Briefing
Implementation Appraisal

European Parliament

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Setting VAT rates

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

This briefing is one in a series of 'Implementation Appraisals', produced by the European Parliamentary Research Service (EPRS), on the operation of existing EU legislation in practice. Each such briefing focuses on a specific EU law which is likely to be amended or reviewed, as foreseen in the European Commission's annual work programme. 'Implementation appraisals' aim at providing a succinct overview of publicly available material on the implementation, application and effectiveness to date of an EU law, drawing on input from EU institutions and bodies, as well as external organisations. 'Implementation appraisals' are provided by the EPRS' Ex-Post Evaluation Unit, to assist parliamentary committees in their consideration of new European Commission proposals, once tabled.

Summary

Council Directive 2006/112/EC lays down rules applicable to the common system of value added tax (VAT). Among other issues, the Council Directive sets a framework for VAT rates. The present VAT system is based on 'the origin principle', which requires that a VAT rate applicable to transaction is determined by the Member State in which the seller is located.

Various studies and reports show that presently several challenges are linked to the implementation of this directive. These challenges include a gradual move from the origin principle to the destination principle, a need to fight VAT fraud, uncertainty for companies involved in cross-border trading, different VAT rates applied in Member States, obsolete rules, and the restrictive list of cases where reduced VAT can be applied, that is included in Annex III of the directive.

The European Parliament has called on the European Commission to update Council Directive 2006/112/EC to respond to these challenges. Similarly, the Council and the European Economic and Social Committee have recommended that this legislation be updated. Furthermore, representatives of various stakeholder groups have voiced requests regarding this piece of legislation. Finally, the European Commission has expressed a willingness to take a more effective and proportionate approach to VAT rates. It is expected that the European Commission will submit this proposal in the third quarter of 2017.

1. Background

Present EU legislation on value added tax (VAT) was crafted over two decades ago 'with the aim of arriving at a definitive VAT system based on the origin principle'.[1] According to the origin principle 'VAT rate that is applicable to a transaction is determined by that Member State where the seller is located'.[2] The current EU VAT legislation is based on directives leaving Member States with choices of form and methods of transposition of the EU legislation into their national legislation. The centrepiece of this legislation is **Council**

[1] The European Commission communication on an action plan on VAT (COM(2016) 148 final), p.11.
[2] The European Commission inception impact assessment on reform of VAT rates (December 2016), p.1.

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Directive 2006/112/EC of 28 November 2006, on the common system of value added tax (the VAT Directive), the main subject of this briefing.[3] Originally, the common criteria for VAT were included in Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes. The VAT Directive codified the sixth Council Directive 77/388 with all its amendments into one document. Since its adoption, the VAT Directive has been amended on 13 different occasions.

In April 2016, the European Commission adopted and presented its action plan on VAT. The action plan set out, among other things, immediate and urgent measures to tackle the VAT gap and adapt the VAT system to the digital economy.[4] One of the key initiatives in the action plan was to modernise the VAT rates policy. In December 2016, as a follow up to the action plan, the Commission submitted a package of initiatives to modernise VAT with regard to cross-border e-commerce, a generalised reverse change mechanism, and VAT rates applied to books, newspapers and periodicals.[5]

The action plan on VAT notes a shift from the origin principle towards the destination principle. According to this principle, the supply of goods or services is exempted from VAT in the Member State of origin and is subject to VAT in the Member State of consumption.[6]

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

Directive 2006/112/EC establishes the common system of VAT and sets a framework for VAT rates. According to Article 2(1) of the directive, several activities are subject to VAT, including:
(a) the supply of goods for consideration within the territory of a Member State by a taxable person,
(b) the intra-Community acquisition of goods for consideration within the territory of a Member State,
(c) the supply of services for consideration within the territory of a Member State by a taxable person, and
(d) the importation of goods.[7]
The directive defines a taxable person as a person who, independently, carries out any economic activity in any place, whatever the purpose or results of that activity (Article 9 (1)).[8]

The VAT rate setting is based on two basic principles; (1) there is a standard minimum VAT rate for all goods and services, and (2) Member States can opt to apply reduced rates to specific goods and services listed in the directive.

