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IMPACT ASSESSMENT

Accompanying the document

Proposal for a Council Directive

amending Directive 2006/112/EC as regards rates of value added tax

{COM(2018) 20 final} - {SWD(2018) 8 final}

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1. INTRODUCTION AND CONTEXT

1.1. Introduction

VAT is a general tax on consumption applied to supplies of goods and services along the whole production and distribution process. It is a major and growing source of tax revenue in the European Union (EU). VAT raised slightly more than EUR 1 trillion in 2015, which corresponds to 7% of EU GDP or 17.6% of total national tax revenues[1]. One of the EU's own resources is also based on VAT (12.4% of the EU budget in 2015)[2]. As a broad-based consumption tax, it is considered to be one of the most growth-friendly forms of taxation.

One of the key strengths of VAT is that, by allowing taxpayers to exactly offset the tax incurred in previous stages of the production chain, it is much better suited than other types of indirect taxes to operate an internal market free of tax distortions. This was the main reason for its early adoption by the EU[3]. It is governed by the VAT Directive[4] which aims at ensuring that the principles underlying the functioning of this tax apply consistently in all Member States.

In recent years, however, the VAT system has been unable to keep pace with the challenges of the global economy and the opportunities offered by new technologies. Therefore, the Commission adopted on 7 April 2016 an Action Plan on VAT[5] (hereinafter 'VAT Action Plan') setting out ways to modernise the VAT system so as to make it simpler, more fraud-proof and business-friendly. In this context, the Commission announced its intention to adopt in 2017 four VAT-related proposals:

1) a definitive VAT system for intra-EU cross-border trade based on the principle of taxation in the Member State of destination in order to create a robust single European VAT area (first step);
2) a modernised VAT rates policy so as to allow Member States greater autonomy on setting the VAT rates;
3) a comprehensive simplification VAT package for SMEs;
4) a proposal to enhance VAT administrative cooperation and EUROFISC.

This impact assessment relates to the second proposal, on rates policy. It is linked with the first legislative proposal aiming to put in place a definitive VAT system as part of the Regulatory Fitness and Performance Programme (REFIT), permanently based on the principle of taxation in the country of destination.

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1 Eurostat, Tax revenue statistics, Eurostat (gov_10a_taxag) http://ec.europa.eu/eurostat/statistics-explained/index.php/Tax_revenue_statistics

2 European Commission, EU Budget 2015, Financial Report http://ec.europa.eu/budget/financialreport/2015/lib/financial_report_2015_en.pdf

3 Common rules were first adopted in 1967.

4 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax – as amended (OJ L 347, 11.12.2006, p. 1)

5 See Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT – Towards a single EU VAT area – Time to decide (COM(2016) 148 final)

1.2. Rules on VAT rates

The VAT Directive sets out a number of rules which constrain Member States' autonomy in fixing the level of their VAT rates. These rules were formulated ahead of the abolition of internal customs checks along with fiscal frontiers in 1993. They include:

Articles 96 and 97:
Member States must apply **a standard rate**, which may not be lower than 15% until 31 December 2017.

Articles 98 and 99:
Member States have the option (but not the obligation) of applying **a maximum of two reduced rates**, not lower than 5%, to supplies of goods and services, listed in Annex III of the VAT Directive (see Table 2). This Annex contains 24 categories of goods and services; importantly, Member States can also apply a reduced rate to *only part of a category*. It allows Member States to tax at a reduced rate or exempt around 65% of household consumption expenditure (see section 1.3).

Member States could not agree to specify any *maximum* for rates. Moreover, in contradiction to the general rules set out above, Member States in 1993 put in place more than **200 derogations** (i.e. exceptions to the general rules) that allow certain Member States to[6]:

- apply rates lower than 5% to products that are listed in Annex III;
- apply a reduced rate (including zero rates) to products that are not listed in Annex III.

These derogations agreed in Council negotiations aimed at allowing all Member States to keep all reduced and zero rates they applied before 1991[7]. The only concession made by Member States was to accept that the derogations would be temporary and expire at the latest with the definitive VAT system[8] and that for most derogations the scope could not be extended.[9]

A full overview of non-harmonised VAT rates is presented in section 9.5.

1.3. Legal framework for these rules

The legal basis for adopting any rules on VAT is Article 113 of the Treaty on the Functioning of the European Union (TFEU)[10]. This article, to which the provisions of the VAT Directive must conform, subjects VAT legislation to an important constraint: any harmonisation of turnover taxes (such as VAT) is allowed only on the condition that such harmonisation is necessary *to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*.

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6 See Box 6 for additional details.

7 Article 110 of the VAT Directive: 'Member States which, at 1 January 1991, were granting exemptions with deductibility of the VAT paid at the preceding stage or applying reduced rates lower than the minimum laid down in Article 99 may continue to grant those exemptions or apply those reduced rates.'

8 With regard to the standard rate, Germany, Spain and Luxembourg agreed to increase their standard rate to 15%, certain Member States accepted to abolish what was a second higher standard rate (so-called luxury rate).

9 This leads to a situation where one Member State can apply a zero rate to wax candles and night-lights, but only if they are white and cylindrical and if they are not decorated, spiralled, tapered or perfumed.

10 Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT

This has consequences for the rules on rates, and an important part of the analysis developed in this Impact Assessment, specifically in the Problem Definition, is to review whether the existing rules respect fully this condition.

Rules on rates, first adopted with an origin-based system in mind, have evolved over the years (see Box 1). In view of the abolition of fiscal frontiers, efforts were made to harmonise VAT rates. This still leaves much to the discretion of Member States some of which continue to rely on derogations granted.

Box 1: Outline of the history of VAT rates rules

1967 Directive 67/228/EEC	Other than **a standard rate**, Member States can apply **reduced or increased rates**. No rules are set on the level of those rates or the goods or services to which reduced or increased rates may be applied.
1977 Directive 77/388/EEC	Member States are allowed, by way of **derogation**, to **maintain existing reduced rates and exemptions with deductibility of the VAT paid at the preceding stage** which satisfy certain specified conditions.
1987 and 1992 COM(87) 321 and COM(92) 5	To pave the way for the internal market, the Commission proposes to harmonise rates, with **a standard rate** of minimum 14% and maximum 20% and **a reduced rate** of minimum 4% and maximum 9% applied to **a short list of goods and services** (foodstuffs, excluding alcoholic beverages; energy products for heating and lighting; water supplies; pharmaceutical products; books, newspapers and periodicals; passenger transport). It also proposes to **abolish all existing derogations**.
1992 Directive 92/77/EEC	The Council decides on **a standard rate** of minimum 15%, accompanied by a sunset clause, and **two optional reduced rates** of minimum 5% which may be applied to **a longer list of goods and services** (now Annex III). It also decides to **maintain all existing derogations** and link their expiry to the entry into force of the definitive VAT system.
1993	With the internal market, **common rules on VAT rates** are for the first time put in place.
1995 COM(95) 731	In view of transition to a definitive system based on taxation at origin, the Commission proposes a **band for the standard rate** (between 15% and 25%).
1996 Directive 96/95/EC	The Council decides to **continue with a standard rate** of minimum 15%.
COM(96) 328	In its programme for the single market, the Commission announces further initiatives to **approximate** (late 1997) and **harmonise** (mid-1999) rates. These initiatives are later abandoned.
1999 COM(99) 62	The Commission proposes, by way of experiment, to allow temporary use of reduced rates for **labour-intensive services**.
Directive 1999/85/EC	The Council agrees on such an experiment but for **specific labour-intensive services only**.
2000 COM(2000) 348	The Commission, as part of its strategy to improve the operation of the VAT system within the context of the internal market, announces a **medium term review and rationalisation** of VAT reduced rates and derogations.
2002 COM(2002) 525	The Commission proposes to **prolong** the experiment for **labour-intensive services**.
Directive 2002/93/EC Decision 2002/954/EC	The Council agrees on the **prolongation** of the experiment for **labour-intensive services**.
2003	Following a review, the Commission proposes to **rationalise Annex III** and

COM(2003) 397	**include categories of goods and services** covered by derogations applied by a certain number of Member States where this has been found not to hamper the proper functioning of the internal market. It proposes to **abolish parking rates** and to **limit the scope of other derogations** so that zero rates and super reduced rates can only be applied to what is included in Annex III.
2006 Directive 2006/18/EC	The Council cannot agree to rationalise Annex III or to rein in derogations but decides to **prolong the experiment for labour-intensive services**.
2011 COM(2011) 851	The Commission, in its communication on the future of VAT, suggests to **adopt the principle of taxation at destination**.
2012 Conclusions from the 3167th meeting on 15.5.2012	The Council concurs that taxation in the Member State of origin of the goods or services is not politically achievable and invites the Commission to examine ways to **implement the destination principle**.
2015 Directive 2008/8/EC	**Destination principle** implemented for B2C services
2016 COM(2016) 148	The Commission outlines **options for modernising** the rules for VAT rules in its VAT Action Plan.
Conclusions from the 3468th meeting on 25.5.2016	The Council welcomes the Commission's intention to propose **increased flexibility on VAT rates**, whilst noting the need for the VAT system to maintain **a sufficient level of harmonisation**.

Source: Commission services

1.4. Utilisation of reduced rates

In practice, the use of reduced rates varies very widely between Member States, reflecting national policy priorities, but only a few Member States make significant use of the flexibility granted to them by the VAT Directive. The differences in the degree of utilisation of reduced rates may be gleaned from the 'rate gap' measure shown in Table 1. This indicator shows what percentage of the theoretical VAT revenue is foregone owing to the recourse made to reduced rates. This is found to be less than 3% in countries such as Denmark, Slovakia, Estonia, Bulgaria and Romania, while at the other extreme it approaches or exceeds 15% in Ireland, Poland, Italy, Luxembourg and Spain. The difference in the degree to which reduced rates are used is consistent with widely different national political preferences on using indirect taxation to pursue social policy objectives[11].

Table 1: Utilisation of reduced rates, % of potential tax base ('rate gap')

Member State	AT	BE	BG	CZ	DE	DK	EE	ES	FI	FR	GR	HR	HU	IE
Rate gap	10.4	12.4	2.8	5.8	7.2	0.9	2.5	14.5	9.1	10.0	13.9	4.1	3.3	17.1
Member State	**IT**	**LT**	**LU**	**LV**	**MT**	**NL**	**PL**	**PT**	**RO**	**SE**	**SI**	**SK**	**UK**	**EU27**
Rate gap	15.6	4.0	14.6	3.2	12.7	12.2	15.9	11.1	2.9	8.3	11.3	1.7	3.3	5.3

Source: 2016 VAT gap report, p. 53

[11] This is because, although reduced VAT taxation can help poorer households and can change consumption behaviour in ways perceived to be desirable, from a budgetary viewpoint it is usually an expensive means of doing so, mainly owing to the fact that reduced rates cannot be targeted to specific groups of consumers. For an extensive discussion of this point, see Institute of Fiscal Studies *et al.*, *A retrospective evaluation of elements of the VAT system*, London 2011.

Table 2: Categories eligible for reduced rates under Annex III

Category	Coverage
1	Foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; live animals, seeds, plants and ingredients normally intended for use in the preparation of foodstuffs; products normally used to supplement foodstuffs or as a substitute for foodstuffs;
2	Supply of water;
3	Pharmaceutical products of a kind normally used for health care, prevention of illnesses and as treatment for medical and veterinary purposes, including products used for contraception and sanitary protection;
4	Medical equipment, aids and other appliances normally intended to alleviate or treat disability, for the exclusive personal use of the disabled, including the repair of such goods, and supply of children's car seats;
5	Transport of passengers and their accompanying luggage;
6	Supply, including on loan by libraries, of books on all physical means of support (including brochures, leaflets and similar printed matter, children's picture, drawing or colouring books, music printed or in manuscript form, maps and hydrographic or similar charts), newspapers and periodicals, other than material wholly or predominantly devoted to advertising;
7	Admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities;
8	Reception of radio and television broadcasting services;
9	Supply of services by writers, composers and performing artists, or of the royalties due to them;
10	Provision, construction, renovation and alteration of housing, as part of a social policy;
10a	Renovation and repairing of private dwellings, excluding materials which account for a significant part of the value of the service supplied;
10b	Window-cleaning and cleaning in private households;
11	Supply of goods and services of a kind normally intended for use in agricultural production but excluding capital goods such as machinery or buildings;
12	Accommodation provided in hotels and similar establishments, including the provision of holiday accommodation and the letting of places on camping or caravan sites;
12a	Restaurant and catering services, it being possible to exclude the supply of (alcoholic and/or non-alcoholic) beverages;
13	Admission to sporting events;
14	Use of sporting facilities;
15	Supply of goods and services by organisations recognised as being devoted to social wellbeing by Member States and engaged in welfare or social security work, in so far as those transactions are not exempt pursuant to Articles 132, 135 and 136;
16	Supply of services by undertakers and cremation services, and the supply of goods related thereto;
17	Provision of medical and dental care and thermal treatment in so far as those services are not exempt pursuant to points (b) to (e) of Article 132(1);
18	Supply of services provided in connection with street cleaning, refuse collection and waste treatment, other than the supply of such services by bodies referred to in Article 13;
19	Minor repairing of bicycles, shoes and leather goods, clothing and household linen (including mending and alteration);
20	Domestic care services such as home help and care of young, elderly, sick or disabled;
21	Hairdressing.

Source: VAT Directive

1.5. The initial choice of an origin-based VAT system and its consequences for the rules on VAT rates

Until 1993, the customs checks at the internal borders constituted an essential element of the VAT system as they allowed checking the dispatch of goods to another jurisdiction needed to operate the export exemption which ensures the neutrality of the system.

However, the abolition of internal fiscal frontiers in that year obliged the EU to choose between two different solutions as concerns intra-EU transactions: taxation of the goods at origin or at destination. While both systems have advantages and disadvantages, the solution pursued was the origin principle, under which the VAT rules applicable to a transaction (including the tax rate to be applied) is determined by the Member State where the seller is located. This choice was made largely on account of the fact that it is the simplest and therefore the least costly for businesses[12].

The implementation of the origin system, however, quickly hit a roadblock: such a system requires a very high degree of rate alignment among Member States to prevent tax distortions, because it provides a tax advantage to suppliers located in lower-rate jurisdictions[13]. Differences in the levels of VAT rates were stark already in 1993; the standard rate, for example, ranged from 15% to 25%[14]. Also in the following years, rates were not aligned and currently the difference between the highest and the lowest standard rate is still 10 percentage points (see section 9.5).

Recognising that quick alignment of rates was unrealistic, a temporary solution was adopted: a transitory system for VAT, based on the destination system for most intra-EU transactions, which would apply temporarily until the adoption of a definitive regime; ahead of the switchover, rate convergence amongst Member States would be encouraged by setting minimum levels for VAT rates and limiting the application of reduced rates. It was hoped that over a period of a few years, Member States would be able to achieve the convergence in rate levels needed to allow the introduction of the planned origin-based definitive system.

In 2012, however, given the lack of meaningful progress on rate convergence, the Commission, with the agreement of the Council and the European Parliament, decided to abandon the objective of a definitive VAT system based on the origin principle in favour of one based on the destination system[15].

As noted in the VAT Action Plan[16], the choice of a destination-based system for the definitive system raises the question of whether, and to what extent, the existing legal limits on rates are still necessary, opening up the possibility of making them less

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[12] This followed a policy orientation established already in 1967. See Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT, "Towards a simpler, more robust and efficient VAT system tailored to the single market" (COM(2011) 851 final), p. 5.

[13] This is because in an origin system, suppliers apply to intra-EU sales the VAT rate applicable in the country where they are located. This implies an immediate and significant tax advantage for all sales to entities located in a higher-rate jurisdiction which are not entitled to a refund of their VAT. As a result, any significant rate differences would fatally undermine the orderly functioning of the Single Market, which relies on the elimination of tax subsidies having a direct impact on cross-border sales.

[14] In Luxembourg and Denmark respectively. See Table VIII, *VAT rates applicable in the Member States of the European Union*, available at http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf

[15] See Communication from the Commission to the European Parliament, the Council and the European Economic And Social Committee on the future of VAT: Towards a simpler, more robust and efficient VAT system tailored to the single market (COM(2011) 851 final), section 4.1. The Communication's conclusions on the destination system were endorsed by the Council conclusions of 15 May 2012.

[16] Communication from the Commission to the European Parliament, the Council and the European Economic And Social Committee on the future of VAT: Towards a simpler, more robust and efficient VAT system tailored to the single market (COM(2016) 148 final). See also: http://ec.europa.eu/taxation_customs/taxation/vat/action_plan/index_en.htm

constraining for Member States. This Impact Assessment assesses the merits of relaxing such limits and evaluates policy options for doing so.

1.6. Recent legislative proposals aimed at implementing a destination-based system

In the last years, several measures were taken to underpin the move towards implementing a system based on the destination principle. An important decision was taken in 2008, when the Council adopted legislation aiming at changing the rules on VAT so as to ensure that VAT on **services** accrues to the country where consumption occurs, and to prevent distortions of competition between Member States operating different VAT rates[17].

The result of this is that already now the taxation of the vast majority of supplies of **services** is based on the destination principle, a change which has been implemented progressively since 2010. The last milestone of the implementation was the implementation of destination-based taxation for electronic services in 2015. Since then, all B2C (business-to-consumer) supplies of telecommunications, broadcasting and electronic services (hereinafter 'electronic services') are taxable at the place where the customer resides and no longer where the supplier is located.

Also the vast majority of supplies of **goods** are taxed where the customer is located or resides, because the place of supply is, as a rule, the place where the goods are located at the time when the supply takes place. The exceptions to taxation at the place of the customer are minor, e.g. cross-border shopping by non-residents and low-volume distance sales, where VAT is charged according to the origin principle (see **Error! Reference source not found.**2 for details).

Box 2: Domains where the origin principle continues to apply

In the case of **cross-border** shopping where tourists (non-resident final consumers) can shop in any EU country paying the local VAT – this is obviously a simplifying provision to avoid having to declare VAT when they re-enter their country.

Distance sales are sales in which goods are transported by or on behalf of a supplier in one EU Member State, to a person in another Member State who is not registered for VAT (final consumer). They typically include B2C mail order sales, phone or tele-sales or physical goods ordered over the internet (except sales of new means of transport, which are excluded from distance selling). If sales do not exceed the annual distance selling threshold, the seller may apply local VAT (origin principle) instead of registering for VAT in the destination country, facilitating compliance. However, once the threshold is surpassed, the destination principle applies, and the supplier becomes liable to VAT in the country of destination. The threshold is set by each Member State; it amounts to EUR 35 000 annually for most Member States but a few Member States apply a threshold of EUR 100 000. However, the Commission's e-Commerce proposal, once adopted, will have the effect of removing this threshold from 2021 and replace it with a global EU threshold of EUR 10 000 for all intra-EU sales[18].

The **flat-rate scheme for farmers** and the **special schemes for travel agents** and **taxable dealers** are small sectoral schemes that mainly aim at simplification in the concerned sectors.

Source: Commission services

[17] Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services (OJ L 44, 20.2.2008, p. 11).

[18] See http://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en

In December 2016, with the e-Commerce initiative[19], the Commission proposed new rules allowing companies that sell goods online to take care of all their VAT obligations in the EU through a digital online portal ('One Stop Shop'), hosted by their own tax administration and in their own language. Such rules already exist for online sellers of electronic services. In this context, the Commission proposed the introduction of a new yearly VAT threshold for all cross-border sales, replacing the current VAT distance sales system as from 2021.

Finally, it should be noted that in December 2016 the Commission also adopted a specific proposal on rates for e-publications – following a particularly urgent demand to establish equal treatment of electronically supplied publications and publciations supplied on any means of physical support.

1.7. Proposal for a definitive VAT system based on taxation at destination and the reform envisaged of the rules on VAT rates

Rules on VAT rates are directly linked to the switchover to the definitive VAT regime, because once the new regime is put in place, existing derogations to the general rules on VAT rates will expiry (see problem 2, section 2.2).

The first proposal on the definitive VAT regime outlines general principles of the definitive VAT regime[20] and a second proposal with detailed arrangements will follow.

Before the entry into force of a definitive VAT system, the derogations problem (problem 2, section 2.2) must be discussed and settled because, as detailed later, this is a political precondition to approval. On the other hand, the adoption of the proposal on VAT rates (including a solution for the derogations problem) would not be conditional upon the adoption of the definitive VAT system, because already now the destination principle has been implemented for the vast majority of supplies of goods and services.

Nevertheless, the entry into force of any major change to the VAT rules should be the same as for the entry into force of the definitive VAT system, because the rules are directly linked (expiry of derogations at the time the definitive regime enters into force).

2. PROBLEM DEFINITION

The causes and consequences of the problems in the current rates regime to be tackled by the upcoming Commission proposal are summarised in the Problem Tree (see **Error! Reference source not found.**). It should be stressed that this initiative aims at dealing with one particular aspect of the VAT system only, namely the rules on setting VAT rates. Nevertheless, as highlighted in section 1, the proposal is linked to a much more wide-ranging proposal, the introduction of the definitive system, in ways that will be described later.

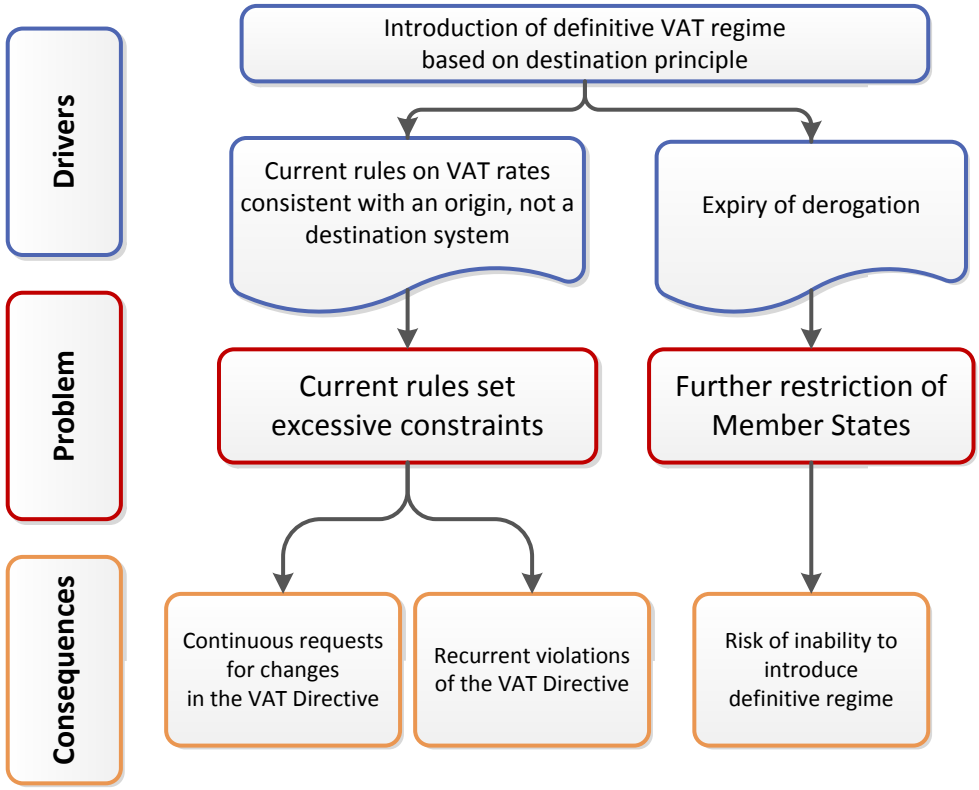
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[19] Proposal for a Council Directive amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods (COM(2016) 757 final).

[20] Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States (COM(2017) 569 final).

Before entering into the specifics of the VAT rate regime, it is important to note that all EU legislation in the tax domain is subject to the unanimity principle. This factor should be taken into account (particularly when considering the abolition of derogations benefiting individual Member States), and more generally shapes the direction of policy outlined in the VAT Action Plan, which is to extend, rather than restrict, the room of manoeuvre for Member States, so long as this is not in conflict with the functioning of the Single Market.

Figure 1: Problem Tree



Source: Commission services

2.1. Problem 1: The current rules set excessive constraints to Member States' tax policies

As already mentioned, the legal framework restricting Member States' autonomy in setting VAT rates was consistent with the objective of achieving a VAT system based on the origin principle, which is no longer current. The design of the rates regime needs to take this change into account, particularly as the unanimity requirement in the tax domain makes it difficult for Member States to extend reduced VAT rates to new areas.

It is widely accepted in the economic literature that a system based on the destination principle is neutral as regards cross-border trade, because all goods and services sold in each market are taxed at the same level, preventing any tax advantage from accruing to producers located in lower-rate jurisdictions[21]. The destination principle is already

[21] See for example OECD, Committee on Fiscal Affairs, Working Party 9 on Consumption Taxes *International Vat/Gst Guidelines: Guidelines On Neutrality,* Paris 2011: http://www.oecd.org/tax/international-vat-gst-guidelines-9789264271401-en.htm.

currently applied to the overwhelming majority of cross-border transactions[22] and this will not change with the adoption of the definitive VAT system. The evaluation of the VAT system carried out in 2011 found that the application of the destination principle to the tax regime for business-to-business (B2B) trade in goods – and since 1 January 2010 for most services – achieved neutrality towards production decisions, and identified some (limited) potential distortions in the areas where the destination principle is not implemented[23]. The few domains where the destination principle does not apply and where instead the origin principle, for reasons of convenience, continues (and will continue) to apply are: cross-border shopping, distance sales (below a certain threshold), and the special schemes for farmers, travel agents and taxable dealers (see **Error! Reference source not found.**2).

In line with this premise, the economic study on the reform of VAT rates[24] commissioned in the context of this initiative (henceforth '2017 VAT rates study'), concentrated on areas where the destination principle was not implemented. It too did not find evidence of any meaningful risk for distortions to the Single Market related to the operation of different levels of VAT rates; even in those higher-risk instances such as areas where the origin principle continues to be applied, the impacts are rather limited (see **Error! Reference source not found.**).

As a conclusion, the constraints to Member States' flexibility in setting VAT rates are no longer consistent with Article 113 TFEU on which the VAT Directive is based and which states that the '*Council shall […] adopt provisions for the harmonisation of legislation concerning turnover taxes […] to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*'.

