 2003, are generally considered to have more than justified all the effort expended.

5. We were therefore surprised that you issued an invitation to comment on such an important document as a redraft of the whole body of VAT law in the middle of the holiday season and expected comments within a two month period, and trust that you will be involving non-European Commission people and giving the project the time and expertise that it warrants in order to ensure that you arrive at the best possible replacement for the Sixth Directive.

6. We have not prepared our own critique of the recast. We endorse the comments of the Chartered Institute of Taxation in their paper submitted to you on 10 October 2003, attached in the Annex. Several people whose comments are included in the attached paper are members of both the Chartered Institute of Taxation's and our VAT committees.

14-69-13
PCB
13.10.03

ANNEX

RECAST OF THE SIXTH VAT DIRECTIVE

Response by The Chartered Institute of Taxation to the provisional draft text published by the European Commission

Introduction

1 The Chartered Institute of Taxation welcomes the proposed consolidation of the Sixth Directive. We encourage the Commission to adopt this project as a concrete intention and urge the member states to give it their enthusiastic support. The amended English language text is easier to read, although there remain some concerns regarding the clarity of some of the text. Fewer discrepancies between the different language texts will help to reduce the number of anomalies between the national VAT systems of the member states and thereby assist cross-border trading within the single market.

2 The English text of the Sixth Directive currently in force suffers from a number of deficiencies. In particular:

- Some of the articles are too long and, in the absence of sub-headings, it is sometimes very difficult to find the required information. The present art 22 is an extreme example of this situation.
- There are too many cross-references. This makes the text very indigestible.
- Essential information applicable to individual member states is set out in the various Accession Treaties.
- The system of numbering is both inconsistent and cumbersome.
- The vocabulary of the English language text sometimes diverges from current English usage.
- The English language text sometimes differs from a majority of the other language texts so that some implementing UK legislation based on the English text may not comply with EU law.
- The Second Directive is now spent as regards the present member states (see the present art 37 of the Sixth Directive). The cross-references to it are inconvenient for readers.
- The references to "ECU" and "EUA" have not yet been replaced by references to the euro.

3 A careful examination of the draft is a massive exercise. Whilst we have approached the task with enthusiasm, we are concerned that the Commission is consulting on a document that "does not necessarily reflect the final views of the Commission" and, more significantly, does not "signify that the Commission is committed to any official initiative in this area". We are also concerned regarding the tight time limit for responses, given that the consultation period spans the holiday season. We note that the UK Government code of practice on consultations recommends 12 weeks as the minimum period for consultations of this nature. Having said this, however, we are grateful for the extended deadline given for the submission of this response.

4 Our general comments are set out below. Specific comments on individual articles are set out in the Appendix.

General comments

5 The VAT Committee appears to be given a more active role, with a requirement for it to be consulted. It remains to be seen whether this has any real effect on its role.

6 We welcome the improved numbering system adopted for paragraphs and sub-paragraphs, but note one aberration. Where there are two levels, a combination of numbers (in the form 1, 2, 3 etc) and letters (in the form (a), (b), (c) etc) is normally, but not always, used. Two different systems are used where there are three levels:

- In the new art 2, for example, the sequence is unbracketed numbers (in the form 1, 2, 3 etc), bracketed numbers (in the form (1), (2), (3), etc) and bracketed letters (in the form (a), (b), (c) etc). We consider that the duplication of numbers makes cross-referencing more difficult.
- In the new art 4, for example, the sequence is unbracketed numbers (in the form 1, 2, 3 etc), bracketed letters (in the form (a), (b), (c), etc) and bracketed Roman numbers (in the form (i), (ii), (iii) etc). We prefer this system.

Whichever system is adopted, it should be used consistently.

The Chartered Institute of Taxation
10 October 2003

APPENDIX

COMMENTS ON INDIVIDUAL ARTICLES

Article 5

It would be helpful to list the countries forming the "territory of the Community".