- A standard VAT rate of minimum 15 % is applicable to all taxable supplies in goods and services (Articles 96 and 97).
- Member States can apply one or two reduced VAT rates of minimum 5 % to certain goods and services included in Annex III of the directive (Articles 98 and 99).[9]

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[3] Other pieces of EU VAT legislation include: Council Directive 2008/9/EC laying down detailed rules for the refund of value added tax, Thirteenth Council Directive 86/560/EEC on the harmonization of the laws of the Member States relating to turnover taxes, Council Directive 2009/132/EC determining the scope of Article 143(b) and (c) of Directive 2006/112/EC as regards exemption from value added tax on the final importation of certain goods, Council Directive 2007/74/EC on the exemption from value added tax and excise duty of goods imported by persons travelling from third countries, and Council Directive 2006/79/EC on the exemption from taxes of imports of small consignments of goods of a non-commercial character from third countries. There are also several implementing acts ensuring uniform application of the VAT Directive, such as, 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.

[4] A VAT gap is the difference between expected VAT revenues and VAT actually collected. See the Commission's estimates of the VAT gap in individual Member States in 2014.

[5] See 2016/0149(COD) with regard to cross-border parcel delivery services, 2016/0406(CNS) on the generalised reverse charge mechanism, and 2016/0374(CNS) on VAT rates applied to books, newspapers, and periodicals.

[6] See action plan on VAT (COM(2016) 148 final), p.4.

[7] The directive provides specific explanations for each of these taxable transactions (Article 14-Article 30).

[8] Under certain conditions, a person who only carries out an activity on an 'occasional basis' can also be considered a taxable person (See, Article 9(2)).

[9] Annex III of the directive includes a list of supplies of goods and services to which reduced VAT rates can be applied, for example, foodstuffs, supply or water and medical equipment and pharmaceutical products.

- In addition to these two basic rules, Member States can, in exceptional cases, apply derogations allowing some goods and services to be taxed at levels lower than 5 %,[10] or even to be exempted from VAT.[11]

The directive (Article 398) also establishes a special advisory committee on value added tax (**the VAT Committee**), which promotes the uniform application of the directive. Several provisions of the directive require that Member States consult the VAT Committee before they adopt exemptions or restrictions into their national legislation.[12]

Table 1 – Current VAT rates applied in the EU Member States

Member State	Reduced VAT rate	Standard VAT rate
Belgium	6/12 %	21 %
Bulgaria	9 %	20 %
Czech Republic	10/15 %	21 %
Denmark	-	25 %
Germany	7 %	19 %
Estonia	9 %	20 %
Ireland	9/13,5 %	23 %
Greece	6/13 %	24 %
Spain	10 %	21 %
France	5,5/10 %	20 %
Croatia	5/13 %	25 %
Italy	5/10 %	22 %
Cyprus	5/9 %	19 %
Latvia	12 %	21 %
Lithuania	5/9 %	21 %
Luxembourg	8 %	17 %
Hungary	5/18 %	27 %
Malta	5/7 %	18 %
Netherlands	6 %	21 %
Austria	10/13 %	20 %
Poland	5/8 %	23 %
Portugal	5/13 %	23 %
Romania	5/9 %	19 %
Slovenia	9,5 %	22 %
Slovakia	10 %	20 %
Finland	10/14 %	24 %
Sweden	6/12 %	25 %
United Kingdom	5 %	20 %

Source: European Commission, **VAT rates applied in the Member States of the European Union**, 2017

[10] For derogations see Title XIII and Article 395 of the directive, that allow Member States to derogate from the common VAT rules in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance. The list of VAT derogations can be found on the website of the European Commission.

[11] With regard to all taxable transactions, the directive allows various exemptions. For example, activities in the public interest, such as education or hospital and medical care, but also most financial and insurance services, are exempted from VAT. See Title IX of the directive.

[12] See, for example, Articles 155, 177 or 281 of the directive. Documentation by the VAT Committee and a list of consultations are published by the European Commission.

