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DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

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VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 1073

NEW LEGISLATION

MATTERS CONCERNING THE IMPLEMENTATION OF RECENTLY ADOPTED EU VAT PROVISIONS

ORIGIN:	**Commission**
REFERENCES:	**New Articles 284, 284a-284e, 288, 288a, 290 and 292a-292d of the VAT Directive** **New Articles 17(1)(a) and (2), 21(2b), 31(2a), 32(1) and 37a-37b of the VAT Administrative Cooperation Regulation**
SUBJECT:	**The SME scheme updated as of 1 January 2025**

1. INTRODUCTION

The date of implementation of the changes introduced by Council Directive (EU) 2020/285[1] to the special scheme for small enterprises is fast approaching. The VAT Committee has already discussed certain aspects of these changes in response to questions put forward by individual Member States. That has resulted in various guidelines being agreed.

Alongside this, work is ongoing to assist Member States in putting in place the IT systems needed for the operation of the updated scheme. In view of questions raised in that context, the Commission services believe it may be useful to look at the entire scheme as updated and its future functioning in view of addressing any issues there may still remain to be addressed.

2. SUBJECT MATTER

The burden derived from the need to observe the various obligations associated with VAT generates a cost of compliance for businesses. For small businesses (‘SMEs’), the compliance cost is proportionally higher and particularly onerous as these are businesses with limited resources.

The special scheme for small enterprises (‘SME scheme’) to be found in Title XII, Chapter 1, of the VAT Directive[2] is designed to ease the burden of compliance on SMEs in dealing with VAT. It currently allows Member States to (i) provide for simplified procedures for charging and collecting VAT; and (ii) exempt SMEs with an annual turnover below a certain threshold from charging and deducting VAT or grant a graduated tax relief.

From the outset, the provisions of the SME scheme were designed for a common system of VAT based on taxation in the Member State of origin. The current SME scheme therefore only allows for an exemption to be granted to enterprises established in the Member State in which the VAT is due. Those provisions are outdated and the shift to taxation at destination has only added to the negative impact that the limitation in access to the SME exemption has on competition in the internal market for SMEs not established in that Member State compared to SMEs that are established there[3].

The reform brought about by Directive 2020/285 seeks to address this. This still leaves it optional for the Member State in which the VAT is due to grant exemption to the supply of goods and services made by SMEs established within its territory (‘domestic exemption’) but once applied the Member State concerned is required to extend that

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1 Council Directive (EU) 2020/285 of 18 February 2020 amending Directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises and Regulation (EU) No 904/2010 as regards the administrative cooperation and exchange of information for the purpose of monitoring the correct application of the special scheme for small enterprises (OJ L 62, 2.3.2020, p. 13).

2 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

3 See recital 4 of Directive 2020/285.

exemption to supplies made within its own territory by SMEs established in other Member States ('cross-border exemption').

While focus of this paper is mainly on the cross-border exemption being introduced, it will also be an occasion to look at the update made to the rules governing the domestic exemption.

3. BACKGROUND

When it comes to taxation, the need to alleviate the burden of compliance faced by SMEs is ever present. Before agreeing common rules governing VAT at EU level, there will have been Member States that had already put in place schemes aimed at easing the burden of compliance associated with the collection of VAT.

From the outset, the Second VAT Directive[4] left it for Member States, subject to consultation, to apply to small enterprises the special system best suited to their national requirements and possibilities. With the adoption of the Sixth VAT Directive[5], steps were taken to include a special scheme for small enterprises, that is the SME scheme. While that scheme provides for common rules, it still leaves room for Member States to continue to apply the schemes already in place, subject to these being in accordance with the said SME scheme[6].

It has left a patchwork of schemes. By updating the SME scheme and bringing it into line with the principle of taxation at destination, Directive 2020/285 will transform it into what can be seen as a common scheme.

4. COMMISSION SERVICES' OPINION

Directive 2020/285 introduces changes to the SME scheme which will apply with effect from 1 January 2025. With these changes, a common framework governing the exemption is being established. This will see the SME scheme transformed into a common scheme akin to other special schemes.

4.1. General points

Most of the special schemes laid down by the VAT Directive are mandatory for Member States to implement. The SME scheme stands out as it is <u>optional</u> for Member States to apply. That is so under *current rules*, and it will continue to be the case with *the future rules*. While not obliged to put in place an SME scheme, all Member States are currently doing so. Whilst almost all are applying an exemption, there are only few availing of a graduated tax relief. From 1 January 2025, the use of the graduated tax relief will no longer be possible.

4 Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax (OJ 71, 14.4.1967, p. 1303), see in particular Article 14.

5 Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (OJ L 145, 13.6.1977, p. 1), see in particular Article 24.

6 See recital 49 of the VAT Directive.

Some of these special schemes are also mandatory for taxable persons. That is not the case with the SME scheme which is also optional for taxable persons to apply as also confirmed by Article 290 of the VAT Directive leaving it open for them to opt for the normal VAT arrangements or for the simplified procedures (*first sentence*). This is the case under *the current rules* and will continue to be so also *in future* clarifying that it will be for Member States to lay down the detailed rules and conditions for applying that option (*new second sentence*). Member States are not able to rely on this to deviate from the rules laid down for the workings of the SME scheme itself.

4.1.1. Territorial scope

Currently, the SME scheme applied by a Member State is limited in scope to taxable persons established within the territory of the Member State concerned. When *in future*, the SME scheme will also be opened to taxable persons established in other Member States, that raises the question of taxable persons whose establishment is in Northern Ireland.

Following the departure of the UK, Northern Ireland remains subject to a limited set of EU rules related to the Single Market for goods and the Customs Union. That includes the common VAT rules applying to goods but not services. As a result of the Windsor Agreement[7], the EU SME scheme will however not apply to cross-border supplies of goods made to or from Northern Ireland. For supplies of goods and services made by a taxable person who is established in Northern Ireland, the UK SME scheme will instead apply subject to respect of the EU threshold for the size of SMEs.

This entails that a taxable person established in Northern Ireland making supplies of goods taxable in a Member State will not have access to exemption under the EU SME scheme. It will see both supplies of goods and services excluded from the cross-border exemption. In the same vein, taxable persons established in a Member State will not be able to access the cross-border exemption for supplies made in Northern Ireland.

4.1.2. Scope of application

Should a taxable person apply the SME scheme, it will in principle see all output transactions of that taxable person fall under that scheme. Contrary to what is the case under the special scheme for second-hand goods, works of art, collectors' items and antiques[8], it is not possible for the taxable person to opt for the normal VAT arrangements to be applied to individual transactions. That is so under *current rules* and will continue to be so *in future*.

That does not entail that all transactions are or will necessarily be eligible for exemption under the SME scheme. In fact, certain transactions are or may be excluded by way of Article 283 of the VAT Directive. Hence, the SME scheme comes with limitations.

4.1.3. Transactions excluded

Currently, occasional transactions, exempt cross-border supplies of new means of transport and supplies of goods and services carried out by a taxable person not

7 See *Press Release on New way forward on the Protocol on Ireland/Northern Ireland* and *Factsheet to the Windsor Framework*.

8 See Article 319 of the VAT Directive.

established in the Member State where VAT is due cannot benefit from the scheme. Other transactions may be excluded by Member States. This will not change *in future* except for supplies of goods and services made by non-established taxable persons for which access to exemption will be granted (cross-border exemption).

Figure 1: Transactions continuing not to be covered

SME scheme

Transactions excluded:

- Occasional transactions
- Exempt supplies of new means of transport made to another Member State
- Supplies of other goods and/or services excluded by the Member State concerned

Occasional transactions are not subject to VAT except where a Member State takes up the option laid down in Article 12 of the VAT Directive. It is an option which allows for Member States to regard as a taxable person anyone (not already regarded as such) who, on an occasional basis, carries out transactions relating to activities capable of qualifying as economic activity. It is relevant in particular to the supply, before first occupation, of a building or parts of a building or the supply of building land.

Should a Member State avail of that particular option, that will see VAT applied to the occasional transactions concerned which in turn would be barred from the SME exemption under Article 283(1)(a) of the VAT Directive. Had a person who carries out transactions on an occasional basis been able to benefit from exemption under the SME scheme, this could have deprived the option laid down in Article 12 of the VAT Directive of its intended utility. Should there be no desire to tax occasional transactions, the Member State could simply refrain from taking up this option.

Most transactions undertaken by taxable persons are unlikely to have been carried out on an occasional basis. If the supply, before first occupation, of a building or parts of a building and the land on which the building stands and of building land (given as a typical example of what may be an occasional transaction) is to be excluded from the SME scheme in full, the Member State concerned will have to exercise the option laid down in Article 283(2) of the VAT Directive.

Where new means of transport are supplied to another Member State, the supply is exempt with a right of deduction under Article 138(1) or (2)(a) of the VAT Directive. This serves to assure that such means of transport, the acquisition of which will be taxed in the Member State of arrival are not burdened by sticking VAT. Where a new means of transport is supplied by a taxable person whose supplies fall under the SME scheme, this would see the supplier deprived of the right to recover the VAT. To avoid double taxation from arising, any supply of a new means of transport made to another Member State is therefore excluded from the SME scheme by way of Article 283(1)(b) of the VAT Directive.

The scope of this exclusion is limited to *new* means of transport *supplied to other Member States* as only such supplies will be exempted under Article 138(1) or (2)(a) of the VAT

Directive. Unless explicitly excluded by the Member State concerned, other supplies of means of transport are therefore admitted under the SME scheme.

Should goods or services be supplied by a taxable person not established in the Member State where VAT is due, those supplies are *currently* excluded from the SME scheme by way of Article 283(1)(c) of the VAT Directive. With the shift to taxation at destination, this exclusion was not found sustainable and *in future* supplies in one Member State by a taxable person established in another Member State will be admitted to the SME scheme. To that end, the said Article 283(1)(c) is deleted.

Other than transactions excluded as a rule, Member States may, as permitted under Article 283(2) of the VAT Directive, decide to exclude any supplies of goods or services of their choosing. Had Member States not been given this option, it could have seen them refrain from putting in place an SME scheme. This is therefore an option which remains in place. Where this option is exercised, it can however be a source of complication *now* but even more so in *future*. It can deprive the SME scheme of its intended simplification as taxable persons with supplies eligible for exemption may at the same time have to apply the normal VAT arrangements. When *in future* the SME scheme is opened to taxable persons established in other Member States, it can also be a source of complication. For the sake of simplicity, the best practice going forward would seem for Member States to refrain from taking up this option or to apply it with moderation.

4.1.4. Interaction with other special schemes

As with any of the other special schemes, it should be clear that to the extent that it is not an independent and exhaustive tax scheme aspects not covered by the provisions of the SME scheme may need to be settled by the normal rules[9].

Another question is how the SME scheme interacts with the various other special schemes laid down by the VAT Directive. Those are:

- the flat-rate farmers' scheme (Articles 295 to 305),
- the travel agent scheme (Articles 306 to 310),
- the second-hand scheme (Articles 311 to 343),
- the investment gold scheme (Articles 344 to 356),
- the Union One-Stop Shop (Union OSS) and the Import (IOSS) schemes (Articles 357 to 369zc).

As regards the flat-rate farmers' scheme, this is a special scheme which Member States may apply where the application to farmers of the normal rules and the SME scheme is likely to give rise to difficulties. With that in mind and also given the treatment afforded under the flat-rate farmers' scheme, it is difficult to see any scope for overlap. In fact, while aiming at farmers, it is an alternative to the SME scheme but still targets only those who are small in size[10].

[9] CJEU, judgment of 19 December 2018, *Skarpa Travel*, C-422/17, EU:C:2018:1029, paragraphs 27-29.

[10] CJEU, judgment of 12 October 2017, *Shields & Sons Partnership*, C-262/16, EU:C:2017:756, paragraph 33.

Under the second-hand scheme, VAT is calculated on the basis of the margin. The question is whether when determining - based on a calculation of the turnover[11] - if the SME scheme applies, it is possible to rely on what is the turnover made under the second-hand scheme given that this is calculated solely by reference to the profit margin achieved. This has been settled by the Court of Justice of the European Union (the CJEU) which, by its ruling in *B (Turnover of a second-hand car dealer)*[12], has confirmed that the schemes are autonomous and while the SME scheme is intended to support the creation, activities and competitiveness of small enterprises, it should not give way for larger enterprises to gain an unjustified competitive advantage. Therefore, the turnover should, according to the CJEU, be calculated on the basis of all amounts (exclusive of VAT) received or to be received, without it being reduced by the amounts paid as would be the case if instead reference would have been made to the profit margin. This is relevant for the second-hand scheme but equally to the travel agent scheme which also taxes on the basis of the profit margin.