Respecting Article 113 TFEU requires that flexibility has to be balanced against the need to ensure the continued proper functioning of the internal market[25]. Therefore, the progressively implemented taxation at destination since 2010 requires flexibility being allowed for Member States, which could not be granted while pursuing taxation at origin. Moreover, the current VAT Directive treats Member States significantly differently and these differences can no longer be justified in a destination-based VAT system (see problem 2).

Box 3: Risk of distortion to the Single Market from the operation of different VAT rates

The 2017 VAT rates study, in line with previous literature and the 2011 evaluation of the VAT system, found that, despite the existence of a large variety of rates, 'under a destination-based VAT system, the scope for economic distortions and harmful tax competition is extremely limited'. This is because in a full destination system, goods supplied from other Member States or imported from third countries are always taxed exactly at the same rate as domestically produced products of the same category.

This conclusion is in line with the answers provided by 17 Member States' tax administrations to a survey

[22] The remaining exceptions are marginal: B2C sales of goods by firms operating below the threshold for distance sales (EUR 35 000 or EUR 100 000), cross-border shopping by consumers and a few special schemes. These exceptions are discussed in the 2017 VAT rates study (PwC et al. , 2017). Intra-EU B2B transactions are unaffected by VAT rate differences owing to the reverse-charging of VAT and, more generally, the deductibility of input VAT.

[23] See Institute for Fiscal Studies (lead), *A retrospective evaluation of elements of the EU VAT system,* London, 2011, p. 52.

[24] PwC PricewaterhouseCoopers LLP (Project Leader), *Reform of rules on EU VAT rates,* 2017.

[25] EC TAX REVIEW 2017–2 "Towards an [Unlawful] Modernized EU VAT Rate Policy, Rita de la Feria & Max Schofield (www.kluwerlawonline.com/ECTA2017010)

asking whether they were aware of any distortions created by rate differences, notably as regards four VAT domains where the operation of the origin principle heightens distortion risks (cross-border shopping, distance sales, special schemes for farmers and second-hand scheme). Table 3 below illustrates the responses received, none of which highlight significant known effects from VAT rates.

Most Member States did not identify any particular impact. The main problems highlighted relate mostly to the lack of respect of the distance sales threshold (where traders sometimes disregard it). However, under the Commission's e-Commerce proposal, starting from 2021 that threshold will be replaced by a global threshold of EUR 10 000 for all intra-EU sales, while compliance will be facilitated by the introduction of a Mini One Stop Shop to allow traders to easily declare VAT due in other Member States[26]. Both changes go in the direction of limiting the impact of the distortion. A full overview of the replies of the Member States is provided in section 9.2 (see Table 88).

The 2017 VAT rates study went beyond the responses of Member States, which focus on the *status quo*, by assessing the distortion potential in a number of case studies specifically selected on the basis of economic and behavioural criteria, to show a high susceptibility to distortion (see part 1 of the study). The impact found for the goods and services selected for the case studies should, by design, be significantly greater than for most goods. Even so, the study found that the scale of the impact from rate differences was not substantial in any instances, except for tourism and the second-hand scheme (see **Error! Reference source not found.**).

Table 3: Evidence and potential scale of impact from rates differences, selected goods and services

Category	Good/Service	Level of evidence	Scale of impact
Foodstuffs	Basket of fast-moving consumer goods	Some	Limited
Vehicle fuel	1 litre diesel	Some	Some
Medical equipment	Powered wheelchair	Limited	None
Jewellery	Luxury wristwatch	Limited	None
Consumer electronics	Notebook computer	Some	Limited
Medical/dental services	Porcelain crown fitting	Some	Some
Hairdressing	Women's haircut (medium-length hair)	Limited	Limited
Distance sales	Academic textbooks	Some	Some
Tourism	Beach/winter sport holidays	Limited	Some/ Substantial
Flat-rate scheme for farmers	Agricultural inputs (pesticides, seeds, etc.)	Limited	Limited
Second-hand scheme	Works of art Used cars	Some	Some/ Substantial

Source: 2017 VAT rates study

In quantitative terms, it is also worth highlighting that the amounts potentially at risk of distortion represent only a tiny fraction of VAT revenue. VAT levied on cross-border shopping by EU residents can be estimated at less than EUR 7 billion in total; this is only about 0.6% of total VAT revenue in the EU. Furthermore, only a small fraction of that amount could realistically be seen as having been relocated owing to VAT competition, as cross-border shopping typically takes place on holidays in which most spending is driven by experiential considerations. The amounts at play in relation to the special systems are an even tinier fraction. As for distance selling, the elimination of the thresholds in favour of a global EU threshold planned for 2021 and the expected increase in compliance should reduce the scope of the problems.

Another avenue for fiscal distortion could arise from a Member State applying a reduced rate on a good specified in such a way as to favour domestically-produced goods over others. This problem is prevented not only by the way the VAT system is structured, but also by the application of the tax neutrality principle (see Box 5 for details).

Finally, one should address a methodological issue. In theory, one could argue that although little evidence of distortion has been found under current rules, this might be because these same rules, by prescribing common minima, limit the maximum potential rate difference to a few percentage points; the same result might therefore not hold under a scenario in which such minima were abolished. However, according to the

[26] https://ec.europa.eu/taxation_customs/business/vat/digital-single-market-modernising-vat-cross-border-ecommerce_en

2017 VAT rates study, the impacts on cross-border shopping only become noticeable on certain categories of goods and services where price savings of 20% or above are achievable, and then essentially in border regions. This result does not change even in the case of high value items, for which the absolute savings can be significant. The finding considerably limits the scope of possible distortions even in a wholly liberalised rate regime.

Consequences of problem 1

While it is not possible to quantify the extent of problem 1, given that the degree of policy restriction is not a measurable parameter, one can nevertheless gauge its seriousness from two consequences flowing from it, namely: the number of requests for changes to the VAT Directive received by the Commission and the number of violations of VAT provisions already in place.

a) Continuous requests for changes in the VAT Directive

Although the existing rules on VAT rates do leave Member States with a wide room for manoeuvre, they nevertheless set significant constraints to their action. This is demonstrated by the high frequency of requests for changes to rate rules; just in the last two years such requests were made by seven Member States in three different domains (see Box 4).

That there is an ongoing need for adaptations to the VAT Directive was confirmed by views expressed in the Group on the Future of VAT (GFV), a group composed of Member State representatives and of the Commission which was tasked with providing a technical assessment of VAT reform options. In particular, in its meeting of 28 April 2017 on the rates system, only a small minority of Member State representatives defended the *status quo*, with a clear majority requesting changes to the scope of application of reduced rates. Similar views were also expressed by stakeholders in the open public consultation (see section 9.2 for details).

Box 4: Recent examples of Member States' requests for changes to the applicable rate regime

Despite the not insignificant latitude enjoyed by Member States in rate-setting, requests for changes to the applicable rate regime, more than two decades after the rules on reduced rates were first established, continue to be frequent (see **Error! Reference source not found.**). These requests are usually linked to the fact that goods or services to which a Member State would like to apply a reduced rate are not listed amongst those eligible under Annex III and therefore must be taxed at the standard rate.

Table 4: Requests for modifications in the VAT Directive to allow for lower rates, 2015-2017

Type of supply	Member States requesting/supporting
Electronic publications	DE, FR, IT, PL, BE
Women's sanitary products	UK
Internet services	HU

Source: Commission services

Experience suggests that requests for allowing lower rates to specific products will continue to be made in the future. This conclusion is supported by the fact that even though Annex III has already been modified

several times in the past, such requests continue to be presented quite frequently. For example, already in 1999, just seven years after rules limiting the discretion of all Member States to set VAT rates[27], Annex III was modified to allow – although on a temporary basis – reduced rates on a range of labour-intensive services, such as small repair services; the renovation of private dwellings; window cleaning and private household cleaning; domestic care services; and hairdressing[28]. The measure was finally made permanent in 2009[29]. Other recurrent requests involve for instance appliances with low energy consumption.

b) *Recurrent violations of the VAT Directive by Member States*

Until now, 40 infringement procedures on rates involving 20 different Member States have been initiated (see

[27] Council Directive 92/77/EEC of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC (approximation of VAT rates) (OJ L 316, 31.10.1992)

[28] Council Directive 1999/85/EC of 22 October 1999 amending Directive 77/388/EEC as regards the possibility of applying on an experiment basis a reduced VAT rate on labour-intensive services (OJ L 277, 28.10.1999)

[29] Council Directive 2009/47/EC of 5 May 2009 amending Directive 2006/112/EC as regards reduced rates of value added tax (OJ L 116, 9.5.2009)

Table 5). The Commission, in its role as Guardian of the Treaties, has to act upon such infringements and initiate proceedings against the Member States concerned. In addition, since 2008 the Commission also initiated 25 EU pilot procedures related to rates, with the aim of addressing the problem before the start of a formal infringement procedure. However, as can be seen from

Table 5, in a large portion of cases the issue cannot be resolved and the procedure continues until the final judgment phase. At present, violations of provisions on rates represent about 7% of all open infringement cases initiated by the Commission in the tax domain. Procedural requirements also generate litigation at Member State level, as national courts must decide whether to refer to the Court of Justice of the European Union (hereinafter 'CJEU') for a preliminary ruling.

As is apparent already from a quick glance at

Table 5, the majority of these infringements relate to specific sectoral transactions of a limited scope[30] and without systemic importance, and as such do not meaningfully distort intra-EU or domestic competition. Nevertheless, these are cases which are often highly sensitive in view of the goods or services concerned (as they may affect primary needs, social or cultural objectives) and of the direct impact that reverting to the standard rate may have on the final consumer. As a result, infringements with minor and local economic consequences have often in the past given rise to heated controversy, typically when an unlawfully broad application of reduced rates was challenged by the Commission.

Particularly, when there is no market distortion it is difficult to justify to the public why Member States should be so constrained in their tax sovereignty as to be prevented from taking decisions on VAT where this has a purely local impact. So, above and beyond the direct economic costs of litigation on the parties, and the impact of legal uncertainty on businesses in the affected sectors, there are also long-term, impossible to quantify negative consequences in terms of the perceived legitimacy of the EU rules in place.

[30] Section 9.7 includes estimates of the scope of the distortions for instances where quantification has been possible. The values found are typically of an order of magnitude of 0.1% of VAT revenues.

Table 5: Infringement procedures on violations of VAT Directive rules on rates

Member State	Reason for infringement procedure
BE	Reduced rate on buildings
CZ	Reduced rate for diapers
CZ	Reduced rates on horses
CZ	Reduced rate on medical equipment
DE	Reduced rate for artists – judgment of 23.10.2003 (C-109/02)
DE	Reduced rate on horses - judgment of 12.05.2011 (C-453/09)
DE	Reduced rate for works of art
EE	Reduced rate on diapers
IE	Reduced rate on horses – judgment of 14.03.2013 (C-108/11)
EL	Reduced rate on bowling
ES	Reduced rate on medical equipment – judgment of 17.01.2013 (C-360/11)
FR	Reduced rate for duty of attorneys – judgment of 17.06.2010 (C-492/08)
FR	Reduced rate on funeral expenses – judgment of 06.05.2010 (C-94/09)
FR	Reduced rate for the 140 first representations – judgment of 28.02.2012 (C-119/11)
FR	Reduced rate on horses – judgment of 08.03.2012 (C-596/10)
FR	Reduced rate on composite supply
FR	Reduced rate on domestic care services
FR	Reduced rates on supply of gas and electricity – judgment of 08.05.2003 (C-384/01)
FR	Reduced rates on medicinal products – judgment of 03.05.2001 (C-481/98)
FR	Reduced rate agricultural products
FR	Reduced rate on e-books – judgment of 05.03.2015 (C-479/13)
FR	Reduced rate for digital press
IT	Reduced rate on horses
CY	Reduced rate on medical equipment
LV	Reduced rate on medical equipment
LU	Reduced rate on e-books – judgment of 05.03.2015 (C-479/13)
LU	Reduced rate on horses
HU	Reduced rate on diapers
MT	Reduced rate for works of art
NL	Reduced rate for sports activity
NL	Reduced rate on horses – judgment of 03.03.2011 (C-41/09)
AT	Reduced rate on waste treatment
AT	Reduced rate on horses – judgment of 12.05.2011 (C-441/09)
PL	Reduced rate on shoes and children's clothing – judgment of 28.10.2010 (C-49/09)
PL	Reduced rate for folk art
PL	Reduced rate on medical equipment – judgment of 04.06.2015 (C-678/13)
PL	Reduced rate on fire-fighting products – judgment of 18.12.2014 (C-639/13)
PT	Reduced rate for attorneys-at-law
SE	Reduced rate on CD books
UK	Reduced rate on environmentally friendly materials – judgment of 04.06.2015 (C-161/14)

Source: Commission services

The high number of infringement procedures in this field raises the question why the rules are violated so frequently and by so many Member States. One answer is certainly that extending reduced VAT rates to new areas is a very long process given the unanimity requirement in the tax domain. By way of example, the final adoption of rules allowing for the permanent application of reduced rates to locally supplied labour-intensive services took several steps, including a three-year experimental period which was extended several times, lasting overall more than ten years, from the late 1990s until the introduction of those permanent rules on 1 January 2010. Such long time frames can occasionally even result in the rules for VAT rates, for example as regards products subject to technological progress, becoming obsolete; this was notably the case for digital publications (see Box 5).

Box 5: The principle of fiscal neutrality and its application in the VAT system

According to EU case law the principle of fiscal neutrality or VAT neutrality is inherent in the common system of VAT and precludes treating similar goods or services, which are in actual or potential competition with each other, differently for VAT purposes. This is an expression of the general principle of equal treatment in matters relating to VAT. It states that if goods or services are similar, they must be subject to the same rate of VAT[31].

In order to determine whether the goods or services in question are similar in nature, account must primarily be taken of the point of view of a typical consumer, so as to establish whether those goods or services meet the same needs of that consumer, while avoiding artificial distinctions based on insignificant differences. The CJEU has held that two supplies of services are similar where they have similar characteristics and meet the same needs from the point of view of consumers, the test being whether their use is comparable, and where the differences between them do not have a significant influence on the decision of the average consumer to use one such service or the other.

The principle of fiscal neutrality remains unaffected by any reform proposal, including those assessed in this impact assessment. It will always bind Member States' tax policy decisions.

Problems of respecting the principle of fiscal neutrality can only appear when specific provisions of the VAT Directive prevent Member States from applying the principle. Today, this is particularly the existence of Annex III and derogations, often very narrowly formulated, that gives rise to this kind of conflict, as the boundary set according to the rate rules may not coincide well with the criterion based on product similarity.

The instances where Annex III or one of the derogations contradict the principle of fiscal neutrality often lead to litigation. For example, the CJEU recently ruled that Annex III prohibits taxing at a reduced rate an e-book for download, while the same e-book supplied on any means of physical support can benefit from such a reduced rate, although the products were considered as similar by the CJEU.

As a result, Member States in adhering to the principle of fiscal neutrality could end up infringing the VAT Directive. The latest example concerns a case where the Dutch Supreme Court (Hoge Raad) on 11 November 2016 held that sunscreen with UVA and UVB filters and toothpaste containing fluoride are pharmaceuticals according to the Dutch Health law and have to be treated similar to other pharmaceuticals that are taxed at the reduced rate in the Netherlands. However, Annex III does not allow granting a reduced rate to sunscreen and toothpaste. It only allows reduced rates for pharmaceutical products of a kind normally used for health care, prevention of illnesses and as treatment for medical purposes.

Stakeholders affected by Problem 1

Problem 1 affects directly Member States, by preventing them from introducing tax policy changes, and the Commission by forcing it to intervene continuously in defence of the application of provisions devoid of EU-level importance. It also affects businesses, insofar as the introduction of reduced rates in violation of the VAT Directive and the subsequent abolition of the said reduced rates create instability in the business environment. The worsening in the tax treatment following reinstatement of the higher rate may make investments made in the meantime, and potentially entire business lines, unprofitable in the sectors affected. Such costs however cannot be quantified.

[31] For further details on this topic reference can, for example, be made to the discussion contained in the Opinion of Advocate General Mengozzi in case C-219/13 *K Oy* delivered on 14 May 2014.

The direct impact on consumers is more limited because rate changes will affect only a small share of their expenditure and the overall level of VAT revenues – as opposed to the portion raised on each good or service – is dictated by budgetary concerns.

2.2. Problem 2: Expiry of derogations will restrict further Member States' room for manoeuvre on rates

Introduction of definitive system triggering the expiry of special provisions (derogations) which currently allow Member States to maintain more favourable tax rates in specific domains

As explained, rules on VAT rates did not really exist before 1993, but the entry into force of the Single Market obliged Member States to agree such rules. After long negotiations a compromise[32] was found in Council at the last minute. The trick was to agree on common rules for the future (minimum of 5% for the reduced rates and a list of goods and services to which such reduced rates could be applied), but not to oblige the then nine Member States to abolish any reduced VAT rates in force at that time. This was achieved by granting derogations and by agreeing that these derogations should expire only once the definitive VAT system enters into force. However, Member States still use these derogations today, 25 years later, and only very few rates covered by the derogations have disappeared since 1993.

Until 2004 as part of their Accession Treaty new Member States could also negotiate derogations that would only be abolished with the definitive VAT system. That covered another 3 Member States. Because the Commission had learnt from the past that Member States did not show any interest in voluntarily renouncing on VAT rates covered by derogations, as of 2004 most of the derogations granted to the newest Member States included a predefined expiry date of 2007 (they eventually expired in 2010 after having been prolonged once).

The last attempt made by the Commission in 2003 to partly abolish some 'old' derogations was blocked by Member States in Council.

As a result, there is a very large disparity in the derogations remaining, with 'old' Member States benefiting from, in some cases, very wide derogations, in contrast with extremely limited deviations from the general rules in the newer Member States.

Box 6: Derogations from the general rules on VAT rates in the VAT Directive

- **Article 110**: Member States which, at 1 January 1991, were granting exemptions with deductibility of the VAT paid at the preceding stage or applying reduced rates lower than the minimum laid down in Article 99 may continue to grant those exemptions or apply those reduced rates. The exemptions and reduced rates referred to in the first paragraph must be in accordance with Community law and must have been adopted for clearly defined social reasons and for the benefit of the final consumer.
- **Article 111**: Subject to the conditions laid down in the second paragraph of Article 110, exemptions with deductibility of the VAT paid at the preceding stage may continue to be granted in the following cases:
  (a) by Finland in respect of the supply of newspapers and periodicals sold by subscription and the printing of publications distributed to the members of corporations for the public good;
  (b) by Sweden in respect of the supply of newspapers, including radio and cassette newspapers for the visually impaired, pharmaceutical products supplied to hospitals or on prescription, and the production of, or other related services concerning, periodicals of non-profit-making organisations;
  (c) by Malta in respect of foodstuffs for human consumption and pharmaceuticals.

[32] Council Directive 92/77/EEC of 19 October 1992 supplementing the common system of value added tax and amending Directive 77/388/EEC (approximation of VAT rates) (OJ L 316, 31.10.1992, p. 1)

- **Article 112**: If the provisions of Article 110 cause for Ireland distortion of competition in the supply of energy products for heating and lighting, Ireland may, on specific request, be authorised by the Commission to apply a reduced rate to such supplies, in accordance with Articles 98 and 99.
- **Article 113**: Member States which, at 1 January 1991, in accordance with Community law, were granting exemptions with deductibility of the VAT paid at the preceding stage or applying reduced rates lower than the minimum laid down in Article 99, in respect of goods and services other than those specified in Annex III, may apply the reduced rate, or one of the two reduced rates, provided for in Article 98 to the supply of such goods or services.
- **Article 114**: Member States which, on 1 January 1993, were obliged to increase their standard rate in force at 1 January 1991 by more than 2% may apply a reduced rate lower than the minimum laid down in Article 99 to the supply of goods and services in the categories set out in Annex III. The Member States referred to in the first subparagraph may also apply such a rate to restaurant services, children's clothing, children's footwear and housing.
- **Article 115**: Member States which, at 1 January 1991, were applying a reduced rate to restaurant services, children's clothing, children's footwear or housing may continue to apply such a rate to the supply of those goods or services.
- **Article 117**: Austria may apply one of the two reduced rates provided for in Article 98 to the letting of immovable property for residential use, provided that the rate is not lower than 10%.
- **Article 118 (parking rates)**: Member States which, at 1 January 1991, were applying a reduced rate to the supply of goods or services other than those specified in Annex III may apply the reduced rate, or one of the two reduced rates, provided for in Article 98 to the supply of those goods or services, provided that the rate is not lower than 12%.
- **Article 119 (parking rates)**: For the purposes of applying Article 118, Austria may apply a reduced rate to wines produced on an agricultural holding by the producer-farmer, provided that the rate is not lower than 12%.
- **Article 120**: Greece may apply rates up to 30% lower than the corresponding rates applied in mainland Greece in the departments of Lesbos, Chios, Samos, the Dodecanese and the Cyclades, and on the islands of Thassos, the Northern Sporades, Samothrace and Skiros.
- **Article 121:** Member States which, at 1 January 1993, regarded work under contract as the supply of goods may apply to the delivery of work under contract the rate applicable to the goods obtained after execution of the work under contract.
- **Article 122**: Member States may apply a reduced rate to the supply of live plants and other floricultural products, including bulbs, roots and the like, cut flowers and ornamental foliage, and of wood for use as firewood.

For more information on the specific VAT rates based on Articles 110 to 122, see section 9.5.

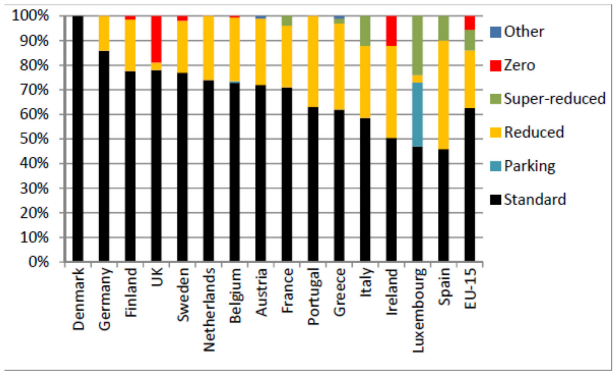
Derogations are also included in **Articles 371 to 390c in combination with Annex X**. These 'stand-still' derogations allow Member States to continue to exempt until the adoption of definitive arrangements certain supplies under the conditions as applied on 1 January 1978. Some of these exemptions are accompanied by a right of deduction in which case they compare to zero rates. That is for example the case with internal air and sea passenger transport services where an exemption with right of deduction is applied by all Member States.

In budgetary terms, the most substantial derogations are the zero rates (under Articles 110 and 111), both because of the greater rate of tax subsidisation and because some zero rates are applied to rather broad categories (e.g. food). Mathis (2004)[33] found that in 2000, the highest share of zero rates was in the UK, accounting for about 20% of the tax base, followed by Ireland at slightly over 10%. The presence of super-reduced and parking rates was significant in Luxembourg; together covering roughly half of the tax base (see Figure 2).

Data by Mathis (2004) is the latest and only data available. While the share of the zero rate in the UK and Ireland should have remained roughly constant, possibly with some erosion due to the lower elasticity to income of many of the goods covered by such rate, Luxembourg has abolished most of the parking rates since then and increased the share of the super-reduced rate.

[33] A Mathis, *VAT Indicators,* European Commission Taxation Papers Nº 2, Brussels 2004: https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_indicators.pdf

Figure 2: Shares of tax base by rate, 2000



Source: Mathis (2004)

All these derogations will expire, given the provisions in the VAT Directive, when the definitive system is implemented. This would then result in Member States losing the ability to legally maintain reduced rates in several domains, further restricting their room for manoeuvre in VAT rates policy compared to the *status quo*[34].

Generally speaking, the expiry of a temporary derogation is not necessarily a problem per se, as the default solution of reverting to the general rules could be an acceptable or even a better solution. However, Member States are strongly opposed to any further restriction in their ability to set rates. Consultation with Member States in the GFV has confirmed that as experienced since the 1990s phasing out an already granted VAT reduced rate is extremely difficult from a political viewpoint, owing to the fact that economic operators have founded their business models on the existing rate system and repealing such a rate would be highly disruptive. Several Member States made it clear when the GFV met on 28 April 2017 that to consider phasing out the existing derogations which allow super-reduced and zero rates was unacceptable. Even a number of the Member States not themselves benefiting from such derogations indicated that phasing them out was not a workable solution (see section 9.2 for details). This is perhaps also linked to the fact that, as showed by the results of the 2017 VAT rates study, the expiry of such derogations would not address any specific problem for the Member States not directly affected.

Speaking of the expiry of the derogations, it should also be mentioned that as at 31 December 2017 the obligation for Member States to set the standard rate at a minimum level of 15% will expire. The expiry of this obligation, unlike what happens for the derogations, does not trigger any immediate consequence given that all Member States levy standard rates that are well above the 15% threshold, and it seems highly unlikely that in the foreseeable future any Member State would wish to cut the standard rate below 15%.

[34] This consequence is qualitatively similar to the impact of Problem 1, and indeed it could be argued that, logically, Problem 2 should be seen as a subset of Problem 1. However, Problem 1 would, in theory, need to be addressed irrespective of the introduction of the definitive system, whereas Problem 2 only emerges in conjunction with the changeover to such a system. Furthermore, each problem can be solved independently of the other. Thus, for presentational reasons, we opt for a separate analysis of the two problems.

Breach of the equal treatment principle

It should be noted that the derogations in their current form contradict the principle of equal treatment. This is because, as explained in Box 6 above, many of these provisions are grandfathering clauses allowing exceptions based on the situation at some past date or to individual Member States (for example, the Article 110 derogation allows the continuation of zero rates in jurisdictions where and as they were in place at the date of 1 January 1991, and the Article 114 derogation allows Luxembourg and Spain to apply a super-reduced rate to the entire Annex III). As mentioned above, the disparity in the application of derogations is very large, creating a divide between pre-1992 Member States and the others.

There is no compelling reason why the same rights in terms of rates should not be extended to the other Member States, given that the rationale for limiting this possibility to some Member States was linked with the now defunct objective of adopting an origin system. Several Member States have pointed out in the GFV that the reform of the rates system must address this breach to the equal treatment principle.

Consequences of the problem

As confirmed by Member States during the GFV consultation, the expiry of these derogations is not an acceptable outcome for many of them. Thus, the lack of a clear and agreed solution extending the effect of the derogations is likely to prevent the introduction of the definitive system in itself.

