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New reporting obligations for EU financial institutions from 2024 onwards

Closing the EU VAT gap

New reporting obligations for EU financial institutions

Introduction: the VAT gap

In 2017, the European Union ("EU") suffered an estimated €137bn loss in tax revenues, due to the inability of the tax authorities to collect VAT from tax payers. One of the causes of this so-called VAT gap is VAT fraud in e-commerce. For tax authorities, it is becoming more and more difficult to monitor and appropriately tax (e-commerce) transactions. This is because tax authorities increasingly need to collect VAT from merchants who are established abroad, partly as a result of the macro-economic effects of globalization, digitization, rise of new economic models such as the platform, gig, and sharing economy, and the shift from origin-based taxation (taxation in the country of the merchant) to destination-based taxation (taxation in the country of consumption).

New measures for better collaboration

As part of a wider package to solve the VAT gap, and in particular VAT fraud in e-commerce, the European Parliament has adopted a Commission Proposal introducing new measures aimed at 'improving the cooperation between tax authorities and financial institutions'. Financial institutions will be required to report merchant payment data to their local tax authorities on a quarterly basis. Local tax authorities will share the payment data with other EU countries through a central database called CESOP (Central Electronic System Of Payment information). The "go-live" date of this reporting obligation for financial institutions will be 1 January 2024, two years later than originally planned.

What are these new reporting obligations for EU financial institutions – and are they proportionate, enforceable and effective?

A closer look at the new reporting obligations

Who should report?

The reporting obligation applies to "payment service providers" as defined in the updated Payment Service Directive (PSD2) - credit, electronic money, post office giro and payment institutions. In practice, banks, card schemes, merchant acquirers and CPSPs will likely be affected the most, as well as retailers and marketplaces that have their own "inhouse" payment service provider governed by PSD2.

Based on the language used in the legislative documents, we believe that the reporting obligation will not apply to financial institutions outside the EU.

Where to file?

The report must be filed with the tax authorities in the "home member state" where the financial institution has its registered office or in the "host member state" where the financial institution provides payment services.

What transactions?

The reporting obligation only applies to cross-border payments. A variety of "payment services" from PSD2, including direct debits, card payments and credit transfers, must be reported when funds are transferred by a "payment service provider" from a payer who is located in an EU member state to a payee (the intended recipient of the funds) who is located in another country – either inside or outside the EU.

The reporting obligation does not apply to the payer's financial institution if he is able to prove that at least one of the payee's financial institutions is in the EU.

A threshold of 25 payment transactions to the same payee in the course of a calender quarter has been proposed – under which payment information does not need to be reported. The location of the payee and payer is determined by the BIC and IBAN codes.

What data?

The purpose of information that needs to be included in the register is to establish the location of the payee, the identity of his or her payment service provider and the executed payment transactions (see table on the next page). This data must be stored for three years.

Required details for reporting

- BIC or any other business identifier code that unambiguously identifies the payment service provider
- Name or business name of the payee
- Any VAT identification number or national tax number of the payee
- IBAN or, if unavailable, any other payment account number identifier that unambiguously identifies the the payee and his location
- BIC or any other business identifier code that unambiguously identifies the payment service provider acting on behalf of the payee, where the payee receives funds without having any payment account
- Address of the payee if available in the records of the payment services provider
- Any executed payment transactions and chargebacks, including:
  - Date and time of the execution of the payment transaction or payment refund;
  - Amount and currency of the payment transaction or payment refund;
  - Member state of origin of the funds received by the payee or on his behalf, the member state, third territory or third country of destination of the refund, as appropriate, and information used to determine the origin or the destination of the payment transaction or payment refund.
  - Any reference which identifies the payment
  - Where applicable, information that the payment is initiated at the physical premises of the merchant.

Are the measures proportionate, enforceable or even effective?

The measures are especially relevant for business to consumer ("B2C") transactions, since in most cross-border business to business ("B2B") transactions, VAT is reported by the business customer rather than first paid by the business customer to the merchant and then reported by the merchant to the tax authorities, so the risk of VAT fraud is substantially lower. Once analyzed, the data provided to tax authorities can provide them with insights and serve to detect fraudulent tax payers that have not reported VAT for corresponding B2C e-commerce transactions.

