Value added tax VAT: reduced rates (amend. Directive 77/388/EEC)

2003/0169(CNS) - 23/07/2003 - Legislative proposal

PURPOSE : to amend Directive 77/388/EEC as regards reduced rates of VAT in order to ensure uniform application. CONTENT : Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to the turnover taxes - Common system of value added tax: uniform basis of assessment authorises Member States to apply one or two reduced rates which may not be lower than 5% and are applicable only to a restrictive list of supplies of goods and services. In a communication in 2000 (COM(2000)348 final), the Commission set out a strategy designed to improve the way the VAT system works under the internal market. It proposed a viable strategy geared to four main objectives : the simplification and modernisation of existing rules, more uniform application of the current rules and a new system of administrative cooperation. The current situation as regards rates is far from satisfactory. The VAT rates applicable in the Community remain highly disparate and very complex. Yet the basic rules are simple: supplies of goods and services subject to VAT are normally subject to a standard rate of at least 15%, but the Member States may opt to apply one or two reduced rates of not less than 5% to goods and services listed in Annex H (restricted list of goods and services eligible for a reduced rate in the Member States). However, these simple rules are complicated by a multitude of derogations granted to certain Member States - in some instances a majority of Member States - during the negotiations preceding Directive 92/77/EEC or their Acts of Accession, derogations which are denied to the others. The rationale for these situations is far from clear and a final decision needs to be taken to either abolish the derogations or open them to all Member States. The situation has given rise to many complaints by traders, reflected in the Commission's 2001 report on reduced rates. Furthermore, in terms of effects on consumption, the Commission remains convinced that the reduction of VAT rates is not the best way of encouraging consumers to buy or use certain goods or services. VAT, unlike excise duty for example, is not designed to change consumer behaviour. Also, a reduction in VAT rates is never passed on in full in consumer prices: often it is negligible and temporary. The purpose of the proposal is to afford Member States equal opportunity to apply reduced rates in certain fields (e.g. restaurants, housing and the supply of gas and electricity) and to rationalise the numerous derogations currently applying in some Member States. The aim is to improve the functioning of the internal market and avoid potential distortions of competition, which have given rise to numerous complaints from traders. Following the experimental application of a reduced VAT rate to certain labour-intensive services, the Commission is convinced that the reduced rate had very little, if any, impact on prices or job creation. A reduction in VAT rates would therefore seem to be a waste of budget resources which could be deployed more usefully. The Commission's aim was to seek a balanced approach for the whole of the European Union. This required going beyond a review of the restrictive list of goods and services to which a reduced VAT rate may be applied (Annex H to the Sixth VAT Directive) and examining the various specific derogations available to some Member States, with a view to avoiding potential distortions ofcompetition. The proposal also includes appropriate measures for a final decision on the VAT rate applicable to labour-intensive services. It does not call into question the optional nature of reduced VAT rates: no Member State will be obliged to introduce new reduced VAT rates. The Commission has adopted the following guidelines to simplify and rationalise rates. Rationalisation of the list of goods and services to which the Member States have the option of applying reduced rates (Annex H) is based on the following: - the option of applying reduced rates is not extended to new categories to which no Member State currently applies reduced rates; - the option of applying reduced rates is extended to categories of goods and services to which certain Member States are already applying reduced rates by virtue of specific derogations with no apparent detriment to the smooth functioning of the internal market. This measure concerns restaurants, housing and the supply of gas and electricity; - the option, currently granted on a transitional basis, of applying a reduced rate to cut flowers and plants is definitively incorporated into Annex H; - two technical changes have been introduced: category 4 (equipment for the disabled) has been clarified, as has the category concerning

sewer, waste treatment and recycling services and street cleaning services. It is proposed that this be achieved by: - abolishing the derogations that permitted certain Member States to maintain reduced rates for goods and services not listed in Annex H ("parking rates"); - confining zero and super-reduced rates (below the 5% minimum) to goods and services listed in Annex H. Certain Member States have been authorised to apply rates lower than those they normally apply to take account of the special geographical situation of certain island or remote areas. These provisions are meaningful only if strictly confined to the local market. The Commission proposes rationalising these derogations in order to establish a clear legal basis for each of them and to prevent abuses by restricting their application to goods and services consumed in the areas concerned (e.g. the application of reduced rates to distance services supplied throughout the EU). The Member States concerned are Austria, Greece, France and Portugal. It is proposed that the scope of reduced rates be reviewed every five years rather than every two years: experience has shown that a period of two years is too short for genuinely new factors to emerge. Where absolutely necessary the Commission can present to the Council a proposal for a directive amending the rules applicable to rates before expiry of the five-year period. In conclusion, the proposed revision represents an important step in the improvement of the common VAT system with a view to improving the functioning of the internal market. It will greatly simplify VAT rates for the whole of the Union, yet safeguard the competence of Member States to decide the VAT rates applicableto their territories. The Commission is proposing neither to change the level of VAT rates nor to abolish the optional nature of the reduced rates. This step is a long way from fully achieving the harmonisation of rates started in 1992 with a view to the completion of the internal market: other steps must follow in due course. An initial review will at any rate take place as part of the revision of the VAT arrangements applicable to public authority activities, associated with the revision of the system of derogations for certain activities in the public interest provided for in Article 13 of the Sixth Directive. A number of existing categories on Annex H already concern goods and services provided by public bodies or for which a derogation is allowed: VAT applies only where bodies are privatised or such services are provided by undertakings which do not meet the conditions for exclusion from the scope of VAT or derogation. Provision is made for some reduced rates in this context. The review is planned for 2004 to allow an impact assessment, designed to analyse the economic, environmental and social impacts of a proposal, to be carried out. The issues of the applicable rates of VAT must of necessity taken into account in this context.