

9 May 2008

BUSINESSEUROPE'S RESPONSE TO THE COMMISSION'S CONSULTATION:

“REVIEW OF EXISTING LEGISLATION ON VAT REDUCED RATES” (MARCH 2008)

Executive Summary

BUSINESSEUROPE supports the application of reduced VAT rates for specific labour intensive and locally supplied services, where they have proven effects on growth and jobs without distorting the functioning of the Internal Market or creating undue pressure on governments' fiscal revenues.

However, the current system is fragmented and complex to use, especially in the case of cross-border activities. Compliance with diverging national classification rules for products or services that may apply for reduced rates is becoming increasingly burdensome for business.

Hence, BUSINESSEUROPE supports the Commission's approach to a new legal framework that would lead to the rationalisation and simplification of the present system. There is today an urgent need for binding legislation providing more uniform provisions for the application of reduced rates. It is up to the Member States to set the level of rates in line with Directive 2006/112/EC.

Regarding the definition of eligible activities, the merits of reduced VAT rates should always be evaluated against: (i) other fiscal and non-fiscal measures that could be used to reach similar policy objectives in more cost effective ways; (ii) the potential impact on cross-border competition and compliance costs for business.

With these elements in mind, BUSINESSEUROPE asks to work towards an agreement on the final structure of VAT rates without delay. The list of areas of activity eligible for reduced VAT-rates must be clearly identified and possibilities for derogation avoided.

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1- Introduction

In specific areas, reduced VAT rates can generate welfare gains without distorting trade in the Internal Market. Their application is probably most efficient when applied to labour-intensive services and other locally supplied services (sections 3 to 6 of the consultation document). However, the present system creates important compliance costs for business, particularly in their cross border activities, and should be thoroughly improved.

BUSINESSEUROPE supports the Commission approach to a new legal framework for reduced VAT rates that would lead to rationalisation and simplification of the present system. The Commission's decision to launch a first limited proposal without engaging an in-depth review of the current VAT structure is understandable given the difficult political context of such a debate. Pending the global revision, BUSINESSEUROPE asks the Commission to give companies legal certainty over a sufficiently long time horizon in the current review.

2- Current VAT structure

The VAT Directive 2006/112/EC provides in Articles 93 to 130 and Annex III and IV a legal framework for the application of VAT rates in Member States. As a basic rule, the standard rate is of at least 15% and up to two optional reduced rates of minimum 5% can be applied to a limited list of goods and services.

In addition, Directive 2006/112/EC grants derogations from these basic rules that are widely used by Member States. For Member States that joined the EU after 2004, derogations to the application of reduced VAT rates are temporary and limited to labour-intensive services. They will expire at the end of 2010.¹ This is also when the minimum of 15% for the standard rate expires and reduced VAT rates for certain labour intensive services cease to apply.

BUSINESSEUROPE sees an easy way to achieve significant release for businesses, if the goods set out in the list of Annex III to Directive 2006/112/ EC were exactly defined.

In the longer run, binding EU-wide legislation should set out uniform provisions for those goods and services to which a reduced rate can be applied. Member States should only be able to specify the reduced rates to be applied, and not depart from the EU definition of goods or services eligible for reduced rates.

¹ Council Directive 2007/75/EC amending Directive 2006/112/EC with regard to certain temporary provisions concerning rates of value added tax.

3- First limited Commission proposal for reduced VAT rates

With regard to the questions set out under section 8.1 regarding the application of reduced rates on locally-supplied services, labour-intensive services, restaurants and housing, as well as their possible extension, our views are the following.

A study undertaken for the European Commission on the impact of reduced rates applied to locally supplied services shows that while reduced rates should not be used as a general political instrument, their targeted application could have positive effects². Reduced rates on labour-intensive services, services provided to final consumers and locally provided services can increase productivity and a shift from the shadow economy to legitimate business activity. However, to be effective in terms of employment and productivity, reduced rates must largely be passed through to the consumer in terms of lower prices of the supplied products or services.

Labour-intensive services³

The Council Directive 2006/18/EC foresees the prolongation of reduced VAT rates for labour-intensive services until 2010 to test its impact, in terms of job creation and combating the 'black economy'. This is fully supported by BUSINESSEUROPE.

In view of the expiry of those provisions in 2010, BUSINESSEUROPE supports a permanent extension of some of the services and the possible inclusion of other services that are local in nature and that fulfil the above-mentioned conditions. This view is confirmed by the results of the Copenhagen study on the economic impact of the application of reduced VAT rates, which states that those measures need to be definitive to be effective.

Restaurant sector

Directive 2006/112 grants the option to Member States of applying a reduced VAT rate to foodstuffs including non-alcoholic beverages (Annex XIII(1)). For restaurant services, 11 out of the 27 Member States are currently allowed to apply a reduced rate on restaurant services, while 16 Member States are not.

The distinction and consequently the application of the correct VAT rate can be difficult and is an administrative burden, especially in restaurants that also offer "take-away" services. For BUSINESSEUROPE to support the addition of restaurant services to Annex III of Directive 2006/112, it should be demonstrated that a reduced rate on restaurant services is the best way to create jobs in this sector.

² Copenhagen Economics Study, 2007

³ Labour-intensive services cover minor repairing of bicycles, shoes and leather goods, clothing and household linen; renovation and repairing of private dwellings; window cleaning and cleaning in private households; domestic care services and hairdressing. Member States may only apply reduced rates to a maximum of three services of those categories.

Services linked to the housing sector

BUSINESSEUROPE shares the view of the Commission that the current legislation can be extended to avoid different fundamental approaches in the housing sector. Applicable services should be restricted to final consumers, which should be a matter of definition. The Commission has demonstrated that there are no cross-border issues.

Technical adjustments

The Commission's suggestion for technical adjustments that grant eligibility for reduced VAT rates to equivalent digital products is very important. For instance, the reduced rate applied to supplies of books, newspapers and periodicals might need to be updated to also cover the supplies of these products in electronic form. For audio books, the assignment of an identification number such as the ISBN could allow unmistakable demarcation as a book and hence eligibility for reduced rates.

4- Global revision of reduced rates scope

With regard to the more global revision of the scope of reduced rates, BUSINESSEUROPE is concerned that the range of services or goods eligible for reduced rates might be extended without giving due consideration to efficiency and effectiveness of this decision but rather to satisfy political ends.

Green products

BUSINESSEUROPE welcomes the Commission's review of incentives for the use of environmental friendly and energy efficient products and would need to see the Commission's detailed proposals in this area before reaching a firm conclusion. This proposal should include an assessment of the efficiency and effectiveness of using reduced VAT rates to promote such products compared with other fiscal and non-fiscal mechanisms.

There could be difficulties in using this approach. There is a risk of cross-border impacts because standards, such as the (voluntary) eco-labelling, are not sufficiently developed and do not cover the whole product span. There are also concerns that even if a fully-fledged energy-/eco-labelling scheme as proposed under the upcoming Action Plan on Sustainable Production and Consumption emerges it will be difficult to guarantee the environmental specification of a specific product over its whole life cycle and it might be difficult to keep up with product development in this field. In addition it could be difficult to guarantee that the reduction in the VAT rate is fully passed on to the consumers and the cross-border impact could be considerable.

Deletion from the list of certain categories currently eligible for a reduced rate

The abolishment of some reduced rates could be perceived as an infringement on subsidiarity. In addition, specific business sectors might suffer strong negative consequences from such a policy. Yet, each item on the list should be checked against the evaluation criteria set out in the introductory letter, namely cost-effectiveness, cross-border impact and compliance costs for business.