Article 6

The new art 6 makes an explicit linkage between the VAT and customs territories of the Community. This is helpful given that special rules are necessary for goods entering or leaving a territory that forms part of the VAT territory (or customs territory) but not both. We consider that "VAT territory" is a convenient term that could usefully be used throughout the recast Directive to identify the following territories with greater clarity:

- Territories of a member state or third country forming part of both the VAT territory and the customs territory.
- Territories of a member state forming part of the VAT territory but not the customs territory.
- Territories of a member state forming part of the customs territory but not the VAT territory.
- Territories of a third country forming part of the customs territory but not the VAT territory.

Article 7

The definition of "third country" in the present art 3(1) has been deleted from the new art 7(c). There no longer appears to be a definition. However, there are references to "third country" in the new arts 16(2)(g), 19, 31, 32(2), 128(d), 141(1)(a), 358(2)(b) and 366(1).

Articles 10 and 11

The present art 4(1) ("any economic activity specified in paragraph 2") suggests that the activities listed in the present art 4(2) amount to an exhaustive list of the activities considered to be economic activities. The new art 10(1) indicates that this is not so. It provides that a person is a taxable person if he carries out an economic activity and the new arts 10(2) and 11(1) merely list certain activities that are "regarded as", "considered to be" or may be treated as, economic activities.

Although the phrase "from time to time" in the present art 28a(4) (first para) is replaced by the word "occasional" in the new art 10(3), this does not assist in determining whether a person becomes a taxable person as a consequence of a single transaction which may, or may not, turn out to be the first of an "occasional" series of transactions.

Article 15

This clarifies the present art 5(6). The new art 15 refers to "reserving" goods for private use, or otherwise "allocating" them for non-business purposes, rather than

referring to their "application" to those purposes. This makes it clear that it is the transfer of goods between business and private, not the ongoing private use, that is being taxed as a supply of goods (cf the new art 25(1) as regarding the supply of services).

Article 16

We welcome the reduction in the number of cross-references.

Article 17

We note that the word "application" in the present art 5(7)(a) has been replaced by "allocation" in the new art 17(a), which is consistent with the new art 15.

Article 18

We note that the words "of ownership" have been inserted in the English text of the new art 18 (first para).

We note that the word "recipient" in the present art 5(8) has been replaced by the word "beneficiary". This potentially changes the present meaning. It may have been intended to clarify that the directive also contemplates non-business transfers such as bequests. There is, however, a risk of confusion because of the particular meaning of "beneficiary" in domestic law.

Article 23

The new art 23(2) sets out the definition of "telecommunication services" derived from the present art 9(2)(e) (ninth indent). It is more logical to include this in a definitional article.

Article 40

The reference to the place where a person has his "permanent address or usually resides" in the present art 9(1) has been replaced by a reference to the place where he has his "domicile or habitual residence". The same phrase is also used in new arts 52(1), 53(1), 55(2) and 338(1). The concept of "domicile or habitual residence" ("domicile" and "residence habitual" in French) differs from member state to member state. In particular, "domicile" has a particular meaning in English law. The phrase causes problems when it is used in directives. There is a need for some uniform definition of what these concepts mean both as regards VAT and customs law and, no doubt, as regards other branches of EU law. In the absence of any common definition, we consider that the phrase should be avoided.

The reference to a "fixed establishment" in the present art 9(1) has been replaced by reference to a "permanent establishment". The same phrase is also used in new arts 52(1), 53(1), 55(2), 131(2) and 339. The term "permanent establishment" is a familiar concept in direct tax law by virtue of the OECD Model Tax Convention on Income and Capital. Article 5(1) of the Convention defines it as "a fixed place of business through which the business of an enterprise is wholly or partly carried on". This brings us back to "fixed establishment" in the present art 9(1) as interpreted by the Court of Justice. We consider that the change does nothing to clarify what is meant. We also regard it is a potential source of confusion: an establishment recognised as a

"fixed establishment" (now "permanent establishment") for VAT purposes will not necessarily be regarded as a "permanent establishment" for direct taxation purposes.

The criterion of "the place where the supplier has established his business" is unchanged. We note that the place where a person is "established" is relevant for a number of purposes, eg in relation to single taxable persons in the present art 4(4) (second para), now art 10(2) (second para).