Stakeholders affected

Member States

All Member States can apply rates lower than 5% ('super-reduced' rates) to at least one category of Annex III and two Member States (Spain and Luxembourg) even to the entire Annex III. Nine Member States (Austria, Belgium, France, Ireland, Italy, Luxembourg, Portugal, Spain and the UK) can apply reduced rates to numerous supplies that are not included in Annex III.

Zero rates (technically, exemptions with a right of deduction) are applied to specific goods in Belgium, Denmark, Ireland, Malta, Finland, Sweden and the United Kingdom; additional zero rates exist in the area of international passenger transport in all Member States.

Box 7: Impact of the expiry of derogations

The biggest impact from the expiry of derogations would be felt by the **UK** and **Ireland**, owing to extensive zero rating in these Member States. The UK applies a zero rate to approximately 20% of all supplies for which VAT cannot be deducted (equivalent to 35% of supplies to final consumers who consume 60% of all the supplies for which VAT cannot be deducted)[35]. If instead of the zero rate a reduced rate of 10% were applied to these supplies, the weighted average rate should increase from approximately 15% to approximately 17%. VAT revenue would increase by around 14%, equivalent to approximately GBP 18 billion per year[36]. The situation in Ireland is similar.

A significant impact can also be estimated for **Luxembourg**, which applies a super-reduced rate of 3% to the majority of the categories of Annex III. This amounts to around 25% of all taxable supplies. If a VAT rate of 5%, instead of 3%, had to be applied, the weighted average rate would increase from 13% to 13.5%. This increase of close to 4% is equivalent to an increase in VAT revenue of close to 4% or EUR 130 million. The budgetary impact is however small compared to the flexibility that is taken away from Luxembourg, because it is allowed to apply a super-reduced rate to the entire Annex III and has the right to introduce such rates at any time. The same is true for **Spain**.

Apart from Luxembourg, also **France**, **Italy** and **Spain** would be obliged to abolish existing super-reduced rates. The impact is deemed to be limited in Italy and France, where the super-reduced rate is limited in application (less than 5% of supplies to final consumers). The same difficulty in approximately estimating the quantitative impact occurs when attempting to quantify the impact of abolishing parking rates, which are mostly targeted VAT subsidies and often concern B2B supplies, for which VAT would be deductible.

Austria would be significantly impacted by having to abolish the reduced rate applied to the letting of immovable property for residential use, which constitutes an important subsidy for social housing. Austria would have to apply a rate of 20% instead of 10%, respectively 13% to the targeted sector, which creates around 15 000 dwellings each year.

Finally, **all Member States** would be obliged to tax international air and maritime transport, including cruises. Abolishing these derogations cannot be quantified, because of the complicated place of taxation rules (VAT would not be applied to the ticket price, but to the distance on/over EU territory which is difficult to determine).

The impact on businesses from the abolition of the rates would depend on the extent of the rate change. Given that profit margins in retail are thin, typically below 10%[37], there is no doubt that substantial changes in pricing would result. The knock-on effects of this would have a major impact on profitability in certain sectors.

The impact on consumers would depend on whether governments would offset the rate increases with cuts in other VAT rates, e.g. in the standard rate. Assuming that offsetting cuts are introduced, the main impact would be a worsening in the distributionary impact of VAT, because lower-income households typically spend a higher proportion of their income on necessities, which make up the bulk of zero-rated and super-reduced supplies.

Other stakeholders

In a VAT system based on the destination principle, there is no direct distortionary impact from cross-border differences in rates. The more favourable tax treatment in certain Member States could give rise to second-order effects only if it resulted in a significantly larger sector and if economies of scale play an important role. While no such case has been identified in practice, as highlighted by the replies of the Member States to the

[35] A study for 2011 found out that the household sector accounts for an average of 60% of all VAT liability in the EU-27 countries. Irrecoverable VAT liabilities from intermediate inputs purchased by sectors producing exempt supplies account for 19%, and the remaining 21% accrue to the Government, NPISHs and irrecoverable VAT on GFCF expenditures of exempt sectors. There is considerable dispersion in these ratios across the EU, with the share of household consumption on total VAT liabilities ranging from a low of 35% in Luxembourg, to a high of 74% in Lithuania. This range reflects both the existence of multiple rates and of exemptions (for instance, the low value for Luxembourg is due to the importance of financial services in the economy and the super-reduced rate of 3% applicable to a large part of Annex III from which mainly final consumers benefit).

[36] This calculation underestimates the impact by neglecting the fact that parts of the zero-rated items, e.g. children's clothing and footwear, would need to be taxed at the standard rate instead of a reduced rate.

[37] See http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html for data on profit margins by industry in the US.

consultation (see **Error! Reference source not found.** and section 9.2.3), the inequality of treatment is resented by stakeholders as a matter of principle. The theoretical impact of a difference in treatment would fall primarily on producers, as most consumers are not likely to spend a substantial share of their revenue on the affected good. Nevertheless, consumers in higher-tax Member States may sometimes feel unduly penalised by a VAT treatment that is less favourable than in other Member States. A good example is represented by the recent public opinion campaigns to extend zero-rate treatment on women's sanitary products, currently allowed only in Ireland, to other Member States[38].

3. EU RIGHT TO ACT

3.1. Analysis of subsidiarity

The current limitations for Member States in setting VAT rates are laid down in the VAT Directive. An initiative to modernise the VAT rules for rates therefore requires a proposal by the Commission to amend that Directive. Thus, action at EU level is justified as it is the only way to solve the problems.

The legal basis is Article 113 TFEU which states: '*The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.*'.

It should be noted that Article 113 TFEU clearly states that provisions to create a harmonised EU framework for turnover taxes such as VAT are only admissible inasmuch as they are necessary to safeguard the functioning of the Single Market and avoid distortions. VAT rules on rates therefore must be established keeping the right balance between preventing situations where rate differences might be so large as to distort competition, and respecting Member States' tax sovereignty in line with the subsidiarity principle.

3.2. Analysis of proportionality and EU value-added

As highlighted by the numerous requests for amendment of the Directive and infringement cases involving rates, it is necessary to improve the current EU legislation, which is unduly constraining for Member States. This can only be done through amendments to the VAT Directive.

This initiative aims at granting Member States more freedom to set VAT rates while maintaining certain safeguards for the Internal Market and national budgets, thereby providing EU added value compared to the current system.

[38] See for example http://www.change.org/p/george-osborne-stop-taxing-periods-period. Similar campaigns were also started in other countries.

4. OBJECTIVES

4.1. General policy objectives

The **main general objective** is to balance the objective of the VAT Action Plan (to allow Member States to maintain all currently existing reduced rates legally applied by them and to increase Member States' leeway on reduced VAT rates) with the mandate of the Council[39] (to avoid distortion of competition, rise in business costs and negative impact on the functioning of the single market).

Another general objective is to prepare the ground for the introduction of the definitive system by providing an accepted solution to the derogations issue. The proposal on rates should smooth the way for the introduction of the definitive VAT system through a more consistent application of the principle of equality of treatment, as opposed to the current system where certain derogations to VAT rates apply only to certain Member States.

4.2. Specific policy objectives

The **specific objectives** of this proposal are listed below. They spell out the general objectives and additionally take into consideration the need to provide a stable and efficient legal framework for rates and the key revenue-raising role of VAT.

1. Provide Member States with sufficient leeway in determining the scope and level of reduced VAT rates,
2. Treat Member States equally;
3. Limit tax distortions;
4. Minimise complexity and business costs;
5. Prevent litigation on VAT rates;
6. Protect VAT revenue from erosion.

It should be recognised that, in many ways, these objectives involve some trade-off with each other. In particular, the more leeway is granted to Member States in setting rates (objective 1), the more difficult it becomes to avoid increases in business costs (objective 4), as Member States may introduce, in an uncoordinated fashion, individual rules that complicate the overall rates landscape and thus, the tax system. Similarly, achieving objective 2 in itself generates greater complication of the tax system and thus conflicts with objective 4. Under these circumstances, clearly the aim must be to find the right compromise between the conflicting policy objectives, as recognised by the Council conclusions that call for a 'carefully balanced' final solution. Thus, in the assessment of the policy options this analysis will analyse carefully the risks stemming from each solution, comparing them with the degree of achievement of each of the policy objectives.

[39] Council conclusions on the VAT Action Plan adopted on 25 May 2016:
'The Council […] WELCOMES the intention of the Commission to present a proposal for increased flexibility for Member States, so that they could benefit from the existing reduced and zero rates in other Member States, INVITES the Commission to include an impact assessment, and STRESSES that a sufficient level of harmonisation in the EU remains required and the adopted solution has to be carefully balanced to avoid distortion of competition, rise in business costs and negative impact on the functioning of the single market.'

Table 6: Intervention logic and policy objectives

Problems /consequences	General objectives	Specific objectives		
Current origin-based rules affect subsidiarity by setting excessive constraints to rates policy	Provide Member States with sufficient leeway on reduced rates, while avoiding distortion of competition, a rise in business costs and a negative impact on the functioning of the Single Market.	Provide Member States with sufficient leeway in setting reduced VAT rates	Limit tax distortions	Prevent litigation on VAT rates
Expiry of derogations creates stumbling block for introduction of definitive system	Prepare the ground for the introduction of the definitive system by providing an accepted solution to the derogations issue	Treat Member States equally	Minimise complexity and business costs	Protect VAT revenue from erosion

Source: Commission services (2017)

4.3. Consistency of objectives with other EU policies

As illustrated in other sections of this Impact Assessment, VAT rate differentiation may, in general, be utilised to help achieve social policy objectives other than revenue raising. In particular, it can be used for distributional purposes or to make more affordable the consumption of certain goods and services deemed to be worthy of social support. However, a substantial consensus among economists exists that VAT is, in general, not the best instrument in this regard owing to the fact that it is not targeted, resulting in higher budgetary outlays than direct subsidies[40]. Hence, this impact assessment does not investigate the use of VAT to achieve policy objectives other than revenue raising; the policy options laid out herein are, however, assessed with regard to the specific objective of granting Member States more flexibility in setting VAT rates, which could facilitate pursuing social policy objectives according to Member States' priorities.

5. POLICY OPTIONS

5.1. Two options outlined in the VAT Action Plan

The VAT Action Plan outlined two broad options. Option 1[41] proposes to keep Annex III and the minimum of 15% for the standard rate and option 2[42] consists of replacing Annex III and the minimum of 15% for the standard rate by safeguards.

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[40] This issue is discussed at length in chapter 10 of Institute of Fiscal Studies (project leader), *A retrospective evaluations of elements of the VAT system,* London 2011, available at http://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/report_evaluation_vat.pdf

[41] "The minimum standard VAT rate of 15% would be maintained. The list of goods and services that can benefit from the application of a reduced rate would be reviewed in the context of the transition to the definitive system and then at regular intervals, in particular taking account of political priorities. Member States would be able to submit to the Commission their views on the needs for adjustment.
The Commission, with the support of the Member States, would analyse whether such changes would pose any risk to the functioning of the single market or distort competition, and would report its findings before any change.

While the description of the options in the VAT Action Plan is of general nature and leaves open the precise definition of the safeguards to be envisaged, both options have in common to maintain all currently existing reduced rates, including derogations, legally applied in Member States and to envisage to grant the derogations, currently only available to some Member States, to all Member States to ensure equal treatment between Member States. The mandate expressed in the Council conclusions on the part on VAT rates of the VAT Action Plan welcomed the intention of the Commission to present a proposal for increased flexibility for Member States, so that they could benefit from the existing reduced and zero rates in other Member States.

The wide extent of the derogations enjoyed by some Member States implies that both options lead to a significant reduction in the constraints on rates set by the VAT Directive. Given that fundamental choice, the main difference between the options consists in the fact that option 1 maintains the current fundamental VAT principle whereby reduced rates are allowed only when specifically permitted, whereas under option 2 reduced rates are allowed unless specifically excluded.

Views by stakeholders

In the Council[43], Member States supported extending existing derogations to all Member States as a solution to the problem of the expiry of derogations. As for the choice between the two options, Member States first in the Council[44] did not express a clear preference, but then in the GFV preferred the more conservative option 1.

As for the open public consultation, a plurality (42%) of respondents supported granting derogations to all Member States, whereas 25% favoured abolishing them. Only 8% of respondents said that the derogations should not be extended to all Member States but be made permanent for those Member States that currently benefit from them. However, one quarter of respondents had no opinion on the matter.

Also the results from the open public consultation show greater support for option 1; 60% of the respondents preferred to keep Annex III, whereas 22% supported its abolition. The other 18% of respondents had no opinion.

However, contradictions in the opinions expressed by Member States and stakeholders appear, when taking into account that the requirement for granting all derogations to all

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Under this option all currently existing reduced rates, including derogations, legally applied in Member States would be maintained and could be included in the list of optional reduced rates available to all Member States, ensuring equal treatment."

42 "The most ambitious approach in terms of granting Member States greater rate-setting power would be to abolish the list and allow them greater freedom on the number of reduced rates and their level.
This option would require safeguards to be put in place to avoid unfair tax competition within the single market, while also guaranteeing legal certainty and reducing compliance costs.
Also under this option all currently existing reduced rates, including derogations, legally applied in Member States would be maintained, the possibility to apply them could be made available to all Member States. The minimum standard VAT rate would be removed."

43 The conclusions adopted by the Council at its 3468th meeting held on 25 May 2016 welcome the intention of the Commission to present a proposal for increased flexibility for Member States, so that they could benefit from the existing reduced and zero rates in other Member States.

44 The conclusions as adopted by the Council welcome the Commission's intention to propose increased flexibility on VAT rates, whilst noting the need for the VAT system to maintain a sufficient level of harmonisation. The adopted solution has to be carefully balanced to avoid distortion of competition, rise in business costs and negative impact on the functioning of the single market.

Member States would be to abolish the minimum of 5% to the entire Annex III[45]. Nevertheless the majority of Member States in the GFV and also 50% of the respondents to the open public consultation suggested to keep the minimum rate, 30% had no opinion and only 20% were against keeping a minimum rate.

5.2. Discarded options

5.2.1. Could derogations be maintained in a definitive system without granting them to all Member States?

The definitive system requires for the rules on VAT rates to treat Member States equally. Therefore, derogations cannot be granted on a permanent basis in a definitive VAT system and could only be introduced as a temporary measure. As reference could no longer be made to a definitive system, it would be necessary to determine a final date for the expiry of the derogations that is reasonable, e.g. five years.

With the prospect of such a date set, Member States however know that the derogations would in fact expire unless a common agreement could be reached to avoid this and unless the Commission would present any proposal, whereas under the current rules each Member State can always delay the expiry of derogations by blocking the entry into force of the definitive regime[46]. As explained in section 5.1 when consulted, Member States could not agree on any proposal that would *de facto* lead to the expiry of derogations. Thus, any option that proposes to prolong derogations in a definitive regime for a limited period of time would require finding a long-term solution for the derogations along the line of what is included in the options analysed in this Impact Assessment.

5.2.2. Is letting derogations (partly or entirely) expire a policy option?

Letting derogations expire partly or even entirely would have been a valid policy option. However, given the implementation of the destination principle and with the proposal for a definitive VAT system based on destination-based taxation, the VAT Action Plan clearly states that Member States should be allowed to keep the VAT rates based on derogations. This is in line with the mandate from the Council and the subsidiarity requirements of Article 113 TFEU outlined in the VAT Action Plan. Any option that would propose to abolish certain derogations would go against the VAT Action Plan, Article 113 TFEU and the Council mandate.

The force of Member States' commitment to an expansive use of derogations is also confirmed by the fact that several attempts by the Commission to abolish certain derogations failed in the past (see Box 1). Only extensions to Annex III were ever adopted by the Council.

From a purely technical viewpoint the expiry of derogations is attractive because of the simplicity of such a solution. It is also consistent with views held by tax economists who question the economic efficiency of reduced rates and overwhelmingly favour a VAT system with a broad base and as little use as possible of reduced rates. However, the VAT Directive now and in future does not prevent Member States from simplifying their

[45] Two Member States are currently allowed to apply rates lower than 5% to the entire Annex III.

[46] Experience from the past relates to temporary derogations for Member States joining the EU in 2004. These derogations had to initially expiry in 2007, but were prolonged at the request of Member States. Eventually, all these derogations expired in 2010 in the absence of any proposal by the Commission.

national rules on VAT rates. Many Member States, in particular Denmark, have opted for simple rules, whereas others make intensive use of VAT subsidies. The latter is consistent with the view of most citizens who support differential taxation and the idea that meritorious or necessary goods deserve a more favourable tax regime. The wide use of reduced, super-reduced and zero rates in some Member States, despite their technical weaknesses, indeed testifies to the substantial political support for using reduced rates as an important tool of social policy. Not surprisingly then Member State representatives in the GFV made it clear that a reform proposal obliging Member States to give up existing reduced rates or longstanding derogations could not be accepted.

5.3. Baseline scenario (no EU action)

The baseline scenario assumes that the scope of Annex III remains unchanged. It also takes into account that the minimum of 15% for the standard rate will expire at the end of 2017 in the absence of any initiative.

Finally, for the purposes of the baseline scenario it is assumed that other legislative proposals on VAT put forward by the Commission are approved and implemented. These are:

- The definitive arrangements for cross-border business-to-business (B2B) trade in goods between Member States (definitive VAT system).

- The implementation of the extension of the One Stop Shop (OSS) in 2021 simplifying e-Commerce which is expected to decrease compliance costs with regard to registering and declaring VAT, but will not directly impact on compliance costs related with the multiplicity of VAT rates.

- The SME VAT Package which would have positive impacts on administration and compliance costs, but would have no direct link to VAT rates and their levels.

5.4. Option 1

While it is easy to agree on equal treatment of Member States and to ask for existing derogations to be granted to all Member States, the size of the derogations problem and the complexity of the legal provisions render it difficult in practice to do so. A solution for the expiry of the derogations is in any event only required once the definitive VAT regime enters into force, which is planned for 2022.

Consequently, a staged approach is necessary taking into account that Member States need a quick solution allowing to deal with their demands to extend or review the scope of Annex III.

Furthermore, a quick solution is needed for the minimum of 15% for the standard VAT rate. The minimum exists since 1993, when the rules on VAT rates first entered into force and was prolonged five times since then. The last prolongation was adopted in 2015 and lasts until the end of 2017. By 2018 the minimum requirement will expire.

In a *first and immediate step* the option would therefore consist of prolonging the minimum standard rate and providing for a regular review of Annex III to make sure its wording is clear and not obsolete, and its contents are in line with technological developments and social and political needs. The review would take place in the VAT

Committee[47], would be based on suggestions from Member States and would be followed by a legislative proposal by the Commission to adapt Annex III as and when needed.

While such a commitment is perhaps more of political significance than legal consequence, it does affect the *status quo* by providing a reassurance to Member States.

A three-year interval has been selected taking into account the preferences of Member States as expressed in the GFV that sufficient time for technical discussion is given in order to allow for technically solid solutions which can be agreed on. This leaves the time needed for discussions to take place in the VAT Committee. The review will prepare and facilitate negotiations in Council, which have consistently proven difficult, time-consuming, and often get bogged down on technical details.

In a *second step*, on 1 July 2022 with the entry into force of a destination-based definitive VAT system, a solution for the derogations problem would be envisaged in order to allow all Member States to benefit permanently from the derogations currently granted to some of them only.

The approach under this option is to grant existing derogations to all Member States without granting flexibility of setting VAT rates that goes beyond what is already applied under the current rules now by at least one Member State.

This would be done by extending further (by products such as children's clothing and footwear) the revised Annex III and abolishing the 5% minimum for it. In addition a new Annex would have to be created to cover all other items (mainly those falling under parking rates) that are not covered by Annex III[48]. Parts of the new Annex would have to be taxed at the minimum of 5% and parts at a minimum of 12% to accommodate for parking rates.

Member States would be allowed to apply a maximum of four reduced rates in order to allow all of them, including Ireland, to continue to apply the same (number of) VAT rates as at present. A possible sub-option would be to only grant Member States three redued VAT rates and to oblige Ireland to either abolish its super reduced rate of 4.8% or its zero rate.

This option will allow granting a substantial part of existing derogations to all Member States but not all. This is because in cases where the conditions for the application of parking or zero rates refer to national provisions outside the VAT system or even specific national institutions, it will not be possible to include such conditions in EU VAT law as part of the general provisions. Nonetheless, parts of these derogations could be granted to all Member States, if the underlying supplies were identified and if agreement on the scope of each provision could be reached, so that potential conflicts with the fiscal neutrality principle could be excluded.

The option is in line with the provisions of Article 113 TFEU, because the additional flexibility granted under this option is already being applied by certain Member States and no problems for the functioning of the internal market and/or distortion of competition could be observed.

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47 See information about the role and functioning of GFV and this Committee in the Glossary.

48 The scope of the new Annex would be large and e.g. include insemination services for all animals and also the supply of livestock semen and horse semen.

The incorporation of divergent national provisions in the enlarged Annex III and a new Annex would require highly complex technical-legislative work and a specific study before any new Annex could be proposed.

Instead of the 35% of household consumption expenditure that must always be taxed at the standard rate under the baseline scenario, it can be assumed that the percentage would decrease under this option to around 25%, as Member States would be allowed to apply a reduced rate (or sometimes even a zero rate) to e.g. children's clothing and footwear, actual rent of housing, wine, short-term hire of vehicles, driving schools and about another 100 items of minor quantitative importance.

Any possible sub-option whereby only some of the derogations, whether fully or partially, are granted **has to be discarded**, because any such scenario would require an arbitrary choice by the Commission between derogations that should be granted to all Member States and derogations that should be left to expire.

The arbitrary choice can be illustrated by a theoretical scenario that would grant all Member States only those super-reduced and zero rates that relate to Annex III. While it appears a valid option, this scenario reflects the perception that Annex III includes merit products, whereas products excluded from Annex III were excluded for good reasons. This is however not true, because the scope of Annex III is largely a result of negotiations in Council and the application of reduced rates simply reflects political choices made at a certain point in time. Under such a scenario Member States could in fact not apply a zero rate for children's clothing and footwear, just to give an example, although this was explicitly requested by Member States during discussions in the GFV.

This option will leave it to the Council, subject to consultation of the European Parliament, to make a choice of the derogations that should be granted to all Member States and those derogations that should expire.

5.5. Option 2

The *first step* of this option is identical to option 1, but as a *second step* this option envisages a different solution for the derogations problem and the rules on VAT rates in a definitive VAT system. This option would imply replacing the current Annex III with a negative list to which the standard rate of a minimum of 15% has to be applied. This solution substitutes the current principle, whereby reduced rates can be introduced only if specifically allowed, with the principle that reduced rates are allowed on any supply unless this is specifically excluded. Replacing Annex III with a negative list aims at a clear and simple solution for the derogations problem and makes the rules on VAT rates more transparent. This principle also corresponds better to the finding that under a full destination principle, it is hard to find evidence of distortion from VAT rates; it is therefore more proportionate to set limits only where these are necessary.

Characteristics and functioning of the new 'negative list'

The negative list would constitute the main safeguard against rate-driven distortions. It addresses the findings of the 2017 VAT rates study which highlighted that, while in the vast majority of cases risks of distortion from cross-border shopping are limited, in specific cases some impact cannot be excluded. Thus, in line with the results of the study, the negative list would comprise **goods subject to excise duties** (alcohol, tobacco and car fuel), **products subject to particular place-of-supply rules** (supply and hire of vehicles), **items subject to the special origin-based schemes** (flat-rate farmers, travel agents and

taxable dealers), **high value items that are easily transportable** (jewellery, weapons and ammunition, telecommunication equipment, works of art), **and exempted services for which Member States have an option to tax** (financial services, gambling and betting services).

The negative list would also include the supply of computer, electronic and optical products (CPA codes 26.3 and 47.00.32), electrical equipment (CPA codes 27 and 47.00.54), machinery and equipment not normally seen as a B2C supply (CPA codes 28 and 47.00.88) and furniture (CPA codes 31 and 47.00.55). This would see the inclusion of all goods for final consumption that could be of a significant value on the assumption that Member States do not want increased flexibility in setting VAT rates with regard to these supplies. This would however limit Member States that envisage in the future to offer a reduced VAT rate for energy saving electrical equipment, including household appliances.

The contents of that negative list would be subject to regular review in order to address any emerging needs. Under the negative list as currently envisaged, three Member States would be obliged to abolish a reduced rate for wine and one Member State to abolish a reduced rate for short-term hire of means of transport.

The negative list as envisaged is supposed to serve as a basis for discussion in Council, assisted by the European Parliament. Given that Member States have expressed in the past interest for rate cuts on environmental products such as electric cars, low-emission light bulbs or solar panels, Council could always decide to shorten the negative list.

Although the unanimity principle makes any agreement in taxation complicated, updating the negative list should be less challenging than updating Annex III. This is because of the different incentives at play. Currently, the main obstacle to agreement in updating Annex III is the fear that any reduction in its scope is bound to generate pressure at national level to cut the rate, once a Member State is free to do so. In contrast, an update of the negative list would go in the opposite direction, guaranteeing Member States from special interest pressure. Of course, it would remain very difficult to include in the negative list items currently at reduced rate in some Member States, but this is not realistic even in the current setting[49]. In addition, the scope of the negative list would be smaller and there would be clearer criteria for adding items to the negative list, as this would normally be linked to a risk of distortion.

Another advantage of a negative list compared to Annex III is that it can be structured according to the common classification of products by activity, abbreviated as CPA in order to provide for a better link to the restructured enhanced web portal that would also be established under this option. Furthermore, the structure of the negative list linked to the CPA would avoid to the maximum extent possible a potential conflict between respecting the list and at the same time adhering to the principle of fiscal neutrality (see Box 5).

The negative list would cover slightly more than 15% of household consumption expenditure, whereas under the current rules 35% percent of household consumption expenditure must always be taxed at the standard rate. Excluded would also be all supplies that do not relate to final consumption and which can therefore only be B2B supplies.

[49] It would be equivalent to reducing the scope of Annex III, which has never happened.

The difference of 20% in the household consumption that under this option could be taxed at the reduced rate (if the negative list, following negotiations in Council, remains as above) compared to what is possible under the current rules would include[50]:

- Furnishings, household equipment and routine maintenance (5.4%), in particular energy-saving equipment
- Clothing and footwear (4.9%)
- Actual rentals of housing (4.7%)
- Consumer electronics (1.3%) and electric appliances for personal care
- Animals not intended for foods production like dogs, cats and race horses
- Musical instruments
- Services not covered under the current Annex III (gardening, personal care, all repair services of movable tangible goods, services supplied by small animal practitioners)
- Electronic services other than e-publications.