Wider scope

However, the scope of the reporting obligation is much wider than merely B2C e-commerce transactions. It includes all cross-border payments, both B2C and B2B, even point-of-sale payments, whether or not there is an element of VAT in the payment processed by the financial institution. Not all payments have an element of VAT payable, due to exemptions (e.g. financial services) or because the transaction is not in scope of VAT at all (e.g. dividend payments, repayments of loan principal). We would expect that this category of non-taxable transactions is substantial both in a relative and an absolute sense. Therefore, there seems to be quite an onerous requirement to report all cross-border payments where only B2C e-commerce transactions are targeted.

EU tax legislation vs. national tax legislation

Such a generic collection of information regarding the tax position of third parties is often not allowed under national tax legislation. National tax legislation generally does not allow "fishing expeditions", but requires a targeted investigation based on grounded suspicions of tax underpayment. The European Commission aims to circumvent these stricter local rules with the new harmonized rules on an EU level. However, it is questionable whether the proposed measures are in line with the principle of proportionality, which is an integral part of EU law and of the national laws of the member states.

More challenges

We expect that it will be challenging for tax authorities to reconcile the amounts that are reported by financial institutions with the amounts reported by tax payers in their VAT return. First, because – as mentioned in this Point of View – both payments relating to taxable and non-taxable transactions will be reported. Second, because the payee is not necessarily the tax payer who is obligated for payment of VAT to the tax authorities, e.g. due to consolidated VAT reporting by VAT groups, VAT fictions, third party payments, or reverse charged VAT. The Commission Proposal does not address how to handle this issue and in turn raises the question of how effective the proposed measures will be.

Applicability

The reporting obligation in principle applies to all financial institutions in the payment chain. The relief for the payer's financial institution where the payee's financial institution is in the EU was introduced in the second version of the proposal. It limites the administrative burden to some extent, but does not prevent that the same information will be reported multiple times if the payment chain involves intermediate parties. This seems unnecessary and disproportionate.

Also, it is not clear whether or not transactions that are reported multiple times by various financial institutions are consolidated in the CESOP database and identifiable as one and the same transaction.

These issues of double reporting could perhaps have been avoided or substantially mitigated by making only one financial institution in the payment chain responsible for the reporting, with a ranking order if not all financial institutions are EU-based.

View of the industry
In addition to the concerns raised in this Point of View, a few other parties have voiced theirs as well. Several industry bodies argue that the new reporting obligation places a huge burden on PSPs and that the industry has not been sufficiently consulted. In our discussions with industry players, we have found that it will be quite a burden for the responsible parties to change their administration and IT systems in order to comply with the new reporting obligation.

Alternative ways to fight VAT fraud

A number of countries outside the EU, such as Colombia and Argentina, have already implemented measures that are more drastic than the Commission Proposal. They have appointed financial institutions as tax collection agents for VAT and other taxes. In other jurisdictions, such as Thailand and Mexico, proposals have been released to appoint financial institutions as VAT-collection agents.

VAT split payments
The European Commission previously considered – but ultimately disregarded – a more rigorous alternative, called VAT split payment. The split payment model refers to a VAT collection method consisting of, in principle, the net taxable amount of a supply being paid to the supplier whilst the VAT amount due on the supply is directly paid to a designated account of the tax authorities (with or without the use of financial institutions). An earlier Deloitte study concluded that the benefit in terms of reductions of the VAT gap are not unequivocally higher than the costs imposed on businesses and public bodies (both administrative costs and cash flow impacts) and are even outweighed when applied to the entire volume of transactions. However, multiple EU jurisdictions (e.g. Poland and Italy) are unilaterally implementing (or considering implementation of) this collection method for certain types of transactions.

Closing remarks

The new EU reporting obligation for financial institutions fits into a wider trend of governments pushing responsibilities around tax reporting and tax collection to businesses - once the exclusive domain of tax authorities. If the policymakers consider this initiative to be successful, we would not be surprised if the reporting obligation for financial institutions is expanded for purposes beyond combatting VAT fraud in e-commerce.

Financial institutions that are affected by these measures, should actively start preparing for the change and should assess whether their administration and IT systems can produce the required reporting data. Many businesses are running or are planning to execute finance transformation programs – we recommend that these new reporting obligations are given some consideration as to how they fit into reporting systems and infrastructure.

Although we understand the desire to obtain more insight into payments received by businesses to help close the VAT gap, the new measures do raise concerns about their effectiveness, enforceability and proportionality. In our view, the European Commission should have sought input from the industry to come to more targeted, proportionate and effective measures. Now that the proposal has been adopted, at the very least, the European Commission should clarify a few important aspects of the new rules in light of the observations mentioned in this Point of View.

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