The investment gold scheme which provides for an exemption with right of deduction, is mandatory for Member States to apply. There could be an overlap but then only if the taxable person is also involved in activities not falling under the investment gold scheme. The turnover should be calculated on the basis of all amounts (exclusive of VAT) received or to be received. Just as with other transactions exempt with right of deduction, it makes sense for amounts derived from transactions falling under the investment gold scheme also to be included.

The Union OSS scheme provides simplified declaration and payment of VAT for certain cross-border transactions. It compares to the SME scheme in that it allows taxable persons established within the Union to interact with their Member State of establishment only. While interaction between the Union OSS and the SME schemes is possible, the IOSS scheme and the SME scheme are mutually exclusive. For more on the interaction, see separate Working paper[13].

4.2. The SME scheme: enter

Member States might encounter difficulties in applying the normal VAT arrangements to small enterprises. Article 281 of the VAT Directive therefore allows them, by reason of the activities or structure of such enterprises and subject to consultation of the VAT Committee, to apply simplified procedures for charging and collecting VAT, such as flat-rate schemes. Such procedures which may not lead to a reduction in the VAT collected will apply subject to such conditions and limits as set by the Member State concerned.

The main feature of the SME scheme, as set out in Articles 282 to 294 of the VAT Directive, is however the exemption which can be granted to small enterprises with a view to reducing the compliance burden derived from having to collect VAT. That is done by granting an exemption from VAT to small enterprises whose output will not be taxed while the VAT paid on input cannot be deducted. The final stage of consumption is thus

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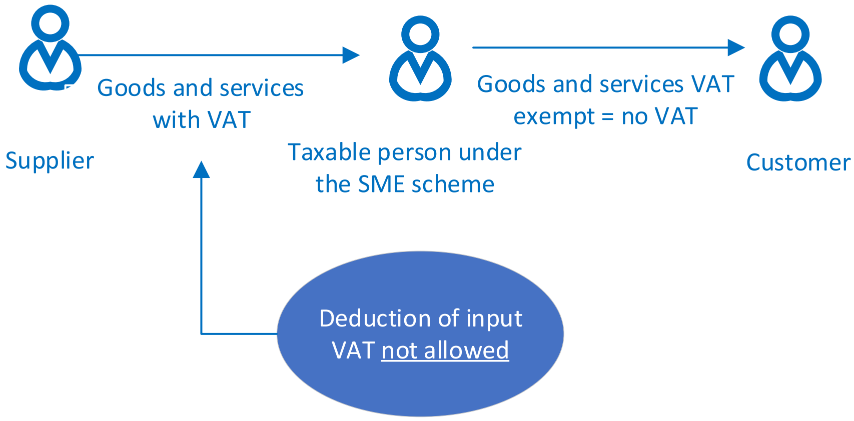
11 Based on Article 288, first paragraph, point (1) of the VAT Directive.

12 CJEU, judgment of 29 July 2019, *B (Turnover of a second-hand car dealer)*, C-388/18, EU:C:2019:642.

13 Working paper No 1069 *The special scheme for small enterprises: interaction with the One-Stop-Shop Union scheme and the Import One-Stop-Shop non-Union scheme.*

deemed to have been reached already at the level of the exempt taxable person and the last transaction to the customer is disregarded for VAT purposes.

Figure 2: Workings of the SME scheme



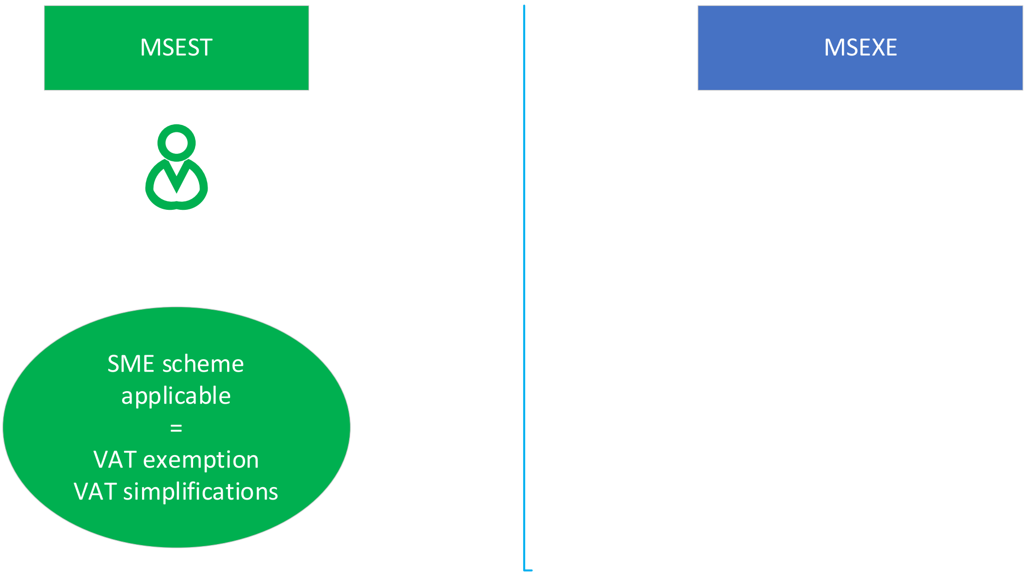
4.2.1. Domestic exemption (existing feature)

Current rules already allow Member States to exempt the supplies of goods and services by taxable persons whose annual turnover is below a certain threshold (or to grant a graduated tax relief). The granting of exemption comes with loss of the right of deduction as can be seen from Article 289 of the VAT Directive which stipulates that taxable persons benefiting from this exemption will not be eligible for deduction.

For setting the threshold for the exemption, Member States are faced with a cap of EUR 5 000 set by Articles 284 and 285 of the VAT Directive, although, under Article 286 of the VAT Directive, those who upon adoption (in 1977) applied a threshold of EUR 5 000 or above may raise it to maintain its value in real terms. For Member States having acceded the European Union subsequently (1978 onwards), higher thresholds have been granted. These are listed in Article 287 of the VAT Directive. As a sign that the current framework is outdated, a considerable number of Member States have by way of derogation granted under Article 395 of the VAT Directive been authorised to apply a higher threshold[14]. In updating the rules on thresholds, it is acknowledged that continuing to modify general rules using measures granted by way of derogation is not appropriate[15].

[14] Altogether 16 Member States (see VAT derogations schedule).
[15] See recital 7 of Directive 2020/285.

Figure 3: Domestic exemption



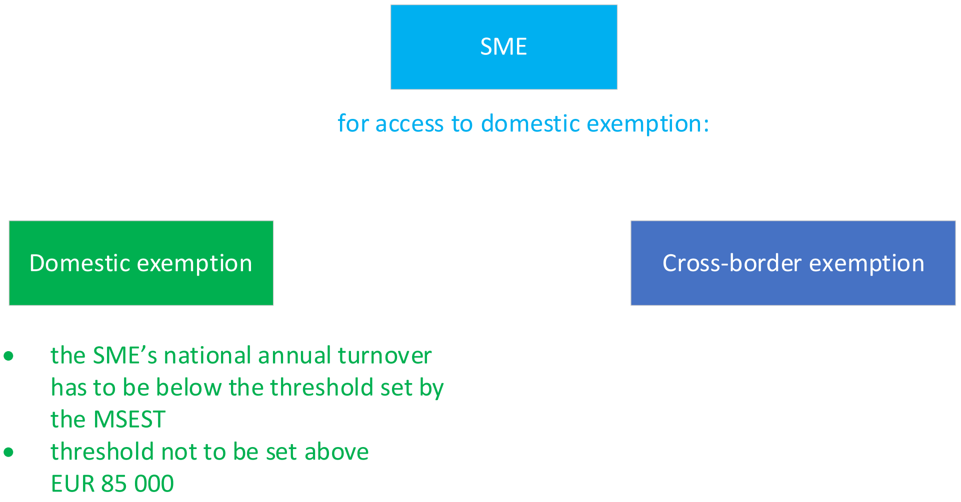
For the domestic exemption, *future rules* will not bring about major changes (apart from the abolition of the graduated tax relief[16]). As is the case today, Member States may continue to apply such an exemption. Given that it is optional, Member States are however under no obligation to put in place this exemption nor are taxable persons eligible required to avail themselves of the exemption. The addition of a measure to allow for the gradual transition from exemption to taxation is however a new feature[17].

Most of the rules by which Member States currently must abide in setting their threshold were put in place in 1977. Those rules are outdated as illustrated by the fact that many Member States have been allowed to apply a threshold that is higher than the basic threshold of EUR 5 000, either based on a measure of permanent nature granted upon their accession or by way of derogation on a temporary basis. It is a point addressed by the *future rules*.

[16] Recital 17 of Directive 2020/285 makes it clear that graduated tax relief is a source of complexity and contributes little to reducing the compliance burden of small enterprises. It has therefore been removed.

[17] See section 4.4.2.a), i) *Transitional measure*.

Figure 4: Conditions to be met



Should a taxable person not avail itself of the exemption in its Member State of establishment (MSEST) or would it be subject to the normal rules as the threshold for the exemption is exceeded, the taxable person might be eligible for deduction. If the taxable person opts for exemption in any other Member State(s) (MSEXE), it should however be clear that to obtain deduction of VAT incurred on inputs procured in the Member State of establishment, those inputs must be connected with taxed supplies. There would be no right of deduction where such inputs are linked to exempt supplies in other Member States[18].

It is up to the taxable person to decide in which Member States to avail of the exemption. Should inputs be procured in a Member State for which the taxable person decides not to avail of the cross-border exemption but has taxed transactions, it is in equal measure so that the VAT incurred on the inputs there can only be deducted if those inputs are connected with taxed supplies.

a) Scope of the domestic exemption

Under *current rules*, the exemption applies to the supply of goods and services carried out by taxable persons other than those not established in the Member State where the VAT is due[19]. That follows from Article 283(1)(c) of the VAT Directive which excludes non-established taxable persons from the benefit of the exemption. It has left room for Member States to consider the exclusion not applicable where a taxable person has a fixed establishment within their territory.

With the *new rules*, it is explicitly specified, under the new Article 284(1) of the VAT Directive, that this (domestic) exemption applies to goods and services supplied by a taxable person established within the Member State where the VAT is due (*first subparagraph*) while for any other Member State, it will be the cross-border exemption that applies (new Article 284(2) of the VAT Directive). In view of these rules, the VAT Committee already had the occasion to discuss what it takes for a taxable person to be

[18] See recital 5 of Directive 2020/285.

[19] Where an exemption applies, VAT will still be due. As a result of the exemption, no VAT will however be payable. The reference to the Member State where VAT is due thus translates into being the Member State in which the place of supply is located.

seen as established in a Member State[20]. That place will be in the Member State where the functions of the taxable person's central administration are carried out, as determined based on criteria equivalent to those laid down in Article 10(2) and (3) of the VAT Implementing Regulation[21]. That is then the place of business (siège) of the taxable person of which there can only be one.

b) Level of threshold

The new Article 284(1) of the VAT Directive also provides a common framework for the exemption by setting the upper level for the annual turnover threshold at EUR 85 000 for all Member States (*second subparagraph*). It will still be for each Member State, subject to that upper level, to set the national threshold(s) that best suit(s) its economic and political conditions. Insofar as the value of the supplies made by a taxable person established in a Member State does not exceed its domestic threshold, exemption will be available[22].

It is explicity stipulated that the threshold(s) set by a Member State may not differentiate between taxable persons who are established and those who are not established in that Member State (*fourth subparagraph*). Had that not been so, it could leave scope for undermining of the freedom of establishment as it would see taxable persons making like supplies treated differently depending on where established.

The annual turnover serving as a reference for the exemption consists of the amounts listed in the new Article 288 of the VAT Directive[23]. When calculating the turnover, the following amounts must be included (*paragraph 1*):

(a) supplies to be taxed if not made under the SME scheme;

(b) zero rated transactions (Article 98(2) or Article 105a);

(c) exempt export transactions and transactions treated as exports (Articles 146 to 149 and Articles 151, 152 and 153);

(d) exempt intra-EU supplies (Article 138) ;

(e) real estate transactions and exempt financial transactions (Article 135(1)(b) to (g)) and insurance and reinsurance services unless ancillary.