Member States could under this option decide to grant specific VAT subsidies to support the above mentioned sectors that under the current rules may only benefit from direct subsidies. Compared to direct subsidies, VAT subsidies tend to be more permanent and they cannot be limited to certain groups of final consumers, e.g. low income households, so they are generally considered not to be the most efficient support tool in terms of costs. On the other hand, they are easier to administer for beneficiaries and have a higher take-up rate, an argument used in their favour by proponents of environmentally efficient household appliances. The interplay between a possibly higher take-up rate and more limited possibility for targeting such rates provides for a mixed picture in terms of the potential ecological impact of this option. Similar considerations apply to the potential greater use of reduced rates to support goods or services deemed worthy of social support[51].

A VAT subsidy for a specific product has an impact on the concerned sector. As discussed in section 6.1, the impact of a tax cut on profits (with possible impacts on salaries and employment) and prices depends essentially on the degree of competition in the sector concerned and the elasticity of demand. Higher competition and higher elasticity will lead to higher pass on and thus to lower prices.

Limitation of the number and level of reduced VAT rates permitted

Currently Member States can apply two reduced rates of a minimum of 5% and all Member States apply in addition a zero rate for international passenger transport services. Furthermore, 5 Member States apply a super-reduced rate. In order to abstain from restricting Member States' freedom in setting VAT rates, Member States need to be allowed to apply the two reduced rates of a minimum of 5% and two additional reduced rates for which the limit of 5% does not apply. This solution will grant Member States the same rights under the general rules in a definitive VAT system compared to today.

As no Member State has expressed any interest in applying additional VAT rates compared to today (see section 9.2 on stakeholder consultation) and because the 2017

[50] Latest available data by Eurostat on household final consumption expenditure by COICOP categories for the year 2014 for EU-28.

[51] This theme is discussed in detail in the study 'A retrospective evaluation of elements of the EU VAT system', Final report, London 2011.

VAT rates study concluded that a significant increase in the number of VAT rates permitted would entail risks for the Single Market as a result of a large potential increase in the complexity of the system, Member States should not be allowed to apply more than four reduced rates under this option in order to respect the objective of simplicity.

The general principle that reduced rates must not distort competition

The explicit introduction of the general principle in the VAT Directive that reduced rates must neither lead to distortions of competition nor hamper the functioning of the internal market would enforce the conditions laid down in Article 113 TFEU.

It should also be noted that even in the absence of a positive list (Annex III), reduced rates will continue to be the exception to the standard rate which remains the default solution. As under option 1 Member States will continue to be able to restrict as much as they want the scope of reduced VAT rates and could even abolish them entirely.

The requirement for reduced rates to benefit only the final consumer: formulation and significance

In order to delimit the scope of the application of reduced rates under this option, the VAT Directive will stipulate that reduced rates can only be applied if they are '*for the benefit of the final consumer*'. Such a provision exists already now, but only applies to a part of the derogations. It reflects the basic principle of VAT, namely that VAT is a consumption tax designed to be borne only by the final consumer[52].

It is important to note that this basic principle has already been interpreted by the CJEU[53]. According to established case-law, the final consumer is the person who acquires goods or services for personal use, as opposed to an economic activity, and thus bears the tax. It follows that reduced VAT rates under this option could not be applied to goods and services that can be used only for intermediate consumption. That does not exclude the use of reduced rates where the goods or services supplied are typically sold to final consumers. Nonetheless, as a basic principle this will in particular prevent Member States from introducing reduced rates that are for the benefit of exempt businesses (e.g. financial institutions) or for the benefit of public bodies that are able to supply services free of VAT to final consumers. Most importantly, it will prevent Member States from applying reduced rates to goods and services that can only be supplied B2B and for which VAT can be deducted. To this extent, the principle will contribute to simplicity of the VAT system[54].

Budgetary safeguard

Finally, this option would include a budgetary safeguard in order to protect Member States from any potential long-term risk (see section 6) of revenue erosion resulting from progressive extension of reduced rates caused by special interest pressure. In particular, individual Member States would not, as a rule, be allowed to extend the scope of reduced

[52] CJEU, judgment of 6 October 2005, Case C-291/03, *My Travel*.

[53] CJEU, judgment of 14 March 2013, Case C‑108/11, *Commission v Ireland*.

[54] Only some B2B supplies of goods and services could be taxed at the reduced rate under this option, which are normally consumed by final consumers, e.g. foodstuff and passenger transport services. In particular for goods the reduced rate treatment would in such cases ensure that the same VAT rate is applied throughout the entire supply chain.

rates if the weighted average VAT rate falls below the level of 12%. This weighted average rate is already calculated by each Member State in order to determine the VAT own resources of the Union. The 12% benchmark has been set based on the fact that in recent years, the lowest (weighted) average VAT rates applied can be found in Luxembourg, Malta, Cyprus, France and Spain ranging between 12% and 15%. All other Member States apply an average VAT rate of above 15% (on an average 19%)[55].

It must be noted that Article 113 TFEU does not allow for the introduction of a pure budgetary safeguard that fixes revenue at a certain percentage, e.g. the gross domestic product (GDP). However, whereas the weighted average VAT rate is technically a revenue safeguard, it refers *de facto* to the average VAT rates applied and can be interpreted as replacing the requirement of a minimum of 5% for the two additional reduced rates.

Box 8: Weighted average VAT rate (implicit VAT rate)

To measure the level of the VAT revenues, focusing on statutory VAT rates is unsatisfactory as, owing to differences in consumption patterns, the average effective tax rate differs in each Member State.

The weighted average VAT rate in a Member State takes into account all VAT rates in force and each VAT rate is weighted with the share of the value of the transactions to which that rate applies as a percentage of the total of taxable transactions. To link this indicator to VAT revenues, only those transactions are taken into account for which VAT cannot be deducted. This includes mainly supplies to final consumers, but also those made to exempt sectors of the economy, including public bodies.

This weighted average VAT rate does not only give an indication of the VAT burden, but also of the tax differentials induced by reduced VAT rates. The closer the standard rate and the weighted average VAT rate are, the smaller the impact of reduced rates. In the extreme case of Denmark, where there is only the standard rate and some exemptions that would count as a zero rate, the standard and the weighted rate are nearly identical. To illustrate this weighted average VAT rate in another way, it is the VAT rate, which if applied to all goods and services subject to VAT, would raise the same VAT revenues as the current array of rates.

Under the Own Resources Regulation[56] Member States are required to calculate a weighted average of VAT, if more than one VAT rate is applied. In order to calculate the weighting of the various rates the Member State shall break down, by VAT rate applied, all transactions which are taxable under its national legislation and which do not entitle the customer to deduction of VAT. Transactions which are subject to exemption with refund of the tax paid at the preceding stage are regarded as taxable transactions subject to a zero rate.

Web portal to include information on VAT rates structured by CPA

The web portal, called 'Taxes in Europe' database (TEDB), financed by the Fiscalis 2020 programme, is the Commission's on-line information tool covering the main taxes in force in the Member States and in particular VAT. The system contains information on around 650 taxes, as provided to the Commission by the Ministries of Finance of the Member States, but it does not cover information on customs duties and tariffs, which can instead be found in the customs tariff database (TARIC). Access to the TEDB is free for all users and the information can be found quickly and easily using the search tool.

For the moment information on reduced VAT rates included in the TEDB is structured according to the categories of Annex III and the various other provisions in the VAT

[55] The value of the weighted average is calculated for the purposes of the Own Resources Regulation. It is confidential and its precise value for the various Member States cannot be made public in this document.

[56] Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 on the definitive uniform arrangements for the collection of own resources accruing from value added tax (OJ L 155, 7.6.1989, p. 9).

Directive allowing for reduced rates. The current structure therefore limits the existing web portal to an information tool for stakeholders other than businesses.

In future this information should be published according to a common statistical classification. This will mean that for the purpose of the web portal the information on rates will no longer be grouped according to the provisions of the VAT Directive, but by product category based on the common classification of products by activity, abbreviated as CPA. The advantage for businesses is substantial, because CPA product categories are related to activities as defined by the statistical classification of economic activities in the European Community (NACE). Each CPA product is assigned to one single NACE activity. This linkage to NACE activities gives the CPA a structure parallel to that of NACE at all levels. As all businesses have to register their business activity according to NACE categories, they will be able to directly retrieve the corresponding VAT rate for their supplies in each Member State.

Member States would be requested to provide the data structured by the CPA classification, but data provided could also be based on the Combined Nomenclature (CN) used for customs purposes, because there is a corresponding CPA category for each CN category[57]. This is in particular important for those Member States which already use CN codes in their national VAT law. Reference to a code used for customs purposes will also considerably reduce ambiguity whenever the good is traded and, in most cases, allow quick and easy identification of the applicable rate, with considerable gains in terms of compliance costs for traders[58]. It *de facto* replaces, from a trader's perspective, the current double classification of goods and services with a single classification.

Amendments to EU legislation governing administrative cooperation[59] will make it mandatory for Member States to provide information on VAT rates according to CPA or CN and oblige the Commission to publish these data.

The costs related to restructuring the information included in the TEDB would be covered by the current contract with the contractor under the FISCALIS 2020 budget[60]. The restructuring would be foreseen for the annual update of 2019, which will commence in October 2018. Member States that do not already use the CN or CPA would have to

[57] There are 29 CN categories not covered in the CPA. 28 out of these 29 relate to engines and vehicles that would not be eligible for a reduced rate. Only one category (used pianos) has to be regrouped to its corresponding category (new pianos).

[58] Owing to the demanding data requirements of compliance cost calculations it has not been possible to supply a numerical estimate for the compliance cost savings obtainable through the web portal. The compliance cost gains will probably differ very substantially from one trader to the next, as they depend heavily on the specific business model of each enterprise. Cost savings will be lowest for businesses with a mainly domestic activity and highest, *ceteris paribus,* for SMEs selling a wide and variable range of products in many EU Member States. The share of the latter type of businesses seems likely to increase, in the medium and long terms, as SMEs seize the greater opportunities for sales over the internet and profit from the simplifications introduced by the definitive regime.

[59] Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (OJ L 268, 12.10.2010, p. 1).

[60] The FISCALIS 2020 will be replaced by another FISCALIS programme under the new multi-annual financial framework (MFF) and financing the TEDB database is considered a priority.

determine the corresponding codes[61]. Problems of delimitation should not occur, but any discussion about what is the correct classification would take place in the VAT Committee.

5.6. Sub-options of option 2

All sub-options are similar to option 2, but aim at restricting Member States' flexibility in specifc areas.

5.6.1. Sub-option 2a

Under this sub-option Member States would only be granted one additional reduced rate compared to today, instead of two under option 2. One additional reduced rate would allow all 23 Member States to keep all VAT rates they currently apply. However, 5 Member States (ES, FR, IE, IT, LU) would need to abolish either the super-reduced rate or zero rate.

5.6.2. Sub-option 2b

Under this sub-option Member States would need to respect an additional weighted average rate of 5% for the reduced rates. This constraint would not oblige any Member State to change any VAT rates with the entry into force of the definitive VAT system. Nevertheless, it is a safeguard to prevent Member States from entirely replacing the existing reduced rates of at least 5% by a super-reduced or zero rate.

5.6.3. Sub-option 2c

Under this sub-option the negative list would be extended by including certain additional goods for which, although the study could find no evidence for it, some risk of distortion could be feared, in a fully liberalised rates regime, because of potential cross-border shopping. These would include goods such as computers, electronic and optical products, watches, musical instruments, electrical equipment and furniture, which have a high unit value and can be transported at an affordable cost by cross-border shoppers.

The negative list would then be extended to cover around 23% of household consumption expenditure, instead of 15% under option 2 and 35% under the current rules, that must always be taxed at the standard rate.

The difference of close to 12% in household consumption that under this sub-option could be taxed at the reduced rate (if the negative list, following negotiations in Council, remains as above) compared to what is possible under the current rules would include[62]:

- Clothing and footwear (4.9%)
- Actual rentals of housing (4.7%)

[61] Estimating the budgetary cost that Member States would have to face to communicate the scope of reduced rates on the basis of the CPA classification is not straightforward, because it depends on the complexity of the national VAT rate structure. In a Member State with a rate structure such as Denmark, these costs would be zero, whereas in other cases Member States would have to rely on at least one classification expert. Labour costs would occur when the system is being set up and in case of changes to the VAT rates.

[62] Latest available data by Eurostat on household final consumption expenditure by COICOP categories for the year 2014 for EU-28.

- Animals not intended for foods production like dogs, cats and race horses
- Services not covered under the current Annex III (gardening, personal care, all repair services of movable tangible goods, services supplied by small animal practitioners)
- Electronic services other than e-publications.

Compared to sub-option 2a, this option would e.g. not allow reduced rates for environmental products such as low-emission light bulbs or solar panels, which have in the past been considered by some Member States.

6. ASSESSMENT OF IMPACTS

6.1. Short-run impacts

Given that the policy options envisaged do not force Member States to change anything but merely provide room for manoeuvre by establishing equal treatment, some assumptions are needed as regards the likely course of action of the Member States, when confronted with greater flexibility.

None of the options has immediate, automatic impacts[63], because Member States would not be obliged to change any of their VAT rates. National governments would only be given increased flexibility in setting VAT rates.

This Impact Assessment assumes that Member States will, in the short run, utilise the newfound room for manoeuvre to make targeted adjustments but will be keen to preserve the main working characteristics of their VAT system, in terms of the revenue raised, the overall operation of the system and the structure of the rates applied. This assumption is founded on a series of considerations of an economic nature and on the lessons that can be drawn from previous experiences with the introduction of new reduced rate categories. To cite some of these considerations:

- VAT is one of the main taxes for Member States, accounting for 18.0% of total taxation revenues[64]; Member States are well aware that any substantial changes would risk directly affecting budgetary stability.

- In line with the previous point, the requests for modification of Annex III, as shown in Box 4, typically involve changes of a limited scope.

- Already under current rules, reduced rates and exemptions with deductibility of the VAT paid at the preceding stage (zero rates) can be applied to up to 50% of the tax base (65% of the tax base of households), so the potential for extension of reduced rates is not very large.

- As highlighted by the discussion on the rates reform in the GFV, Member States overwhelmingly envisage limited adjustments to the scope of reduced rates; with

[63] The one immediate impact would be on litigation between the EU and Member States in regard to violations of rate rules in the VAT Directive. Depending on the update of Annex III, some or many of the open infringement procedures would cease under both options.

[64] 2014 data. Source: European Commission, Taxation Trends 2015.

some of them explicitly rejecting any significant broadening of their application (see section 9.2.2).

- The policy option with the greatest potential impact, option 2, will provide for a significant increase in rate flexibility only from 2022.

- Finally, past extensions of the scope of reduced rates, such as the 1999 extension to labour-intensive local services, did not give rise, EU-wide, to any visible negative impact on VAT revenues. VAT revenue indeed, on average, increased markedly in the years after 1999[65]. Only some Member States chose to extend their use of reduced rates, and those that did had ways of compensating targeted revenue shortfalls, e.g. by increasing the level of rates.

As such, this impact assessment assumes that direct social and economic impacts of the reform options on the economy as a whole are negligible in the short run. There may however be sectoral impacts given that targeted changes to the VAT system may occur. In such cases, rate cuts on specific products would impact, in the absence of significant changes in overall VAT revenue, solely the concerned sector(s).

As it is unknown where (if at all) such targeted changes would take place, it is not possible to estimate what their impact would be. In general, the introduction of a sectoral rate cut could benefit producers in the sector concerned or final consumers demanding the product in question, or the benefits could be shared between the two parties. Economic theory suggests that the characteristics of each sector, most particularly the supply and demand elasticity and the competitiveness of the industry, determine how much the reduction of VAT increases profits (with the attendant knock-on effects on sectoral salaries and employment) and how much is passed on to final consumers in the form of price cuts. Higher competition and higher demand elasticities would, in general, lead to higher pass-on and lower prices[66].

In theory, under a strict formulation of the assumption of constant VAT revenue, any revenue shortfall due to a sectoral rate cut would have to be absorbed by increases in the standard VAT rate or in other rates. However, looking at the revenue impact witnessed in past infringement cases, typically amounting to significantly less than 1% of VAT revenue (for more on the Economic impact of VAT infringements, see section 9.7) and to the clear policy orientation of Member States to introduce only very limited budgetary adjustments (for more on the Stakeholder consultation, see section 9.2), this effect can be considered negligible in the short run. Similarly, the social, distributional and employment effects would be negligible outside the concerned sector(s).

The environmental impacts would be even more specific and would depend strictly on Member States' choices. Whereas under option 1 they would be restricted by the new Annex III, option 2 would allow for the possibility to use VAT subsidies, instead of direct subsidies, to promote e.g. energy efficient products. However, at the same time –

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[65] The arithmetic average of VAT revenues in Member States, at 7.0% of GDP in 1999, increased steadily in the following years peaking at 7.9% in 2006. See European Commission, *Taxation Trends in the European Union,* 2012 edition, p. 186.

[66] Supply elasticity has the opposite effect, with a low elasticity resulting in higher price cuts. For completeness one should also distinguish between short- and long-term elasticity, the second of which is notably linked to the barriers to entry in the sector.

depending on the decisions made by Member States – environmentally harmful products could also end up benefiting from reduced VAT rates.

6.2. Longer-run effects

For the longer term, it would be incorrect to assume a near constancy of revenue or of the other major characteristics of the VAT system, as social, economic and political forces may come into play and influence policy choices, so that over time the cumulative effect of changes might become perceptible. In the absence of any certainty on the long-term direction of policy, this Impact Assessment concentrates on the potential risks of each option in order to illustrate their possible long-term impacts and compare them to the baseline scenario.

The longer-term risks stemming from a greater degree of tax rate flexibility have been identified by the 2017 VAT rates study as follows:

1. the risk of introducing fiscal distortions[67] in the Internal Market;

2. the risk of generating excessive complexity and costs for operators and tax administrations, discouraging intra-EU trade and thus undermining the functioning of the Internal Market;

3. the risk of creating legal uncertainty and fostering litigation between the Commission as the Guardian of the Treaties and Member States and at Member State level, thus endangering business investment and generating costs;

4. the risk of eroding VAT revenues.

As the objectives of the initiative explicitly include limiting these risks, they are discussed, for each option, in the section dealing with the effectiveness of the various policy options. As a terminological point, it should be noted that part of what could be understood as fiscal distortion is covered under the litigation risk (see Box 9).

[67] For the purposes of this Impact Assessment "economic distortion" is defined as the relocation of economic activity between jurisdictions, motivated purely by differences in VAT rate levels, as opposed to other factors, such as lower costs or higher demand. This definition therefore includes responses to tax regimes by both consumers and businesses, and a wide range of possible activities such as cross-border shopping, distance sales, and tourism.

Box 9: Fiscal distortion

The concept of fiscal distortion is a complex one, as it involves, first, an assessment of whether a difference in taxation is sufficiently large to have an impact on the market, and secondly, whether the difference in taxation is justified – e.g. on grounds of tax sovereignty or subsidiarity – or whether it conflicts with the operation of the Single Market and creates room for manipulation. Given that neither of these assessments is always clear-cut, the EU legislator has made a number of pragmatic choices, which, in simplified terms, could be said to centre on the distinction between taxes which directly affect the sale price of a good or service, where harmonisation measures are sometimes necessary, and taxes which do not directly affect the sale price, where rules prohibiting discrimination on the basis of nationality apply but no harmonisation is required. The former have been identified essentially as indirect taxes (notably turnover taxes such as VAT and excise duties), whereas the second group includes direct taxes.

It should be noted that while this approach is broadly supported by economic theory, in view of the tighter link of indirect taxes with the market price, indirect impacts of direct taxation on the market price certainly exist, and indirect taxes are not always fully translated into the sales price. As such, complete tax neutrality is not achievable, but the EU rules are generally effective in largely shielding the Single Market from distortions caused by indirect taxes. In particular, VAT has very attractive properties in this regard, because the zero-rating of exports coupled with the application of the destination principle ensure an almost complete tax equivalence between domestic products and equivalent imported products; no imported product can be disadvantaged or advantaged because of different VAT rates in the country of origin or destination, because both the imported and the domestic product pay in the end exactly the same VAT.

The deviations from tax equivalence which are minor relate to the following cases:

a) Products for which the destination principle does not apply. These were examined by the 2017 VAT rates study and for these, the impact from tax differences is direct and first-order.

b) Products deriving some inputs from exempt sectors. This is because, technically, the VAT embedded in inputs from exempt sectors cannot be deducted and thus intervenes in price formation. As a result, a sector with a high share of inputs from, e.g., the financial sector, can be slightly disadvantaged in international trade, if the domestic VAT rate is high. This is, however, a second order effect[68].

c) Other second-order competitiveness effects from the operation of other taxes.

The 2017 VAT rates study focussed on a), as the cases covered there were first-order effects. The results of the study are listed in **Error! Reference source not found.**. Second-order effects under b) and c) are small and can be neglected.

The explanations above relate to tax distortions in the same market, e.g. related to the *same* good or service. Somewhat different considerations apply to tax distortions between merely *similar* products. Here, a distortion can occur if a sector is unduly penalised – or advantaged – from a different VAT rate applying on its product vs the products of competitors, in the absence of an economic justification for this. This type of distortion is prohibited, in the EU system, by a general provision, Article 110 TFEU.

In the VAT domain, infringements of Article 110 TFEU have not occurred, partly because the rate applicable to each supply is set by the more specific VAT Directive. In a situation, however, whereby rate rules would be extensively liberalised, a risk might occur of VAT rates being set on very narrow bases, which would multiply the risk of unfair competition – e.g. wine being taxed differently than other similar alcoholic drinks, or cars being taxed depending on their characteristics and so on. While an *à la carte* differentiation in the rates applied on similar products would clearly work against fair competition, it should be stressed that existing rules do not necessarily prevent the problem, having regard to the very narrow nature of certain derogations and to Member States' freedom to restrict the application of reduced rates to subsets of the categories listed in Annex III. Thus, from the viewpoint of legal principles the situation does not change with the liberalisation of rate rules, as Article 110 TFEU continues to apply. Nevertheless, the risk that infringements to the tax neutrality principle would increase in a liberalised regime is discussed under the the objective to 'prevent litigation'.

Finally, another form of tax distortion could occur in the event that the compliance costs for economic operators to conduct intra-EU or import transactions increase so much compared to domestic transactions, to create a trade barrier. This type of risk is covered under the objective 'minimise complexity and business costs'.

[68] For a well-known explanation of this effect, see P. Krugman, M. Feldstein, *International Trade Effects of Indirect Taxation*, NBER Working Paper No. 3163, November 1989. Note that the authors use the term 'VAT rebated on exports', which is equivalent, in the EU context, to the destination system. VAT is not rebated on exports in an origin system.

7. COMPARISON OF THE OPTIONS

7.1. Effectiveness in achieving the objectives

7.1.1. Provide Member States with sufficient leeway in determining the scope and level of reduced VAT rates

The baseline (*status quo*) substantially fails to achieve this objective, as explained in section 2.1. Both main reform options, in contrast, provide Member States with greater leeway, but to a different extent.

Under option 2 Member States enjoy an extensive leeway in introducing new reduced rates, being limited in this choice essentially only by the negative list, which is aimed to forestall the risk of distortion of competition. Indeed, under option 2 the principle is introduced, that reduced rates are allowed unless specifically excluded. The two sub-options also substantially widen Member States' leeway over reduced rates, although to a slightly lesser extent owing to the introduction of some limitations to Member States' discretion; under sub-option 2a, five Member States would have to reduce the total number of rates compared to currently, and under sub-option 2b, reduced rates overall would have to exceed a certain minimum threshold, irrespective of overall VAT revenue. Under sub-option 2c flexibility would not be granted with regard to goods that have always been subject to the standard rate in all Member States.

Under option 1 the leeway is clearly smaller than under option 2, as Member States will still be bound to a predefined (updated) Annex III, but would enjoy a significant expansion of their ability to introduce reduced rates, in the order of 10% of household consumption. Sub-option 2c aims to reduced or even eliminate the difference between option 2 and option 1 by extending the negative list. The main limitation here comes from the fact that particular provisions stemming from legacy national rules may eventually be impossible to integrate in a reformed Annex III, potentially leading to some elimination of existing reduced rates. Given the fact that it is politically and economically more sensitive to abolish an existing reduced rate than to introduce a new one with a narrower scope, this could potentially turn out to be a stronger downside than currently anticipated. This could warrant a less favourable assessment of this option.

7.1.2. Treat Member States equally

In the *status quo*, as explained in section 2, this objective is not achieved as Member States are treated substantially differently with regard to derogations. Both main options provide a solution to this problem. However, under option 1 some derogations would be difficult to grant to all Member States and would therefore have to disappear, leading to a slightly lower effectiveness of option 1 in solving this problem. Under option 2 and its sub-options, in contrast, certain derogations could be challenged on the basis of the general principle (benefit of the final consumer) and Article 107 TFEU (State aid); this would however lead to benefits in terms of achieving other objectives.

7.1.3. Limit tax distortions of competition

Under a destination-based system, the scope for distortion of competition and harmful tax competition under the *status quo* is limited. The 2017 VAT rates study suggests that VAT-motivated cross-border shopping is unlikely unless VAT differentials create price differences equivalent to the more extreme price differences for excisable goods currently prevailing between some Member States; such large VAT differentials are unlikely under

the existing VAT system and also under any of the options. This is the basis for our assessment that this objective is substantially achieved under all options. The main potential for distortion lies with the special schemes for travel agents and taxable dealers (also works of art) operating under the origin principle, but these have a narrow scope.

Under neither of the main reform options potential incidences of distortion of competition increase during the first step compared to the baseline scenario. Based on the recommendations by the VAT Committee, the Commission would only propose an extension of Annex III where any potential distortion of competition could be excluded. Such modifications to the Annex (similar to the one proposed for e-publications) could rather reduce distortion of competition by enabling tangible and digital products that are similar to be taxed equally.

Under option 1, much like in the *status quo*, the risk of economic distortions driven by VAT rate differentials is limited. The extension of existing derogations to all Member States appears unlikely to generate differences in VAT treatment between countries sufficient to create economic distortions and motivate harmful tax competition, because such differences already exist and no distortion of competition could be observed apart from border regions. The economic impact will be limited to narrow border regions, given the size of transactions necessary to make cross-border shopping economically rational. One might however expect limited sectoral impacts for the tourism sector[69].