Articles 41 – 55

The term "where the customer *is identified for VAT purposes*" is used in arts 41 (second para), 44 (second para), 46 (second para), 47 (second para), 50 and 51 (first para) whereas arts 52(1), 53(1) and 55 identify the entities as "taxable" or "non-taxable" persons. It is unclear why different phrases have been used.

Article 43

The difficulty in redrafting the present art 9(2)(b) lies in the absence of clarity in the phrase "having regard to the distances covered". If a flight from a place in country A to a place in country B involves over-flying country C, it is necessary to apportion the flight to countries A, B and C in ratio to the lengths of the flights over each country. The case law is unclear as to how the ratio should be applied if Country C is a third country (or international waters). For example, the distance apportioned to Country A could be either:

$$\frac{A}{A+B} \quad \text{or} \quad \frac{A}{A+B+C}$$

Article 48

The new art 48 states: "Member States need not apply VAT to that section of the intra-Community goods transport operation over waters which do not form part of the territory of the Community". This is a cumbersome way of indicating that VAT need not be applied to that part of a voyage or flight crossing waters that do not form part of the territory of the Community.

Article 52

We note that the term "consultant" in the English text of the present art 9(2)(e) (third indent) has been retained in the new art 52(1)(c), but the term "consultancy bureaux" has been changed to "consultancies". It is unclear what difference exists between a "consultant" and a "consultancy" (or, indeed, a "consultancy bureaux").

We refer you to our comments on the new art 40 regarding the terms "domicile or habitual residence" and "permanent establishment" used in new art 52(1).

Article 53

We refer you to our comments on the new art 40 regarding the terms "domicile or habitual residence" and "permanent establishment" used in new art 53(1).

Article 55

We refer you to our comments on the new art 40 regarding the terms "domicile or habitual residence" and "permanent establishment" used in new art 55(2).

Article 59

The references to "delivery" and "performance" in the present art 10(2) (first sub-para, first sentence) have been removed. This makes it clear that the new art 59 is dealing with the time when tax becomes chargeable, not the time when the legal conditions for making the supply have been met – this is dealt with in the new arts 13(1) and 23(1).

Article 74

The phrase "accounted for" in the English text of the present art 11A(3)(b) is replaced by "applying" in the new art 74(b). This change suggests that price discounts and rebates are excluded from the taxable amount if they arise under the terms of the contract between the parties. The change also suggests that it is immaterial whether credit is given immediately (ie by deduction on the invoice relating to the goods or services concerned) or subsequently (ie by means of a credit note).

Article 79

In art 79(3), the phrase "transfer of cargo" in the present art 11B(3)(b) (second para) has been replaced by "intermediate reloading". The new phrase is less clear than the old one.

Article 84

The word "information" in the English text of art 11C(2) is replaced by the word "factors" in the new art 84 (1) and (2) (first para). This follows the usage in the new art 79.

Articles 85

The word "or" at the beginning of the new art 85(b) should follow the semi-colon at the end of para (a).

Article 93

The first para provides that the Council must review the scope of reduced rates "starting in 1994". Is it necessary to include historical information of this nature?

Article 99

As a matter of English usage, the phrase "they must, in large measure, be provided …" is preferable to the phrase "they must be, in large measure, provided …" used in the new art 99(b).

Article 100

The new art 100 requires member states to "inform the Commission before 1 November 1999". We consider that the article should be drafted from a present day perspective. In effect, the article provides that the new art 98 is confined to member states who informed the Commission before 1 November 1999 and who were authorised by the Council in accordance with the new art 98 (first para).

Article 101

We note that the deadline for preparing a detailed report (ie 1 October 2002) has now passed.

Article 103

The phrase "exemptions with refund of the tax paid at the preceding stage" has been replaced by "exemptions with the right to deduct VAT paid at the preceding stage". This change reflects more accurately the mechanism for deduction of input tax. We note that the new phrase has also been used in arts 104, 106 and 107(2).

The cross-reference to art 17 of the Second Directive is replaced by the phrase "clearly defined social reasons and for the benefit of the final consumer". This is a welcome simplification.