Calculation of the turnover under the new Article 288 of the VAT Directive is based on the amount attributable to (most) supplies made by the taxable person. That includes not only the supplies that would have been taxed if not falling under the SME scheme

[20] Discussed by the VAT Committee at its 121st meeting based on Working paper No 1051 *The new special scheme for small enterprises and fixed establishments*.

[21] Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax (recast) (OJ L 77, 23.3.2011, p. 1).

[22] This is subject to any use made by that Member State of the option provided for under Article 283(2) of the VAT Directive to exclude transactions from exemption under the SME scheme. This exemption in any event does not, by way of Article 283(1)(a) and (b) of the VAT Directive, apply to transactions carried out on an occasional basis or to the supply of new means of transport.

[23] See also section 4.3.b), ii) *Details on reporting*.

(*point (a) of paragraph 1*) but also transactions benefiting from a zero rate (*point (b) of paragraph 1*) and certain exempt transactions (*points (c), (d) and (e) of paragraph 1*).

It is not possible for this calculation to split the value of a supply made up by more components if it qualifies as a single supply[24]. That could for example be so if the supply is made to the same purchaser, comprised by two or more items, linked by their nature and coming under a single contract of sale for an overall price.

Under the new Article 288 of the VAT Directive, the amount of disposals of the tangible or intangible capital assets of a taxable person is however not to be included (*paragraph 2*). Capital assets are acquired by a taxable person to be used for the purposes of its business and as is the case with the deductible proportion determined in accordance with Articles 174 and 175 of the VAT Directive, their disposal is not seen as part of the turnover of the taxable person insofar as the capital assets have first been put to such use.

As the amounts listed serve to calculate the turnover of a taxable person, these are all amounts linked to <u>output transactions</u>. As a general rule, amounts linked to input is not to be taken into consideration. The amount of intra-EU acquisitions made by the taxable person is therefore not supposed to be included in this calculation. Nor is the value of services for which the taxable person is liable to account for VAT under Article 196 of the VAT Directive. Both are <u>input transactions</u> for which identification pursuant to Article 214(1)(b) and (d) of the VAT Directive is required[25].

The turnover will have to be calculated Member State by Member State, with the Union turnover made up by the totality of this turnover. The calculation of turnover generated in a particular Member State is only supposed to include the amount of output transactions <u>with a place of supply in that Member State</u>. It will include supplies of goods exported as the place of supply remains in the Member State concerned while supplies of services made to non-EU customers will be excluded but only if the place of supply of those services is located outside the EU. Should goods be exported without there being a supply as might be the case where they are moved to a stock in a third country, there will be no turnover generated. Such should therefore not be included in the calculation of the turnover.

For those Member States which are not part of the euro area, the new Article 284 of the VAT Directive makes clear that the conversion of thresholds into their national currency will need to be calculated using the exchange rate published by the European Central Bank on 18 January 2018[26] (*paragraph 6*). As stipulated by the new Article 288a of the VAT Directive, that is also the exchange rate to be applied to any transitional measure applied (*paragraph 3*)[27].

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[24] CJEU, judgment of 2 May 2019, *Jarmuškienė*, C-388/18, EU:C:2019:348.

[25] The implications of this were discussed by the VAT Committee at its 121st meeting (see section 4.3.b), vii) *Turning to other obligations*).

[26] This is the date of the original proposal presented by the Commission (Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards the special scheme for small enterprises, COM(2018) 21 final).

[27] See section 4.4.2.a), i) *Transitional measure*.

c) Number of thresholds possible

Most Member States apply a single threshold. Some are however in a position to apply varying thresholds for different business sectors. An example of this is Malta where the threshold to apply by a taxable person depends on whether the economic activity consists principally in the supply of goods or in the supply of services, be it with a low value added (high inputs), or with a high value added (low inputs). In future, all Member States may, based on the new Article 284(1) of the VAT Directive, opt to apply more than one threshold (*third subparagraph*).

In this context, it is clarified that where Member States decide to apply varying thresholds, this would need to be based on objective criteria (*second subparagraph*). In setting such varying thresholds, that enables for a distinction to be made based on the type of supplies made (objective) but not the nature of the supplier (subjective). Member States are therefore not permitted, under the new rules, to apply a separate threshold of exemption for a particular category of taxable persons such as lawyers, authors or artists as that would see the exemption based on a subjective criterion. They could however instead decide to design the exemption in such a way that it would target the type of services typically supplied by the particular category of persons concerned. Such would qualify as an objective criterion.

d) Criteria to be used where more than one threshold is put in place

This may still leave questions as to which criteria to use for distinguishing between the varying thresholds put in place by a Member State. It has been suggested that recourse should perhaps be made to NACE[28]. An alternative could also be to draw on CPA[29]. Such use is however not stipulated by the new Article 284(1) of the VAT Directive (*second subparagraph*). Other than requiring that the criteria used be objective, Member States are free to decide how to set the varying thresholds.

That being said, the rules put in place still should enable, based on the supplies made by the taxable person, to determine which threshold is applicable. As the supplies of a taxable person may span across different thresholds, any Member State applying more than one threshold will through the criteria put in place also need to ensure that it is clear under which particular threshold the taxable person will fall. Where, for example, a Member State applies one threshold for the supply of goods and another for the supply of services, there is a need to settle which of these thresholds applies where a taxable person supplies both goods and services. What should be kept in mind is that the taxable person may only benefit from one threshold. A decisive factor could for example be the relative proportion whether in value or quantity of goods and services supplied. Whatever the factor, this would need to be governed by objective criteria.

The decision as to which threshold, in the case at hand that for the supply of goods or that for the supply of services, is applicable cannot entail that the taxable person concerned is

[28] The Statistical Classification of Economic Activities in the European Community. The current version is revision 2 and was established by Regulation (EC) No 1893/2006 of the European Parliament and of the Council.

[29] Commission Regulation (EU) No 1209/2014 of 29 October 2014 amending Regulation (EC) No 451/2008 of the European Parliament and of the Council establishing a new statistical classification of products by activity (CPA) and repealing Council Regulation (EEC) No 3696/93 (OJ L 145, 4.6.2008, p. 65).

only granted partial access to exemption. Should a taxable person fall under the threshold for supply of goods, also its supplies of services would benefit from exemption. To exclude such supplies on the grounds that only supplies of goods are covered by the threshold is not possible. Where transactions are excluded from the SME scheme by a Member State exercising the option provided for under Article 283(2) of the VAT Directive[30], any such exclusion will need to be objective in nature. It could not justify excluding supplies of services made by a taxable person falling under a threshold for the supply of goods.

As activities of a taxable person change, this may impact which threshold will apply. If activities fluctuate over the year, it could result in a need for constant adaptation which would be impossible to manage for the taxable person and tax administrations alike. To avoid the upset that this could cause and to ensure a certain continuity, it seems by way of best practice that an assessment should be made only once a year to determine whether a shift from one to another threshold is called for.

e) Varying thresholds and limits to use

Where varying thresholds are applied as now explicitly permitted by the new Article 284(1) of the VAT Directive, it must be ensured that a taxable person eligible to benefit from more than <u>one sectoral threshold</u> can only use one of those thresholds (*third subparagraph*)[31]. If that were not to be the case, this could put into question the upper threshold of EUR 85 000 as it would leave room for a taxable person to cumulate the benefit. That could extend the benefit of exemption beyond the annual turnover threshold of EUR 85 000 which is the maximum set.

Given that the level of threshold will vary if sectoral thresholds are applied, it is indispensable that rules are put in place to set the limits between the thresholds applied so as to leave no doubt as to which threshold to apply. If for example different thresholds are applied for the supply of goods and the supply of services, the defining element for a taxable person with mixed supplies could for example be decided by the category of supplies that generates the highest turnover. If a threshold is applied for a particular sector like that of art and culture, a requirement to fall under that threshold could for example be that a minimum of turnover is derived from artistic and cultural activities.

The decision as to which threshold would apply should be determined on the basis of objective criteria put in place by the Member State concerned. It cannot be left for the taxable person to decide nor can the use of a particular threshold be reserved for certain taxable persons as that would run counter to the requirement of fixing thresholds based on objective criteria.

Where different sectoral thresholds are applied, this cannot for taxable persons with mixed supplies result in part of those supplies being excluded from the exemption. Should a Member State apply one threshold for supplies of goods and another threshold for supplies of services, it may be that for a taxable person supplying both goods and services the

[30] See section 4.1.3 *Transactions excluded*.

[31] As can be seen from section 4.2.1.d) *Criteria to be used where more than one threshold*, this does not in itself entail that part of the activities undertaken by the taxable person will not be eligible for exemption.

threshold for supplies of goods will apply but that will still see supplies of services exempt.

If a taxable person is eligible to benefit from more than one threshold, the Member State concerned must ensure that the taxable person uses only one of those thresholds (*third subparagraph*). Therefore, it should be clear that in case a Member State has put in place a general threshold and also applies one or more sectoral thresholds, all these thresholds – general and sectoral – will be seen as sectoral thresholds and that only one of them can be used by a taxable person who could benefit from more than one of them.

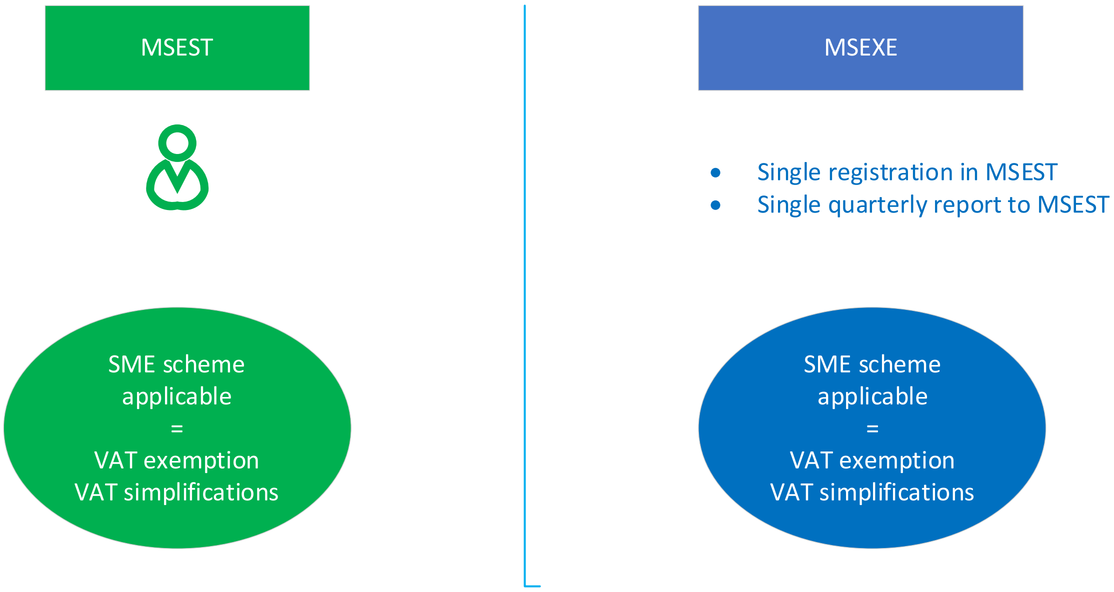
Other than objective criteria, it is also specified that thresholds set by Member States may not differentiate between taxable persons who are and those who are not established within their territory (*fourth subparagraph*). This is in keeping with the purpose of the update made to the SME scheme which seeks to ensure equal access.

4.2.2. Cross-border exemption (new feature)

Current rules prevent the exemption (and any graduated tax relief) provided for under the SME scheme to apply for cross-border transactions. Article 283(1)(c) of the VAT Directive indeed stipulates that the arrangements of this exemption (or graduated tax relief) shall not apply to supplies of goods or services carried out by a taxable person who is not established in the Member State in which the VAT is due. While goods or services that are subject to VAT in a Member State may benefit from exemption if supplied by a taxable person established in that Member State, this will not be the case if instead the taxable person is established in another Member State.

In *future*, this will change as Article 283(1)(c) of the VAT Directive is deleted. The main novelty of the reform is that the benefit of the exemption granted under the SME scheme will be extended to taxable persons established in Member States other than the one in which the VAT is due (this is in turn referred to as the Member State of exemption). Member States are not obliged to make use of this (domestic) exemption but should use be made, the new Article 284(2) of the VAT Directive stipulates that they must also grant that exemption to taxable persons established in another Member State (by way of cross-border exemption).