2. EU-level reports, evaluations and studies

European Commission inception impact assessment on Directive 2006/112/EC on the common system of value added tax (December 2016)

This inception impact assessment[13] noted that the proposal aims to tackle two main problems. First, the inception impact assessment argued that the current VAT rates were too limiting for Member States. According to the document, the current design of the rates regime made it difficult for Member States to extend reduced VAT rates to new areas. The document also showed that extending reduced VAT rates required unanimity in the Council. This according to the Commission rendered the rules for VAT rates obsolete in some areas. This, according to the Commission, led to multiple breaches of EU rules as Member States were 'tempted to act themselves'.[14] Another problem identified was that the directive contained several derogations to VAT rates that were set to expire when the definitive regime was adopted. According to the inception impact assessment, lack of decision on these derogations would cause legal and economic uncertainty for several sectors.

The general objectives of the upcoming proposal are supposed to (1) take the subsidiarity principle into account following the switch to the destination system, (2) achieve a more neutral rates regime for the Member States, and (3) prepare the ground for the parallel introduction of the definitive VAT regime.

European Commission communication on an action plan on VAT (April 2016)

The European Commission set a 'pathway to the creation of a single EU VAT area' in its action plan on VAT.[15] According to the Commission, the common VAT system was an important source of revenue in the EU that corresponded to 7 % of EU GDP in 2014.[16] Consequently, the Commission underlined the need to reboot and modernise the system and to bring it up to date with the challenges of today's economy. The Commission admitted that the VAT system needed reform with regard to its simplicity and efficiency. Furthermore, the reform needed to strengthen the combat against the growing risk of fraud and improve trust between business and tax administrations, and between EU tax administrations.[17] To tackle these challenges, the Commission planned to present various legislative proposals, including a definitive VAT system, a VAT package for SMEs and VAT rates.
With regard to the latter issue, the action plan noted that the existing rules did not sufficiently take technological and economic developments into account, including e-books and electronic newspapers. Furthermore, it questioned the aim of establishing a VAT system based on the 'origin principle', which, according to the Commission, in practice 'developed into a system based on the destination principle'.[18] This discrepancy allowed for 'greater diversity in VAT rates' in Member States.[19] The European Commission also argued that the existing rules were rather rigid and slow, as the extension of reduced-rate treatment to new areas has to be taken unanimously by the Council.[20] The action plan in this context requested greater freedom for Member States, and proposed two options:

1. extension and regular review of the list of goods and services eligible for reduced VAT rates set out in Annex III of the directive, or
2. abolition of the list.

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[13] The Better Regulation Guidelines (SWD (2015) 111 final) describe an 'inception impact assessment' as a roadmap for initiatives subject to an impact assessment. It sets out the description of the problem, issues relating to subsidiarity, policy objectives and options, and the likely impacts of each option in greater detail.
[14] To date, the European Commission has started more than 40 infringement proceedings regarding VAT rates.
[15] The European Commission communication on an action plan on VAT (COM(2016) 148 final), p.3.
[16] *ibid.*
[17] *ibid.*
[18] *ibid.*, p.11.
[19] *ibid.*
[20] *ibid.*

The first option intended to maintain a standard VAT rate of 15 %. Member States would be able to submit their proposals and opinions on adjustments to the list to the Commission. The Commission would have to carry out an analysis of these opinions before deciding whether or not to adapt the list.[21]

The second option intended to remove the minimum standard VAT rate, as well as the list. By abolishing the list, this option intended to give Member States greater flexibility in setting VAT rates. This option however also included several limitations, such as safeguards preventing unfair tax competition within the single market.[22]

European Commission study on implementing the 'destination principle' to intra-EU business-to-business supplies of goods (June 2015)

This study researched the VAT system and the application of the origin principle.[23] The study identified two fundamental issues with the current VAT system: (1) the existence of additional obligations and costs linked with compliance with the VAT rules for businesses engaging in cross-border (intra-EU) trade, and (2) the level of VAT fraud within the EU. The study claimed that the cross-border VAT compliance costs are 11 % higher than domestic trade VAT compliance costs. As to the existence of the VAT fraud, the study estimated that 'missing trader intra-community' fraud[24] alone is responsible for a loss of approximately €45 billion to €53 billion annually.[25]

The study assessed five policy options selected by the Commission services:

- limited improvement of current rules,
- taxation following the flow of goods,
- reverse charge following the flow of goods,
- alignment with the place of supply of services, and
- taxation following the contractual flow.