Under option 2 and its sub-options the negative list to which the standard rate has to be applied would include all supplies, where the place of taxation could still lead to economic distortions. These are supplies under certain special schemes, vehicles and high value and easy-transportable goods. As an additional safeguard the general principle that reduced VAT rates may not create distortion of competition would be explicitly mentioned in EU VAT law instead of only being derived from Article 113 TFEU.

The 2017 VAT rates study indicates that greater rate differentials could by definition always result in more tax competition, and more relocation of economic activity across borders for tax reasons in the case of cross-border shopping or tourism. Nevertheless, case studies, literature review and additional analyses suggest that this effect would still be of limited magnitude, as VAT differentials would need to approximate some of the larger excise differentials observable between Member States in order to have a substantial impact. Therefore, under this option a small number of high-risk items would be included in the negative list. Nevertheless, to take into account the wider potential scope of the reduced rates and the transitory impacts of litigation (see also section 7.1.5), option 2 and sub-options 2a and 2b are prudentially assessed slightly lower than option 1 and than the baseline in terms of this objective.

[69] The VAT rates study (PwC et al., 2017) suggests that a minimum floor with regard to VAT rates on goods and services provided to tourists might be considered to prevent 'a race to the bottom' in VAT rates for tourism. However, any such minimum rate level should be consistent with maintaining the competitiveness of the European Union as a whole, relative to other international destinations. Furthermore, under the current rules VAT rates applied to tourism services are already the lowest amongst all sectors (25 Member States apply a reduced rate to accommodation and 18 Member States apply a reduced rate to restaurant services). One Member State applies a super-reduced rate to accommodation and restaurant services and under this option all other Member States would be allowed to do so. Still, it seems that this option would create only limited additional room for Member States to further decrease VAT rates on tourism services. However, in recent years in many Member States specific tourist taxes on accommodation were introduced in order to compensate for the low VAT rates in the sector.

7.1.4. Minimise complexity and business costs

The current system allows for great variation of VAT rate structures in the Member States. This results in substantial costs for businesses. Traders need to know whether a reduced rate is applied in a particular case and if so at which level, particularly upon changeover to the definitive system where businesses will have to apply the VAT rate of the Member State of destination. This can be cumbersome, especially when VAT is due in a Member State where the business is not established, and when any of the over 200 derogations applies. As a result, under the *status quo* the objective of minimising complexity and business costs cannot be said to be attained.

To assess how compliance costs for businesses would evolve under the various policy options, we note that such costs are positively correlated with the diversity of VAT regimes: the more different rules are applied within the EU, the more businesses have to spend to comply with the rules in the various Member States. Any increase in system complexity thus would tend to increase costs for businesses and, incidentally, also for the tax administrations.

In the first stage of both of the main reform options, changes to Annex III would be limited and not give rise to any additional complexity.

In the second stage of option 1 complexity increases relative to the *status quo*, because Member States would be enabled to introduce one or two additional VAT rates, a super-reduced and a zero rate for certain products as a result of opening up derogations to all Member States.

The literature review and additional analysis from the 2017 VAT rates study indicate that business costs derived from complexity are significant, providing compelling reasons for Member States to limit the number of rate bands in their VAT system. A Swedish survey carried out by the Swedish Tax Board on compliance costs of VAT in Sweden[70] also shows that there is a clear correlation between the costs of handling VAT in businesses and the number of rates of VAT to be handled[71].

The maximum possible impact on complexity is large; if all Member States took advantage of all derogations permitted, this would lead them to operate a standard rate, three reduced and super-reduced rates, and an additional zero rate. The introduction of new VAT rates poses challenges for businesses not just in terms of invoicing, but also in terms of accounting, record-keeping, tracking legislative changes, and so forth. However, the introduction of many new rates seems highly unlikely, and complexity is rather likely to grow in a gradual, accretive fashion. Taking this into account, we assess option 1 as scoring somewhat less well than the baseline on minimising business costs.

Under option 2, in the second stage businesses trading across borders will be able to access information on rates, and in particular on which goods and services are eligible for reduced VAT rates and (thanks to the CPA) how these are classified in each jurisdiction. The web portal structured by the CPA will act as the key tool to limit complexity. Member States will be obliged to upload on the webportal data according to CN or CPA and the

[70] Compliance costs of value-added tax in Sweden, report 2006:3B, Skatteverket: http://skatteverket.se/omskatteverket/rapporter.4.584dfe11039cdb626980000.html

[71] The study indicates that a uniform rate of VAT in Sweden would entail a reduction of compliance costs by approximately SEK 500 million (or approximately EUR 54 million).

Commission will publish this information. Businesses will thus be able to cut their compliance costs by using the web portal[72]. This is important in particular for businesses in the e-Commerce sector that in future will be able to use the extended one stop shop. The cost reduction will be strongest, proportionally, for SMEs.

Another important safeguard to avoid complexity under option 2 is the introduction of the general principle that reduced VAT rates must be for the benefit of the final consumer. In conjunction with the negative list, this principle excludes that products typically supplied between businesses only could benefit from a reduced VAT rate. Applying the standard rate in those cases helps to preserve simplicity for typical B2B supplies, which represent the bulk of international trade[73], with no financial impact on businesses, because they can generally deduct input VAT.

Assessing the impact of option 2 on business costs requires comparing the positive impact of the web portal/CPA with the negative impact that can derive from greater system complexity. Under option 2, Member States would face fewer restrictions to introduce new reduced rates, or to extend them to new areas, which could well lead to an increase in system complexity. However, it seems highly unlikely that Member States would introduce large changes in the VAT rate structure very quickly, on account of the technical complexity of doing so and the potential repercussions on revenue. Any trend towards greater system complexity is thus likely to be gradual and a result of cumulative, rather than revolutionary, changes. In contrast, the introduction of the web portal/CPA should take place by the time of the introduction of the definitive regime.

Taking into account that the benefits of the web portal will accrue at introduction across the whole spectrum of goods and services, while the costs from greater complexity will manifest themselves gradually; as well as of the fact that the possibility to recover from the web the applicable VAT rate for a given good or service constitutes a significant simplification for traders, it can be argued that the cumulative impact of option 2 on business costs will be a cost reduction.

Nevertheless, it has to be recognised that there are a certain number of risks to this conclusion. First, while a basis for the CPA already exists for goods in the form of the CN nomenclature, it will have to be reviewed, and the classification system for services needs to be set up. Second, experience with web tools shows that there could be risks to the successful implementation of an easy-to-use portal for businesses, particularly in the initial phases. As such, we prudentially allow, in the comparison of options table, also for a worse outcome of this option on business costs, particularly in the short run.

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[72] This decrease in compliance costs cannot be quantified at present. This is due to several reasons, in particular that the Standard Cost Model (SCM) for the quantification of compliance costs is highly dependent on the specific procedure adopted. The detailed arrangements of the future definitive VAT system are still to be agreed upon and will not enter into force before 2022. Anyhow, the details of those arrangements, e.g. the concept of a certified taxable person would not impact on the scope of Annex III or the level of VAT rates, but should generally decrease compliance costs for large businesses and some SMEs. Obviously, the lack of a fully specified procedural baseline prevents the formulation of SCM-based quantitative estimates also for the present Impact Assessment on rates; nevertheless, all these impacts are taken into account on a qualitative basis in the remainder of the analysis and in particular when assessing the impact of the various policy options as outlined below.

[73] Intermediate goods trade represented about USD 7 trillion in 2013, compared to USD 4 trillion for primary goods, almost USD 4 trillion for consumer goods and around USD 3 trillion for capital goods. It can be assumed that the vast majority of intermediate goods and most capital goods would involve products not used for household consumption. See UNCTAD, *Key statistics and trends in international trade 2014*, United Nations, Geneva, 2015.

As for sub-option 2a, the fact that it implies a reduction in the total number of rates speaks for a more favourable impact on business costs than in the case of option 2. This is not the case for sub-options 2b and 2c, which have a similar impact on business costs as option 2.

7.1.5. Prevent litigation

Baseline

The *status quo* solution fails to achieve this objective as shown by the large number of ongoing infringement procedures on VAT rates issues (see section 2.1).

Harmonised EU-level rules regarding which goods and services are eligible for which kinds of VAT rates have historically led to litigation between the Commission and Member States, arising from attempts made to apply VAT rates not deemed permissible under the VAT Directive. While many issues are now part of settled EU case-law, the risk of litigation persists and may increase in light of a less consensual EU political environment and of greater favour for national solutions. On the basis of the arguments developed in the problem definition, we assume a continuation of the current trend whereby Member States regularly introduce reduced rates in violation of the VAT Directive.

It is even possible that current political dynamics seeing stronger calls for sovereignty in many Member States, result in more frequent 'go it alone' solutions, increasing the number of violations and infringement cases. Thus infringements are likely to continue generating litigation between the Commission and Member States at the same or a higher rate. The litigation risk could further increase in a definitive VAT regime, because Member States would have to increase VAT rates significantly for the supplies that are currently covered by derogations.

In addition, in the absence of updates to Annex III, the obsolescence of certain provisions, like in the case for e-publications, would gradually become more marked and thus conflicts with the principle of fiscal neutrality.

Option 1

The assessment of litigation risks in this scenario is complex because several effects will come into play and some of them will partially offset each other. On the one hand, the complexity of the legal-technical work required and the addition of new categories for which case law is either lacking or limited could increase the scope for ambiguity, and thus for subsequent litigation.

On the other hand, regular updating of the list of goods and services eligible for reduced rates should minimise the scope for conflict between the policies that Member States want to pursue and what is allowed under the VAT Directive. This would reduce litigation between the Commission and Member States on rates driven by the wish of individual Member States to apply a reduced rate to areas where the VAT Directive currently does not allow this. Since this option would markedly widen the admissible scope for the application of a more favourable treatment, the scope for conflict should naturally diminish and would probably involve disputes primarily linked to boundary issues.

These two effects run in opposite directions; the net impact will thus depend on which of the two turns out to be the stronger. Overall, it seems likely that the second effect would dominate and there would be a decline in Commission-Member State lawsuits.

However, a different type of litigation could arise from the narrow scope of some of the existing super-reduced and zero rates once they are extended to all Member States. It is conceivable that in some instances economic operators might attempt to challenge the limited scope of these provisions, once introduced not as exceptions as is currently the case, but rather as general provisions of the VAT Directive, on grounds of breach of the fiscal neutrality principle. There might be financial interest in challenging national rate legislation if, for example, businesses operating in a closely related market are excluded from the reduced rate, based on equal treatment grounds. To overcome this risk, each national provision will have to be reviewed independently before granting it to all Member States, but the process will be complex, particularly if Member States cannot agree to extend the scope of narrow derogations or do away with them.

It should be noted that total social costs of litigation (i.e. the sum of private and public and public direct and indirect costs) might increase if the nature of disputes were to involve private entities more frequently than at present. Currently, litigation mostly involves the Commission and Member States, as the Commission attacks rate provisions that do not conform to the VAT Directive; participation of private entities is relatively rare, on account of the fact that economic operators rarely have an interest in challenging a Member State law granting a reduced rate. It is however impossible to predict how frequently this second type of litigation would occur (if at all), with much depending on the outcome of the first judgements of this type.

It is difficult to estimate which, if any, of these opposing effects will prevail; as such, option 1 is assessed to be roughly equivalent to the *status quo* in terms of litigation risk.

Option 2

Also under option 2 opposing effects come into play. First, the new rules will render obsolete litigation under the current framework with regard to the correct interpretation of Annex III and the legal provisions by which derogations are granted. Although some scope for conflict between what individual Member States do and the VAT Directive remains, linked e.g. to the new safeguards introduced by option 2 the fact that option 2 liberalises extensively rate-setting in itself reduces the scope for litigation.

On the other hand, that impact must be weighed up against the risk of Member States accidentally or deliberately contravening TFEU provisions prohibiting State aid and protectionist taxation, as well as the principle of fiscal neutrality as it has been established in case-law on VAT. It is impossible to predict to what extent, if any, Member States will adopt VAT rate policies leading to infringements of State aid rules (Article 107 TFEU), prohibition of protectionist taxation (Article 110 TFEU) or violation of fiscal neutrality, compared to the baseline scenario and option 1. As such, it cannot be excluded that litigation risk increases under this option, noting also that the rules in the VAT Directive are relatively clearly defined in comparison to the higher-level principles articulated in the TFEU. For this reason, option 2 is assessed as less effective than the baseline on this objective. A similar picture applies to sub-options 2a, 2b and 2c.

7.1.6. Prevent revenue erosion

Nature of the problem

The potential for revenue decrease – defined as the maximum possible drop in revenue allowed by VAT rules – is actually quite high under the current rules, owing to the large hiatus between actual rates and the minima set by the VAT Directive. By way of example,

if a Member State decided to apply the minimum standard rate of 15% and a single reduced rate of 5%, which the Member State could apply to 50% of all supplies for which VAT cannot be deducted, this would result in a weighted average VAT rate of 10%. Compared to the EU-28 mean of 18% (the mean is 19% for those Member States which cannot apply super-reduced or zero rates), the potential risk of revenue erosion can be estimated at nearly 50%. This potential risk increases further after the expiry of the 15% minimum for the standard rate; however, this is a purely theoretical risk; the central role of VAT as a revenue raiser makes rash across-the-board cuts in rates unrealistic. Rate cuts would also normally be reversible.

The real risk for VAT revenue is not that of a sudden revenue shortfall due to extensive rate cuts, but that of erosion, i.e. that successive extensions of reduced rates to new categories end up compromising permanently its revenue raising capacity. As experience shows, the decision to grant a reduced rate is very rarely reversed. Nevertheless, governments remain free to increase the level of any reduced rate, if its budgetary costs become excessive; this can offset the revenue impact of the extension of the reduced rate to new areas.

Baseline scenario

Under the baseline scenario, revenue erosion is prevented by the existence of Annex III, which offers governments an opportunity to resist pressure to extend reduced rates to new domains. Once a reduced rate is granted to a good or a service, limitations in the number of rates also reduce the scope for lobbying, as reducing further the rate for a particular interest group will generally require reducing the VAT on a range of other goods and services in the same band. This amplifies the budgetary cost, making the request harder to grant. This is a general feature; the more extensive the category to which a rate cut could be extended, the less likely it is that the rate cut is granted.

Overall, it can be assumed that in the baseline scenario VAT revenue would remain unchanged at close to current levels, owing to ongoing budgetary needs and to the key role of VAT as a source of revenue[74] in the short run. Also the expiry of the 15% minimum for the standard rate would not have any immediate impact given the fact that all Member States have standard rates well above that level.

Option 1

Option 1, by increasing the scope of goods and services for which reduced rates are legally permitted, raises the possibility of increased domestic pressure for rate reductions on particular categories of goods and services. For this reason, it scores less well than the *status quo* on revenue erosion. However, it has to be recognised that, in previous instances where reduced rates were extended to selected new categories, this did not cause a reduction in VAT revenue, which has on the contrary shown a consistent upward trend. This is because tax authorities have resorted to increases in the standard rate or other revenue-raising measures to offset the impact of targeted changes.

[74] There could only be an impact of the *status quo*, if the Commission decided to launch infringement procedures in cases where Member States interpret widely the wording of Annex III and if subsequently Member States would amend their national VAT law voluntarily or subsequent to a ruling of the CJEU confirming the position of the Commission. Such a scenario is however unlikely, because the Commission would only launch infringement procedures where Member States clearly infringe the VAT Directive or violate the principle of fiscal neutrality.

Member States would under this option be enabled to apply VAT rates lower than 5%, including zero rates, to products included in a significantly enlarged Annex III. Applying such super-reduced or zero rates could have a negative budgetary impact in the Member States, depending on the use they make of the flexibility offered.

As is the case for the baseline scenario, the maximum potential risk for erosion is high. If Member States decided to apply 0% to the entire Annex III (at least 50% of all supplies for which VAT cannot be deducted) and a standard rate of 15%, the weighted average rate could decrease to 7.5%. Compared to the EU-28 mean of 18% (the mean is 19% for those Member States which cannot apply super-reduced or zero rates), the risk of revenue erosion can be estimated at nearly 60%. The quantification of this additional risk of revenue erosion compared to the baseline scenario can also be illustrated by a more complex approach (see Box 10).

Another way of illustrating the risk of additional risk of revenue erosion under this option and the difficulty to distinguish this risk from that already existing under the current rules is to look at the most widespread *de facto* zero rate, which relates to passenger transport services. The current rules already allow applying a reduced rate to all passenger transport services whilst a zero rate can be applied to most international passenger transport services.

A recent study on the current VAT rules for passenger transport (hereinafter 'passenger transport study')[75] estimated that VAT revenue from passenger transport services for EU-27 in 2010 amounted to EUR 8.8 billion, which nearly entirely originated from domestic passenger transport services. According to the VAT gap study[76], the total VAT revenue in EU-27 in 2010 (the study used data for 2010) was EUR 861 billion of which EUR 8.8 billion represent 1%. This is the maximum risk of revenue erosion, but already under the current rules Member States could apply a reduced rate to passenger transport services, so a large part of VAT revenues originates from applying the standard VAT rate. The additional risk of revenue erosion under this option should therefore relate to Member States applying a zero rate instead of a reduced rate, which would represent far less than half of the risk already present in the current system.

The example of passenger transport illustrates just how difficult it is to assess the real risk from granting Member States more flexibility, when they are not using most of the flexibility already available. While extending a zero rate may pose a theoretical risk of revenue erosion, in practice this risk can vary considerably as a function of sectoral specificity. The example of passenger transport offers a good illustration of this as, realistically, the risk of erosion appears quite different depending on the market segment.

Zero rating all *domestic* passenger transport is only a potential risk, because Member States currently taxing it at the standard are well aware of what the passenger transport study emphasises, namely the enormous potential that the application of VAT in this sector would have in terms of generating revenue and the limited impact of applying reduced or zero rates on the demand for such services (due to low elasticities of demand and pass-through rates that are very low, varying between 7% and 50%). Conversely, zero rating all *international* passenger transport is a much more likely risk, as already now only few Member States tax international road and rail transport. This difference between the

[75] http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/common/publications/-studies/report_passenger_transport.pdf

[76] https://ec.europa.eu/taxation_customs/sites/taxation/files/2016-09_vat-gap-report_final.pdf

two segments can be explained by the action of economic factors similar to those at work in the tourism industry. However, international road and rail passenger transport only generated VAT revenues of EUR 0.5 billion in EU-27 in 2010 (0.06% of VAT revenues)[77]. Nearly all VAT revenues stem from domestic passenger transport services.

Box 10: Quantifying the potential for revenue erosion under option 1

For this calculation Member States that already apply super-reduced and zero rates to more than only few items have to be left out. A risk of revenue erosion exists also for these Member States, but for them it is significantly lower as compared to those Member States that could introduce super-reduced and zero rates and it also depends on how far they already use these rates.

In regard to the 21 Member States currently not able to apply super-reduced or zero rates, the illustration takes into account the average standard VAT rate applied by them, which is 22%, the average reduced VAT rate applied by them, which is 9%, and the mean of the average weighted rate estimated for each of these Member States, which is 19%. This information allows calculating that in these 21 Member States on average 77% of the products supplied to final consumers and exempt sectors are taxed under the standard rate and 23% are taxed under reduced rates. Under this option these Member States would be allowed to apply a zero rate (instead of 9%) to around 70% of the supplies already under the reduced rate, i.e. they could apply a zero rate to 16% of all products supplied to final consumers and exempt sectors (23% * 0.7 = 16%). If Member States used all their flexibility, the mean of the weighted average rate could decrease to 17.6%. Compared to 19%, this is a decrease of 8%. This decrease is equivalent to a decrease of 8% in VAT revenues. So as a maximum the additional possible impact on VAT revenues for the average of the 21 Member States that do not have super-reduced and zero rates is 8% or EUR 64.6 billion.

A small additional risk of revenue erosion also exists for Member States already applying such rates as they would be enabled to enlarge the scope of super-reduced and zero rates used, something which is not possible under the current rules.

However, even if the additional risk of revenue erosion is small under this option and Member States confirmed their opposition to extending the use of such rates during the consultation, special interest pressure would increase once Member States had more flexibility to lower the level of reduced rates e.g. for basic items like foodstuff. A replacement of reduced rates by even lower rates would then normally have to be compensated by an increase in the standard rate. It would therefore have no significant systemic effects, but could lead to higher rate divergence.

Finally, the risk of revenue erosion is higher if zero rates are extended than if reduced rates are, as the reduced rates may easily be increased once their budgetary cost becomes excessive, but this does not apply to zero rates; to reduce budgetary losses from zero rates, the only option is to transform them into reduced rates, which is politically more difficult.

Option 2

Maximum potential reduction of revenue

Under this option, a Member State could decide to apply a zero rate to 85% of all supplies to households, which represent on average 60% of all supplies for which VAT cannot be deducted. However, the general principle that reduced rates must be for the benefit of the final consumer would significantly contribute to prevent exempt businesses and public bodies benefiting from such zero rates. Zero rates could e.g. be granted for the construction of new buildings for residential purposes and not to new buildings in general.

[77] Furthermore, albeit the possibility of a zero rate being applied, the shift in the place of taxation to the place of departure in a definitive VAT system for international passenger transport as currently foreseen under the VAT Directive could even lead to increased VAT revenue, because it would become easier for Member States to tax these supplies including air and maritime passenger transport, which is currently exempt in all 28 Member States.

Thus, under this option a zero rate could be applied to 50% (85% * 60%) of all supplies for which VAT cannot be deducted.

However, the revenue safeguard foreseen under this option will prevent revenues from falling below the levels prevailing today in the most lightly taxing Member States of the EU. These Member States will have little room for extending the scope of reduced rates or lowering VAT rates under this option.

Likely impact on revenues

Obviously, the budgetary safeguard, like all safeguards in the field of indirect taxation, by prescribing a minimum level, cannot prevent Member States with currently high weighted average rates from significantly lowering their VAT rates; but this would be a tax policy decision that Member States should be free to take. However, it is unlikely that Member States that depend on VAT revenues and that have established high VAT rates despite the existing possibility to lower the rates under the current rules, will do so under revised rules.

Nonetheless, the additional flexibility provided by this option would render Member States more susceptible to special interest pressure, as there is no legal obstacle to reducing any particular rate band, or moving any particular good and service to a lower rate band. While the targeted restrictions on high-risk goods and services in the negative list would provide some legal limits, these are not anticipated to apply to a particularly wide range of products. The vulnerability to domestic pressures would be more acute where there are no limitations on the number of rate bands a country could implement: pressure groups could then propose a particular rate for a particular product, and political justifications for targeted sectoral benefits are usually easy to find.

In the past, Member States have reacted differently to such pressure. Some have resisted entirely, in particular Denmark has never introduced any reduced rates. Looking at the percentage of household final consumption expenditure taxed at the standard rate, there are several Member States where the percentage amounts to nearly 90% (no impact of special interest pressure) and at the other end there is one Member State where this percentage is only around 35%, but this percentage has not varied over the past decades. All other Member States lie within this range, mostly between 50% and 70%[78].

Experience from when Annex III was extended to cover labour-intensive services also shows that VAT revenues did not in actual fact decrease. This is because lowering VAT rates led to taxation of previously undeclared supplies (for instance in the HORECA and construction sectors), while the level of other VAT rates were increased. Notably, from 2004 to 2014 VAT as percentage of GDP increased by 0.4 percentage points, from 6.6% to 7%, in the EU-28 and VAT as a percentage of total taxation also increased by 0.4 percentage points from 17.6% to 18%.

Overall, however, option 2 scores worse than the *status quo* on the risk of VAT erosion because it facilitates the granting of reduced rates to specific new categories. For the same reason, it also scores lower than option 1.

[78] Detailed data is provided by each Member State to the Commission to calculate the VAT-based own resources, but this data is not published and therefore only rough estimates could be used for this impact assessment.

Sub-option 2a

Sub-option 2a makes it slightly more difficult to extend a reduced rate to a new sector because the policymaker has fewer rate bands at its disposal. This leads to a greater clustering effect, which, as discussed above, discourages rate cuts. This effect however does not seem strong enough to warrant a strong distinction between the risk of revenue erosion under option 2 and sub-option 2a; both are more exposed to this risk than the *status quo* and option 1.

Sub-option 2b

Sub-option 2b contains an additional budgetary safeguard preventing the weighted average of all reduced rates to fall below 5%. By putting an additional hurdle to rate cutting, this sub-option scores better on VAT erosion, although its revenue impact appears, from preliminary calculations, not to be very significant.

Sub-option 2c

The extension of the negative list can be an effective tool in reducing the risk of revenue erosion, depending on its final coverage. With a significantly extended list, in terms of revenue erosion sub-option 2c would score close to option 1.

7.2. Efficiency

For a detailed overview of the main risks affecting the achievement of the various policy objectives, please see section 9.8, which summarises the assessment laid down in the previous section.

7.3. Coherence

Both options are coherent with the subsidiarity approach outlined in the VAT Action Plan, providing Member States with more flexibility in setting VAT rates in a destination-based VAT system.

Table 7: Comparison of options

Objective	Baseline	Option 1	Option 2	Sub-option 2a (with one less rate)	Sub-option 2b (5% minimum average rate)	Sub-option 2b (extended negative list)
Provide sufficient leeway in setting reduced rates	--	+	+++	++	++	++[+]
Treat Member States equally	--	++	+++	+++	+++	+++
Limit tax distortions	++	++	+/++	+/++	+/++	+/++
Minimise complexity and business costs	-	--	-/+[+]	0/++	-/+[+]	-/+[+]
Prevent litigation	--	--	--/---	--/---	--/---	--/---
Prevent revenue erosion	++	+	-/--	-/--	-/+	+

Key: symbols indicate the degree by which each option attains the relevant objective

+++/--- objective fully achieved / not achieved

++/-- objective substantially achieved/not achieved

+/- objective achieved/not achieved to a limited extent

The symbol '/' indicates alternative outcomes, depending on circumstances

7.4. Conclusions

With regard to the risks, it is important to recall that under the current rules and also with enhanced flexibility Member States will always retain full ability to safeguard revenue by not lowering the VAT rates, and thus can control to what extent the budgetary cost is proportionate to the objective pursued. Member States can also simplify their national VAT rates system, but they would not be obliged to do so by EU law. Therefore, both options respect the integrity of the VAT system.