Figure 5: Cross-border exemption



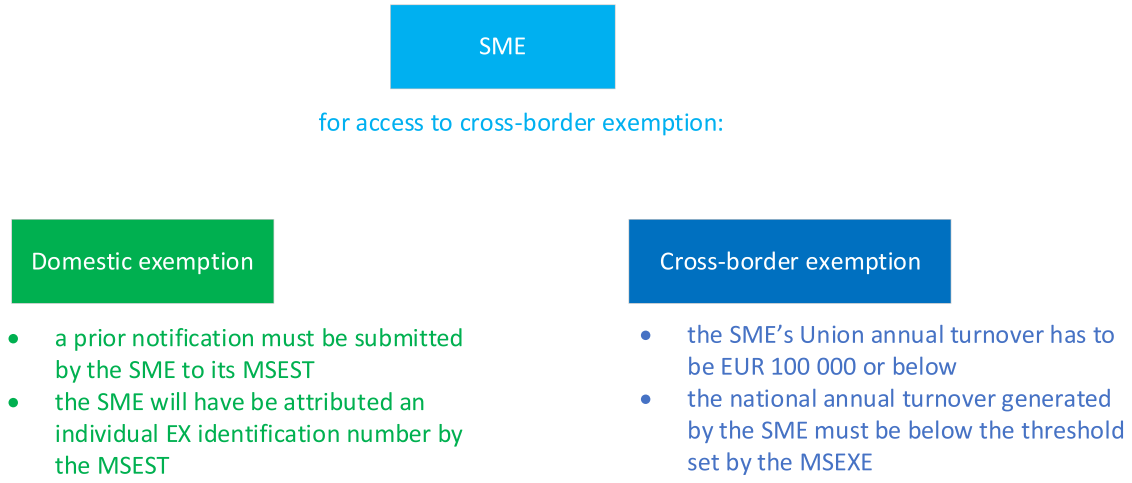
This will enable non-established taxable persons to benefit from cross-border exemption. Opening of the exemption under the SME scheme to non-established SMEs will see it aligned with the principle of taxation at destination and is supposed to address the negative impact on competition in the internal market for taxable persons established in other Member States[32].

a) Conditions for the cross-border exemption to apply

Just like with the domestic exemption, a common framework is put in place for the cross-border exemption. As distortions could arise if non-established taxable persons were given access to this new exemption regardless of the turnover generated in other Member States[33], it was decided that for a taxable person to be eligible to benefit from cross-border exemption, its Union annual turnover must not exceed EUR 100 000. This threshold serves as a safeguard to ensure that only small enterprises can gain access to the cross-border exemption. If exceeded, the taxable person is excluded from the cross-border exemption even if the value of the supplies made in the Member State of exemption is below the annual turnover threshold set by that Member State. Nevertheless, the domestic exemption in the Member State of establishment remains applicable irrespective of the exceedance of the Union threshold as long as the domestic threshold is not exceeded. Indeed, an SME should not be forced out of the domestic SME scheme because of its extension.

[32] See recital 4 of Directive 2020/285.
[33] See recital 9 of Directive 2020/285.

Figure 6: Eligibility and conditions to be met for access



Hence, contrary to the domestic exemption, the cross-border exemption is subject to two conditions that are cumulative: (a) the Union annual turnover of the taxable person does not exceed EUR 100 000, and (b) the value of supplies made in a given Member State does not exceed the threshold set by that Member State. If a taxable person's annual turnover is below the turnover set by that Member State, but the Union annual turnover is exceeded, the taxable person will therefore be excluded from the exemption.

It is not required that the domestic exemption is applied in order for a taxable person to benefit from the cross-border exemption. Still, the turnover generated in the Member State where the taxable person is established will count towards the calculation of the Union annual turnover.

b) Access to the cross-border exemption

For access to this exemption, the new Article 284(3) of the VAT Directive stipulates that the taxable person must *first* give prior notification to its Member State of establishment and be identified by an individual number in that Member State only (*first subparagraph*). No such requirement applies should the taxable person decide only to avail of the domestic exemption. In that case, access to the domestic exemption will rather depend on the rules put in place by the Member State concerned and will not necessarily require prior registration. A Member State may in fact decide, based on the new Article 292b of the VAT Directive, to release taxable persons applying the domestic exemption only of the obligation to identify.

For access, the taxable person must in this prior notification indicate the Member State(s) in which the cross-border exemption is taken up. There is no requirement for the taxable person to avail of the exemption in all the Member States in which supplies are made. Had that been so, the cross-border exemption could have been deprived of its utility as this would have seen a taxable person whose Union annual turnover is not above EUR 100 000 excluded from the cross-border exemption simply on account of having exceeded the threshold in one of these Member States (or in the Member State of establishment).

To gain access to Member States other than those indicated in the prior notification, the taxable person would need to make an update to the prior notification pursuant to the new Article 284(4) of the VAT Directive.

Second, to be able to exempt supplies made in Member States other than that where established, the taxable person must be identified for the application of the exemption by an individual number. Only once the individual identification number is obtained or an update is made to this number the taxable person can avail itself of the exemption.

Identification must, for the reasons of simplification and reduction of compliance costs[34], be made only in the Member State where the taxable person is established. While the taxable person will be given an individual identification number with the suffix 'EX' by its Member State of establishment, this will not be attributed before the Member State(s) of exemption concerned have been consulted. In case the taxable person avails itself of the SME scheme in certain Member States but not in all, it may have been attributed more than one number: an individual EX identification number issued by the Member State of establishment and a regular number issued by each of those Member States in which the taxable person does not avail itself of the SME scheme or alternatively an individual VAT identification number issued by the Member State of establishment should the OSS Union scheme be in use.

i. Prior notification

The requirement to give prior notification is supposed to allow an effective control of the application of the cross-border exemption and to ensure that Member States have access to the necessary information[35]. It essentially serves for the Member State of establishment to make sure that a taxable person is eligible for exemption, that is that the Union annual turnover of the taxable person has not exceeded EUR 100 000, and for the Member State of exemption to verify whether the taxable person meets the conditions for exemption, that is that the turnover generated in that Member State falls below the national threshold.

In terms of content, the new Article 284a(1) of the VAT Directive requires the prior notification to contain at least the following information:

(a) the name, activity, legal form and address of the taxable person;

(b) the Member State or Member States in which the taxable person intends to avail itself of the exemption;

(c) the total value of supplies of goods and/or services carried out in the Member State in which the taxable person is established and in each of the other Member States during the previous calendar year;

(d) the total value of supplies of goods and/or services carried out in the Member State in which the taxable person is established and in each of the other Member States during the current calendar year prior to the notification.

Other than details to identify the taxable person concerned, it is necessary in the prior notification to specify in which Member State(s) the exemption will be taken up. Subject to the taxable person being eligible for and meeting all the conditions of exemption, it is only in that or those Member State(s) that the exemption will apply.

[34] See recital 10 of Directive 2020/285.
[35] See recital 10 of Directive 2020/285.

The prior notification must also include information about the total value of supplies of goods and services, past and present, made not only in the Member State of establishment and the Member State(s) of exemption but also in any other Member State. This is to enable the Member State of establishment to verify whether the taxable person is eligible for the SME scheme. For that, the new Article 288a of the VAT Directive makes clear that the Union annual turnover threshold must not be exceeded in the current calendar year nor have been exceeded in the previous calendar year (*paragraph 2*).

For any Member State applying more than one threshold, the total value to be reported will need to be broken down along the lines of those thresholds[36].

What must be specified is the total value of supplies made during the previous calendar year and during the current calendar year up till making the prior notification. If the prior notification is made on 1 July 2025, it will be necessary to indicate the total value of supplies made by the taxable person during the whole of 2024 and the first half of 2025. Should the prior notification instead be made on 1 January 2025, only the total value of supplies made during 2024 would have to be indicated while there would be nothing to report for 2025. Information about the value of any supplies made after the prior notification is submitted will be captured by the subsequent reporting[37].

If no turnover is generated in the previous calendar year which could happen when faced with a start-up, this should not in itself stand in the way of access. It could be that a taxable person starting its economic activity on 1 April 2025 submits a prior notification a month later. The total value of supplies made during 2025 should be indicated whilst for 2024, the total value will have to be indicated as '0', similarly to what is the case for the regular reporting[38].

Where, in a particular Member State, the domestic annual turnover threshold was exceeded in the year before the prior notification is submitted[39], the taxable person will not, on account of the new Article 288a(1) of the VAT Directive, be able to benefit from exemption in that Member State (*first subparagraph*). Where, instead, the Union annual turnover threshold was exceeded, the taxable person will, based on the new Article 288a(2) of the VAT Directive, not be able to benefit from the cross-border exemption in any Member State (*first subparagraph*). It is for that reason that the prior notification must also include information about the value of supplies made during the previous calendar year.

That information will not necessarily suffice where in case the domestic annual turnover threshold is exceeded, a Member State decides to take up the option laid down in the new Article 288a(1) of the VAT Directive to extend the exclusion to two calendar years (*first subparagraph*). To accommodate for that, the new Article 284a(1) of the VAT Directive requires that in regard to such Member States, the taxable person will need in the prior notification to report the value of supplies both in the previous year and the year before that (*second subparagraph*). In terms of implementation and for the taxable persons concerned, this is obviously a source of complication as there will be a need to know to which Member States this applies.

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36 For more details see section 4.3.b), i) *What to report*.

37 See section 4.3.b) i) *What to report* and ii) *Details on reporting*.

38 See section 4.3.b) *Cross-border exemption (new feature)*.

39 The Member State granting the exemption may extend this period to two calendar years.

ii. Update to prior notification

For a taxable person to take up exemption in Member States not already indicated in its prior notification, it will be necessary to make an update to the prior notification.

When a prior notification is updated, it makes little sense to require the taxable person to provide information already held by the Member State of establishment. Therefore, the new Article 284a(2) of the VAT Directive only obliges a taxable person making an update to provide the above information insofar as this has not already been reported under the new Article 284b of the VAT Directive.

Other than indicating the Member State(s), the taxable person is however obliged to include a reference to the individual EX identification number previously attributed to it by the Member State of establishment under the new Article 284(3)(b) of the VAT Directive. That will enable to link the update to the prior notification previously made by the taxable person concerned.

iii. Individual identification number

Member States are not obliged under the *current rules* to register taxable persons covered by the exemption under the SME scheme. Article 272(1)(d) of the VAT Directive, deleted as of 1 January 2025, in fact allows them to release such taxable persons from certain or all VAT obligations, including the requirement to identify for VAT purposes. That is intrinsically linked to the scope of an exemption not being open to taxable persons established in other Member States.

With the *new rules*, that will change but only where use is (also) made of the cross-border exemption. In that case, the Member State of establishment will be obliged, under the new Article 284(3)(b) of the VAT Directive, to identify any taxable person who upon submission of a prior notification is found eligible for exemption in another Member State. Should use only be made of the domestic exemption, the Member State of establishment may still dispense the taxable person of the requirement of such identification. That follows from the new Article 292b of the VAT Directive.

Given the flexibility currently enjoyed by Member States, there was no desire to be prescriptive in terms of the type of number used for the identification required for the cross-border exemption. Instead, Member States are free to choose between using:

i. the individual VAT identification number already allocated to the taxable person in respect of that person’s obligations under the internal system,
ii. a number with the structure of a VAT number, or
iii. any other number for the purpose of the identification.

No matter what is chosen, the number must include the suffix ‘EX’. This serves as indication that the taxable person to which the number is attributed falls under the SME scheme. It can be necessary for the customer to know whether its supplier is a taxable person whose supplies are exempt under the SME scheme. It may for example be that a taxable person receiving services from another Member State wants to reassure itself that it will not be faced with liability by way of reverse charge under Article 196 of the VAT Directive. With that in mind, it is for Member States, based on the individual identification number, to confirm whether a taxable person is an SME and in which Member State(s) it is exempt. This requirement, provided for in the new Article 31(2a) of the VAT Administrative Cooperation Regulation[40], will be implemented through a new SME-on-Web application.

c) Procedure to follow for gaining access

As is clear from the new Article 284(5) of the VAT Directive, the cross-border exemption will as regards the Member State(s) indicated in the prior notification only apply once the taxable person is informed of its individual identification number ('EX number') while for Member State(s) featured in an update it will be when the taxable person receives confirmation that the number has been updated (*first subparagraph*). Hence, there is a procedure to follow in order for a taxable person to gain access to this exemption.

