

# European Commission again objects to Latvia's request for reverse charge VAT (2/4/18)

In last week's edition of **Flash News** we informed our MindLink.lv subscribers that on 12 January 2018 the European Commission refused Latvia's request for reverse-charge VAT on domestic supplies of consumer electronics and household electrical appliances. A week or so later the Commission again objected to Latvia's request for reverse-charge VAT, this time on domestic supplies of construction products. Let us take a closer look.

The goal is to minimise fraud

Given the large number of fraud cases, Latvia has adopted reverse-charge VAT on construction services. The responsible Latvian agencies claim that this step has reduced VAT fraud in this sector. However, Latvia recognises that after the adoption of reverse-charge VAT there has been a rise in VAT refunds to taxable persons in the construction products sector, which may be partly due to a rise of fraud in supplies of construction products. Latvia believes that some of the registered taxable persons in the building trade are not acting in good faith and are not disclosing the real volumes of construction products used in supplying construction services.

According to the information provided by Latvia, similar to other sectors, taxable persons in the building trade are using the same methods for evading VAT:

- a) they overstate their deductible input tax;
- b) their suppliers of construction products are questionable (the "missing trader"), and the origin of goods cannot be identified; and
- c) they acquire construction products from buffer entities and then deduct input tax.

Latvia also recognises that the building trade has the highest percentage of shadow economy, i.e. businesses are not reporting their income and are paying cash in hand.

In its request of 12 October 2017 to the Commission, Latvia stated that the person to whom goods or services are supplied will become responsible for paying VAT to the government. By adopting reverse-charge VAT on domestic supplies of construction products from 1 January 2018, Latvia wants to fight fraud in the building trade.

The Commission's view

The Commission explains that the adoption of reverse-charge VAT should be considered only if the goods cannot enter final consumption at the same time, a bad taxpayer is replaced with a trusted one, and there is no risk of fraud at retail level or in other member states that are not using this scheme.

The Commission notes that the goods may be intended for private consumption, thus creating the risk of fraud moving down the supply chain, which would be even more difficult to control. Moving the entire VAT payment obligation to the last link in the chain would increase this risk. There is also the risk that fraud will move to other member states.

The Commission also explains that reverse-charge VAT is not a long-term solution and cannot replace proper control measures for this sector and for taxable persons. Although Latvia claims in its request that it has adopted a wide range of control measures for fighting VAT fraud, it fails to cite the reasons why such control measures might not be sufficient to fight fraud in the construction products sector. However, Latvia has not specified exactly what measures have been or will be taken to fight fraud in this sector.

According to the information provided by Latvia, several types of fraud have been detected in the construction products sector. Although a domestic reverse-charge VAT scheme is effective to fight the missing trader fraud, this is not an appropriate tool for fighting other types of fraud, such as non-disclosure of quantities purchased. So the measure being requested by Latvia will not be the best solution to the fraudulent situation in the construction products sector.

Since the Commission has found that Latvia's adoption of reverse-charge VAT could adversely affect fraud at retail level and in other member states, the Commission's report of 18 January 2018 objects to Latvia's request for reverse-charge VAT on domestic supplies of construction products, because this measure would not be the best tool for eliminating the complicated fraud in this sector.

Considering the Commission's two objections to reverse-charge VAT on domestic supplies, we have to agree with the Commission that the Finance Ministry and the State Revenue Service have an insufficient range of control measures for preventing VAT fraud and they want to transfer all the VAT obligations to the retail sector, which could open up new opportunities for VAT fraud.

However, taxable persons that make domestic supplies of goods attracting reverse-charge VAT should monitor the Finance Ministry's next steps in order to prepare themselves for any proposed amendments or for the Commission's approval for the adoption of reverse-charge VAT.