The risk of increased complexity under both options compared to the baseline scenario has to be weighted up against the additional flexibility that Member States gain under each option and particularly the fact that the baseline scenario carries the risk that the definitive VAT system may not become reality, because Member States would not accept the expiry of derogations.

If the options are compared, option 2 is the preferred option from a technical point of view, because it provides for general rules to solve the derogations problem and contributes to harmonisation by introducing the CPA classification for the negative list and by setting as a general principle that reduced rates must be for the benefit of the final consumer. The problem of option 1 lies in the fact that it aims at extending significantly an already excessive and unstructured list of goods and services to which reduced VAT rates can be applied. Thus, conflicts with the principle of fiscal neutrality are likely to increase.

No solution is optimal. As there is little or no harmonisation of VAT rates under the current rules, finding a common denominator for common restrictions on Member States' freedom in setting VAT rates can only be achieved by Member States in Council after consulting the European Parliament and the Economic and Social Committee.

Both options render transparent the size of the derogations problem and the fact that the current flexibility is still not enough to cater for all demands by Member States for reduced rates. As a matter of fact, under both options Member States could no longer use the argument of equal treatment in order to obtain a specific rate (e.g. zero rates for tampons or children's clothing) without naming the consequences.

7.5. Preferred option

The most effective option in achieving all objectives seems to be sub-option 2c, which extends the negative list and restricts Member States in applying reduced rates to most goods for final consumption. However, given the unanimity requirement in the area of taxation it will eventually be for the Council, after consulting the European Parliament and the Economic and Social Committee, to define the items to be included in the negative list. Proposing a limited or an extended negative list will not preclude any outcome that the Council envisages.

Proposing a negative list instead of the current Annex III requires that stakeholders are informed about the magnitude of the derogations problem and the complexity of the current system in order to justify the reason behind the change of paradigm. The intransparent rules on VAT rates have allowed Member States to benefit from disharmonised rules at EU level, while the general rules always suggested harmonisation. Already the short negative list under option 2 would oblige certain Member States to abolish reduced VAT rates for heating oil, short-term hire of means of transport and the extended negative list under sub-option 2c would not allow Member States to introduce reduced rates for energy-efficient or energy-saving goods.

8. MONITORING

The preferred option would generally not oblige Member States to change the VAT rates they currently apply with the exception of rates that could contradict Articles 107 and 110 TFEU. Monitoring is required with regard to the changes in the national VAT laws concerning these exceptions.

Monitoring is also required with regard to the correct application of the rules on VAT rates included in the VAT Directive. Until the entry into force of a definitive VAT system the Commission will continue to monitor that Member States, when applying reduced rates, respect minimum rates, the scope of Annex III and its limitations and the scope of derogations granted to them. Compliance of Member States with the rules will continue to be enforced and could always lead to infringement procedures.

Beyond that, the monitoring at EU level takes place in a continuous review of the scope of the reduced rates applied in line with Article 100 of the VAT Directive. To this extent, there is also a continuous collection of information about the VAT rates in place in each Member State. Such information is currently published by the Commission in the document 'VAT rates applied in the Member States of the European Union', which primarily serves as an information tool for researchers, businesses and final consumers.

With the implementation of a definitive VAT system, such information would be collected on a mandatory and standardised basis. A web portal would provide accurate and timely information on the reduced VAT rates in place in each Member State. A list of products according to CPA that are not covered by the standard rate in each Member State would be included in the web portal and regularly updated by the Member States.

Monitoring would focus on the correct application by Member States of the negative list, the general principles and the principle of fiscal neutrality.

Monitoring of the quantitative safeguard, the weighted average rate, would also be required. Data on the weighted average rate is already available and submitted by all Member States to the Commission for calculating the VAT own resources.

An evaluation report reviewing the negative list, the general principles and the safeguards would be prepared by the Commission five years after the entry into force of the new rules. The evaluation should assess in how far the safeguards are effective and efficient in mitigating the risks assessed in this impact assessment (litigations and revenue erosion) and to what extent the risks analysed in this impact assessment might have materialised. The evaluation results would be communicated to the Council in the form of a report, which would conclude on a potential need for reviewing the negative list, the general principles or safeguards and hence the need for a legislative initiative.

It would also be required to repeat the evaluation every five years, in particular because the negative list would require a constant review.

9. ANNEXES

9.1. Procedural information

9.1.1. Agenda planning and Work Programme References

This initiative is part of the Commission Work Programme 2017 and REFIT.

The Agenda Planning Reference is 2017/TAXUD/007. The Inception Impact Assessment was published on 22 December 2016[79].

9.1.2. Inter-Service Steering Group

An Inter-Service Steering Group was set up for the follow-up of the VAT Action Plan. The Steering Group met on five occasions, on 5 December 2016, 6 April 2017, 14 June 2017, 26 September 2017 and 26 October 2017 to discuss a general reform on VAT rates. The following Directorates-General (DG) and services were consulted: DG Agriculture and Rural Development, DG Budget, DG Communications Networks, Content and Technology, DG Competition, DG Economic and Financial Affairs, DG Education and Culture, DG Environment, DG Eurostat, DG Internal Market, Industry, Entrepreneurship and SMEs, DG Justice and Consumers, the Secretariat-General and the Legal Service. The feedback received from these directorates and services was taken into account in the report and the draft by DG TAXUD was amended during the process.

[79] http://ec.europa.eu/smart-regulation/roadmaps/docs/2017_taxud_007_vat_rates_en.pdf

9.1.3. Consultation of the Regulatory Scrutiny Board

The Impact Assessment Report was submitted to the Regulatory Scrutiny Board for a first time on 30 June 2017 and a second time on 5 October 2017.

On 24 October 2017, the Regulatory Scrutiny Board gave a positive opinion with reservations. The report was further adjusted in order to integrate the Board's recommendations. The recommendations by the Regulatory Scrutiny Board have been addressed as follows:

Board recommendation	**What has been done?**	**Where?**
1. It is not clear on what grounds the report states that 'the Commission policy course is now firmly oriented towards the pursuit of flexibility in setting VAT rates, rather than harmonisation'. This seems inconsistent with the views of most stakeholders and the conclusions of the ECOFIN Council.	The corresponding sentence under option 1 has been deleted. The general objective has been clarified.	Section 5.4 Section 4.1
2. It is not clear why the only way to ensure equality of treatment of Member States is by extending on a permanent basis all derogations. It actually prejudges the preferred option.	It is explained that equal treatment could also be achieved without extending derogations to all Member States, for example by letting derogations expire or by proposing selective abolition of derogations. Details on the failure of past Commission proposals aiming at abolition of derogations have been added.	Box 1 and section 2.2
3. The report downplays other important specific objectives, such as minimizing complexity and costs – notably for businesses as requested by the Council – or protecting VAT revenues from erosion.	Specific objectives have been added and assessed accordingly. Minimizing complexity and costs, which was initially covered by the specific objective 'risk of introducing excessive compliance costs for operators and tax administrations', has become a particular specific objective.	Sections 4.1 and 7
4. The definition of the baseline has been modified in the resubmitted report and is now confusing.		
5. The report does not consider sub-options within the two polar options of extending all derogations to al versus introducing a minimal negative list to which the standard rate applies.		
6. The comparison of the options does not adequately take into account the risks associated to complexity		

legal uncertainty and litigations, business costs and tax erosion. It does not provide a sufficient basis for a preferred option.
Further considerations and adjustment requirements
(1) The report needs to clarify whether and on what grounds it can assert that 'the Commission's policy course is now firmly oriented towards the pursuit of flexibility in setting VAT rates rather than harmonisation'. It should explain how this is consistent with the 25/05/2016 ECOFIN conclusions (welcoming increased flexibility only on existing reduced and zero rates), the 09/11/2016 ECOFIN conclusions (considering that 'further harmonisation in the area of VAT relating to cross-border transactions is needed and should be continued to be carried out'), the 24/11/2016 EP Resolution (considering that 'a simple system for VAT which demands fewer exemptions is necessary') and the majority view of all stakeholders (in favour of maintaining the simplicity of the VAT system and limit rate differences, even if this limits the room for manoeuvre of Member States).
(2) The baseline should be revised to include the introduction of the definitive VAT system, based on the destination principle. It cannot be argued that the proposal on VAT rates is not conditional upon the adoption on the definitive VAT system, while justifying at the same time the case for further rate flexibility by the establishment of the definitive regime based on the destination principle. As a 'no-policy-change' scenario, the baseline could also include the continuation of the 15% minimum for the standard rate and the temporary extension of all existing derogations (especially if this is deemed necessary for the adoption of the proposal on the definitive VAT system).
(3) The report has to align the specific objectives with the Council conclusions and make them more balanced across flexibility for Member States, equal treatment, preservation of the single market, avoiding distortions to competition, avoiding rise in business costs and preserving a sufficient degree of harmonisation. Extending the effect of derogations on a permanent (rather than on a temporary) basis and for all (instead for only those Member States requesting it) has to be properly motivated rather than considered as an objective in itself.
(4) The report should better justify the use of Art 113 TFEU as a legal basis for the measures envisaged under the proposed options.
(5) The envisaged options continue to be based on a 'lowest common denominator' perspective, with no effort to design other sub-options. Such an approach should be reconsidered especially since the report concludes that the proposed options are not acceptable to Member States anyway. The report must include and assess more (sub-options regarding, for example, the number of reduced rates (for instance, limiting them to three, as envisaged in the VAT rates study) and/or the type of safeguards (for instance, keeping an average 5% minimum rate, envisaging different formulations of the budgetary safeguard or extending derogations only when necessary and on a temporary basis). Option 2 defines the negative list based on a minimalist approach. It does not consolidate current practice like for derogations under option 1. Therefore the report has to consider possible extensions of the negative list as sub-options to option 2.
(6) The report should elaborate on the risk analysis. Most of the potential negative impacts on the single market (distortions of competition, increased complexity and business costs, legal uncertainty and litigations), or on budget revenues depend on the potential actions Member State are likely to take once they have more freedom to set VAT rates. The report should present a more thorough risk analysis assessing in a systematic way the likelihood of the identified risks and the proposed risk mitigating

measures. The comparison of the options should better reflect these dimensions. The report should be comprehensive on costs and refer to the administrative costs of setting up the web portal to support the implementation of options.
(7) In order to facilitate sound decision-making by the political level, the different options should be more rigorously and transparently assessed. In case of a preferred option, the choice should also clearly distinguish and weigh out aspects related to its technical pertinence, its political feasibility and its respect of the integrity of the VAT system.

9.2. Stakeholder consultation

Consultation strategy

The approach taken to consult stakeholders about this initiative centred on three initiatives: an open public consultation, a consultation of Member States in the Group on the Future of VAT (a forum where Member States' administrations provide the Commission with technical advice on legislative initiatives in the field of VAT) and a Eurobarometer survey.

9.2.1. Open Public Consultation

A public consultation on the reform of VAT rates was carried out from 21 December 2016 until 21 March 2017. The goal of the consultation was to gather the opinions of different groups of stakeholders regarding the reform envisaged by the Commission and the way it should be achieved. The choice of the open public consultation was driven by the fact that a wide variety of stakeholders are affected by this tax, namely tax administrations, businesses, non-profit organisations and citizens, tax practitioners, associations, etc. The consultation also targeted academics and tax experts.

A questionnaire was made available to stakeholders on the EU Survey website asking them their opinion on the current system as well as on the objectives, the priorities and the means the Commission should pursue in its proposal.

The questionnaire was available in English, but respondents could attach detailed opinions in their national language. 327 replies were received and 60 position papers were submitted. The strongest share of replies (38%) represented sectoral associations, 26% of responses came from businesses, while less than 10% of the respondents (in total 28) were private persons. In terms of geographical coverage, 62% of the responses from businesses originated from Sweden and Bulgaria, which needs to be taken into account when interpreting the survey results for EU businesses.

The questionnaire was divided in three separate parts to target the different groups of respondents: one with questions for businesses, one with questions for tax experts and associations and finally one with questions to all stakeholders.

Opinions differed as to the priorities for reform: 52% of all respondents indicated simplicity of the VAT system, whereas 29% indicated flexibility for Member States. 19% of the respondents had no opinion.

However, only 14% of the respondents wanted to keep the current system, indicating a need for reform. With regard to specific reform scenarios 46% of the respondents

preferred option 1 and 22% of the respondents preferred option 2, while 17% of the respondents had no opinion.

General remarks

The majority of questions were only asked to specific groups of respondents; only 4 questions were asked to all participants. For example, businesses were mainly asked about their practical experience with the VAT system. Being the collector and main target of the VAT rules, the questions focused on their experiences, the problems they encounter in their daily activities, the constraints the VAT system puts on them, its flaws and what could be improved or changed to make the system more business-friendly. Tax administrations from two Member States replied using the EU Survey tool and one by email.

Part 1: Questions asked to all stakeholders

When asked about the priorities of a reform, 52% of the respondents indicated simplicity of the VAT system, 29% indicated flexibility for Member States and 19% had no opinion.

These answers should be analysed according to the different groups of respondents. Too few private citizens participated to analyse them as a separate group; thus, only businesses and associations can be analysed separately. Similarly to the results of all respondents, the majority of businesses opted for simplicity, whereas 34% thought that more flexibility for Member States should be a priority. Associations replied similarly to businesses.

Of particular interest is the submission of a stakeholder that referred to the 2011 Green Paper (COM(2011) 851 final), which called for a VAT system characterised, *inter alia*, by user-friendliness i.e. a single set of clear and simple VAT rules. The stakeholder in question suggested that, for general consumption goods and services, the rules should be the same for all Member States. Leeway could be granted to Member States '*but only in specific sectors, which regard solely the internal market (the so-called 'short leash')*'.

With regard to a specific element of flexibility for Member States, the number of rates, 52% of all participants did not want to give more flexibility to Member States, whilst 26% would allow Member States an unlimited number of rates and 23% had no opinion. Businesses and associations answered similarly.

With regard to the minimum of 15% for the standard VAT rate, again 52% of the respondents suggested to keep this minimum. 32% had no opinion and 16% were against keeping a minimum. Only very few associations want to abolish the minimum.

A stakeholder considers that an option for a higher VAT rate should be included. In his view, this would:

– create the opportunity to overcome (at least partly) the often criticized regressive effect of VAT;

– create more flexibility to impose a higher VAT rate to demeritorious goods, such as goods which may harm health or the environment; and

– allow compensating for fiscal losses generated by the application of reduced rates.

With regard to specific reform scenarios, 14% wanted to keep the current system. 46% preferred option 1 and 22% preferred option 2. 17% of the respondents had no opinion. Businesses' support for option 2 was stronger compared to other stakeholders whereas associations demonstrated preference for option 1.

It was suggested that the Commission check:

- as regards the goods and services already subject to a reduced rate, whether economic, social or technical reasons which justified its application are still valid and whether the related implementation ways can be improved. In particular, *'reduced rates justified in the past can have distorting effects as, meanwhile, the economic, commercial and legal context has changed'*;

- as regards the items for which the application of a reduced VAT rate will be requested, whether there are economic, social or technical reasons justifying their inclusion among the items subject to a reduced rate.

22% of all respondents that suggested abolishing the list of products subject to reduced rates were asked about general safeguards to avoid tax competition between Member States.

Multiple answers were possible, but no clear direction with regard to safeguards could be obtained from the answers. 15% said that no safeguards are necessary and the preferred safeguards were 'basic rules not further specified' (45% of the respondents) and 'Member States informing the Commission about their plans' (41% of the respondents).

Only 7 out of the 73 respondents specified their answer, but only two tried to specify safeguards. These two respondents provided the same answer 'services benefiting from reduced rates must: (1) be labour-intensive; (2) largely be provided directly or indirectly to final consumers; (3) be mainly local and not likely to cause distortion of competition'. These principles were in fact the principle on which an extension of Annex III with labour-intensive services in 2009 was agreed and no safeguards with regard to goods were mentioned by these two respondents.

All respondents were asked how information on VAT rates should be provided. Multiple answers were possible. It is noteworthy that most respondents did not provide an answer. 15% mentioned a European database accessible to everyone. It was further suggested that the publication of VAT rates in force be managed at EU level and not at national level.

Part 2: General analysis

The stakeholder categories targeted were as follows: business; tax expert, tax advisor or tax practitioner; trade/business/professional association; academic institution, think-tank; non-governmental organisation, consumer association; national tax administration; other public authority, public institution, including national or regional parliaments; private citizen; other.

Less than 10% of the respondents (in total 28) were private persons and nearly 40% were associations. Nearly 20% of the respondents are based in Belgium. This reflects the large share of associations participating in the consultation. There was a surprisingly high number from Bulgaria and Sweden; businesses from the two countries are even more overrepresented.

Part 3: Analysis for businesses only

62% of the answers come from Sweden and Bulgaria, so for this entire section the answer cannot be generalised. They could only reflect the situation in these Member States.

42% of the respondent businesses were small businesses with 1-9 employees, while 35% were medium-sized businesses, namely businesses with 10-249 employees. Of big businesses (with 250 or more employees), only 22% responded. Out of the businesses that responded, 47% sell their goods only domestically while 31% engage in cross-border sales to 5 or more Member States; 17.5% are involved in cross-border transactions to 2-4 Member States.

19% of business with cross-border activities consider that rates have a major influence on the purchasing behaviour of their cross-border customers, whereas 12% consider that they are only a marginal factor and 12% that they are not important. Surprisingly, half of the businesses did not answer this question. When asked about the impact of complexity of VAT rates on cross-border sales, 48% of businesses indicated that they never considered potential difficulties with VAT rates to be important. A rather high percentage (almost 30%) did not express an opinion, while only 16.5% feared difficulties due to VAT rates - but this did not prevent them from pursuing sales opportuinities in other Member States.

Part 4: Mixed groups

49% of stakeholder experts in VAT, associations and citizens consider that the range of goods and services listed in Annex III of the VAT Directive is not adequate. Examples of the goods/services that these stakeholders suggested to include in Annex III include e-publications, basic energy provisions, eye care, horses, children footwear/clothes/nappies, driving licences, digital media, housing, landscape services, renovation services, female hygiene products, beach facilities, travel agency services, ecolabel products, accommodation rents, floricultural products, cultural goods and services.

As to the question on whether granting additional flexibility to Member States would create new distortions of competition, the views are divided with almost identical percentages. Hence we cannot draw a clear conclusion on this matter.

Businesses, tax experts and associations have signalled a number of cases of distortions of competition. In several cases, however, such distortions are not substantiated. The stakeholders often consider that any price difference between similar products/services is equal to a distortion of competition (e.g. where repair and maintenance work to private dwellings is subject to a standard rate whereas construction work for new buildings is zero-rated). This is not always the case.

The issue of public bodies was among the distortions signalled. It was pointed out that the current VAT system allows for an artificial distinction between public and private providers of waste services, which leads to a distorted playing field at the expense of EU consumers. It was maintained, in particular, that Article 13 of the VAT Directive is being interpreted in different ways by Member States, which as a consequence treat certain taxable services as non-taxable, even in markets that are open to competition.

The stakeholder that raised the issue suggests that waste management be included in the list of taxable activities (Annex I of the VAT Directive), which was created explicitly with the goal to avoid distortions of competition between public and private bodies. In his view, the fact that waste management is not included in the list is all the more

problematic, given that waste management is an activity in which the private sector is actively involved and which is capital (requires huge investments) and labour-intensive, thus rendering the sector very sensitive to VAT.

The stakeholder at issue maintains that on the basis of the current wording of Article 13, *'it could be argued that, if waste management is organised as a public service task that public bodies have to perform under public law (i.e. waste management is an activity 'in which they engage as public authorities'), there is no market since private service providers do not perform the same activity as they are not obliged to perform waste management services (i.e. the public service obligation is part of the activity 'waste management' so that private service providers cannot perform the same activity) and therefore there is no competition which could be distorted either'*. It is argued that such a narrow interpretation of Article 13 neglects the fact that public bodies could – and, with regard to the positive effect on the efficiency of public services, should – outsource services to private service providers. It also allows Member States to exclude certain activities / services from competition and the relevant EU law simply by classifying them as 'public service tasks'/responsibilities of public administration. According to the stakeholder at issue, it should be made clear that Article 13 also covers the competition for the market and not only the competition in the market.

Another distortion signalled by a few stakeholders concerns passenger transport. It was maintained that the current VAT system, through voluntary derogations, distorts competition within the transport sector. More specifically, it was mentioned that while in many cases bus and rail are subject to VAT, aviation and maritime transport are not. In the stakeholders' view, '*this means that the most carbon intensive mode, aviation has prices which are artificially lower, creating distortions between rail/bus and aviation/ferry'*. Depending on the interests of their sector, stakeholders suggest either to implement VAT on all forms of passenger transport or to exempt all cross-border passenger transport.

Further distortions were signalled in the fields of construction, visual health services, smoking cessation products, renewable equipment for the direct production of energy, medical spa treatment, etc.

As to the number of VAT rates, 52% of the respondents consider that there is no need for more rates, while 26% would like to allow Member States an unlimited number of rates. Half of the respondents suggest to maintain the current minimum standard rate of 15% and the minimum reduced rate of 5%.

In terms of the position papers submitted, the vast majority advocate the application of reduced/zero rates to the products/services of direct interest to the respondent or the application of a standard rate to their competitors.

Conclusion

The opinions of the respondents vary widely; hence there is no clear consensus on any of the issues. Given that the responses are sometimes contradictory, it may be assumed that a number of respondents lack knowledge of the VAT system or certain aspects thereof.

What can be noted, however, is that the respondents are in principle satisfied with the current number of VAT rates as well as with the current minimum standard and reduced rate. In contrast, only 14% of the respondents want to keep the current VAT rates system, indicating a need for reform. Respondents consider that the scope of the list of goods and services eligible for reduced rates should be extended to include more products and

services. As to the reform options, the respondents indicated a preference for simplicity of the VAT system and a slight preference for option 1.

9.2.2. Consultation of the Group on the Future of VAT (GFV)

The 18th GFV meeting, which took place on 28 April 2017, served as a consultation with Member States on the initiative at issue. The Member State delegates were asked to take a position on the technical paper No 057 *Technical options for the 2017 Commission proposal on 'Reform of rules on VAT rates'* (section 9.6) prepared by the Commission services.

The Commission services stressed that the purpose of the working document is to consult Member States' tax administrations on a number of technical elements related to the proposal. It was explained that, in accordance with the Commission's Action Plan on VAT of 7 April 2016, two reform options are put forward. They aim to modernise rules on VAT rates to bring them fully in line with a destination-based VAT system and to allow Member States more flexibility in setting VAT rates. The first option would result in a proposal to extend and regularly review Annex III to the VAT Directive (the list of goods and services eligible for reduced rates), whereas the second option would result in an outright abolition of Annex III.

The floor was subsequently opened for the delegates to state their position on the questions posed in the working document. Certain delegations requested to be given the possibility to submit their position in written form at a later date. The Commission accepted the request and set a deadline within which written comments should be submitted. Three Member States submitted written comments. The questions and the views expressed by the delegates, during the discussion and in writing, were as follows:

1. What categories of Annex III require adaptation, in the view of Member States? What criteria should be used to identify priorities?

The majority of Member States expressed preference for option 1 and agreed with a regular update of Annex III. Examples of Annex III categories which Member States would like to see updated or clarified include categories 1, 4, 7, 8, 9, 10, 11 and 13. Member States suggested a number of goods/services to be included in Annex III, notably international transport by train and boat, telephony services, laptops, motorcycle helmets, horses, children's goods such as clothes, footwear, etc., Internet access services, and sanitary protection products.

Option 2 was discarded by most delegations. Member States consider that full flexibility in the determination of VAT rates may result in many risks, the major ones being a significant complication in the implementation and monitoring of reduced rates by business and tax administrations, a significant increase in the political pressure to introduce new reduced rates, the unequal treatment of similar supplies of goods and services in the single market, and the reduction of the Member States' budget revenues from VAT. Moreover, it was sustained that from a technical and political point of view, it would be very difficult to negotiate a negative list of supplies that would not to be taxed at a reduced rate.

Almost one third of the Member States were satisfied with the *status quo*. If required, they would be willing to accept option 1 but are against full subsidiarity and thus wish to retain a certain degree of harmonisation.

A minority of Member States expressed opposition to any adaptation of Annex III on the basis that this would (a) be inconsistent with the objective of harmonisation, (b) render the VAT rates system more complex both for administrations and businesses, and (c) make it politically difficult for Member States to take goods/services out of the extension in the future, by subjecting them to the standard rate. It was argued that, according to studies, reduced rates are ineffective as a tool to lighten consumers' tax burden. The Member States in question expressed worries that the initiative may be detrimental to cross-border trade and ultimately the internal market. Equally important for them seems to be the question of budget. One delegation took the view that the tax base should be broadened instead.

A couple of Member States expressed preference for greater flexibility – but not in cases of distortion of competition. They would not like to see more restrictions imposed on Member States.

A few Member States sustained that the issue is political and thus it is premature to hold a discussion at this point; decisions should be taken at Council level. Six delegations did not articulate an opinion but stated that they would submit their position in writing.

As regards the criteria to be used for the extension of the list, most Member States consider that technological, economic and social developments are essential, whereas environmental and health factors were also mentioned. One delegation maintains that no specific criteria should be used when identifying priorities; Annex III should be adjusted when needed, for instance when problems with delimitation occur.

There is broad agreement that clarification of the scope of the categories in Annex III is necessary to address ambiguous terminology, with a thin minority of delegations considering that only clarification is needed, not extension.

2. Which arrangements would the Member States favour for the updating of Annex III? How should the process be defined? At what intervals should the regular review of Annex III take place?

Less than half of the delegations responded to the question. Most of those considered that the update of Annex III should be conducted through the standard procedure, which is in the Council, upon consultation with the GFV. Some, however, believed that it may not be worth involving the GFV, while others thought that the current Council procedure is too complex and time-consuming and should be simplified. Other suggestions included the Working Party on tax questions, an additional Working Group to be created and a comitology procedure.

As to the frequency of the regular review of Annex III, only one suggestion was put forward, according to which the review of Annex III should take place at regular intervals of 3-5 years. A further suggestion put forward in a written contribution, which was received by the Commission services at a later stage, agreed with a 5-year regular interval. The update could take place by means of either a Directive or an Implementing Regulation.