The procedure is initiated by the taxable person submitting the prior notification or an update to the Member State where it is established. In that prior notification (or update), the Member State(s) in which the taxable person intends to avail of the exemption should be indicated.

i. Member State of establishment

Given that the taxable person must be identified only in the Member State where it is established, it is essential to determine which Member State is the Member State of establishment. That is, as said above, the Member State to which the prior notification or any update should be submitted and where the taxable person will be identified for the SME scheme whether or not the exemption is applied in that Member State. In the absence of a uniform approach, the risk is that a taxable person could end up being registered in multiple Member States which, amongst other, would undermine the in-built safeguard made up by the Union annual turnover threshold.

Having discussed what it takes to be seen as established in a Member State[41], the VAT Committee already agreed[42] that this must be taken to be the Member State where the functions of the taxable person's central administration are carried out as determined based on criteria equivalent to those laid down in Article 10(2) and (3) of the VAT Implementing Regulation. Should a taxable person only have a fixed establishment within the Union, the Member State where this fixed establishment is located cannot be regarded as the Member State of establishment. Had that been the case, it could have seen a taxable person able to register in more than one Member State which would be at odds with the requirement for the taxable person to be identified in one Member State only, namely the Member State of establishment. If room is left for identification in a Member State with only a fixed establishment, it carries the risk of doubling up on the exemption. For that reason, should a taxable person be identified for output transactions in a Member State other than the Member State of establishment, the taxable person will be barred from exemption under the SME scheme in that Member State.

Should a taxable person have a fixed establishment in a Member State other than their Member State of establishment, it could be that the fixed establishment is already

[40] Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (recast) (OJ L 268, 12.10.2010, p. 1).

[41] See section 4.2.2.c), i) *Member State of establishment*.

[42] See guidelines resulting from the 121st meeting of 21 October 2022 – Document B – taxud.c.1(2023)5257065 – 1056 (p. 286).

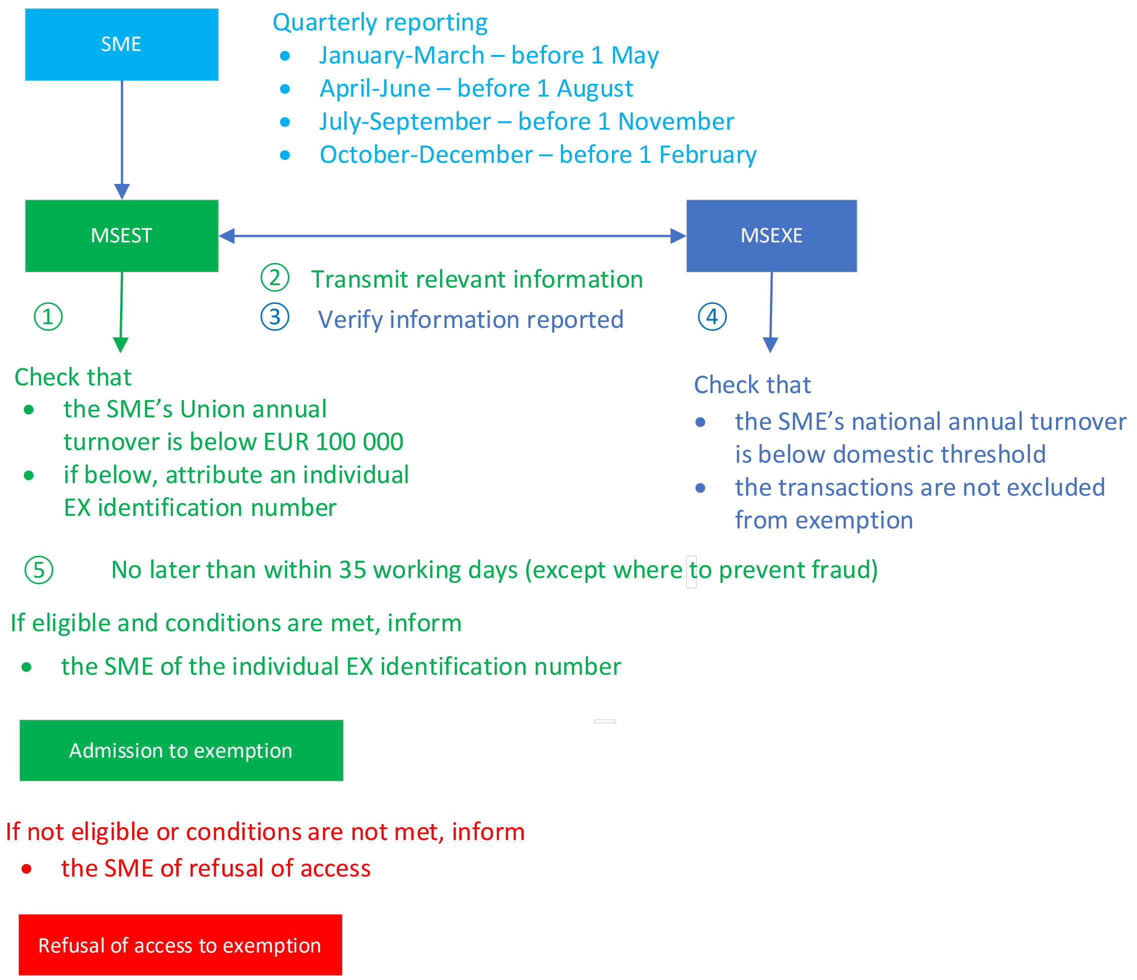
registered for its output transactions there. If that is so, access to the cross-border exemption in that Member State is predicated on that fixed establishment being de-registered. It is a point to be verified by the Member State of exemption as part of the process.

As a taxable person can only have its business in one place, the place where the taxable person has only a fixed establishment cannot be seen as the Member State of establishment. For that reason, it must also be concluded that a taxable person having its place of business outside the Union may not be admitted to the SME scheme. There simply is not, as the rules stand, a singular point of connection that could serve as the Member State of establishment for such a taxable person. The taxable person could in fact have a fixed establishment in multiple Member States.

ii. Process involving Member States

The procedure to gain access to the cross-border exemption under the SME scheme for which the taxable person first needs to obtain an individual EX identification number features a process involving both the Member State of establishment and the Member State(s) of exemption to which are each attributed task(s). It is the outcome of that process which informs the decision to admit the taxable person or refuse access.

Figure 7: Overview of process



Upon receiving the prior notification or an update thereto, the Member State of establishment is tasked with verifying whether the taxable person is eligible for the SME scheme (task 1). This is a task that follows from the new Article 37b(1) of the VAT Administrative Cooperation Regulation. With that in mind, information about the total value of supplies of goods and services made by the taxable person throughout all Member States during the current and previous years must be included in the prior notification.

This task should be accomplished before the Member State of establishment proceeds to allocate an individual identification number (task 2) and as envisaged under the new Article 37a(1)(a) of the VAT Administrative Cooperation Regulation, transmits, within 15 working days of it becoming available information about that number, details on the taxable person and its activity and the date of commencement of the exemption under the SME scheme to the Member State of exemption concerned for further verification (task 3). That is information which should be available as and when the prior notification or an update thereto is received.

It will be for the Member State of exemption to verify whether the conditions for exemption to be applied are met. That includes checking that the turnover of the taxable person is below the threshold applicable and that the transactions are not excluded from exemption. As for access to the cross-border exemption a taxable person is supposed for its output transactions to be identified in the Member State of establishment only, the Member State of exemption would also need to verify that the taxable person concerned is not registered there for output transactions. If indeed the taxable person is registered in the Member State of exemption, this will stand in the way of taking up the exemption in that Member State.

If the total value of supplies made by the taxable person exceeds the Union annual turnover threshold of EUR 100 000 or did so in the previous year(s), this stands in the way of access to the cross-border exemption and will be the end of the process resulting in refusal (*scenario 1*).

Should the supplies however not exceed the Union annual turnover threshold, it will be for the Member State of exemption to verify whether the conditions for exemption are met (task 4). This involves a check of the taxable person's national annual turnover being below the domestic threshold and other conditions for the exemption to apply. The new Article 37b(2) of the VAT Administrative Cooperation Regulation stipulates that within 15 working days of having received the above information, it must confirm to the Member State of establishment, based on the values reported, that the domestic annual turnover threshold is not exceeded in the current calendar year nor in the previous calendar year(s). That is necessary if the condition laid down in the new Article 284(2)(b) of the VAT Directive for access to exemption is to be met and for exclusion under the new Article 288a(1) of the VAT Directive not to kick in.

If, upon verification, the Member State of exemption confirms to the Member State of establishment that the conditions for the exemption to apply are met, it is for the Member State of establishment to inform the taxable person of its individual identification number (task 5). It will see the process end in admission (*scenario 2*).

If instead the Member State of exemption informs the Member State of establishment that one or more of the conditions for the exemption are not met (that could be so if the domestic annual turnover threshold is exceeded or the supplies are excluded from exemption, or a period of exclusion applies), this prevents access to the cross-border exemption and the process will once again result in refusal (*scenario 3*).

Where exemption is requested in more than one Member State, confirmation of the conditions being met must be obtained from all those Member States of exemption. If in a Member State of exemption that is not the case, this will prevent access to the cross-border exemption in that Member State but not in other Member States. This will see the process end in partial admission only (*scenario 4*).

iii. Duration of this process

The new Article 284(5) of the VAT Directive specifies that the exemption applies once the taxable person is informed of its individual EX identification number or an update of this number (*first subparagraph*) and that this is supposed to be no later than 35 working days after receipt of the prior notification or update thereto (*second subparagraph*). This entails that, in normal circumstances, the Member State of establishment will need to inform the taxable person of the outcome of the process by then. It should still leave a minimum of 5 working days to turn this around by the deadline imposed (15 working days for task 3 + 15 working days for task 4 + 5 working days for task 5).

Reference is made to working days which, as stipulated[43], are all days other than public holidays, Sundays and Saturdays[44]. It entails that public holidays will have to be disregarded as working days. Public holidays are the days designated as such in the Member State in which action is to be taken[45]. For each task, whether allocated to the Member State of establishment or to the Member State of exemption, it therefore will have to be the working days of the Member State concerned that matters. Should there be a discrepancy in what are the public holidays, this could tighten the process.

While rules are put in place governing the duration, subject to the deadline of 35 working days it is for the Member State of establishment to handle the process. Should a taxable person look to avail of the cross-border exemption in more than one Member State, the Member State of establishment is unlikely to hear back from the Member States concerned all at the same time. In that case, the Member State of establishment could inform the taxable person of its individual EX identification number as soon as it hears back from one of those Member States and update that number as other Member States come back with confirmation. The Member State of establishment could however also decide to hold of until all Member States have reacted.

- *Start of process*

The process starts when the taxable person submits the prior notification. If the taxable person were to correct information already submitted or add to this, the question is how this will impact the process and its duration. As this is susceptible to upset the process and with more than one Member State involved, there is a need to agree on a common approach.

43 Regulation (EEC, Euratom) No 1182/71 of the Council of 3 June 1971 determining the rules applicable to periods, dates and time limits (OJ L 124, 8.6.1971, p. 1).

44 See as defined by Article 2(2) by Regulation 1182/71.

45 See as defined by Article 2(1) by Regulation 1182/71.

Where information is faulty or not complete, a taxable person should be given access to correct or fill any such flaw or gap. It could for example be that data on turnover is flawed and needs to be updated. Leaving that without correction could impact the outcome and there should therefore be made room for such correction. To avoid spill over on the process itself, it seems that the clock should better be reset to reflect the date of correction. Should information contained in a prior notification submitted at the end of March (30 March) be corrected by the taxable person five days later (4 April), this would then see the start of the process delayed till 4 April.

Where information is added after submission, this could arguably be seen as an update to the prior notification. It is certainly the case where the taxable person wishes to add another Member State of exemption. Any such update should be treated separately and where the prior notification is yet to be (fully) processed, it seems appropriate to suspend the process for that update until the prior notification is settled. If the prior notification is submitted at the end of March, it would see the start of the process for the update delayed till late May.