In this regard, the study estimated that option 4 would generate the most significant compliance costs savings for all types of businesses analysed. The study estimated that the monetary impact of this option across businesses is approximately €2.7 billion.[26] With regard to the levels of VAT fraud, the study considered option 2 as the best choice, as it anticipated that this option could significantly reduce the scale of VAT fraud.[27] The study concluded that options 2 and 5 could generate the biggest economic impact on the EU economy.[28]

European Commission communication on the future of VAT (December 2011)

The Commission communication intended to set out the fundamental features of a future VAT system, and provided a list of priority areas for further action.[29] The Commission discovered that the 'origin principle' was not achievable in the foreseeable future and should be abandoned.[30] According to the Commission, abandoning this principle allowed the launch of substantial changes in the VAT system.

Reform of VAT should lead to a simpler, more efficient and robust and fraud-proof VAT system. With regard to a simpler VAT system, the communication noted: (1) the need to introduce a one-stop-shop concept for VAT; it also acknowledged the need (2) to provide businesses with more accessible and better information on VAT regimes at EU level; (3) to improve the governance of VAT at EU level; and (4) to standardise VAT obligations. Regarding a more efficient VAT system, the Communication promised: (1) to broaden the tax base; and (2) to review the VAT rate structure. As to a robust and fraud-proof VAT system, the communication

[21] *ibid*., p.12.

[22] *ibid*., pp.12-13.

[23] The study was outsourced by the European Commission and carried out by Ernst & Young LLP in 2015.

[24] 'Missing trader intra-community' fraud is selling of goods by a fraudulent business without paying the VAT. For a broader explanation of the term see, footnote 2 of the study, p.13.

[25] *ibid.,* p. 17.

[26] *ibid.,* p. 15.

[27] *ibid.,* p. 17.

[28] *ibid.,* p. 18.

[29] COM(2011) 851 final, pp.4-5.

[30] *ibid*., p.5.

intended: (1) to establish a quick reaction mechanism to deal with 'sudden fraud'; (2) to combat VAT fraud; and (3) to review ways of collecting VAT.[31]

European Commission green paper on the future of VAT (December 2010)

In this paper, the Commission intended to look critically at the EU VAT system in order to strengthen its coherence with the single market, its capacity to raise revenue, and its contribution to other policies.[32] According to the Commission, reform of the VAT system could play a crucial role in supporting the delivery of the Europa 2020 strategy. The Commission noted the need for a simpler VAT system, as the complexity of the existing rules was burdening businesses. It also pointed to a need for a better functioning single market, as domestic and intra-EU transactions were to be treated differently for VAT purposes. The Commission furthermore highlighted its intention to tackle VAT fraud and to align the VAT system with changes in technology and the economic environment.[33] Already in this paper, the Commission noted a shift from the 'origin principle' in the EU legislation.[34]

3. European Parliament position/MEPs' questions

3.1 European Parliament resolutions

European Parliament resolution of 24 November 2016 on proposals towards a definitive VAT system and fighting VAT fraud

Parliament noted that the existing VAT rates in the Member States caused 'great uncertainty for companies involved in cross-border trading'.[35] According to Parliament this unpredictability was linked, for instance, with questions regarding collection of VAT, the risk of VAT fraud, or different VAT rates set for different product categories within the same country. In this regard, Parliament called on the Commission to study the impact of VAT fraud by mid-2017. The Member States were asked to 'agree on increasing convergence in VAT rates' (point 25). The Commission was called upon to assess the impact of failure to harmonise VAT rates at Union level and a removal of these obstacles (point 26). Parliament also supported the regular review of the list of goods and services eligible for reduced VAT rates and called for political priorities to be taken into account when reviewing the list (point 27).

According to Parliament, the complete abolition of minimum tax rates might cause considerable competition distortions and problems in the single market. It highlighted the need for greater harmonisation (point 28). Parliament noted that the VAT system was complicated and called for its simplification (point 31). It called for an internet portal containing information on the VAT rates in the Member States. The Commission was called upon to set out a list with updated information on VAT rules in every single Member State (points 50 and 51). Furthermore, Parliament asked for 'comprehensive and qualitatively-sound impact assessments' regarding the Commission's plans to reform the VAT system (point 54).