3. Do the Member States desire more flexibility concerning the number of VAT rates? What should be the maximum number of VAT rates allowed?

Delegations seemed to be divided on this issue.

Half of them opted for maintaining the *status quo*, which is a maximum of 5 rates, and suggested that each Member State keep their current rate structure. A delegation pointed out that the number of categories to which the reduced rates may apply is equally important.

The other half expressed a preference for fewer rates, reaching a broad consensus for a maximum of 3 rates, which would render the VAT system simpler. A few delegations proposed to abolish zero rates, while another pointed out that zero rates do not constitute rates from a legal point of view and thus should not be considered as such.

One delegation submitted two specific scenarios regarding the number and level of rates. These are as follows:

(1) Maintaining the existing derogations for exemption with a right of deduction at the preceding stage outside Annex III, taking into account that the reduced rate cannot be 0%, and review Annex III in relation to which Member States will have the right to apply a standard VAT rate combined with two reduced rates of at least 5%

or

(2) Application of the standard rate combined with two reduced rates (of at least 5% but no more than the permitted minimum rate of the standard rate) for the supplies of goods and services listed in Annex III of the VAT Directive and an explicit right of application of one derogation per Member State which may be in the form of an exemption with a right of deduction at the preceding stage.

The same delegation suggested to insert an explicit provision in the VAT Directive which would allow for an exemption with a right of deduction at the preceding stage of the supply of international passenger transport, as such exemption is currently applied by a large number of Member States (thirteen).

4. What are Member States' views on the need for a minimum rate level, and what should this level be?

Most delegations favoured retaining minimum rate levels, arguing that their potential abolishment would result in less harmonisation and increased complexity for businesses. The majority of delegations considered the current thresholds of 15% for the standard rate and 5% for the reduced rate to be satisfactory.

Amongst the Member States which considered that the 15% threshold for the standard rate is adequate, some would not mind revising it – on condition that it be kept to a similar level –, whereas others did not agree with a possible increase.

Only one delegation suggested to increase the standard VAT rate to around 17%-18%, while another took the view that the standard rate should be at least twice as high as the reduced rate.

As to the minimum threshold for the reduced rate, one delegation was in favour of it being slightly reduced. Another delegation considered that the threshold would depend on whether the existing derogations remain or are phased out. A third one argued that, if it is decided to limit the number of rates, no restrictions should be imposed as to the rate level.

In terms of super-reduced and zero rates, the discussion was inconclusive. Certain Member States supported zero and super-reduced rates, while others were against reducing rates to 0% in order to limit the risk of revenue erosion.

A delegation pointed out that, even under the current system, there is no equality amongst Member States; to illustrate this view, it provided the hypothetical example of a Member State with 30% standard rate and 20% reduced rate in comparison to another with 20% standard rate and 10% reduced rate.

5. Do Member States favour extending derogations to all Member States or phasing them out? Should the derogations be introduced in a new Annex III, which would include zero and super-reduced rates?

A clear majority of the delegations which expressed a position were in favour of extending derogations to all Member States. As to the way this should be done, some were flexible, some suggested to include the derogations in a special Annex III, some proposed a review of Annex X with a view of moving certain items contained therein to Annex III, but most did not provide comments.

A minority opposed the extension of derogations to all Member States, considering that such a move would jeopardise the existing harmonisation level and would create significant political pressure for Member States' governments. It is the same Member States which maintained reservations about the use of zero rates and super-reduced rates. Two delegations suggested phasing out derogations.

Member States underlined that the issue of derogations requires profound consideration before any change.

6. Do Member States favour implementation on the same date of all changes to rate rules, including derogations, or should there be different times for entry into force? If so, what elements should enter into force later?

Roughly one third of the Member States considered that the implementation of changes to VAT rate rules should be connected with the definitive system (although one delegation pointed out that reference should be made not to the definitive system but to the destination principle). In contrast, a few Member States considered that such changes should be implemented as soon as possible and in any case not at the same time as the entry into force of the definitive system.

With regard to the timing of the implementation, the delegations were divided. Some thought that the changes should take place at the same time, whereas some would like to see them taking place gradually. The latter thought that modification of Annex III may be possible rapidly as regards goods/services to which the destination principle already applies and in any case before the definitive system is put in place. A few delegations considered that the timing will depend on the option chosen as well as on the decision concerning derogations; they maintained that it is not appropriate to set any timeframe at this point. In a written submission sent to the Commission services following the meeting, a Member State suggested that the application of the minimum standard rate be extended after 1 January 2018, so as not to allow a period during which there is no requirement for a minimum standard rate.

7. Would Member States favour the use of the Combined Nomenclature to define Annex III categories?

While Member States broadly agreed that the use of the CN could mitigate the complexity of the VAT rates system, experience at national level has demonstrated that this may entail a number of problems. It was stressed that, being a customs instrument, the CN has a different aim from than that of a VAT instrument. It covers only goods whereas Annex III contains not only goods but also services. Moreover, there are nuances in relation to some Annex III items e.g. pharmaceutical products *'of a kind normally used for health care'*, which cannot be covered by the CN. Furthermore, the CN contains categories for 'other' goods. It is unclear what such categories cover. Lastly, given that the CN changes and is restructured frequently, uncertainty may arise as to the rates of new products added to the CN. In sum, the use of the CN may not be as straightforward as it seems.

The Commission services concluded that while no consensus was reached on several important questions, the discussion provided useful insights, including the openness expressed by some Member States on exploring whether solutions can be found to make better use of the possibility to link Annex III to the Combined Nomenclature.

9.2.3. Consultation of Member States concerning the existence of distortions stemming from VAT rate differences

Member States' tax administrations were consulted during the preparation of the 2017 VAT rates study with regard to the existence of impacts or distortions on their domestic market stemming from VAT rate differences with other Member States. The following table gives an overview of their replies.

Table 8: Summary of replies from tax administrations on the impact of VAT rate differences

Country	Cross-border shopping	Distance sales	Farmers	Auction
Belgium	No data	No significant impact noted	No data	No data
Croatia	No data	No data	Not applicable	No data
Cyprus	Not aware of VAT effect. Prohibitive cost to access local market.	Limited impact. Any effect likely not to be driven by VAT rates.	No data. Impact likely to be limited in any case.	Auction industry negligible. Second-hand car market significant, but cross-border impacts are limited.
Czech Republic	No indication of VAT effect	No indication of VAT effect	Not applicable	No data
Estonia	Significant level of cross-border shopping between Finland and Estonia as well as between Estonia and Latvia - but mostly related to excise goods.	No indication of significant level of distance selling to Estonia below the threshold, though risk analysis focused on larger vendors.	Not applicable	Auction industry negligible
Finland	Not aware of VAT effect at present. Some cross-border shopping between Finland and Sweden or Estonia. Potential for growth in cross-border shopping in	Significant levels of distance sales into Finland involving suppliers in other Member States. Approx. 25-30% of distance sellers to Finland are not	No indication of issue	No indication of issue

Country	Cross-border shopping	Distance sales	Farmers	Auction
	case of more differentiated VAT rates.	registered for VAT even if the threshold for VAT registration exceeded. This could be motivated by differences in rates.		
Hungary	No relevant data. VAT one element of price; currency effects more significant. Significant number of high-value cars noted in Hungary with non-Hungarian number plates.	Significant issues with non-compliance noted, and studies conducted. VAT differences are a major factor in price. Goods involved include pet food, electronic devices, TV-s, laptops, games, toys, sporting equipment, sporting clothes, perfumes, etc.	No data	Issues with inappropriate use of second-hand scheme for cars, clothes, etc.
Ireland	Perception of VAT differences between UK/Ireland has led to cross-border shopping, (mainly groceries, alcohol, clothing and durables) though price mark-ups and exchange differences play a more significant role.	Significant level of purchases into Ireland from UK. Wide range of measures used to monitor internet retail activity directed at customers in Ireland. Focus on prohibited goods, high value imports, and high duty goods such as tobacco and alcohol.	Issues noted with farming inputs that are zero rated in the UK for VAT purposes, such as live animals. No systematic data compiled.	Significant issues noted with second-hand vehicle imports, (fraudulent or incorrect VAT documentation, resulting in VAT qualifying imports being treated as margin vehicles); missing trader fraud.
Italy	Aware of some cross-border shopping but reliable data are lacking.	No data currently, but investigating ways of improving monitoring in future.	No data	No data
Latvia	Not aware of any issue.	Aware of significant amount of distance sales, but detailed data lacking. VAT not considered a significant factor.	Not aware of any issue.	Not aware of any issue.
Lithuania	No data. Anecdotal evidence of Lithuanians travelling to Poland to shop.	Not aware of any issue.	Not aware of any issue.	Not aware of any issue.
Luxem-bourg	Indirect tax authorities cannot distinguish between supplies made to residents and non-residents. Lower VAT rates generally offset by higher costs related to e.g. real estate and personnel costs.	No data	Not aware of any issue.	Not aware of any issue.
Malta	No issues due to location.	No data. However, aware of increased levels of ecommerce. Overseas vendors likely due to market competition and availability of product, as well as convenience.	Not applicable.	Auction industry negligible.
Nether-lands	Some cross-border shopping noted, with products including coffee, tobacco, alcohol, diesel and LPG. Not	Lack of data, but known issues particularly where some products available at reduced rates elsewhere (e.g. pet	Not aware of any issue.	Not aware of any current issue. Problems noted between 2011 and 2012 due to

Country	Cross-border shopping	Distance sales	Farmers	Auction
	aware of significant VAT-related effect.	food).		relatively high rate of VAT on import of artworks into Netherlands.
Poland	No data	No data	No data	No data
Slovenia	Significant level of inbound cross-border shopping, due to lower prices (particularly for services).	No significant impact noted	Not aware of any issue.	Not aware of any issue.
UK	No data; impact believed to be low due to limited land borders.	No systematic data. Anecdotally there are significant levels of distance sales into and out of the UK.	Not aware of any issue.	Not aware of any issue.

Source: 2017 VAT rates study

9.2.4. Consultation by means of the Eurobarometer

A Eurobarometer survey[80] was commissioned by the Commission to investigate the knowledge that Europeans have of VAT levels in their country and to assess the importance citizens attach to VAT as a source of public revenue. It explored their awareness of reduced rates and perceptions of how these may impact the national public budget. It also looked at cross–border purchasing behaviour within the EU, with respect to both goods and services bought over the Internet and those purchased while visiting other EU Member States. This survey was carried out by TNS Opinion & Social in the 28 Member States between the 11 and 20 October 2014. Some 27 868 respondents from different social and demographic groups were interviewed face-to-face for its purposes.

A summary of the results is provided below.

Two-thirds (65%) of European citizens were able to correctly cite their national standard VAT rate, while 35% either gave a wrong answer or were unable to answer. With the exception of Finland (49%), the UK (47%), France (41%) and Ireland (31%), a majority of respondents in all Member States were able to correctly state the standard VAT rate in their country.

More than eight in ten (84%) European citizens thought that VAT is an important revenue source in their country. This opinion was shared by at least 72% of respondents in every Member State. While the majority thought VAT is an important revenue source, nearly half of respondents (48%) also believed that they pay a higher rate than in other Member States, while 25% thought it is about the same and just 10% thought it is lower.

Another key element of this survey was to measure the awareness of reduced rates and perceptions of how these may impact the national public budget.

Once again, a majority of European citizens (61%) were aware that reduced rates of VAT are applied in all Member States including in their country to a number of goods and

[80] http://ec.europa.eu/commfrontoffice/publicopinion/index.cfm/Survey/getSurveyDetail/yearFrom/1974/yearTo/2015/surveyKy/2024

services, while just over a third (36%) were unaware of these different VAT rates. When asked about the impact of reduced VAT rates on the national public budget, a majority of EU citizens (56%) thought that the application of reduced VAT rates leads to a 'very important' or 'fairly important' reduction in revenue.

After being provided with a series of four statements relating to reduced VAT rates, this survey found that more than four in ten Europeans (43%) were in favour of abolishing reduced rates and replacing them with different alternatives, while slightly less than four in ten (39%) thought that reduced VAT rates should continue unchanged. The most chosen alternative was lowering the standard VAT rate on all goods and services (24%), which was followed by a system where only the poorer households receive an annual fixed cash allowance (10%) and finally a system where every household receives an annual fixed cash allowance (9%). It is worth noting that just under a fifth of respondents (18%) did not know or understand enough to give their opinion about these alternatives to reduced VAT rates.

The survey asked respondents about their cross-border purchase behaviour for private purposes, both via the Internet (online shopping) and on trips to other Member States. Three in ten of respondents (30%) had purchased goods or services in another EU Member State in the last 12 months, close to the 29% who had done so in the previous survey conducted in 2012.

Over half of European citizens (56%) who use the Internet had made online purchases of goods and services from sellers based in their own country in the last 12 months, an increase of eight percentage points since 2012. Under a fifth or respondents (19%) had made purchases from sellers based in another EU Member State (+4 pp from 2012).

Around a fifth of European citizens (22%, -2 pp since 2012) had made purchases of goods and services for private purposes when visiting other countries, either during a business trip or holiday or when making a trip primarily to purchase goods or services.

The reasons why European citizens had chosen to purchase goods or services from another country were also explored. The most frequently mentioned reason was the lower price (57%), followed by greater choice (30%) and better quality (18%).

9.3. Who is affected by the initiative and how?

The Commission intends to grant flexibility to Member States by the legislative initiative. Thus, only Member States are *directly* affected by this initiative. It should also be noted that the policy options envisaged, and in particular the preferred policy option, do not oblige Member States to modify any of the current VAT rates. If Member States do not avail themselves of the greater leeway in fixing VAT rates provided by this initiative, there would be no actual impact of the initiative, except for the required adaptations in the EU and national legal system, to integrate the new legal arrangements.

However, if any Member State does avail itself of the possibility to extend reduced, super-reduced, or zero rates to new domains, the following stakeholders would be affected:

a) **Member State treasuries** would obviously face the corresponding revenue losses, unless the extension of reduced rates was offset by other rate increases or by other compensating measures. There would be no impact in terms of the **EU own resources**.

b) **Taxable persons** carrying out sales in the affected sectors would face some **adaptation and learning costs** related to the change in VAT rates, but would benefit from **a reduced VAT liability**. This would allow them to reduce the (VAT-included) final sales price. The economic impact of the rate change itself would depend on several factors, but most importantly on which proportion of sales was realised to other VAT taxable persons (generally, businesses) or to non-taxable persons such as consumers or VAT-exempt legal persons. In the first case, the impact is negligible, because VAT levied on purchases of business inputs is refunded. In the second case, the lower VAT liability allows the seller to choose between reducing the final (VAT included) price by the same amount as the VAT cut, or to offset (in whole or in part) the VAT cut with an increase in the pre-tax price, and pocket a higher profit margin. Economic theory predicts that the choice between these two extremes will ultimately depend on the short- and long-run elasticity of supply and demand in each sector. The adaptation and learning costs would be small from a one-off change, but would add up if the tax system as a whole becomes more complicated. This latter risk is discussed in the Impacts section, under 'compliance costs'.

Apart from the impact on prices, taxable persons may benefit from a positive or negative cash flow effect. This effect might be relatively sizeable for businesses in specific sectors, but would almost entirely cancel out at an aggregate level.

c) If the VAT rate is cut and producers do not capture the entire cut in their profit margins, **consumers** of the affected goods (including **VAT-exempt legal persons**) will benefit from lower final prices. However, it is worth noting that often VAT cuts on specific goods are financed by equivalent increases in the standard VAT rate, so that at an aggregate level, the benefit for the average consumer is nil; only those that have an above-average consumption of the affected good benefit, while those that do not consume those goods will lose out on average.

9.4. Evaluation and studies supporting this impact assessment

9.4.1. Sequence and scope of relevant studies

The rules on VAT rates, besides being an important research area in the economic literature, were also subject to many Commission-launched reviews and studies which constituted an important knowledge base for this impact assessment. The most relevant recent studies and evaluations are listed in the following.

In 2007 a '***Study on reduced VAT applied to goods and services in the Member States of the European Union***' by **Copenhagen Economics**[81] examined the theoretical and empirical merits for reduced VAT rates.

In 2011, DG TAXUD commissioned '***A retrospective evaluation of elements of the EU VAT system***' carried out by the **Institute for Fiscal Studies IFS et al.**[82]. The findings of the study have been used as a starting point to the examination of the current VAT system. This comprehensive evaluation exercise covered all important aspects for the design of an improved VAT system.

In 2013, a '***study on the economic effects of the current VAT rates structure***' by a consortium led by the **Netherlands Bureau for Economic Policy Analysis CPB**

[81] The study by Copenhagen Economics is accessible for download here.
[82] The evaluation of the EU VAT system by IFS can be accessed here.

followed up on the main evaluation[83]. The focus of this study was on the economic effects that would follow from abolishing zero and reduced rates, under various hypotheses, including the introduction of compensatory measures.

A specific, additional study was carried out for this Impact Assessment by **PwC PricewaterhouseCoopers LLP (Project Leader)** on the '***Reform of rules on EU VAT rates***'[84]. This study, which analysed the current rules for VAT rates in the light of the destination principles, reviewed all instances where the origin principle still applies. The case studies included serve as an assessment of the current rules and in particular focus on the analysis of potential impacts of increased flexibility in setting VAT rates for Member States. The results of this study constitutes the basis of section 2 of this Impact Assessment (problem definitions) and also section 7 (comparison of options).

9.4.2. Summary of central aspects of the underlying studies

The evaluation of elements of the VAT system in 2011 was carried out before the current Better Regulation Guidelines had been established. More importantly, at that point in time, the VAT system was still set to lead to the origin system for VAT in the definitive regime. For the evaluation, this implied that the research questions in particular with respect to the system of VAT rates and the possible recommendations of the evaluation were focussing on the extent to which the VAT rates structure has been effective to prepare for an origin based definitive regime.

The decision later on for a destination based principle implies a fundamental change of the orientation of the VAT system. To the extent that reduced VAT rates and diversification had been analysed in the evaluation of 2011, conclusions were drawn in the light of the destination principle, thus limiting the direct applicability of the findings. Nevertheless, the study retains its usefulness and constitutes one of the bases for this review.

The subsequent studies in 2013 and 2017 were set up as specific external studies to collect information and external expert knowledge on specific economic effects of the VAT and on the assessment of possible design options for a reform of rules on EU VAT rates. This means that these studies were not set up as retrospective evaluations following the Commission standards for evaluations.

In the following, findings from the evaluation of 2011 and from the specific studies have been re-organised to provide a summary assessment of information.

Objectives of the current approach to setting of VAT rates

The rules on VAT rates were originally conceived to **encourage rate convergence** amongst Member States by setting minimum levels for VAT rates and **limiting the application of reduced rates**: Rate convergence was an economic requirement to allow the introduction of an origin-based definitive regime.

In an origin-based VAT system, Member States – depending on their particular circumstances – may have an incentive to lower VAT rates in order to encourage suppliers to relocate to their jurisdiction in order to increase VAT revenues. Consequently, the constraints on VAT rates currently contained in the VAT Directive were intended to

[83] For the study by CPB, follow this link.
[84] The final report has been submitted by the consortium in May 2017; publication is pending.

forestall, or at least mitigate any risks of tax competition which would lead governments to reduce VAT rates to prevent erosion of the VAT base (the so-called 'race to the bottom'). This risk only applies to origin-based VAT systems, as a fully destination-based VAT system could not lead to distortion of competition.

Effectiveness: To what extent have these objectives been achieved?

The rules on VAT rate setting had only a limited impact on rate convergence and on limiting the application of reduced rates. Contrary to the idea of minimum rates as setting a factual minimum of applied VAT rates, furthermore only to be applied to an agreed limited number of products, there exist some 200 derogations for rates lower than 5% for products listed in Annex III of the VAT Directive or for reduced rates for products not even included in that Annex III. Similarly, the rate gap varies considerably across Member States. This indicator shows what percentage of the theoretical VAT revenue is foregone owing to the recourse to reduced rates. The difference in the degree of the utilisation of reduced rates is consistent with widely different national political preferences on using indirect taxation to pursue social policy objectives – but also shows that there was a limited impact on the extent that Member States could effectively be encouraged to rate convergence across Member States.

The current rules were also not effective in preparing the ground for an origin-based definitive regime. In fact, the destination principle is applied to the overwhelming majority of cross-border transactions. Finally, the limited effectiveness of the VAT rates system can also be shown by the large number of 40 infringement procedures plus 25 pilot procedures only on reduced VAT rates.

Efficiency: To what extent are costs proportionate to the intended benefits?

The constraints to Member States for setting VAT rates represent a cost, in particular in case of infringement procedures of non-existing economic relevance, by creating uncertainty for businesses. The only benefit for Member States lies in the fact that the restrictions by EU law reduce special interest pressure.

The rules on VAT rate setting had been put in place with an origin-based VAT system in mind. As explained, rate convergence is a prerequisite for the successful introduction of an origin-based VAT system. The vision of introducing an origin-based VAT system in turn provided for valid reasons to put in place stringent constraints, limiting Member States' freedom to change the level of VAT rates. Given the decision to establish a destination-based VAT system, these restrictions have no longer other benefits than a limited benefit with regard to revenue protection. However, even within the origin-based VAT system, it is questionable whether costs incurred could still be considered proportionate with respect to the intended benefits. The Commission is required to follow up any infringement of the VAT rates system with the respective infringement procedure, and this in principle independent of the often limited economic relevance of the infringement. Such infringement procedures tie resources both at Member State level as well as at the European Commission, while achieving little benefits in terms of limiting the risk of tax competition, given the limited relevance of most infringements.

The constraints to Member States to change VAT rates or decide freely on the level of VAT rates could similarly be considered as a type of implicit costs. Within the context of an origin-based system, these restrictions can be considered proportionate, given the intention to encourage rate convergence. However, in view of the decision to now switch

instead to a destination-based VAT system, the constraints to Member States are not justified anymore but considered as unnecessary or excessive.

Relevance: How well do the original objectives still correspond to the current needs?

The change from the envisaged origin-based VAT system towards a destination-based VAT system implies a complete U-turn of the underlying principles. Given that the destination-based VAT system does not pose a risk of market distortion, this reduces the relevance of the original objective to encourage rate convergence to limit tax competition. A revision of the VAT rate system therefore requires also a reconsideration of the objectives, adjusted to the newly introduced principle of a destination-based VAT system.

There is no longer a correspondence, because the original objective has been changed. The restrictions were only linked to preparing the ground for the origin-based system. As this is not given anymore and studies show that there is no market distortion to be expected from differences in VAT rates in a destination based system, the restrictions are not relevant anymore.

Coherence: To what extent does the intervention remain internally coherent?

The current system of VAT rate setting was coherent with an origin-based VAT system, but is no longer coherent within a destination-based VAT system. To this extent, the rules on VAT rates are no longer coherent with the subsidiarity principle.

EU Added Value: To what extent does action continue to be required at EU level?

While preparing for an origin-based VAT system, convergence of VAT rates was an economic requirement. Such a convergence of VAT rates across Member States could only be envisaged by action at the EU level and accompanying measures like setting minimum levels for VAT rates and limiting the application of reduced rates.

The change to a destination-based VAT system logically has consequences on the consideration whether actions continue to be required at EU level, or whether subsidiarity analysis would not rather indicate that Member States are better placed to decide on the setting of individual VAT rates. Given that the switch to the destination principle neutralizes the risk of market distortion, this should be reflected in an adapted approach to VAT rate setting and limit the restrictions to Member States. After all, the observed difference in the degree of the utilisation of reduced rates is consistent with widely different national political preferences on using indirect taxation to pursue social policy objectives. As these differences in VAT rates do not cause market distortions, Member States should be free to follow their individual national preferences. The continued requests for modifications of the VAT Directive to allow for lower rates are a clear indication that Member States are interested to adapt VAT rates to national preferences.

There is no requirement for restricting Member States in setting VAT rates. The only requirement at EU level is to limit complexity of the VAT system in order to ensure the functioning of the internal market.

The continued requests for modifications of the VAT Directive to allow for lower rates and the difference in the degree of the utilisation of reduced rates is consistent with widely different national political preferences on using indirect taxation to pursue social policy objectives.

Position of the Commission towards studies and findings:

On the reliability of results and triangulation of findings: The analysis of the VAT system carried out in the studies is solid and in line with the scientific consensus. Literature has consistently pointed to the lack of efficiency of the VAT system, so that the findings of the studies are non-controversial and have been indirectly confirmed by many other researchers.

On compliance costs: The regulatory costs of the existing system with regard to rates have mostly been investigated from the perspective of the costs for businesses to comply with VAT rates, with fewer results available as regards the costs for the public administration. Chapter 4 of the retrospective evaluation of the VAT system expounds on the results from this strand of research. While the details differ, most studies concur on the 'three main lessons' identified by Prof. Evans in 2008, namely that compliance costs are high and significant; they are regressive; and they are not falling over time.

On the need to act now: In the Action Plan on VAT the Commission announced a proposal for a definitive VAT regime based on taxation in the Member States of destination, which requires accompanying measures and amendments of the VAT Directive with regard to the rules on VAT rates.

9.5. VAT rates applied in the Member States at 1st January 2017



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VAT rates

applied in the Member States

of the European Union

Situation at 1st January 2017

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N.B.: The purpose of this document is to disseminate information about the VAT rates in force in the Member States of the European Union.

The information has been supplied by the respective Member States and complemented by the Commissions services but part of the additions has not been verified yet by some Member States.

The Commission cannot be held responsible for its accuracy or completeness, neither does its publication imply any endorsement by the Commission of the Member States' legal provisions.

