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COMMISSION

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 395 of Council Directive 2006/112/EC

1. BACKGROUND

Pursuant to Article 395 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[1] (the VAT Directive), the Council, acting unanimously on a proposal from the Commission, may authorise 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. As this procedure provides for derogation from the general principles of VAT, in accordance with the case-law of the Court of Justice of the European Union (CJEU), the national derogating measures referred to in Article 395 of the VAT Directive which are allowed 'in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance', must be interpreted strictly and those measures must also be necessary and appropriate for realising the specific objective which they pursue and have as little effect as possible on the objectives and principles of the VAT Directive[2].

By letter registered with the Commission on 17 December 2019, Italy requested an authorisation to apply a measure derogating from Article 193 of the VAT Directive. In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 5 May 2020 of the request made by Italy. By letter dated 6 May 2020, the Commission notified Italy that it had all the information it considered necessary for appraisal of the request.

As a general rule, the person liable for the payment of VAT to the tax authorities under Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the derogation requested by Italy is to place that liability on the taxable person to whom the supplies are made (the so-called reverse charge mechanism), in the case of all contracts that involve atypical supply of staff, meaning the provision of services carried out by means of procurement contracts, sub-contracting, entrustment to consortia or other associated companies, characterized by a predominant use of labour at the customer's business premises, with the use of capital goods owned by the customer, or in any case attributable to him. The aim of the requested derogation is the fight against fraud.

2. REVERSE CHARGE

The person liable for the payment of VAT pursuant to Article 193 of the VAT Directive is the taxable person supplying the goods or services. The purpose of the reverse charge mechanism is to shift that liability onto the taxable person to whom the supplies are made. The reverse charge is often used in order to tackle VAT fraud taking place in targeted sectors of the economy, in particular through the use of 'missing trader' structures.

[1] OJ L 347, 11.12.2006, p. 1

[2] See judgment of 27 January 2011 in case *Vandoorne* C-489/09, EU:C:2011:33, paragraph 27.

Missing trader occurs when traders sell goods or provide services, collect the VAT from their customers and subsequently disappear without remitting the VAT they collected from their customers to the tax authorities. By designating the person to whom the goods or services are supplied as the person liable for the payment of VAT in such cases, the domestic reverse charge mechanism has been found to eliminate the opportunity to engage in that form of tax evasion.

3. THE REQUEST

Italy requests, under Article 395 of the VAT Directive, that the Council, acting upon a proposal of the Commission, authorises it to apply a special measure derogating from Article 193 of the VAT Directive as regards the application of the reverse charge mechanism in relation to domestic supplies of services involving the atypical supply of staff.

The request therefore covers the provision of services, carried out by means of procurement contracts, sub-contracting, entrustment to consortia or other associated companies, characterized by a predominant use of labour at the customer's business premises, with the use of capital goods owned by the latter or in any case attributable to him. It does not include supplies of services to public administrations and cases of staff leasing by the *Agenzie per il lavoro* (certified employment agencies), governed by Legislative Decree No 276 of 10 September 2003 and authorized to carry out the activity of labour intermediation and staff leasing, recruitment and outplacement.

Italy submits that the introduction of the derogating measure is necessary to fight fraud occurring in the sector of atypical supply of staff. According to the request, the pattern of the fraud involves several actors, notably the suppliers of staff, which are producers' and workers' cooperative societies, and the customers, which are usually well-established companies that subcontract the workforce they need to carry out their activities. Between both parties, there are consortia, which act as intermediary between the suppliers and the customers.

The cooperative societies invoice the services provided (the supply of staff) charging VAT on the total cost of the service. Given the nature of the services supplied (mainly, workforce), the main cost for these companies is the payment of the salaries to their workers, which does not entail any input VAT. Thus, the total amount of input VAT paid by them is very low. As a result, these companies usually have little input VAT, which they can deduct from their output VAT. This should normally lead to a position of debt towards the Treasury regarding VAT. However, it has been observed that, in practice, an important number of these suppliers of staff do not remit VAT to the Tax Authorities. In some instances, they artificially increase their input VAT in order to create a tax credit through non-existent input operations. This fictitious tax credit is used to offset[3] tax debts related to VAT, social security contributions and other taxes these companies should

[3] The offsetting of tax credits is regulated by Member States' national legislation.

withhold. In other instances, they underreport the VAT due or simply do not pay the amount of VAT due.

According to the estimates included in the request, 30% of the fraud is caused by VAT unpaid by the companies providing the atypical supply of staff, which would be affected by the reverse charge mechanism, and the other 70% is caused by fake input VAT, misused to pay social security contributions and withholding taxes on the remunerations of the contracted staff through an offsetting mechanism.

By designating the person to whom the services are supplied as the person liable for the payment of VAT, Italy would like to combat the above fraud, which occurs in the sector of atypical supply of staff.

Aside from the reverse charge mechanism, Italy will introduce other anti-fraud measures concerning other direct taxes. In particular, it will introduce a mechanism whereby the tax debt would fall on the customer rather than on the business that supplies the worker, similar to the mechanism for social security contributions. Finally, a measure prohibiting the offsetting of credits (including VAT credits) for the payment of social security contributions and withholding taxes will also be implemented. This measure will prevent that artificially created VAT credits are used for the payment of the debts related to social security contributions and withholding taxes.