It appears that the Commission's follow-up document to this resolution has not yet been published.

European Parliament resolution of 11 September 2012 on the online distribution of audiovisual works in the European Union

Although this resolution predominantly dealt with the online distribution of audiovisual works, Parliament called for initiation of 'a debate on the issue of the divergent VAT rates applied in Member States', and called on the Commission and the Member States 'to coordinate their action in this area' (point 59). Parliament also stressed the need to apply the same VAT rate to cultural audiovisual works sold on- and off-line (point 61).

[31] Various European Commission communications were adopted between 2008 and 2011 with regard to the VAT Directive.
[32] COM(2010) 695, p.3.
[33] *ibid*., p.6.
[34] *ibid*., p.7.
[35] P8_TA(2016)0453.

In its follow-up, the European Commission noted that its 2011 communication on the future of VAT promoted a review of the existing VAT structure.[36] According to the Commission, the review of the existing VAT structure was supposed to lead to the abolition of reduced VAT rates constituting an obstacle to the functioning of the internal market, and the abolition of reduced VAT rates on goods and services whose consumption is discouraged by other EU policies. Moreover, similar goods and services should each be subject to the same VAT rate.

European Parliament resolution of 17 November 2011 on the modernisation of VAT legislation in order to boost the digital single market

Parliament pointed out that, with regard to VAT rules, the EU should develop 'solutions tailored to its own needs'.[37] In order to develop a genuine single market, according to Parliament, Member States should be allowed to apply a reduced VAT rate to electronically supplied services with a cultural content (point 4). It noted that e-books that were subjected to a standard VAT rate, while Member States could apply reduced VAT rates to the supply of books on all physical media (point 2). Parliament furthermore considered that a review of VAT legislation allowing Member States a more flexible application of reduced VAT rates should comply with principles laid down in Council Directive 2008/8/CE (point 8). It also stressed that any review of the VAT system should lead to its simplification (point 8).

It appears that the Commission's follow-up document to this resolution has not yet been published.

European Parliament resolution of 13 October 2011 on the future of VAT

In this resolution, Parliament welcomed the Commission's green paper on overhauling and reforming the VAT system (point 1).[38] Parliament called on Member States to move towards a 'broad based VAT system' (point 7). Furthermore, it called for 'a harmonised standard or reduced VAT rate for all intra-EU cross-border travel, regardless of the mode of transport, and for harmonised rules on VAT deductibility' (point 10). Parliament noted market distortions, as some modes of transport (bus and train) are subjected to VAT, while other modes are not (point 12). As to deductibility, Parliament noted the complexity of the rules, which cause problems for businesses (point 14). It found that the VAT system moved away from 'the initial commitment by Member States to implement the origin principle', and agreed that it was necessary 'to recognise the status quo and move towards a destination principle' (points 15 and 16). According to Parliament, this appeared to be 'a promising route that should be further analysed and needs to be accompanied by the introduction of well-functioning one-stop shops by Member States' (point 16). The Commission was asked, among other things, to submit a report comprising a binding list of common goods and services eligible for a reduced VAT rate or an exemption under the VAT Directive (point 22).

It appears that the Commission's follow-up document to this resolution has not yet been published.

3.2 Written questions by MEPs

The Members of the European Parliament have addressed, in writing or orally, several questions to the European Commission in which they have asked the Commission to provide its answers or explanations with regard to various issues related to VAT rates. The following examples provide an excerpt of the most relevant Members' questions from the latest parliamentary term.

Written question by Andrzej Zdrojewski (EPP, Poland), 9 May 2017

[36] SP(2012)766/2.
[37] P7_TA(2011)0513.
[38] P7_TA(2011)0436.

The Member asked the Commission whether the planned amendment of Council Directive 2006/112/EC intended to introduce specialised tools to gather data relating to the VAT rates that are applied in individual Member States.

