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REPORT

on the proposal for a Council directive amending Directive 77/388/EEC on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to be applied
(COM(2005)0136 – C6-0113/2005 – 2005/0051(CNS))

Committee on Economic and Monetary Affairs

Rapporteur: Zsolt László Becsey .

Symbols for procedures

*	Consultation procedure *majority of the votes cast*
**I	Cooperation procedure (first reading) *majority of the votes cast*
**II	Cooperation procedure (second reading) *majority of the votes cast, to approve the common position* *majority of Parliament's component Members, to reject or amend the common position*
***	Assent procedure *majority of Parliament's component Members except in cases covered by Articles 105, 107, 161 and 300 of the EC Treaty and Article 7 of the EU Treaty*
***I	Codecision procedure (first reading) *majority of the votes cast*
***II	Codecision procedure (second reading) *majority of the votes cast, to approve the common position* *majority of Parliament's component Members, to reject or amend the common position*
***III	Codecision procedure (third reading) *majority of the votes cast, to approve the joint text*

(The type of procedure depends on the legal basis proposed by the Commission.)

Amendments to a legislative text

In amendments by Parliament, amended text is highlighted in ***bold italics***. Highlighting in *normal italics* is an indication for the relevant departments showing parts of the legislative text for which a correction is proposed, to assist preparation of the final text (for instance, obvious errors or omissions in a given language version). These suggested corrections are subject to the agreement of the departments concerned.

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on the proposal for a Council directive amending Directive 77/388/EEC on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to be applied
(COM(2005)0136 – C6-0113/2005 – 2005/0051(CNS))

(Consultation procedure)

The European Parliament,

– having regard to the Commission proposal to the Council (COM(2005)0136)[1],

– having regard to Article 93 of the EC Treaty, pursuant to which the Council consulted Parliament (C6-0113/2005),

– having regard to Rule 51 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A6-0323/2005),

1. Approves the Commission proposal as amended;

2. Calls on the Commission to alter its proposal accordingly, pursuant to Article 250(2) of the EC Treaty;

3. Calls on the Council to notify Parliament if it intends to depart from the text approved by Parliament;

4. Asks the Council to consult Parliament again if it intends to amend the Commission proposal substantially;

5. Instructs its President to forward its position to the Council and Commission.

Text proposed by the Commission	Amendments by Parliament

Amendment 1
ARTICLE 1
Article 12, paragraph 3, point (a), subparagraph 1 (Directive 77/388/EEC)

The standard rate of value added tax shall be fixed by each Member State as a percentage of the taxable amount and shall be the same for the supply of goods and for the supply of services. From 1 January	The standard rate of value added tax shall be fixed by each Member State as a percentage of the taxable amount and shall be the same for the supply of goods and for the supply of services. From 1 January

[1] Not yet published in OJ.

2006 until 31 December 2010, the standard rate may not be less than 15%.	2006 until 31 December 2010, the standard rate may not be less than 15% ***and may not be more than 25%.***

Justification

It is important to prevent growing divergence in the standard rates of VAT applied by the Member States from leading to structural imbalances in the EU and distortions of competition in certain sectors of activity. Therefore the Commission should represent its proposal.

Amendment 2
ARTICLE 3 A (new)

	Article 3 a
	The Commission shall carry out a general assessment of the macro-economic impact of implicit and standard VAT rates and the implications for the budgetary revenue of the Member States in the period up to 1 January 2007.
	The assessment shall pay attention to allowing the Member States the same possibilities to apply reduced VAT rates to goods and services.

Justification

The provisions of the VAT regulations must be sufficiently flexible and allow the Member States to react to the changing economic situation.

EXPLANATORY STATEMENT

Legal framework

Pursuant to the second subparagraph of Article 12(3a) of the Directive 77/388/EEC[1], the Council, on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, decided unanimously on the level of the standard VAT rate to be fixed by each Member State as a percentage of the taxable amount.

In October 1992, resulting from the strategy of approximation of tax rates, these provisions were amended by the Council's Directive 92/77/EEC[2], setting up the minimum standard rate at the level of 15%, to be applied initially until December 31, 1996. As the first Commission's report on the results of this agreement proved there was no significant distortions in competition and the trade creation/deflection effects were limited, it was suggested to introduce no changes in the minimum VAT rate and the principle of 15% were therefore extended first until 31st December 1998[3] and with two further extensions, it is to expire with 31st of December 2005.

In view of the rapidly approaching expiry date, the Commission has presented a proposal to extend that provision once again, until 31st of December 2010. It could be argued that most important goal of this legislation is to serve smooth operation of VAT system in an enlarged EU. It can help to provide for new thoughts regarding establishment of a better-functioning internal market. The task of the European Parliament is therefore to support these priorities and provide, if possible, for a new swing in performing economic aims set up by Lisbon Strategy.