- *End of process*

The new Article 284(5) of the VAT Directive requires the Member State of establishment to inform the taxable person of the individual EX identification number no later than 35 working days after the prior notification was received (*second subparagraph*). It is therefore imperative to avoid delays in the process. If no response is received from the Member State of exemption within the prescribed 15 working days taking into account public holidays on the side of that Member State, this cannot stand in the way of the timely communication by the Member State of establishment of the said number to the taxable person. The lack of response must be taken as (silent) confirmation that the conditions are met as inaction can hardly justify the Member State of establishment being put in a situation where in the face of the above deadline it has to refuse access to the exemption.

There may obviously be situations where Member States require more time for verification. More such time can however only be granted where this is needed in order to prevent tax evasion or avoidance. It must be clear this can only be evoked by Member States in individual cases presenting a specific risk of tax evasion or avoidance. Those are expected to be exceptional cases but when any such case arises, it could see the process run beyond the 35 working days.

Any delay must be strictly limited to the time it takes to carry out the necessary checks. Should more time be needed for checks to prevent tax evasion or avoidance, the Member State of exemption would in any event need to inform the Member State of establishment of this to avoid that silence translates into agreement. This should enable the Member State of establishment to suspend the deadline and inform the taxable person concerned.

iv. Steps to be taken upon shift in place of establishment

While likely not to happen often, there may be a shift in the place where the functions of a taxable person's central administration are carried out. As, for the SME scheme to apply, a taxable person must be identified only where established, the taxable person will need to get identified in the Member State to which it moves the functions of its central administration (*Member State 2*). Prior to that, it will be necessary for the taxable person, through an update to the prior notification, to inform the Member State from which the functions of its central administration are moved of this (*Member State 1*). Member State 1 would need to deactivate the individual 'EX' identification number first issued before Member State 2 can go through the process of issuing another 'EX' number.

Even though a case could be made for a simplified procedure to handle that particular situation, no provision has been made for this. It is therefore difficult to imagine how it would be possible to proceed in any other way than that described above.

v. Legal protection

As can be seen from the above process, separate tasks are attributed to the Member State of establishment and to the Member State of exemption. This raises questions as to which Member State should ensure the legal protection of a taxable person availing of exemption under the SME scheme. Those were already discussed by the VAT Committee at its 121st meeting[46], with the discussion resulting in guidelines[47] by which it is clarified from which Member State a taxable person needs to seek legal redress if refused access to or excluded from exemption under the SME scheme.

If refusal or exclusion is the result of the Union annual turnover threshold being exceeded, this will rest with the Member State of establishment while it will be with the Member State of exemption should the domestic threshold be exceeded or the activity shift to transactions excluded from exemption. When transmitting the decision, the Member State of establishment should tell the taxable person the reasons for refusing access to or exclusion from exemption and indicate in which Member State legal redress may be sought.

4.3. The SME scheme: remain

Granting of the exemption under the SME scheme aims to overcome difficulties in applying the normal VAT arrangements by small enterprises. That does not entail that taxable persons benefiting from this exemption are (necessarily) relieved of all obligations.

a) Domestic exemption (existing feature)

Under the *current rules*, Article 272(1)(d) of the VAT Directive allows Member States by way of simplification to release taxable persons covered by this exemption from certain or all obligations referred to in Chapters 2 to 6 of Title XI of the VAT Directive. This probably finds its explanation in the fact that it is a measure limited in its scope to the territory of the Member State of exemption. It is however a provision which with the reform of the SME scheme will be deleted.

This does not, however, entail new registration or reporting obligations for taxable persons availing themselves of the domestic exemption only[48]. Member States will *in future* be able to rely on the new Articles 292b, 292c and 292d of the VAT Directive to release taxable persons of the obligation:

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46 Working paper No 1049 *The new special scheme for small enterprises: legal protection*.

47 See guidelines resulting from the 121st meeting of 21 October 2022 – Document A – taxud.c.1(2023)3139286 – 1055 (p. 285).

48 See recital 19 of Directive 2020/285.

- to state the beginning of their activity pursuant to Article 213,
- to be identified by means of an individual number pursuant to Article 214, except when carrying out transactions covered by point (b), (d) or (e) of Article 214,
- to submit a VAT return laid down in Article 250,
- to issue invoices, keep accounts or submit recapitulative statements referred to in Articles 217 to 271.

If taxable persons applying the cross-border exemption were to be released of all obligations, this would undermine the operation of the cross-border exemption. Member States may therefore not release taxable persons who also avail of the cross-border exemption from the obligation to state the beginning of their activity, to be identified by means of an individual number and to submit a VAT return. When it comes to other obligations like invoicing and accounting, no such constraint applies.

While not obliged to put in place any of the above simplifications, it is *in future* so that Member States, as a minimum, should give taxable persons availing themselves of the domestic exemption only access to simplified reporting obligations[49]. The focus here is on identification and reporting.

i. Identification

Where identification of exempt taxable persons is required, the procedure put in place by Member States must, according to the new Article 292b of the VAT Directive, not take longer than 15 working days (*second paragraph*). Only in specific cases where additional time for carrying out the necessary checks to prevent tax evasion or avoidance is required, identification of an exempt taxable person may take longer. Delay in identification will however need to be linked to the circumstances of an individual case and cannot justify glitches of a systemic nature.

ii. VAT return

Where exempt taxable persons are required to submit a VAT return, Member States must, according to the new Article 292c of the VAT Directive, allow this to be a simplified return covering the period of a calendar year (*second paragraph*). This will not be binding on the exempt taxable person who is free to opt for the application of the tax period set in accordance with Article 252 of the VAT Directive. Whilst the interval for submission will be shorter, it still remains a simplified return.

b) Cross-border exemption (new feature)

To gain access to the cross-border exemption, a taxable person must first submit a prior notification[50]. This likens a statement of the beginning of the taxable person’s activity under Article 213 of the VAT Directive, with the prior notification to be made to the Member State of establishment only. If found eligible and meeting the conditions for exemption, it will then be for the Member State of establishment to identify the taxable person by an individual EX identification number[51]. That tallies with the identification required under Article 214 of the VAT Directive.

[49] See recital 16 of Directive 2020/285.
[50] For further details, see section 4.2.2 *Cross-border exemption (new feature)*.
[51] See also section 4.2.2 *Cross-border exemption (new feature)*.

Once identified, the taxable person is obliged, under the new Article 284b of the VAT Directive, to report the total value of supplies carried out during the calendar quarter in the Member State of establishment and in each of the other Member States (*paragraph 1*). If in one or more of the Member States, no supplies have been made, this should explicitly be indicated by ‘0’.

Reporting should be done to the Member State of establishment only within one month of the end of the calendar quarter (*paragraph 2*). For the first calendar quarter, which covers the months of January, February and March, reporting thus has to be made by 30 April at the latest.

The taxable person should, as stipulated in the new Article 284(3)(b) of the VAT Directive, only be identified in the Member State of establishment[52]. This also has implications in terms of other obligations faced by the taxable person as set out in the new Article 284d of the VAT Directive.

i. What to report

The taxable person has for each Member State to report the value of supplies carried out during the calendar quarter in the Member State concerned. Reporting should be done by the taxable person under its individual EX identification number. As can be seen from the new Article 284c(1) of the VAT Directive, this does not cover all supplies (*point (a) of the first subparagraph*). Supplies exempt under Articles 132, 135 and 136 of the VAT Directive are for example not supposed to be included. Only the amounts listed in the new Article 288 of the VAT Directive will count towards the value to be reported[53]. That includes supplies exempt under Articles 146 to 149 and Articles 151, 152 and 153 of the VAT Directive.

The new Article 284c(1) of the VAT Directive requires the value of supplies which is to be reported Member State by Member State to be done in euro (*point (b) of the first subparagraph*). Member States having not adopted the euro may however require the value expressed in their national currencies (*second subparagraph*). For conversion, the exchange rate published by the European Central Bank on the first day of the calendar year, or, if no publication on that day, on the next day of publication must be used.

Where varying thresholds are applied by the Member State granting exemption, it is stipulated that the value of supplies as regards each threshold must be reported separately (*point I of the first subparagraph*). It will impact the prior notification as well as any subsequent reporting. Should distinct thresholds for example be applied for goods and services, the taxable person will need for that Member State to report both the value of supplies of goods and the value of supplies of services. With a single threshold applied, the taxable person only needs to report the total value of supplies of goods and services. Where the option laid down in the new Article 284(1) of the VAT Directive is used resulting in more than one threshold being applied, it can in terms of reporting therefore be a source of complexity (*second subparagraph*).

[52] See also section 4.2.2.c) *Procedure to follow for gaining access*.
[53] For more see section 4.2.1.b) *Level of threshold*.

ii. Details on reporting

As said, the taxable person has to report the value of supplies for all Member States. It leaves room for three scenarios:

i. Member State in which supplies are made and exemption is applied

What has to be reported under the new Article 288(1) of the VAT Directive is the overall value of exempt supplies made in the Member State concerned. That covers supplies that would have been taxed had the exemption under the SME scheme not applied (*point (a)*) but also includes transactions exempted with deductibility of VAT paid at the preceding stage, so zero-rated (*point (b)*) and transactions exempted by way of export (*point (c)*). While those transactions also fall under the SME scheme if applied, their value would not – without it being specified as is the case – be captured as, under the normal rules, they are not taxed.

The value of exempt intra-EU supplies should be included but only where the exemption provided for in Article 138 of the VAT Directive applies (*point (d)*). It is worth noting, however, that according to Article 139 of the VAT Directive that exemption does not apply to the supply of goods carried out by taxable persons who are covered by the exemption under the SME scheme. Nor does the exemption apply where to the supply of goods to taxable persons, or non-taxable legal persons, whose intra-Community acquisitions of goods are not subject to VAT pursuant to Article 3(1) of the VAT Directive except where the customer takes up the option to submit its intra-Community acquisitions to VAT laid down in Article 3(2) of the VAT Directive. This kind of supplies, including arguably the transfer of own stock, will instead be exempt under the SME scheme and must be reported as such (*point (a)*).

It is only the value of the exempt transactions specified that should be included. Certain activities in the public interest and other activities that are exempted under Articles 132, 135 and 136 of the VAT Directive should therefore not be counted, except for real estate transactions, financial transactions as referred to in points (b) to (g) of Article 135(1) of the VAT Directive, and insurance and reinsurance services insofar as these are not ancillary (*point (e)*). With its ruling in *AJFP Caraş-Severin and DGRFP Timişoara*[54], the CJEU made clear that the concept 'ancillary transactions' is an autonomous concept of EU law and refers to certain transactions which are not part of the taxable person's usual business activity.

ii. Member State in which supplies are made but exemption is not applied

What has to be reported is to reflect what would have been reported under the new Article 288(1) of the VAT Directive in terms of value had the exemption been applied. In this instance, that covers the global value of supplies made in the Member State concerned that are taxed, zero-rated and exempt by way of export.

To this, the value of exempt intra-EU supplies should also be included (*point (d)*). Indeed, the supply of goods made to another taxable person or a non-taxable legal person acting as such located in another Member State will be eligible for exemption under Article 138 of

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[54] CJEU, judgment of 9 July 2020, C-716/18 *AJFP Caraş-Severin and DGRFP Timişoara*, EU:C:2020:540, paragraphs 30, 38 and 39.

the VAT Directive as in this instance the taxable person is not covered by the exemption under the SME scheme. The transfer of own stock will be treated as a supply by way of Article 17 of the VAT Directive. Whether that supply will qualify for exemption under Article 138 of the VAT Directive however depends on whether the stock is transferred to a Member State in which the taxable person avails of exemption under the SME scheme and the volume. It is only where during the calendar year the value of acquisitions made by an exempt taxable person exceeds EUR 10 000 that these will be subject to VAT in accordance with Article 3 of the VAT Directive. That is the scenario where the exemption under Article 138 of the VAT Directive can kick in for the transfer of own stock.

Finally, also the value of real estate transactions, financial transactions as referred to in points (b) to (g) of Article 135(1) of the VAT Directive, and insurance and reinsurance services unless ancillary should be included.

iii. Member State in which no supplies are made

If no supplies are made in a Member State, the taxable person is supposed to indicate this by a reference to ‘0’.

iii. What about corrections

As is the case under the normal VAT rules or when identified for the Union OSS scheme, there may also be situations where a taxable person will need to correct values already reported under the SME scheme, for example to make up for (innocent) mistakes or to reflect a return of goods where, for example, the customer goes back on a deal. The question is how to handle this. It is a question that will (primarily) arise where the deadline for reporting has passed.