Answer given by Pierre Moscovici on behalf of the Commission, 11 July 2017

The Commissioner replied that, at EU level, monitoring of VAT rates takes place as part of a review of the scope of reduced rates, pursuant to Article 100 of the directive. Furthermore, he noted that the Commission publishes information on VAT rates in its document on **VAT rates applied in the Member States of the European Union**. He added that, in future, the information on VAT rates will be collected on a 'mandatory and standardised basis'.

Written question by Claudia Țapardel (S&D, Romania), 25 January 2017

The Member pointed to VAT disparities in the EU Member States causing inconsistency in EU tax policy and asked whether the Commission intended to draw up recommendations regarding minimum and maximum VAT levels in the Member States. Furthermore, the Member asked how the Commission intended to resolve the problem of VAT-free zones in the Union and whether there were any priority areas for the application of reduced VAT.

Answer given by Pierre Moscovici on behalf of the Commission, 16 March 2017

The Commissioner explained that the 2016 action plan on VAT put forward two options for reform of the rules on VAT rates. In this regard, he noted that the action plan envisaged granting Member States even more flexibility on VAT rate-setting, without suggesting introduction of a maximum rate, nor did it indicate priority areas for reduced VAT. The Commissioner also noted that the Commission was not aware of any specific problems concerning VAT-free zones. He also informed that the Commission intended to finalise its proposal in the course of 2017.

Written question by Tibor Szanyi (S&D, Hungary), 18 August 2016

The Member inquired whether VAT reduction and/or VAT exemption on electric and hybrid electric vehicles was in conflict with European law, including Directive 2006/112/EC.

Answer given by Pierre Moscovici on behalf of the Commission, 26 September 2016

The Commissioner informed the Member that the VAT Directive did not provide for special rules on the supply of electric or hybrid motor vehicles. He noted that under the general rules, the supply of motor vehicles is subject to the standard VAT rate. He added that the Commission, in its 2016 action plan on VAT, included options that would allow Member States more flexibility regarding setting VAT rates.[39]

4. Council and European Council

The Council of the European Union ('Council') and the European Council addressed the issue of VAT rates in their conclusions on several occasions.

For instance, in its 2012 **conclusions on the future of VAT**, the Council supported a simpler, more efficient and neutral, robust and fraud-proof EU VAT system. The Council noted that a reform of the EU VAT system should 'aim at making it more effective and efficient, removing unjustified exemptions and broadening the tax base, in order to contribute to fiscal consolidation and growth'. The Council also emphasised the importance that the simpler VAT system should not impose additional burdens on businesses. The Commission was called upon to present several proposals, including one to create a standardised VAT declaration. The Council also took note that the Commission favoured a restricted use of reduced VAT rates in order to increase the efficiency of the VAT system.

In its 2016 **conclusions on the VAT action plan and on VAT fraud**, the Council agreed that, among other things, the EU VAT system needs to be modernised and improved. It called for robust legal rules that hamper VAT fraud (point 1). The Council also underlined the need for an improvement in information exchange, which can help the fight against VAT fraud. In this regard, the Commission was asked to propose 'ways of

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[39] As well as the above-mentioned questions, Members of the European Parliament have during the years asked various questions with regard to the VAT rates, for example, E-004156-17, E-001520-17, E-001029-17, E-007590-16, E-001733-16 or P-003087-16.

addressing legal obstacles and practical limitations that might exist in the EU and in the Member States' (point 5). Furthermore, the Council recognised the difference between the Member States regarding exposure to VAT fraud (point 10). With regard to VAT rates, the Council took note of the actions proposed by the Commission action plan on VAT and the Commission's intention to submit a legislative proposal proposing a reform of the VAT system giving more freedom to Member States (point 29). The Council also welcomed the Commission's intention to present a legislative proposal for increased flexibility for Member States regarding VAT rates. The Council called for an impact assessment to be included in that proposal (point 30). The Council further stressed that there is a need for 'a sufficient level of harmonisation in the EU' regarding the VAT system in order 'to avoid distortion of competition, rising business costs, and negative impact on the functioning of the single market' (point 31).

In its **March 2016 conclusions**, the European Council welcomed the Commission's intention to submit legislative proposals that would increase Member States' flexibility 'with respect to reduced rates of VAT, which would provide the option to Member States of VAT zero rating for sanitary products' (point 15). The European Council's **October 2013 conclusions** also noted that work to tackle tax evasion, tax fraud, aggressive tax planning, tax-base erosion and profit shifting is important for the digital economy. In this regard, the European Council welcomed the Commission's initiative to set up an expert group on taxation of the digital economy (point 4).