Sixth Directive

The origins of the current general turnover tax regime date back to 1967's First VAT Directive[4,] perceived as the first political and economic commitment of establishing a common VAT scheme. The next economic achievement in this field was the already mentioned Sixth VAT Council Directive[5] that entered into force on 1 January 1978. This Directive constitutes a general framework drawing up key features of a multi-phased net general turnover taxation

Further VAT developments on the way to establish internal market

In line with the starling 1985 *"White Paper"* on internal market published under presidency of Jacques Delors, the Commission tabled a substantial package of proposal related to, among others, the VAT issues. As soon as the set of solutions proposed by the Commission in 1987

[1] Council Directive of 17 May 1977 - generally known as *the Sixth VAT Directive*.
[2] Council Directive of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC (approximation of VAT rates).
[3] Council Directive 96/95/EC of 20 December 1996 amending, with regard to the level of the standard rate of value added tax, Directive 77/338/EEC on the common system of value added tax.
[4] Council Directive 67/227/EEC of 11 April 67 on the harmonisation of legislation of Member States concerning turnover taxes - generally know as the First VAT Directive.
[5] See: *Reference 1.*

proved unacceptable to the Member States governments, the Council elaborated a strategy aiming at establishing a transitional system, introduced by the above mentioned Council Directive 92/77/EEC[1] and thus materialising the general patterns of the Single European Market. In accordance with the Directive Member States accepted, on a temporary basis, the 'principle of destination' for taxation of cross-border economic transactions, which, despite they still remained desperate to switch to the 'principle of state of origin' as a high priority in the near future, has been ever since applicable to trade in the EU despite a number of outstanding issues. This however, lays beyond the scope of this legislation and the Rapporteur wish not to touch upon this issue in his present report.

Apart from establishing the minimum VAT standard rate at the level of 15%, (practically only Luxemburg, Cyprus and Malta apply the minimum rate), the Member States had been given the opportunity to apply one or two 'reduced rates', set at the level not lower than 5% and to be applied to certain specific categories of goods and services annexed to the Directive plus natural gas and electricity provided that it creates no distortions of competition. The Directive modified as well the original Article 28(2) of the Directive 77/388/EEC, ensuring carrying forward the reduced rates being in force on 1 January 1991.

Nevertheless, this Council Directive provides an exclusive but temporary right to those Member States who applied lower general rate than 13 % before 1 January 1991 for levying super-reduced rates on supplying restaurant, social and care-associated services, child clothing and footwear, maintenance services.

Although the Commission had proposed twice to set up a rate band of 15% of the minimum rate and 25% of the maximum rate (derived from the real rates applied in the Member States - no Member State applies the VAT standard rate higher than 25%)[2], the Council rejected the proposals in both cases, keeping only the provisions on the 15% minimum.

Shift towards indirect taxation - stimuli for future debate

European Parliament's ultimate goal is to contribute to boosting economic productivity and growth rate in the EU. In order to achieve these high-rank objectives we should have a very serious discussion on overhauling taxation system stimulating further growth and employment in Europe, especially in the light of the 'World Economic Outlook' published on the 21st of September 2005 by the International Monetary Fund, expressing growing disappointment with the Euro Area countries struggling with weak domestic demand and unwillingness of Europeans to swallow the bitter medicine of structural reforms. Further reading is even more alarming showing Europe legging behind its competitors, notably the US, Japan and China.

It is believed that shifting from direct to indirect taxation, i.e. from employees and economic performance towards consumption, could substantially reduce the overall tax burdens on income and capital and therefore, by causing less disincentives to work or set up business, rise the long-run economic potential, growth and employment. It is beyond question that lower marginal tax rates (employees retain more of what they earn) will eventually overcome the Europe's troublesome sluggish economic growth rate and expand the aggregate supply that will in turn, through downward pressure, improve competition and contribute broadly to

[1] See: *Reference 2.*
[2] *"VAT rates applied in the Member States of the European Community",* DG TAXUD DOC/1636/2005, situation as for July 1, 2005: only Denmark, Hungary and Sweden apply the maximum 25% and Cyprus and Luxembourg the minimum 15%.

better functioning of the Internal Market. It is enough to mention the eighties and nineties when several economies on the verge of bankruptcy decided to cut down the marginal tax rates and experienced in result 7% of real economic growth (Turkey, average over 4 years), 9.3% in South Korea (average over 8 years), 4% in Great Britain (average over 4 years after dozen years of economic stagnation), 4% in Austria, 4.1% in the Netherlands and 4.3% in Belgium (first couple of years of the tax reform)[1].