Article 114

The phrase "contract to make up work" has been replaced by "work under a contract". The new phrase may be less immediately understandable but, as it is defined in the same way, there is no change of substance.

Article 116

The present requirement that exemptions apply subject to conditions that the member state "shall lay down" has been replaced by a requirement that the exemptions shall apply "under conditions laid down by Member States". The new text arguably removes the obligation on member state to lay down new conditions to apply the exemptions, although conditions already in place will be followed.

Article 117

The term "independent groups of persons" used in the present art 13A(1)(f) has been carried forward unchanged to the new art 117(1)(f). The term may be contrasted with the equivalent term in the French text – "groupements autonomes de personnes", ie an independent body. We consider that the English text should be amended to make clear that it is the *members* (not the group) who must be "carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons".

Article 120

The words "and factoring" included in the English and Swedish texts of the present art 13B(d)(3) have been deleted from the new art 121(1)(d) notwithstanding the recent judgment of the Court of Justice in *Finanzamt Groß-Gerau v MKG-Kraftfahrzeuge-Factory GmbH* (case C-305/01) [2003] STC 951, ECJ. The Court held that "debt

collection" included factoring and that it was accordingly excluded from exemption. We consider that the words "and factoring" should be included in all language texts rather than being deleted from the English and Swedish texts.

The term "leasing or letting" used in the new art 120(1)(l) contains a tautology. The terms "leasing" and "letting" have the same meaning in English law and identify a single concept of property transaction. The French text, by contrast, refers to "l'affermage et la location de biens immeables" and thus appears to identify two different concepts of property transaction. Both concepts should be reflected in the English text.

Article 122

We refer you to our comments on art 120 regarding the term "letting and leasing" used in the new art 122(1)(d).

Article 123

The words "out of the territory referred to in art 3 but within the Community" in the present art 28cA(a) (first para) are replaced by "out of their territory" in the new art 123(1). The word "their" creates an ambiguity. It is presumably intended to mean the *member state's* territory, but it could be interpreted as meaning the *vendor's* (or *acquirer's*) territory. If applied in the latter sense, the word "their" could have an adverse effect for certain business "customers" who are not resident in the member state of despatch. It could also open up the possibility of abuse where "new means of transport" are concerned.

Article 127

The new art 127 uses the expression "intra-Community goods transport services" rather than the expression "intra-Community transport of goods" defined in the new art 45. The present art 28cC uses yet another expression.

Article 131

It appears that the word "invoice" at the beginning of the third line of the new art 131(2) (second para) should read "an invoice".

We refer you to our comments on the new art 40 regarding the term "domicile or habitual residence" used in new art 131(2).

Article 151

The term "taxable transactions" in the present art 17(2) has been changed to "taxed transactions". The reason for this change is unclear. Taxable transactions are transactions that are capable of being taxed. The concept of "taxed transactions" gives rise to conceptual difficulties in relation to goods and services taxed at a zero- rate or denatured under, for example, the present arts 5(8) and 6(5).

Article 155

We note that the new art 155(1) applies to goods and services "used" by a taxable person whereas the present art 17(5) (first para) applies to goods and services "to be used" by taxable persons.

Article 168

The new art 168 imposes an obligation on member states to "lay down the detailed rules" for applying new arts 166 and 167. Arguably, although the procedures laid down by the member states are applied, there is currently no duty to create them.

Article 169

The phrase "… if the reference period has been extended, the corresponding fraction …" has been added to the new art 169(2). This clarifies the situation where the adjustment period has been extended from the general five years in new art 169(1).

The phrase "adjustment period" in the present art 20(2) (third para) is carried forward into art 169(1) (third para). However, as noted above, the term "reference period" has been used in art 169(2). The same term should be used in both provisions to maintain consistency.

Article 171

The phrase "suitable measures" in the present art 20(4) (third indent) is replaced by "measures necessary" in the new art 171(c). This may limit the scope for member states' measures, as they must be shown to be "necessary" to ensure unfair advantage is not created, rather than merely "suitable".

Article 172

The present art 20(5) merely requires members states to have "regard to the need to avoid distortion of competition" in order to rely on this article. In the new version, however, a member state may only rely on this article "provided there is no distortion of competition". This appears to be a more stringent test.