5. European Economic and Social Committee and Committee of the Regions

The European Economic and Social Committee (EESC) also considered VAT and changes to the VAT system as an important part of its work. For instance, the Section for Economic and Monetary Union and Economic and Social Cohesion's **2018 priorities** expressed the EESC's intention to continue its work on the EU VAT rate structure, with a view to advancing towards a definitive VAT regime (point 3).

Furthermore, in its **July 2016 opinion on VAT action plan**, the EESC explained its position on the Commission's action plan. While the EESC welcomed the action plan, it took the view that the transformation of the current VAT system should lead to 'a definitive VAT system that is clear, consistent, robust and comprehensive, as well as proportionate and future-proof' (point 1.4). The EESC insisted upon the flexibility of the new VAT system, while supporting legal certainty. The system must be transparent, and in order to increase its simplicity, 'the number of reduced rates and exemptions must be limited' (point 1.11). The EESC also called for an application of 'the country of destination principle', without however leading to 'fragmentation and excessive complexity' (points 3.1.6 and 3.1.7). The EESC also welcomed the intention to tackle VAT fraud (point 3.3.1). The EESC raised concerns that increased flexibility on reduced VAT rates might lead to greater fragmentation of VAT rates (point 3.6.1). The complexity of the current VAT system and the need to simplify the system for SMEs was also raised in other EESC opinions, such as the **2017 opinion on the start-up and scale-up initiative**.

The Committee of the Regions (COR) also welcomed the Commission's action plan on VAT (**October 2016 opinion**). The COR highlighted that the differences in VAT rules and their rates have 'a particular impact on border regions and the activities of SMEs in these regions' (point 7). It also pointed out the fragmentation and complexity of the VAT system. This, according to the COR, led to 'major compliance costs for businesses involved in cross-border trade' (point 6). The COR also emphasised that the current list of reduced VAT rates lacked transparency and a well-defined rationale (point 26). The Committee considered it necessary to review this list, seeking 'harmonisation in order to avoid distortion of competition within the single market for SMEs' (point 26). Furthermore, the COR expressed its belief that 'giving Member States more leeway in setting rates will inevitably lead to greater differences in rates which might distort the single market and impose burdens on businesses' (point 29). The COR also called for further simplification of rules and procedures linked to different VAT regimes in cross-border trade in its July 2017 **opinion on smart regulation for SMEs**.

6. European Commission public consultation

Between 20 December 2016 and 20 March 2017, the European Commission carried out a public consultation on the reform of VAT rates. The summary report of this public consultation was published in June 2017. The public consultation received 327 replies. In addition, 60 position papers were submitted. The large majority of the respondents were associations (trade, business, or professional) while replies from individuals were limited. Approximately one half of all respondents believed that the list of goods and services eligible for reduced VAT included in Annex III of the VAT Directive should include more goods and services, while one third of respondents considered the current list as adequate.[40] More than half of the respondents indicated that the VAT system should be simplified, and one third of the respondents called for broader flexibility for Member States.[41] Furthermore, more than half of the respondents were satisfied with the minimum standard VAT rate of 15 %. In addition, a majority of respondents preferred a regular review of the list of goods and services, while keeping minimum standard VAT at 15 %, over abolishing the list and allowing Member States greater freedom on the number of reduced rates and their level.[42]

The summary report concluded that the opinions of the respondents varied widely, that there was no clear consensus on any of the issues, and several results were contradictory.[43] However, the report noted a generally fair level of satisfaction with the current number of VAT rates and the current minimum for the standard and reduced VAT rate.

During the same period, the Commission also carried out a public consultation on the special scheme for small enterprises under the VAT Directive and a public consultation on the definitive VAT system for Business to Business (B2B) intra-EU transactions on goods. The summary report on the definitive VAT regime (June 2017) noted that only fully harmonised legislation can exclude complexity in the system.[44] Furthermore, the report mentioned that the respondents called for improvements in clarity and legal certainty. The summary report on the special scheme for SMEs also noted that respondents called for further harmonisation and simplification of the VAT system for SMEs across the EU. Both summary reports also acknowledged that the responses were not numerous (121 and 113), with the majority of respondents being businesses and business organisations.