When it comes to the Union OSS scheme, Article 369g of the VAT Directive stipulates that after its submission any amendment that must be made to the VAT return is to be included in a subsequent return within three years of the date on which the initial return had to be submitted. No similar provision can be found in the SME scheme which is silent on the particular issue of corrections. It leaves a lacuna which needs to be filled.

Although different in purpose, these schemes are similar in construct as in both cases the Member State of establishment is a focal point for the taxable person *vis-à-vis* activities in other Member States. In the case of the Union OSS scheme, data is reported with a view to payment of VAT on the supplies made while the purpose of reporting of data under the SME scheme is to monitor that the conditions of the exemption are and continue to be met. This is however all data pertaining to the turnover generated by the taxable person.

Correcting data already reported under the SME scheme should certainly be possible within the reporting period. With data for the first calendar quarter (January through March) having to be submitted within one month (by the end of April), a taxable person may have reported early (early April) which would leave time for correction. What is left to settle is the situation where there is a need to correct data later than that (whether in the month of May or much later).

To fill the lacuna which can hardly be left, inspiration could perhaps be sought from the Union OSS scheme. That there should be room for correction was always recognised. From the outset, correction required the original OSS VAT return to be resubmitted. Now, amendment to data reported can be done in a subsequent return within three years of submission of the original OSS VAT return.

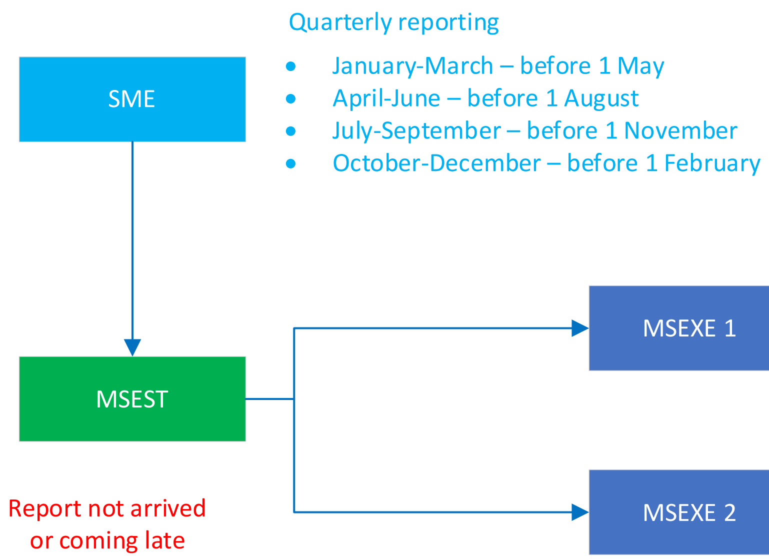
Where there is a need for correction, no matter what has caused this, this could lead to either an increase or a decrease in the turnover already reported. For the taxable person, a correction triggered by the return of goods could result in a decrease in the turnover previously reported while if caused by other circumstances, the correction could also result in an increase in that turnover. Either way, an increase or a decrease is susceptible to have an impact on the (continued) access to exemption.

With that in mind, it seems most appropriate to agree for any such a correction to be made the taxable person should resubmit the original report.

iv. Failure to adhere to reporting obligation

According to the new Article 284b of the VAT Directive, reporting should be done to the Member State of establishment only within one month of the end of the calendar quarter (*paragraph 2*). If there is a failure to adhere to this, it could have repercussions for the taxable person. While this cannot be grounds for depriving the taxable person of exemption, the new Article 284d of the VAT Directive leaves room for other steps to be taken by Member States to remedy this failure (*paragraph 3*).

Figure 8: Failure to report



These are among the scenarios that could arise should a taxable person be late in reporting or not report at all:

Scenario 1: VAT obligations may be imposed on the taxable person under the normal rules but none of the Member States of exemption decides to avail of this option. That will uphold simplifications offered by the SME scheme but still leaves room for the Member State of establishment to sanction the transgression.

Scenario 2: One of the Member States of exemption decides to oblige the taxable person to fulfil VAT obligations within its territory. That can for example see the taxable person required to register and submit a VAT return in that Member State and will detract from the simplifications otherwise offered under the SME scheme. Should those obligations not be adhered to, it will be for the Member State of exemption to sanction this.

Scenario 3: All Member States of exemption decide to oblige the taxable person to fulfil VAT obligations within their territory. That can for example see the taxable person required to register and submit a VAT return in all those Member States and will upend the simplifications otherwise offered under the SME scheme. Any lack of adherence to these obligations can be sanctioned by the Member State of exemption concerned.

Scenario 4: Contrary to the Member States of exemption, the Member State of establishment decides to impose obligations on the taxable person. While as a result of that the taxable person can be required to submit a VAT return, it is difficult to see how the Member State of establishment should be able to impose registration. Such a registration would double up with the identification under the SME scheme and must therefore be seen as inadmissible.

This option is obviously a tool available for Member States to apply but caution is advised as to when and for what to put this tool to use. It is particularly important given the impact that the imposition of further obligations will have on taxable persons whose transgression may be insignificant (that could for example be the case if the report for a calendar quarter submitted to the Member State of establishment is a couple of days late) and/or infrequent (that would be so where late submission is not repetitive). There could perhaps be some merit in agreeing what should be seen as the lowest bar for a Member State to decide to impose such obligations, also keeping in mind the need to respect the proportionality principle.

v. How to report

It is for each Member State of establishment to determine how reporting is to be done. Whilst the new Article 284c(2) of the VAT Directive permits the Member State of establishment to require information to be submitted by electronic means, it is not compulsory for the Member State of establishment to impose such an obligation. Where nevertheless this is required, the electronic submission will be subject to the conditions laid down by the Member State concerned.

vi. When the Union annual turnover threshold is exceeded

Reporting serves for the Member State of establishment and any of the Member State(s) of exemption to monitor how the turnover of the taxable person evolves. Reporting is not real time but only supposed to be done to the Member State of establishment within one month of the end of the calendar quarter. Measures introduced under the new Article 288a(2) of the VAT Directive leave a period for the necessary transition from exemption to taxation.

Should the Union annual turnover threshold be exceeded, no such period of transition is however afforded. It is with that in mind that the new Article 284b(3) of the VAT Directive obliges the taxable person to (i) inform the Member State of establishment within 15 working days of having exceeded the Union annual turnover threshold, and (ii) report the value of supplies made from the start of the calendar quarter up till that time. It is not because of this respite given to the taxable person that the period of exemption is extended. As stipulated by the new Article 288a(2) of the VAT Directive, once the Union annual turnover threshold is exceeded the cross-border exemption ceases to apply as of that time.

The question is when exactly that time is. Knowing at what exact moment in time during the day the transaction that will see the Union annual turnover threshold exceeded actually takes place, is not evident. Given the variables this throws up, it could in fact be difficult to establish and manage. That favours a reading whereby *that time* is translated into being the day of the transaction. It would see the cross-border exemption cease to apply only at the end of the day (24h00 CET) at which point taxation kicks in.

vii. Turning to other obligations

As already indicated, the taxable person is supposed to be identified in the Member State of establishment only. As set out in the new Article 284d of the VAT Directive, a taxable person availing itself of the cross-border exemption in a particular Member State of exemption will therefore be released of certain obligations in that Member State (*paragraph 1*). Hence, under the VAT Directive, the taxable person will not be required:

(a) to be registered for VAT purposes pursuant to Articles 213 and 214;

(b) to submit a VAT return pursuant to Article 250.

The new Article 284d of the VAT Directive also makes clear that where, in addition to the cross-border exemption, the domestic exemption is applied, the taxable person will also be released of obligations in the Member State of establishment (*paragraph 2*). The taxable person will not in respect of supplies covered by the exemption be required to submit a VAT return pursuant to Article 250 of the VAT Directive.

With a taxable person falling under the SME scheme only supposed to be identified in the Member State of establishment, a requirement of registration for output transactions made in a Member State of exemption will result in a clash and must be avoided. Once identified under the SME scheme which comes with a requirement of reporting, the submission of a VAT return doubles up on what is already reported and must also be avoided. Releasing the taxable person of the above obligations is necessary given that the construction serves to avoid the doubling up of obligations.

The taxable person could however be captured by other obligations imposed by the Member State(s) of exemption. Invoicing is particularly relevant given that invoices must be issued for B2B supplies under Article 220 of the VAT Directive or may be required for B2C supplies by way of Article 221 of the VAT Directive. According to Article 219a of the VAT Directive, invoicing is, as a matter of principle, subject to the rules applying in the Member State in which the supply of goods or services is deemed to be made (*paragraph 1*) rather than those of the Member State of establishment where the taxable person is identified for the SME scheme while for supplies made under the Union OSS scheme, it will be the rules of the Member State of identification applying (*paragraph 2(b)*).

While in a cross-border scenario of B2B supplies there is scope for applying the invoicing rules of the Member State of establishment, this is not so with B2C supplies. That certainly will be a source of complication if more widely Member States impose an obligation of invoicing for those B2C supplies. Contrary to what is the case for supplies made under the Union OSS scheme, there is (unfortunately) no scope for supplies made in a Member State of exemption to be subject to the invoicing rules of the Member State of establishment.

Should a Member State of exemption put in place digital reporting, it may be that a taxable person for the issue of invoices would have to register in that Member State. The VAT Committee already at its 121st meeting discussed the implications of a scenario focused on input transactions where registration is required in a Member State other than in the Member State of establishment[55]. That resulted in guidelines to confirm that the taxable person may not on that account be deprived of the benefit of exemption although to avail of the SME scheme a taxable person must be identified in the Member State of establishment only[56]. While those guidelines focus on intra-Community acquisitions of goods, the same must be concluded where, as recipient of services, supplied from another Member State the taxable person is required to identify on account of being the person liable for payment of VAT.

Registration in respect of output transactions, on the other hand, would deprive the taxable person of exemption and as such imposing this is at odds with the rules of the SME scheme which require identification in the Member State of establishment only. Even if it is in the hands of a Member State of exemption to require the issue of invoices, this could not come with a requirement of registration.

4.4. The SME scheme: leave

The SME scheme has its limits. Given that it is optional to apply, the taxable person may at any time decide to cease applying the exemption voluntarily. The exemption may however also come to an end where the annual turnover threshold in a particular Member State, subject to a period of transition, or the Union annual turnover threshold is exceeded. In that case, cessation will be compulsory.

4.4.1. Voluntary cessation

No common rules are put in place to say what is expected from a taxable person applying the domestic exemption only but wanting to cease to do so. This falls to the Member State of establishment to regulate.

As regards the cross-border exemption, the new Article 284(4) of the VAT Directive obliges the taxable person to inform the Member State of establishment of its decision to cease applying the exemption (*first subparagraph*). This should be done by way of an update to the prior notification.

It is also stipulated when cessation becomes effective (*second subparagraph*). That will, as a rule, be so on the first day of the calendar quarter following that during which the update is received. If, for example, the Member State of establishment receives such an update on 15 May, the exemption will cease to apply on 1 July. To process this update, the Member State of establishment needs time. Where it is received during the last month of a calendar quarter, the exemption will only cease to apply on the first day of the second

55 Working paper No 1049 *The new special scheme for small enterprises: interaction with rules on intra-Community acquisitions*.

56 See guidelines resulting from the 121st meeting of 21 October 2022 – Document C – taxud.c.1(2023)5499576 – 1063 (p. 287).

month of the following calendar quarter. Should the update therefore be received on 10 June, the exemption ceases to apply only on 1 August.

4.4.2. Compulsory cessation

Cessation is not in all instances voluntary. Rather, it will be compulsory if and when the annual turnover threshold of a Member State (in part) or the Union annual turnover threshold (fully insofar as the cross-border exemption is concerned) is exceeded. This will see an end to the exemption.

a) Annual turnover threshold of a Member State being exceeded

Under the *current rules*, it is not specified at which moment in time the exemption ceases to apply. While cessation should at best coincide with the moment that the threshold of a Member State is exceeded, the absence of a provision settling the matter leaves room for the Member State concerned to delay the transition to taxation. *In future*, this will change as it is specified when the exemption ceases to apply. It is in principle the moment that the threshold is exceeded[57] but that is tempered by new measures put in place to delay the impact and provide for a transition to taxation.

i. Transitional measure

To ensure gradual transition from exemption to taxation, the new Article 288a(1) of the VAT Directive stipulates that although the threshold is exceeded, the taxable person should be allowed to continue to benefit from the exemption for a limited time[58]. This is a measure available to a taxable person whether established and benefiting from the domestic exemption or not established but benefiting from the cross-border exemption. In applying this measure, it is not permitted for a Member State to differentiate between taxable persons who are established and those who are not established in that Member State.

