COMMISSION OF THE EUROPEAN COMMUNITIES

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Request from the Dutch Government for authorization to introduce a measure derogating from the Sixth VAT Directive (77/388/EEC) pursuant to Article 27(1) and (2) of that Directive in respect of the charging of tax in the ready-to-wear clothing industry

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I.   **Introduction**

(a)   In accordance with Council Directive 77/388/EEC,[1] Member States are required to apply the common system of value added tax. Under Article 27(1) of that Directive, the Council may authorize any Member State to introduce special measures for derogation from the Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

(b)   In a letter from the Office of the Dutch Permanent Representative received by the Commission's Secretariat-General on 19 July 1994, the Commission was informed of a measure aimed at avoiding certain types of tax evasion in the ready-to-wear clothing industry.

(c)   In a letter from the Commission's Secretariat-General dated 16 August 1994, the other Member States were informed, in accordance with Article 27(3) of the above Directive, of the measure proposed by the Dutch Government. Under paragraph 4 of the same Article, the Commission or any Member State may request that the matter be raised by the Council.

II.   **Description of the measure**

In March 1982 the Dutch Government submitted, pursuant to Article 27(1) to (4) of the Sixth VAT Directive (77/388/EEC), a request for a derogation from Article 21(1)(a) of the said Directive providing for a scheme whereby the obligation to pay the VAT due from subcontractors in the building, structural engineering and shipbuilding industries can be shifted to the contractor.

Since neither the Commission nor a Member State requested that the matter be raised by the Council within the time limit laid down by Article 27(4) of the Directive, the derogatory measure requested is deemed to have been granted by the Council on 20 June 1982.[2]

A similar derogation was authorized, by Council decision of 23 November 1992,[3]

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[1]   OJ No L 145, 13.6.77, p. 1. The Directive was last amended by Directive 94/5/EC (OJ No L 60, 3.3.94, p. 16).

[2]   OJ No C 197, 31.7.82, p. 1.

[3]   OJ No L 351, 2.12.1992, p. 33.

for the ready-to-wear clothing industry. The decision enabled the Dutch Government to pass legislation introducing a scheme for transferring the charging of tax, with the obligation to pay VAT falling on the ready-to-wear firm (the contractor) and no longer on the subcontractor.

The measure now envisaged by the Dutch Government is designed to extend the scope of this scheme for shifting the payment of the tax and consists in collecting from the manufacturer's customer the VAT for which the contractor would normally be liable under Article 21(1)(a) of the Sixth Directive.

III. Commission opinion

Article 21 of the Sixth Directive establishes the principle that it is the taxable person carrying out the taxable transaction who is himself liable to pay the tax.

The Sixth Directive provides for derogations from that principle only where the taxable person is not established in the territory of the country.

As a general rule, the Commission takes the view that the designation of the person for whom the taxable transaction is carried out as the person liable for VAT must be limited to exceptional cases since it conflicts with the very principles of VAT (staggered payments, invoicing of VAT by the taxable person carrying out the transaction and deduction by the person for whom the transaction is intended).

Following authorization by the Council, the Dutch Government brought in certain provisions derogating from this principle. According to it, those provisions, which designate the person for whom the transaction is intended as the person liable for payment of the tax, were essential for combating evasion in the building, structural engineering, shipbuilding and ready-to-wear clothing industries.

Such evasion occurs when the trader effecting the supply, i.e. the subcontractor, invoices the contractor for VAT but does not pay the tax to the authorities, while the contractor, for his part, deducts the VAT invoiced to him. More often than not, the authorities are unable to recover the tax since, by the time the evasion is discovered, the subcontractor has already wound up his business and only a slight chance of recovery remains.

In the request for a derogation which it submitted in 1992 in respect of the ready-to-wear clothing industry, the Dutch Government explained that this type of evasion had been discovered in the relationship between small ready-to-wear clothing workshops (the subcontractors) and ready-to-wear clothing firms (the contractors). The authorities' chances of recovery were minimal since the workshops were often small firms which barely had their own means of production and which were established in rented industrial premises or in dwellings. Moreover, many such firms frequently changed hands.

It was to enable effective measures to be taken against this type of evasion that the derogations were granted by the Council. The Dutch Government is now

requesting an extension of the derogation with a view to enabling the manufacturer's customer (the person for whom the transaction is intended) to be designated as the person liable for payment of the tax to the authorities instead of the contractor (the taxpayer carrying out the transaction). This provision is part of new rules which the Dutch Government, at the request of the Dutch Parliament, has decided to issue in order to continue to combat tax and social security fraud in the ready-to-wear clothing industry.

However, the Commission notes that the Dutch Government no longer finds that the evasion described above (invoicing of VAT without payment to the authorities, on the one hand, and deduction of the said VAT, on the other) occurs in the relationship between the contractor and the manufacturer's customer. The difficulties of recovering VAT not paid to the authorities, which are typical of this form of evasion, do not arise as far as the contractors are concerned.

It would seem that the proposed provision is instead part of a set of measures for combating evasion in areas other than VAT.

Admittedly, the procedure provided for by Article 27 of the Sixth Directive enables Member States to introduce special measures for derogation from the Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

But the tax evasion or avoidance against which derogatory measures taken pursuant to Article 27 of the Sixth Directive can be applied are bound, given the scope of the Directive, to affect the proper charging of value added tax adversely.

The measures envisaged by the Dutch Government are thus not warranted in the context of the common system of VAT since they are designed to combat evasion which only affects areas other than VAT.

The Commission is accordingly of the opinion that a derogation from Article 21 based on Article 27 cannot be justified since the real aim pursued (combating the evasion of taxes other than VAT and of social security contributions) is neither a simplification of the procedure for charging VAT nor a means of combating the evasion or avoidance of VAT.

IV.   **Conclusion**

Since the arrangements in question give rise to fundamental objections, the Commission requests that the matter be raised by the Council in accordance with Article 27(4) of the above-mentioned Directive.

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DOCUMENTS

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