7. Citizens' petitions

Several petitions were submitted to the European Parliament dealing with VAT rates in individual EU Member States. In the case of petition 0407/2009, for example, a citizen complained about the fact that in Germany, family-oriented products (such as children's clothes or shoes) were taxed with a higher VAT than luxury products (truffles or racehorses). In petition 0564/2016, the petitioner suggested that national VAT could be abandoned and a common VAT in all European Union countries could be introduced. In petition 0442/2015, the petitioner asked that the VAT on solar panels in the EU be reduced to 0 % and suggested that this measure be applied to all other products producing 'clean' energy. Furthermore, in petition 2621/2014, an EU citizen advocated an increase in the income limit for exemption from paying VAT for small businesses.

8. Stakeholders' comments

Various stakeholders provided their comments on the current system of VAT rates. The following positions provide only an example of opinions adopted or presented in this regard.

The representative of national business federations, BUSSINESSEUROPE, in its position paper on the VAT action plan (2016), welcomed the action plan that should lead to a single VAT area in the EU. It expressed its

[40] Summary report, p.4.

[41] *ibid.*

[42] *ibid.,* p.5.

[43] *ibid.,* p.6.

[44] Summary report, p.9.

support for 'the destination principle' to apply to VAT, and noted that further work needs to be done regarding VAT collection methods. It also called for a comprehensive package of measures that would simplify VAT and ease the administrative burden for SMEs. This should, for example, include an improved one-stop-shop or EU VAT information portal.

The position paper on a VAT SME scheme (2017) by the European Association of Craft, Small and Medium-sized Enterprises (UEAPME) demanded that all SMEs should be covered by VAT. UEAPME called for a simplified VAT obligation that should be mandatory for Member States and should be available to all SMEs. According to UEAPME, one of the most important simplification measures would be the introduction of a one-stop-shop for VAT. UEAPME also provided a position paper on the VAT action plan (2016) and supported the Commission's intention to simplify the VAT system for businesses. Furthermore, EUAPME argued that additional autonomy for Member States with regard to setting VAT rates may not distort competition within the single market. It also insisted on easy accessible information on VAT rates applicable in all Member States.

The European Centre of Employers and Enterprises providing Public Services and Services of general interest (CEEP) welcomed, in its opinion on the EU VAT action plan (2016), the Commission's pragmatic approach with regard to reduced VAT rates. According to the CEEP, a single European list did not seem appropriate, due to the diversity of tax policies across Member States. CEEP expressed its belief that the existing VAT regime was balanced and should be maintained. Nevertheless, CEEP called for a clear alignment of VAT rules with EU public procurement rules.

9. Other sources of reference

Remeur, C., Reduced VAT rate for e-publications, European Parliament, EPRS, May 2017.
Katsarova, I., E-Books: Evolving markets and new challenges, European Parliament, EPRS, February 2016.
Remeur, C., The same VAT rate for print and e-publications, European Parliament, EPRS, May 2017.
Dražen, R., Dessimirova, D., Indirect taxation, European Parliament, March 2017.

Table 2 – Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

EP committee responsible at the time of adoption of the EU legislation: Committee on Economic and Monetary Affairs (ECON)
Date of adoption of original legislation in plenary: 20 June 2006
Deadline for transposition of legislation: 1 January 2008 (Article 412 (1), Council Directive 2006/112/EC)
Planned date for review of legislation: The European Commission is obliged to report on the application of Chapter 1 (Special scheme for small enterprises) of the directive. According to Article 293 of the directive, the Commission presents this report to the Council at four-year intervals. The report should be based on the information provided by Member States.
Timeline for new amending legislation: The REFIT proposal on VAT rates are presumed in Annex 1 of the Commission work programme 2017. The European Commission intends to submit its proposal in the third quarter of 2017.[45]

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[45] Also the Commission's list of *points prévus* of 25 July 2017 (SEC(2017)353 final) notes that this is 'a possible item for September-December 2017'.