4. THE COMMISSION´S VIEW

When the Commission receives requests in accordance with Article 395 of the VAT Directive, these are examined with a view to ensure that the basic conditions for granting a derogation are fulfilled, i.e. whether the proposed specific measure simplifies procedures for taxable persons and/or the tax administration or whether the proposal prevents certain types of tax evasion or avoidance. In this context, the Commission has always taken a restrictive, cautious approach to ensure that derogations do not undermine the operation of the general VAT system, are limited in scope, necessary and proportionate.

Any derogation from the system of fractioned payment can, therefore, not be more than a last resort and an emergency measure and must offer guarantees as to the necessity and exceptional nature of the derogation granted. These conditions do not seem to be met in the case at hand, for the reasons explained below.

Point (b) of Article 199(1) of the VAT Directive allows Member States to apply the reverse charge mechanism to the supply of staff engaged in the construction sector, a measure that Italy has already implemented. The request submitted by Italy in relation to the supply of staff has a much wider scope, as it would be a cross-cutting measure that would potentially affect ample sectors of the economy, applying to different production and distribution stages. It should be noted that any company in any sector of the economy could be affected, as a recipient of the service, by this measure, wherever they decide to

outsource the workforce they need for a concrete task. Further, any company providing staff as part of its business, should verify if it complies with the criteria laid down to determine when a company is providing atypical supply of staff and consequently subject to the application of the reverse charge. Thus, it is a measure of a general nature that seems not to be sufficiently targeted to combat a concrete fraud situation.

It should be noted that Italy has already been granted two special measures of a general nature to combat VAT fraud: the split payment mechanism[4] for the supplies of goods and services to public authorities, to companies controlled by public authorities and to companies listed on the stock exchange that are included in the FTSE MIB index, and the mandatory generalised electronic invoicing[5]. Granting another special measure like the one requested would imply an increased de-harmonization of the Italian VAT system from the common system of VAT established by the VAT Directive, and a further complication for businesses, increasing their administrative burden, therefore going beyond what is necessary to address a particular fraud situation. For the suppliers, they will have to verify first if the company to which they are supplying the service is a company under the scope of the split payment mechanism. If that is not the case then they will have to verify whether the supply they are carrying out qualifies as an atypical supply of staff. If that is the case they will have to apply the reverse charge mechanism; otherwise, the normal VAT arrangements apply. Therefore, they could be confronted with three possible ways to charge VAT on their daily operations, increasing the possibilities for mistakes, litigation and penalties. For the recipients of the service, they will also have to verify whether the supply they are receiving qualifies as an atypical supply of staff, potentially creating the same problems regarding mistakes, litigation and penalties.

Moreover, according to the request, the fraud the measure aims to tackle has two components. About 30% of the fraud is caused by VAT unpaid by the companies providing the atypical supply of staff , while the other 70% is caused by fake input VAT used to pay social security contributions and withholding taxes on the remunerations of the contracted staff through an offsetting mechanism. The reverse charge mechanism applied to the atypical supply of staff would only aim at tackling the 30% of the total fraud, the one stemming from the lack of payment. However, it would not avoid companies artificially increasing their input VAT to create undue tax credits for the payment of social security contributions and withholding taxes, therefore leaving unresolved 70% of the total fraud.

[4] Council Implementing Decision (EU) 2017/784 of 25 April 2017 authorising the Italian Republic to apply a special measure derogating from Articles 206 and 226 of Directive 2006/112/EC on the common system of value added tax and repealing Implementing Decision (EU) 2015/1401, OJ L 118, 6.5.2017, p. 17-19.

[5] Council Implementing Decision (EU) 2018/593 of 16 April 2018 authorising the Italian Republic to introduce a special measure derogating from Articles 218 and 232 of Directive 2006/112/EC on the common system of value added tax, OJ L 99, 19.4.2018, p. 14-15.

According to information submitted by Italy, a mechanism whereby the tax debt would fall on the customer rather than on the business that supplies the worker, similar to the mechanism for social security contributions is foreseen for direct taxes. Further, a measure prohibiting the offsetting of credits (including VAT credits) for the payment of social security contributions and withholding taxes will also be implemented. Given that such measures would tackle the most significant percentage of the VAT fraud linked to the supply of atypical staff, the introduction of an exceptional mechanism such as the reverse charge becomes more difficult to justify.

Regarding the first component of the fraud, the VAT unpaid by the companies providing the atypical supply of staff, this is a problem that should be tackled through conventional measures such as routine inspections and auditing. In this regard, the mandatory generalised electronic invoicing should be an extremely useful tool for the early detection of this fraud in order to address it.

Therefore, the measure requested by Italy does not seem limited in scope, necessary and proportionate to address the specific fraud situation linked to the atypical supply of staff. It would be advisable to analyse first the results of the measures implemented in relation to direct taxes and compensation of credits, together with the use of mandatory e-invoicing and control measures on this sector.

5. CONCLUSION

On the basis of the above-mentioned elements, the Commission objects to the request made by Italy.