Article 173

The new art 173 provides that the measures taken by Member States should ensure that a taxable person does not enjoy an "unfair advantage" whereas the present art 20(6) merely requires that a taxable person should not "benefit". This change of wording may affect the manner in which the present UK legislation is interpreted.

Article 268

As a matter of style, we consider that the unnumbered first and second paragraphs of the new art 268 should be numbered (ie as arts 268(1) and 268(2)) and that the numbers used in the first paragraph should be replaced by letters (ie as art 268(1)(a), (b) and (c)).

Article 314

There appears to be an ambiguity in both the present art 26aC(7) and the new art 314. Are the goods supplied where "the sale of those goods" takes place or where the "public auction" takes place? It may be that the place is the same in both cases. However, this may not necessarily be so and it is safer to put the matter beyond doubt.

Article 323

The new art 323(1)(2) brings into a single five line paragraph the four test for investment gold coins previously shown as indents of the present art 26bA (first para, point (ii)). We consider that it is clearer to use indents.

We consider that cross-referencing would be clearer if the two sub-paragraphs of the new art 323(1) were styled as art 323(1)(a) and 323(1)(b) rather than art 323(1)(1) and 323(1)(2).

The existing art 26bA (first para, point (i), second sentence) is now art 323(2). Similarly, the existing 26bA (second para) is now art 323(3). These provisions qualify the exemptions in the new art 323(1)(1) and (2). Separating the qualifications from the paragraphs to which they relate could confuse or mislead.

Article 325

The word "the" in the second line has been transposed. For "the and importation" substitute "and the importation".

Article 331

The word "operator" in the eighth line is an odd choice of word. The proper word is "member" as it refers to a member of a bullion market regulated by the Member State concerned.

VAT may be applied to supplies by (a) a member to another member, (b) a member to a non-member, and (c) a non-member to a member. On this basis, it may be simpler to replace the first sentence as follows:

> "Any Member State may, after consulting the VAT Committee, apply VAT to specific transactions between (a) a taxable person who is a member of a bullion market regulated by the Member State concerned, and (b) a taxable person, whether or not that person is such a member."

Article 333

The new art 333(2) deals with the position of a "customer" who is not a member of a regulated gold bullion market being a "taxable person" solely in respect of an "opted" transaction in the new art 331. This appears to be at odds with the new art 10, which defines "taxable person" as being someone who carries on an "economic activity". One is either a taxable person or one is not. The proper reference should be to someone (a taxable person) who is required to be registered for VAT. Article 331 only applies where the parties are taxable persons.

Article 335

The words "be entitled" in the third line are otiose. This arises from the fact that the phrase "shall be entitled" has been replaced by the phrase "shall have the right".

Article 336

The current requirement to keep records in respect of "substantial" transactions is changed to a requirement to keep records in respect of "significant" transactions.

Article 338

We refer you to our comments on the new art 40 regarding the phrase "permanent establishment" used in the new art 338(1).

Article 339

We refer you to our comments on the new art 40 regarding the phrase "domicile or habitual residence" used in the new art 339.

Article 365

The reference to "tax evasion or avoidance" in the present art 27(1) is extended to "tax fraud or evasion or avoidance" in the new art 365(1). In UK law, the difference between "tax fraud" and "evasion" is not clear.

Article 374

The Commission is required to report every fourth year (previously every second year) on the application of the common system of VAT.

Annex I

The reference to "commercial publicity bodies" in the English text of the present Annex D point 10 has been changed to "commercial advertising agencies" in the new Annex I point 10. The new description appears to be narrower than the old in that it seems to exclude such activities as public relations. This sometimes forms part of the activity of an advertising agency but it is often carried on as an independent activity.

Annex VI

The reference to "general stock farming" in the present Annex A point II(1) is provisionally changed to "stock rearing" in the new Annex VI point 2(a). It is difficult to think of a better description, although "livestock" may be a better word than "stock". This is an appropriate word to describe cattle, sheep, pigs, etc (the animals that appear to be included). The word is not normally applied to the beasts listed separately (eg silkworms and snails).