Value added tax VAT: reduced rate on labour-intensive services (amend. Directive 77/388/EEC)

1999/0056(CNS) - 02/06/2003 - Follow-up document

PURPOSE : Assessment of an experimental application of a reduced rate of VAT to labour-intensive services. CONTENT : In 1998 the Council invited the Member States to experiment with a reduced rate of VAT on labour intensive services, which are not exposed to cross-border competition. The aim being to assess what impact, if any, such a policy would have on overall job creation. The labour intensive services covered included the repair of bicycles, shoe and leather goods and of clothing and household linen. Also included were renovation and repair of private dwellings, window cleaning, domestic care services and hairdressing. A total of nine countries took part in the experiment. In July 2002 a preparatory meeting was held between the Commission and the Member States to assess the results of the experiment. This Communication investigates and reports on the conclusions of that meeting. The results of the experiment would seem to vindicate the Commission's long-standing view that a reduced VAT rate has little or no impact on job creation. The Commission's assessment is based on the following conclusions. Firstly, the link between VAT reduction and job creation is not a direct one. When they conducted price surveys, Member States discovered that reduced VAT rates did not necessarily translate into reduced consumer prices. Instead, part of the VAT reduction was used to increase the margins of the service providers. In other words the reduced VAT rate acted as a subsidy for a particular sector. Secondly, the measure could only have an impact on firms, which already have legal status. Not those operating partly out of the black economy. With part of the work being done illicitly it is difficult to assess the impact the black economy will have on job creation. Thirdly, in certain cases, (though most notably that of bicycle repair), service providers refused to apply the reduced rate, arguing that the measure was too complex. Fourthly, the experiment took place at a time of economic growth and stability and at a time when there was a downward trend in unemployment. Thus, the possible effects of the VAT reduction were subsumed beneath the overall effect of economic growth. Fifthly, when some sectors actively tried to recruit more staff they encountered difficulty with recruitment. Thus, rather than employing more staff they resorted to over-time. To conclude, the Commission suggests that reducing VAT rates is not the most effective means to generate greater employment. According to Commission calculations, a reduction in labour charges creates 52% more jobs than a reduction in VAT rates in relation to the cost to the budget. Lastly, the Commission remains unconvinced that the experiment had any impact on reducing black market activity. To conclude therefore, the Commission recommends that the best way forward is to concentrate on the objectives of the new VAT strategy, namely to modernise the common system of VAT, simplify it, strengthen it and apply it in a more uniform fashion.