By contrast, fiscal pressure deriving from financing social model in EU reaches up to 40 % of GDP funded mostly from direct taxes in comparison with 26% in US and Japan. It is therefore urging for the European Parliament to initiate a fresh and open debate about necessary streamlining of the EU's taxation system to revive the economic growth. Launching a broad strategy of changing the financing of the social model, meaning a shift from taxation of income to taxation of consumption, would be desirable way to go. According to the European Commission, a drop in income tax of 1% of GDP together with an increase in consumption tax of 1% of GDP could generate some kind of synergy effect producing extra growth exceeding 1%[2].

Permanent derogations granted to particular Member States (such as super-reduced rate, parking rate, zero rate listed under the title XVI Transitional provisions Article of the 6th Directive, etc.) are applied to a great number of taxable transactions. In the year 2000, 69% of the average EU-15 VAT taxable transactions, were taxed at the standard VAT rate[3]. Admission of the 10 new countries could not change this ratio but to a relatively small extent. Taking into account all VAT rates existing in the Member States (standard + reduced), gives us an implicit VAT rate that is in average 30% lower than the statutory standard rates in force in the Member States. In the given 2000, the EU-15 average statutory standard VAT rate was 19.4% (within the band with a minimum of 15% and maximum of 25%) whilst the implicit VAT rate (i.e. average effective VAT rate, VAT burden which means substituting VAT rates in force for one VAT rate without any revenue loss) reaches up to 15.9% hiding larger volatility Member State by Member State.

Rapporteur's position

Agreeing with the Commission that the VAT standard rate scheme currently in force has worked out satisfactorily and divergences between standard VAT rates that distort competition and trigger structural imbalances should be avoided, the Rapporteur approves the 15% minimum VAT rate and disapproves the idea of applying a band with a maximum rate of 25%. As the present regime expires with the 31st of December 2005, the extension proposal should be adopted as soon as possible and be forwarded to the Council yet before the December ECOFIN meeting.

However, in the light of above mentioned arguments, the Rapporteur asks the Commission to elaborate a general assessment on implicit and standard VAT rates and associated revenue, budgetary implications on the EU up to 1 January 2007, and - in accordance with its results - to present a guideline or draft legislative proposal examining the opportunity of increase in standard compulsory VAT rate. It should be, nevertheless, dealt in parallel with discussions in the Council on the reduction - or extension in case of the new Member States, as

[1] The Library of Economic and Liberty: *Price Waterhouse; International Bureau of Fiscal Documentation.*
[2] The European Commission Paper: Shifting the tax burden - from direct to indirect tax.
[3] The European Commission: Taxation Papers: VAT indicators 2004/2.

communicated by the Commissioner for Taxation and Customs - of permanent VAT derogations laid down in the Sixth VAT Directive applied at present in EU-15 exclusively.

PROCEDURE

Title	Proposal for a Council directive amending Directive 77/388/EEC on the common system of value added tax, with regard to the length of time during which the minimum standard rate is to be applied
References	COM(2005)0136 – C6 0113/2005 – 2005/0051(CNS)
Date of consulting Parliament	27.4.2005
Committee responsible Date announced in plenary	ECON 10.5.2005
Committee(s) asked for opinion(s) Date announced in plenary	
Not delivering opinions Date of decision	
Enhanced cooperation Date announced in plenary	
Rapporteur(s) Date appointed	Zsolt László Becsey 10.5.2005
Previous rapporteur(s)	
Simplified procedure – date of decision	
Legal basis disputed Date of JURI opinion	/
Financial endowment amended Date of BUDG opinion	/
Discussed in committee	5.10.2005 11.10.2005 14.11.2005
Date adopted	14.11.2005
Result of final vote	+: 36 –: 1 0: 0
Members present for the final vote	Zsolt László Becsey, Pervenche Berès, Sharon Margaret Bowles, Ieke van den Burg, David Casa, Jonathan Evans, Elisa Ferreira, José Manuel García-Margallo y Marfil, Jean-Paul Gauzès, Robert Goebbels, Benoît Hamon, Gunnar Hökmark, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Othmar Karas, Wolf Klinz, Kurt Joachim Lauk, Astrid Lulling, Hans-Peter Martin, Gay Mitchell, Cristobal Montoro Romero, Joseph Muscat, John Purvis, Karin Riis-Jørgensen, Dariusz Rosati, Eoin Ryan, Antolín Sánchez Presedo, Peter Skinner, Ivo Strejček, Sahra Wagenknecht
Substitute(s) present for the final vote	Katerina Batzeli, Jorgo Chatzimarkakis, Ján Hudacký, Alain Lipietz, Jules Maaten, Thomas Mann, Charles Tannock
Substitute(s) under Rule 178(2) present for the final vote	
Date tabled	17.11.2005 A6/0323/2005
Comments (available in one language only)	