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## Review of existing VAT legislation on public bodies and tax exemptions in the public interest

The European Commission invites interested parties to submit their contributions in response to the questions raised in the consultation document *“Review of existing VAT legislation on public bodies and tax exemptions in the public interest”*. BUSINESSEUROPE welcomes the initiative from the European Commission. Because an increasing number of member-companies are involved in business-transactions within this sector BUSINESSEUROPE wants to highlight the importance of neutral, simple and modern VAT rules that work for all parties and member states.

### Background

BUSINESSEUROPE is very much involved in the pending discussion on the new VAT regime, initiated by the European Commission by the presentation of the Green Paper on the future of VAT. In the subsequent published Communication the VAT regime in the public sector has been listed as one of the priority actions for the coming years.

BUSINESSEUROPE agrees with this prioritization and is pleased that the European Commission has taken a next step in this area by launching the Consultation. In a reaction to this document BUSINESSEUROPE hereby presents the further view of European business on this important VAT-subject.

### Lack of neutrality – distortion of competition

As underlined in the reaction of BUSINESSEUROPE to the Green Paper, the current VAT rules in the public sector are not neutral and distortion of competition is becoming a serious problem. On the one hand public bodies have developed more and more into regular economic operators. In that field BUSINESSEUROPE mentioned, among others, construction work, financial and insurance services, different forms of consultancy, services of recruitment and selection and outplacement and career guidance as examples. On the other hand private businesses have become more and more active in sectors that used to be the privileged domain of public bodies. Examples mentioned by BUSINESSEUROPE are energy, public transport, waste management, healthcare, social care and education. Furthermore it was noticed that public bodies and private business are increasingly involved in public-private partnerships.



## **Article 13 VAT Directive – Public bodies acting as public authorities**

A problematic article is article 13 of the VAT Directive. According to this article public bodies are not regarded as taxable persons in respect of activities in which they engage “as public authorities”. According to ECJ-jurisprudence, this regards activities engaged in by bodies governed by public law under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private traders. However, according to article 13, public bodies shall be regarded as taxable persons if the treatment as non-taxable persons would lead to significant distortions of competition. Article 13 also provides that bodies governed by public law shall, in any event, be regarded as taxable persons in respect of certain activities (among others telecommunication services, water and energy supply, goods and passenger transport, port and airport services and the running of industrial canteens). But this tax liability does not apply if the activities are carried out on such a small scale as to be negligible.

It is clear that these rules do not only create unequal treatment, but are also very complicated and lead to legal uncertainty. Therefore BUSINESSEUROPE advocates a redrafting of article 13 in such a way that Member States may apply an exemption, but only in case of the exclusive competence of public bodies to provide pure public goods. Then the exemption is restricted to activities for which public bodies are never in competition with business. As a consequence of the discretionary ability of Member States (“may” instead of the current “shall”) Member States are not obliged to apply the exemption.

## **Articles 132-134 VAT Directive – Tax exemptions in the public interest**

To tackle distortion of competition between public and private sector, the exemptions of services in the public interest of article 132-134 of the VAT Directive should, in the view of BUSINESSEUROPE, only depend on the nature of the service. Additional conditions for the application of exemptions which concern the nature of the entity (eg. the entity which provides the service must be non-profit making; the entity must be recognized by the government) should be abolished. The exemptions should not apply when there is a distortion of competition.

A formal procedure must be put in place which makes it possible to (anonymously) lodge a complaint against distortion of competition. There should also be audits ex officio when tax authorities identify a possible distortion of competition.

BUSINESSEUROPE confirms the aspects raised by the European Commission as regards the input side due to the fact that input VAT is not deductible if the relevant input supply is related to non-taxable or tax-exempt outputs. An increasing number of companies have highlighted the negative impact on business created by the combination of exemptions, higher VAT-rates within EU and no input-VAT deduction.



BUSINESSEUROPE believes that this leads to cascade effects, self-supplies and a disincentive to invest or to outsource even where services could be provided more efficiently by another entity if the VAT aspect was irrelevant. Inefficiencies are created in the production and delivery of services by the public sector or a private business with no VAT deduction because spending decisions are often based on VAT aspects rather than on real economic factors.

In the view of BUSINESSEUROPE solutions within the scope of VAT are preferred instead of separate refund systems that could lead to a more complex system with difficulties to achieve transparency. Alternatives are needed.

- One way could be the introduction of zero-rating for activities in the public interest. This does not only express the public service character of those activities, but also leads to deductibility of input VAT. The introduction of zero-rating can however only be envisaged after a level playing field is realized between the public and private sector by the measures mentioned above :
  - the redrafting of article 13 of the VAT Directive, and
  - the introduction of the rule that the application of tax exemptions of services in the public interest of article 132-134 of the VAT Directive shall only depend on the nature of the service
- Another way that leads to deductibility of input VAT is granting an option to tax the performed activities in the public interest.

The essential importance of input VAT deduction is also specifically addressed in the Green Paper:

*“The right to deduct input VAT is fundamental to ensuring that the tax is neutral for business. The extent to which VAT is deductible is the key factor, but other factors include when and how VAT should be deducted.”*

BUSINESSEUROPE agrees with this statement and would like to emphasise that losing the right to deduct input VAT can lead to large distortions and disturbance of competition.

Regarding the current exemption of public postal services it is noticed that this exemption is not applied uniformly by Member States and that ECJ-jurisprudence did not lead to a uniform interpretation so far. Further, due to the VAT package 2010, the exemption might cause legal uncertainty in cases of cross-border services. The recent past has shown that Member States will not achieve consensus on reformulating the exemption in the short term. Therefore BUSINESSEUROPE advocates the implementation of an unambiguous definition of public postal services in article 132 VAT Directive.



## A gradual approach

Concerning a legislative proposal it is essential that economic activities of a similar nature are treated equally, irrespective of whether they are performed by public bodies or business entities in the private sector. The VAT rules should not play any role in the choice made by public bodies for the insourcing or outsourcing of contracts. The model of “full taxation” of public bodies offers an adequate solution. The model is future proof, because it automatically ensures a level playing field in a changing relationship between the public and the private sector.

However, in this further opinion BUSINESSEUROPE takes into account that the European Commission, considering the outcome of the public consultation on the Green Paper and the discussions with Member States in the Group on the future of VAT, promotes a gradual approach towards taxation. In the view of the European Commission a future legislative proposal "would concentrate on activities with a greater degree of private sector involvement and a heightened risk of distorted competition". Against this background and having regard to the effects of the expected difficult implementation of the full taxation model BUSINESSEUROPE agrees with the proposed gradual approach. In the view of BUSINESSEUROPE that approach includes a redrafting of article 13, modifications of the exemptions of the articles 132-134 VAT Directive in order to establish a level playing field between the public and private sector and the introduction of measures which lead to deductibility of input VAT with regard to activities in the public interest laid down in articles 132-134 of the VAT Directive.

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