Insofar as the threshold is not exceeded by more than 10% (*first subparagraph*) or 25% (*second subparagraph*), depending on the choice of the Member State concerned, the exemption will continue to apply. It may even be that no ceiling is set by the Member State (*third subparagraph*). No matter what, this measure of transition may in any event not result in granting of exemption if and when the turnover of the taxable person in the Member State concerned exceeds EUR 100 000.

A Member State applying a threshold of EUR 85 000 (*example 1*) could therefore not allow a taxable person exceeding the threshold by no more than 25% to continue to benefit from the exemption as that leaves room for an exemption of EUR 106 250. The Member State could stick to 10% which would see a taxable person with a turnover up to EUR 93 500 able to continue to benefit from the exemption. If, instead, the Member State decides not to apply a ceiling, it could not allow the taxable person to continue to be exempted once the turnover exceeds EUR 100 000.

The choice is most likely predicated on the level of the threshold applied by the Member State concerned. It is for example difficult to imagine that a Member State applying a threshold of EUR 8 000 (*example 2*) would stay by a transition of 10% as it leaves the

[57] This follows from the fourth subparagraph of the new Article 288a(1) of the VAT Directive.
[58] See recital 14 of Directive 2020/285.

taxable person with an exemption of EUR 8 800 only. In that situation, the expectation is that the Member State would opt for 25% resulting in an exemption of EUR 10 000.

Where a Member State decides not to apply a ceiling (*example 3*), it will need to ensure that, by way of transition, the turnover does not exceed EUR 100 000. It applies equally where a Member State takes up the option of 10% or 25%. This cap reflects the safeguard of the Union annual turnover threshold.

This enables a Member State applying a threshold of EUR 85 000 to allow a taxable person exceeding that threshold to continue to benefit from the exemption as long as the turnover of the taxable person does not exceed EUR 100 000. It ensures that the benefit of that exemption cannot be extended beyond what is the Union annual turnover threshold, including in cases where a taxable person only avails of the domestic exemption for which the safeguard put in place for the cross-border exemption does not apply.

By way of derogation, a Member State may also decide not to avail of this measure of transition (*fourth subparagraph*). In that case, the exemption ceases to apply as soon as the threshold is exceeded (*example 4*). Where on the other hand the transitional measure is applied, this will only be once the threshold expanded by 10% or 25% is exceeded. In example 1, the exemption will only cease to apply when the turnover exceeds EUR 93 500 while in example 2 it will be when exceeding EUR 10 000. Should no ceiling be applied as in example 3, it will be as soon as the ultimate threshold of EUR 100 000 is reached or, alternatively, by the end of the year.

ii. Domestic threshold being exceeded

When the domestic threshold in a particular Member State is exceeded, whether or not a period of transition is granted, the exemption ceases to apply. As of that moment, the exemption ceases to apply in that particular Member State although the taxable person may be able to benefit from exemption during a period of transition. After that, the exclusion will cover the remainder of the calendar year but, as stipulated in the new Article 288a(1) of the VAT Directive, also the following calendar year (*first sentence of the first subparagraph*). If the exemption ceases to apply in 2025, the taxable person will therefore also be excluded in 2026 and can only once again gain access to exemption in the Member State concerned in 2027.

If the Member State takes up this option, the exclusion may be extended to two calendar years (*second sentence of the first subparagraph*). That could see the taxable person re-admitted only in 2028.

b) Union annual turnover threshold being exceeded

With the *new rules*, the exemption under the SME scheme is also opened to taxable persons established in other Member States. In addition to the domestic threshold, the granting of exemption to a non-established taxable person is also subject to a Union annual turnover threshold which, if exceeded, entails that the taxable person will no longer be eligible for the cross-border exemption. As specified by the new Article 288a(2) of the VAT Directive, the exemption will cease to apply at that moment.

i. Transitional measure

While a period of transition is envisaged when the domestic threshold is exceeded, this is not the case as concerns the Union annual turnover threshold. The reason for that can be found in the threshold itself and its purpose. The Union annual turnover threshold serves as a safeguard to ensure that only small enterprises are given access to the exemption.

If and when the Union annual turnover threshold is exceeded, the taxable person will, contrary to the situation where the threshold of a particular Member State is exceeded, not be able to rely on such a period of transition. That would have deprived the Union annual turnover threshold of its purpose as a safeguard.

ii. Consequence of the threshold being exceeded

The situation where the Union annual turnover threshold is exceeded is settled by the new Article 288a(2) of the VAT Directive.

Should this threshold have been exceeded during the preceding year, a taxable person will not be able to benefit from the cross-border exemption in the current year (*first subparagraph*).

If instead the threshold is exceeded during the current year, the cross-border exemption will, given the absence of a period of transition, cease to apply at the moment the threshold is exceeded (*second subparagraph*). As of that moment taxation will kick in.

This will not deprive the taxable person of exemption in its Member State of establishment as the Union annual turnover as a condition is only applicable to the cross-border exemption. If below the annual turnover threshold in that Member State, the taxable person will therefore be able to continue to benefit from the domestic exemption.

Reporting done each calendar quarter enables the Member State of establishment to monitor the evolution in the taxable person's overall turnover. When the Union annual turnover threshold is exceeded, the new Article 284b of the VAT Directive in any event requires the taxable person to inform the Member State of establishment of this within 15 working days (*paragraph 3*) and that Member State is required, according to the new Article 284e(a) of the VAT Directive, to deactivate the identification number of that taxable person. It must be done without delay and will most likely come after the threshold is exceeded but that cannot be seen in itself to bring a period of grace. Rather, the deactivation should be done with effect from the moment the threshold is *de facto* exceeded[59].

c) Closing report

While under the SME scheme, a taxable person is obliged, under the new Article 284b of the VAT Directive, to report the total value of supplies carried out during the calendar quarter in the Member State of establishment and in each of the other Member States (*paragraph 1*). When exceeding the Union annual turnover threshold, the taxable person is also obliged, within the said 15 working days, to report the value of supplies made from the beginning of the relevant calendar quarter up until the date that threshold was

[59] See also section 4.3.b), vi) *When the Union annual turnover threshold is exceeded*.

exceeded (*paragraph 3*). This is the final report to be submitted and will serve to cross-check what is the date of exceedance.

Where a bankruptcy puts an end to the activities of a taxable person, this can also see the immediate departure of the taxable person from the SME scheme. This is not in the hands of the taxable person concerned and can hardly be handled through the procedure envisaged under the new Article 284 of the VAT Directive which provides for cessation to take effect as from the next calendar quarter or the following calendar quarter (*paragraph 4*). With that in mind, it seems appropriate to assimilate the case of bankruptcy with that where the Union annual turnover threshold is exceeded. If agreed, the taxable person would then be seen as required to inform its Member State of establishment and submit a final report within 15 working days of the bankruptcy.

d) Deactivation or adaptation of the individual identification number

There are various cases where the Member State of establishment will be obliged to deactivate the individual identification number or adapt it in view of new information received. As listed in the new Article 284e of the VAT Directive, deactivation or adaptation is required where:

(a) the total value of supplies reported by the taxable person exceeds the Union annual turnover threshold;

(b) the Member State of exemption has notified that the taxable person is not eligible for the exemption or the exemption has ceased to apply in that Member State;

(c) the taxable person has informed of their decision to cease to apply the exemption;

(d) the taxable person has informed, or it may otherwise be assumed, that their activities have ceased.

These are in the main cases that should be self-explanatory. The Member State of establishment is for deactivation able to rely on information from the taxable person, whether included in the quarterly report or provided separately, or a notification from the Member State of exemption. Whether deactivation or adaptation, the Member State of establishment will also be guided by information included in an update to the prior notification used by the taxable person to indicate the cessation or the take up of the cross-border exemption in one or more further Member States.

A case that could leave room for doubt is one where a taxable person appears to have ceased its activities but has not informed the Member State of establishment thereof. If it can be assumed that activities have ceased in one or all of the Member States of exemption, the Member State of establishment is supposed to adapt or deactivate the individual identification number of the taxable person. It is not specified how and on which basis the Member State of establishment may reach such conclusion.

When it comes to the Union OSS scheme, Article 369e(b) of the VAT Directive (also) similarly obliges the Member State of identification to exclude a taxable person where it may (otherwise) be assumed that its taxable activities under that scheme have ceased. According to Article 58a of the VAT Implementing Regulation, this is so where the taxable person for a period of two years has made no supplies of goods or services in any Member State of consumption covered by the Union OSS scheme.

When it comes to the SME scheme, deactivation (or adaptation) will in fact see the taxable person excluded (in full or partly) from the cross-border exemption. The implications of such a step can be serious, also given that to regain access the taxable person will have to go through a procedure lasting 35 working days (or more). The question is therefore whether to draw a parallel with the Union OSS scheme and conclude that where no supplies of goods or services have been made over a period of two years in one or more Member States, it can for the SME scheme be assumed that the taxable person has ceased its activities in that or those Member States. This could possibly be drawn from reporting done by the taxable person.

The new Article 284b of the VAT Directive requires any taxable person availing itself of the cross-border exemption to report for each calendar quarter the total value of supplies carried out in each Member State, indicating this as ‘0’ if none are made. Where, for a calendar quarter, a taxable person reports to have made no supplies in one or more of the Member States of exemption, this can therefore not in itself be taken as an indication that activities in that or those Member States have ceased (*scenario 1*). This is also the case where the taxable person has no supplies to report for any of the Member States of exemption (*scenario 2*). Otherwise, it could stand in the way of the taxable person gaining access to the cross-border exemption ahead of commencing its activities.

Should the taxable person continue to report having made no supplies (*scenario 3*), the question is at which moment it can be assumed that activities have ceased. If inspiration is to be found with the Union OSS scheme, activities could be assumed to have ceased where over a period of 8 consecutive calendar quarters no supplies are reported. Given what is at stake, the question is whether this period can be said to suffice. It is certainly difficult to imagine that the period should be shorter.

Where a taxable person is not abiding by the obligation of reporting (*scenario 4*), this cannot in itself be taken to mean that activities of the taxable person have ceased. For that, an update to the prior notification ought to have been made. Should no report be submitted, it will in the first place be for the Member State of establishment to pursue the matter[60]. In the face of sanctions, one would expect any taxable person having ceased its activities to indicate this.

If alongside not abiding by the obligation of reporting a taxable person is found to have registered for output transactions in one or more of the Member States of exemption (*scenario 5*), rather than cessation of activities, this will, in principle, result in the taxable person no longer being eligible for the SME scheme in the Member State(s) concerned. Should output transactions include some that are excluded from exemption[61], a taxable person may be required to register but in that case this cannot render the taxable person ineligible for the SME scheme.

60 That could be for the Member State of exemption but then only if obligations have been imposed on the taxable person following failure to adhere to reporting obligations (see section 4.3.b), iv) *Failure to adhere to reporting obligation*).

61 See section 4.1.3 *Transactions excluded*.

4.5. Conclusion

This paper seeks to clarify the workings of the new SME scheme that will come into place on 1 January 2025, also with a view to agree on issues where it is necessary to reach common grounds. Given the construct of the SME scheme, it is essential to ensure uniform application.

Amongst the issues to settle are the following:

1) Who are eligible for access to the SME scheme:
Only taxable persons established within the EU will be eligible while taxable persons established outside the EU should not be. Having a fixed establishment in a Member State cannot be taken to mean that a taxable person established outside the EU is seen as established in that Member State.

2) What is required if more than one threshold is applied by Member States:
Applying more than one threshold will see all qualify as sectoral thresholds.
Criteria used for distinction between such thresholds must be objective and not subjective.
Impact on data to be put in the prior notification and quarterly report respectively.

3) What in terms of obligations:
How to handle corrections to prior notification or quarterly report. Balancing how an obligation to issue invoices is implemented such as not to prevent access to the SME scheme. Best approach to take regarding obligations imposed by any Member State of exemption upon failure to respect obligations in the Member State of establishment.

4) When exemption ceases to apply:
Pinpointing moment that the Union annual turnover threshold is seen as exceeded.

5) How to handle individual 'EX' identification number issues:
When able to presume activities have ceased. Whether to reuse number or issue new one upon re-entry to the SME scheme after a period of quarantine.

5. DELEGATIONS' OPINION

Delegations are asked to express their opinion on the Commission services' opinion.

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