I. List of VAT rates applied in the Member States (in %)

Member States	Code	Super-reduced Rate	Reduced Rate	Standard Rate	Parking Rate
Belgium	BE	-	6 / 12	21	12
Bulgaria	BG	-	9	20	-
Czech Republic	CZ	-	10 / 15	21	-
Denmark	DK	-	-	25	-
Germany	DE	-	7	19	-
Estonia	EE	-	9	20	-
Ireland	IE	4.8	9 / 13,5	23	13.5
Greece	EL	-	6 / 13	24	-
Spain	ES	4	10	21	-
France	FR	2.1	5,5 / 10	20	-
Croatia	HR	-	5 / 13	25	-
Italy	IT	4	5 / 10	22	-
Cyprus	CY	-	5 / 9	19	-
Latvia	LV	-	12	21	-
Lithuania	LT	-	5 / 9	21	-
Luxembourg	LU	3	8	17	14
Hungary	HU	-	5 / 18	27	-
Malta	MT	-	5 / 7	18	-
Netherlands	NL	-	6	21	-
Austria	AT	-	10 / 13	20	13
Poland	PL	-	5 / 8	23	-
Portugal	PT	-	6 / 13	23	13
Romania	RO	-	5 / 9	19	-
Slovenia	SI	-	9.5	22	-
Slovakia	SK	-	10	20	-
Finland	FI	-	10 /14	24	-
Sweden	SE	-	6 / 12	25	-
United Kingdom	UK	-	5	20	-

N.B.: Exemptions with a refund of tax paid at preceding stages (zero rates) are not included above (see section V)

II. Application of reduced VAT rates by the member states to the categories of goods and services contained in Annex III of VAT Directive 2006/112/EC 0 = zero rate (exemption with refund of tax paid at preceding stage); [ex] = exemption; N/A = not applicable

	Category	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
1	Foodstuffs	6 12 21	20	10 15	25	7 19	20	0 4.8 9 13.5 23	13 24	4 10	2.1 5.5 10 20	5 13 25	4 5 10	5 19	21 12	21	3	5 18 27	0	6	10	5 8 23	6 13 23	9	9.5	20 10	14	12 25	0 20
2	Water supplies	6	20	15	25	7	20	[ex] 23	[ex] 13	10	5.5	13 25	10	5	21	21	3	27	[ex]	6	10	8	6	9	9.5	20	24	25	0
3	Pharmaceutical products	6 21	20	10 15	25	19	9	0 23	6 13 24	4 10 21	2.1 5.5 10 20	5 25	10 22	5	12	5 21	3 17	5 27	0	6 21	10	8	6 23	9	9.5	10	10	25 0	0 20
4	Medical equipment for disabled persons	6 21	20	15	25	7	9	0 23	13 24	4 10	5.5	5 25	4 22	5	12	5	3 17	5 27	5	6 21	20	8	6	9	9.5	10	24 [ex]	25 [ex]	0 5
	Children's car seats	21	20	15	25	19	20	13.5	24	21	20	25	22	5	21	21	17	27	18	21	20	8	6	19	22	20	24	25	5
5	Transport of passengers	6 0	20	15 0	[ex] 25	7 19	20 0	[ex]	24	10	10	25	10 [ex]	5 9	12 [ex]	9 21	[ex] 3	27	0	[ex] 6 21	10 13	8	6	19	9.5	0 20	10	6 0	0
6	Books	6 21	20	10 15	25	7	9	0	6 24	4 21	5.5 20	5	4 22	5	12	9	3	5	5	6	10	5 23	6 23	5	9.5	10	10	6	0
	Books on other physical means of support	21	20	21	25	7 19	20	23	24	4	5.5 20	5	4 22	19	21	21	3	5	5	6	20	5 23	6 23	5	9.5	10	24	6 25	0 20
	Newspapers	0 6 21	20	10	0 25	7	9	9	6 24	4 21	2.1 20	5 13 25	4	5	12	9	3	5	5	6	10	8 23	6 23	5	9.5	20	10 24	6	0
	Periodicals	0 6 21	20	10	25	7	9	9	6 24	4 21	2.1 20	5 13 25	4 22	5	12	9	3	5	5	6	10	5 23 8	6 23	5	9.5	20	10 24	[ex] 6	0
7	Admission to cultural services (shows, cinema, theatre)	[ex] 6	[ex] 20	15	25 [ex]	[ex] 7	20	[ex] 9	24 6	[ex] 21	2.1 5.5 10 20	5 25	10 25	[ex] 5	[ex] 5	[ex] 21	3	18	5 27	6 18	[ex]	8 13	[ex] 13 23	5 13 19	9.5	20	10 [ex]	6	20
	Admission to amusement parks	6	20	15	25	19	20	9	24	21	10 20	25	22	5	21	21	3	27	18	6	13	8	23	19	9.5	20	10	25	20
8	Pay TV/ cable TV	21	20	[ex] 21	25	19	20	23	[ex] 24	21	10	[ex] 25	22	19	21	21	3 17	[ex] 27	18	21	10	8 23	23	19	22	[ex] 20	24	25	20
	TV licence	[-]	20	[ex] 21	25	[ex]	20	[ex]	[-]	21	2.1	N/A	4	N/A	[-]	21	N/A	[ex] 27	[ex]	[ex]	10	23	6	19	[ex] 22	[ex] 20	10	[ex]	[ex]
9	Writers, composers etc.	6 21 [ex]	20	15	[ex]	7	20	23	24	21	10	[ex] 25	[ex] 22	5	[ex]	21	3 17	27	18	6 [ex]	20 13	8 [ex]	23 [ex]	19	9.5	20	[ex] 10	6	20
10	Social housing	12 6	20	15	25	19	20	13.5	24 [ex]	4 10	5.5 10 20	25	4	5	21	21	N/A	27	[ex] 5	21	20	8	[ex] 6	5 6	9.5	20	24	25 [ex]	20 5 0
10a	Renovation and repairing of private dwellings (*)	21 6	20	15	25	19	20	13.5	24	10	5,5 10 20	25	10	5	21	21	N/A	27	18	21 6	20	8 23	6	19	9.5	20	24	25	5
10b	Window cleaning and cleaning in private households	21	20	15	25	19	20	13.5	24	21	10 20	25	22	19	21	21	8	27	18	21 6	20	23	23	19	9.5	20	24	25	20
11	Agricultural inputs	6 12 21	20	15 21	25	7	20	0 4.8 13.5 23	13 24	10	10 20	25	4 10 22	5 19	21	21	3 17	27	18	6	10 13	5 8 23	6 13 23	9 19	9.5	20	24 14	25	20
12	Hotel accommodation	6	9	15	25	7	9	9	13	10	10	13	10	9	12	9	3	18	7	6	13	8	6	9	9.5	20	10	12	20

12a	Restaurant and catering services	12	20	15 21	25	19	20	9 [ex]	24	10	5.5 10	25	10	9	21	21	3 17	18 27	18	6	10	8	13	9	22 9.5	20	14	12	20
13	Admission to sporting events	6 [ex]	20	15	[ex] 25	7 19	20	[ex]	24	10 21	5.5	25	10 22	5	21	21	3 [ex]	27	18	6	13	8	23	5	9.5	20	10 [ex]	[ex] 6	20
14	Use of sporting facilities	6 [ex]	20	15	[ex] 25	[ex] 19	20	9	24	[ex] 21	20	[ex] 25	22	5	21	21 [ex]	3	27	7	6 [ex]	[ex]	8	23 [ex]	19	9.5	20 [ex]	10	6 [ex]	20
15	Social services in so far as those transactions are not exempt pursuant to Articles 132, 135 and 136 of the Directive 2006/112/EC	6 21	20	[ex] 15	25	7	[ex]	[ex]	24 [ex]	4 10	20	25	[ex] 5 22	[ex]	[ex]	[ex]	17	[ex]	[ex]	[ex] 21	[ex] 10	23	6 23	19	22 [ex]	20 [ex]	[ex]	[ex] 25	[ex]
16	Supplies by undertakers and cremation services	6 21	20	15	[ex]	19	20	[ex]	24	21	20	25	[ex]	19 5	21	21	3	27	18	[ex]	20	8	[ex]	19	9.5	20	[ex]	[ex]	[ex]
17	Medical and dental care in so far as those services are not exempt pursuant to points (b) to (e) of Article 132(1) of the Directive 2006/112/EC	21 [ex]	20 [ex]	[ex] 15	[ex]	7 [ex]	[ex]	[ex] 13.5	24 [ex]	21 [ex]	[ex]	25	[ex]	5	[ex]	21 [ex]	17	[ex]	[ex]	[ex] 21	20	23	[ex] 6	19	[ex]	[ex]	[ex]	[ex]	[ex]
18	Collection of domestic waste and street cleaning, other than the supply of such services by bodies referred to in Article 13 of the Directive 2006/112/EC	21	20	21 15	25	[-] 19	20	13.5	24 [-]	10	20 10	25	10	5	21	21	3	27	18	21	10	8	6	19	9.5	20	24	25	0 20
19	Minor repairing (including mending and alteration) of:																												
	Bicycles	6	20	21	25	19	20	13.5	24	21	20	25	22	19	21	21	8	27	5	6	20	8	6	19	9.5	20	24	25	20
	Shoes and leather goods	6	20	21	25	19	20	13.5	24	21	20	25	22	19	21	21	8	27	5	6	20	8	23	19	9.5	20	24	25	20
	Clothing and household linen	6	20	21	25	19	20	13.5	24	21	20	25	22	19	21	21	8	27	5	6	20	8	23	19	9.5	20	24	25	20
20	Domestic care services (**)	21	20	15	25	[ex] 19	20	[ex]	13	21	5.5 10	25	[ex]	19	21	21	[ex] 17	27 [ex]	5	[ex]	20	[ex] 23	6	19	9.5	20	24	25	20
21	Hairdressing	21	20	21	25	19	20	9	24	21	20	25	22	5	21	21	8	27	18	6	20	8	23	19	9.5	20	24	25	20

(*) excluding materials which form a significant part of the value of the supply
(**) e.g. home help and care of the young, elderly, sick or disabled

III Application of the parking rate in certain Member States

Member States which, at 1 January 1991, were applying a reduced rate to the supply of goods or services other than those specified in Annex III may apply the reduced rate to the supply of those goods or services, provided that the rate is not lower than 12 %.

BELGIUM

Parking rate of 12% applicable to:

1. Certain energy products such as:
- coal and solid fuel obtained from coal
- lignite and agglomerated lignite (except for jet)
- coke and semi — coke from coal, lignite and peat
- uncharred petroleum coke used as fuel.

2. Certain tyres and inner tubes for agricultural tractors and machinery, excluding tyres and inner tubes for forestry tractors and cultivators.

IRELAND

Parking rate of 13.5% applicable to:

1. Energy for heating and light
2. Movable property used in the construction and maintenance of immovable property
3. Supply of immoveable property
4. Services consisting of the routine cleaning of immoveable property
5. Repair and maintenance of movable property
6. Services relating to the care of the human body
7. Certain specific tourist services
8. Services relating to photography
9. Services supplied by jockeys
10. Works of art and antiques
11. Short-term hire (less than 5 weeks) of:
- motor vehicles designed for the conveyance of persons by road
- ships, boats and other vessels not exceeding 15 tonnes gross designed for the conveyance of passengers
- sports and pleasure craft, including yachts, cabin cruisers, dinghies, canoes, skiffs and racing boats
- caravans, mobile homes, tents and trailer tents.

12. Driving schools
13. Professional services supplied by veterinary surgeons

LUXEMBOURG

The parking rate of 14% applies to:

1. Wines with an ABV of 13% or less, with the exception of sparkling wines, liqueur wines and fortified wines
2. Solid mineral fuels, mineral oils and wood intended for use as fuel, with the exception of wood for heating
3. Washing and cleaning products
4. Printed advertising matter, commercial and similar catalogues; tourism publications
5. Heat, cooling and steam, with the exception of heat provided by heating networks
6. Safe custody and administration of securities
7. Administration of credit and credit guarantees by a person or organisation other than that granting the credit

AUSTRIA

The parking rate of 13% applies to:

1. Wine from farm production carried out by the producing farmer

PORTUGAL

The parking rate of 13% applies to:

1. Wine

2. Agricultural tools and utensils, mobile silos, tractors, pumps and other machinery designed exclusively or mainly for the purpose of agriculture, cattle breeding or forestry.
3. Diesel for the agriculture

III. List of super-reduced rates (less than 5%) applied in the Member States (N.B.: The list is not exhaustive)

GOODS and SERVICES	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
Food products							4.8		4	2.1		4				3												
Beverages: Mineral water/lemonade																3												
Clothing and footwear for children																3												
Pharmaceuticals									4	2.1						3												
- Books									4			4				3												
- Books on other physical means of support									4			4				3												
- Newspapers									4	2.1		4				3												
- Periodicals									4	2.1		4				3												
Television licence fees										2.1		4																
Reception of radio and TV																3												
- Hotels																3												
- Restaurants																3												
Admission to cultural services, shows (cinema, theatre, sports)										2.1						3												
Use of sports installations																3												
- Treatment of waste and waste water																3												
- Collection of household waste																3												
Passenger transport																3												
Property sector:																												
- Supply of new buildings												4				3												
- Renovation and repairs																3												
- Construction work on new buildings									4			4				3												
Royalties																3												
Medical equipment for disabled persons												4				3												
Water distribution																3												
Social services									4																			
Supplies by undertakers and cremation services																3												
- Cut flowers and plants																												
- Pesticides, natural and artificial fertilizers												4																
Raw wool																3												
Agricultural inputs							4.8									3												

IV. Cases where the zero rate is applied to consumption in the legislation of the Member States (article Title VIII, Chapter 4 of the VAT directive 2006/112/EC)

BELGIUM

- Supplies of daily and weekly newspapers and periodicals of general information
- Supplies of certain recovered materials and by-products

DENMARK

- Sales of newspapers normally published at a rate of more than one issue per month
-

IRELAND

- Supplies of printed books and booklets, including atlases, but excluding:
- newspapers, periodicals, brochures, catalogues, directories and programmes,
- books of stationery, cheque books and similar products,
- diaries, organisers, yearbooks, planners and similar products the total area of whose pages consist of 25 per cent or more of blank spaces for the recording of information,
- albums and similar products, and
- books of stamps, tickets or coupons.
- Supplies of some food and drink intended for human consumption
- (excluding certain products such as alcoholic beverages, manufactured beverages, ice-cream, confectionery, biscuits, pastries and savoury products such as crackers, crisps, popcorn and roasted nuts)
- Supplies of seeds, plants, trees, etc. used for food production
- Supplies of certain fertilisers in units of not less than 10 kg
- Supplies of animal feeding stuffs excluding medicine which is packaged, sold or otherwise designated for the use of dogs, cats, cage birds or domestic pets.
- Supplies of orally administered medicines for human consumption
- Supplies of orally administered medicines for animal consumption excluding medicine which is packaged, sold or otherwise designated for the use of dogs, cats, cage birds or domestic pets.
- Supplies of certain articles of feminine hygiene
- Supplies of medical equipment such as wheelchairs, walking frames and crutches, orthopaedic appliances and other artificial parts of the body (excluding false teeth, corrective spectacles and contact lenses)
- Supplies of articles of clothing and footwear for children of average size under the age of ten
- (excluding clothes made of fur or skin and articles of clothing and footwear not marked with the size or age)
- Supplies of wax candles and night-lights that are white and cylindrical, excluding candles and night-lights that are decorated, spiralled, tapered or perfumed.
- Services provided by the Commissioners of Irish Lights in connection with the operation of lightships, lighthouses or other navigational aids.
- Life saving services provided by the Royal National Lifeboat Institution including the organisation and maintenance of the lifeboat service.

MALTA

- Supplies of food products for human consumption, except for supplies of pre-cooked dishes and certain highly processed products, such as ice-cream, chocolates, manufactured beverages or beverages subject to excise duty, and pet foods
- Supplies of seeds or other means of propagation of plants classified under the above paragraph
- Supplies of live animals of a type generally used as, or yielding or producing, food for human consumption
- Supplies of pharmaceuticals, medicines only where prescribed

FINLAND

- Printing services for membership publications of non-profit making organisations

SWEDEN

- Services with regard to production (basically printing services) of membership periodicals, staff periodicals and periodicals issued by non-profit organisations, including services related to such

production, such as distribution services
- Medicine supplied on prescription or sold to hospitals or imported into the country to be supplied on prescription or sold to hospitals

UNITED KINGDOM

- Supplies of food and drink for human consumption (excluding alcoholic drinks, confectionery, crisps and savoury snacks, hot food, sports drinks, hot takeaways, ice cream, soft drinks and mineral water)
- Supplies of animals and animal feeds, and plants and seeds - if the animal or plant produces food that is normally used for human consumption.
- Supplies of water other than water for enterprises, distilled or mineral water
- Supplies of pharmaceuticals, medicines only where prescribed
- Supplies of medical and surgical instruments, aids only to handicapped persons (excluding hearing aids, dental prostheses, spectacles, etc.)
- Supplies of children's clothing and footwear
- Supplies of books, children's painting and picture books, newspapers, periodicals, magazines, brochures, leaflets, pamphlets, sheet music, maps, publications (Some items are standard-rated such as exercise books, letterheads, posters)
- Construction of buildings for residential purposes; approved alterations to listed buildings
- Sale or long lease of a new dwelling with garage or parking space
- Supplies of certain materials by a person supplying the above-mentioned services, excluding maintenance and repair work
- Supplies for and by charity organisations of goods donated with a view to being sold
- Supplies of magnetic tape, tape recorders, etc. to the Royal National Institute for the Blind
- Supplies to a charity organisation of radio receivers for free loan to blind persons
- Sewage services
- The transport of passengers in any vehicle, vessel or aircraft with the capacity of carrying at least 10 passengers; or by the Post Office; or by any scheduled service
- The transport of passengers or freight from or to a place outside the United Kingdom
- Supplies of certain caravans and houseboats
- Supplies of boots and helmets for industrial use
- Supplies of motor-cycle and cycle helmets
- The issuing of banknotes

IV. ***VAT rates generally applied in the Member States to certain products or services***

0 = zero rate (exemption with refund of tax paid at preceding stage); [ex] = exemption; [m] = taxation on the margin; [-] =out of scope; N/A = not applicable

GOODS and SERVICES	BE	BG	CZ	DK	DE	EE	IE	EL	ES	FR	HR	IT	CY	LV	LT	LU	HU	MT	NL	AT	PL	PT	RO	SI	SK	FI	SE	UK
Alcoholic beverages																												
Spirits	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Wine	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	14 17	27	18	21	20 13	23	13	19	22	20	24	25	20
Beer	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19 9	22	20	24	25	20
Non-alcoholic beverages																												
Mineral water	6	20	15	25	19	20	23	13	10	5.5 10	25	22	5	21	21	3	27	18	6	20	23	13	9	9.5	20	14	12	20
Lemonade	6	20	15	25	19	20	23	24	10	5.5 10	25	22	5	21	21	3	27	18	6	20	23	23	9	9.5	20	14	12	20
Fruit juices	6	20	15	25	19	20	23	24	10	5.5 10	25	22	5	21	21	3	27	18	6	20	5 23	6	9	9.5	20	14	12	20
Clothing																												
Adults	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Children	21	20	21	25	19	20	0	24	21	20	25	22	19	21	21	3	27	18	21	20	23	23	19	22	20	24	25	0
Children nappies	21	20	21	25	19	20	0	24	21	20	25	22	19	21	21	17	27	18	21	20	8 23	6	19	22	20	24	25	0
Footwear																												
Adults	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Children	21	20	21	25	19	20	0	24	21	20	25	22	19	21	21	3	27	18	21	20	23	23	19	22	20	24	25	0
Tobacco	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Hifi-Video	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Computer, smartphones	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
E-books	21	20	21	25	19	20	23	24	21	5.5 20	25	4 22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Household electrical appliances	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Furniture	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Furs	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Jewels	21	20	21	25	19	20	23	23	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Telecommunication services																												
Phone/ fax/ telex/etc.	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Pay TV/ cable TV	21	20	[ex]	25	19	20	23	24 [ex]	21	10	[ex] 25	22	19	21	21	3 17	27	18	21	10	8 23	23	19 [ex]	22	20 [ex]	24	25	20
TV licence	[-]	20	[ex] 21	25	[ex]	20	[ex]	[-]	21	2.1	N/A	4	19	[-]	21	N/A	27	[-]	[ex]	10	23	6	19	[ex]	20	10	[ex]	[ex]
Energy products																												
Natural gas	21	20	21	25	19	20	13.5	13	21	20 5.5	25	10	19	21	21	8	27	[-] 18	21	20	23	23	19	22	20	24	25	5

Electricity	21	20	21	25	19	20	13.5	13	21	20 5.5	25	10	19	21	21	8	27	5	21	20	23	23	19	22	20	24	25	5
District heating	21	20	21	25	19	20	13.5	13	21	5.5 20	25	22	19	12	9	8	5	18	21	20	23	23	19	22	20	24	25	20
Firewood	6	20	15	25	7	20	13.5	24	21	10	25	10	19	21	21	8	27	18	21	13	8	6	19	22	20	24	25	20
Timber for industrial use	21	20	21	25	7 19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Petroleum products																												
Petrol (unleaded)	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Diesel fuel	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	13 23	19	22	20	24	25	20
LPG	21	20	21	25	19	20	23	24	21	20	25	22	5	21	21	8	27	18	21	20	23	23	19	22	20	24	25	20 5
Heating oil	21	20	21	25	19	20	13.5	24	21	20	25	22	19	21	21	14	27	18	21	20	23	23	19	22	20	24	25	5
Lubricants	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Motor vehicles	21 6 [m]	20	21	25	19	20	23	24	21	20	25	22 4 [m]	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Passenger transport (domestic)																												
Air	6	20	15 21	[ex]	19	20	[ex]	24	10	10	25	10	N/A	12	21 9	3	27	0	21	13	8	6	19	9.5	20	10	6	0
Sea	6	20	N/A	[ex]	19 7 [-]	20	[ex]	24	10	10	25	10	9	12	21 9	N/A	N/A	0	6	N/A	8	6	19	9.5	N/A	10	6	0
Inland waterway	6	20	15 21	[ex]	19 7	20	[ex]	24	10	10	N/A	10	N/A	12	21 9	3	27	N/A	6	10	8	6	19	9.5	20	10	6	0
Rail	6	20	15 21	[ex]	19 7	20	[ex]	24	10	10	25	10 [ex]	N/A	12	21 9	3	27	N/A	6	10	8	6	19	9.5	20	10	6	0
Road	6	20	15 21	[ex] 25	19 7	20	[ex]	24	10	10 0	25	10 [ex]	5 9	12	21 9	3	27	0 18	6	10	8	6	19	9.5	20	10	6	0
Passenger transport (international)																												
Air	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Sea	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	N/A	N/A	0	0	N/A	0	0	0	0	N/A	0	0	0
Inland waterway	6	0	0	0	7 0	0	0	24	10	10	N/A	0	N/A	0	0	0	0	N/A	6	0	8	0	0	N/A	0	0	0	0
Rail	6	0	0	0	19 7	0	0	24	10	0	25	0	N/A	0	0	0	0	N/A	6	10	0	0	0	0	0	0	0	0
Road	6	0	0	0	19 7	0	0	24	10	10 [ex]	25	0	0	0	0	0	0	N/A	6	10	8	0	0	9.5	0	0	0	0
Travel agencies	21 [m]	20 [m]	21 [m]	25 [m]	19 [m]	20 [m]	23 [m]	24 [m]	21 [m]	20 [m]	25 [m]	22 [m]	19 [m]	21 [m]	21 [m]	17 [m]	27 [m]	18 [m]	21 [m]	20 [m]	23 [m]	23 [m]	19 [m]	22 [m]	20 [m]	24 [m]	25 [m]	20 [m]
Hotels	6	9	15	25	7	9	9	13	10	10	13	10	9	21	9	3	18	7	6	13	8	6	9 19	9.5	20	10	12	20
Take away	6	20	15	25	7	20	9	13 24	10	10	25	10	5	21	21	3	18 27	18	6	10	8 23	13	9 19	22 9.5	20	14	12	0 20
Bars and cafés																												
Bars and cafés	21	20	15 21	25	19	20	9 23	24	10	10	13 25	10	9 19	21	21	3	27	18	6	20	8 23	23 13	9 19	22	20	24	25	20

Night clubs	21	20	21	25	19	20	23	24	10	10	13 25	22	19	21	21	3	27	18	6	20	23	23	9 19	22	20	24	25	20
Alcoholic beverages	21	20	21	25	19	20	23	24	10	20	13 25	10	19	21	21	17	27	18	21	20	23	23	9 19	22	20	24	25	20
Consumption on board ships, aircraft or trains																												
Goods								13 24					0			3 17					5 8 23	6 13 23	9 19				
Services								24					9 19			3 17					0 8	13 23	9 19				
Cut flowers and plants																												
Decorative use	6	20	15	25	7	20	13.5	24	21	10	25	10	19	21	21	8	27	18	6 21	13	8	6	19	9.5	20	24	25	20
Food production	6	20	15	25	7	20	0	13 24	10	5.5	25	10	5	21	21	3	27	0	6	10	5 8 23	6	9 19	9.5	20	14	25	0
Immovable property																												
Social Housing (category 10/ Annex III)	6 12	20	15	25	19	20	13.5	24	4 10	5.5 10 20	25	4 10	5	21	21	N/A	27 5	[ex]	21	20	8	[ex] 6	5	9.5	20	24	25 [ex]	20 5 0
Renovation and repairing (category 10a / Annex III)	6 21	20	15	25	19	20	13.5	24	10	5.5 10 20	25	10	5	21	21	N/A	27	18	6 21	20	8 23	6 23	19	9.5	20	24	25	20 5
Building land	[ex]	20	21	25	[ex]	20	13.5	24	21	20	25	22	[ex]	21	21	[ex]	27	[ex]	21	[ex]	23	[ex]	19	22	[ex]	[ex]	[ex]	20
Supplies of new buildings	21	20	21	25	[ex]	20	13.5	24	10 21	20	25	4 10 22	19	21	21	[ex] 3	27 5	[ex]	21	[ex] 20	8 23	[ex]	19	22 9.5	20	[ex]	[ex]	0 20
Construction work on new buildings	6 12 21	20	21	25	19	20	13.5	24	4 10	20	25	4 10	19	21	21	3 17	27	18	21	20	8 23	6 23	19	22 9.5	20	24	25	20 0
Agricultural Inputs																												
Pesticides and plant protection materials	12 21 6	20	21	25	19	20	23	24	10	10 20	25	22	5	21	21	17	27	18	21	20	8	6	9	9.5	20	24	25	20
Fertilisers	12 21	20	21	25	19 7	20	0 23	24	10	10 20	25	4	5	21	21	3	27	18	21	13 20	8	6	9	9.5	20	24	25	20
Treatment of waste and waste water	21	20	15 21	25	[-] 19	20	[-] 13.5	24	10	10 20	25	10 22	5	21	21	3	27	18	21	10	8	23 6	19	9.5	20	24	25	20 0
Collection of household waste, …	21	20	15	25	[-] 19	20	[-] 13.5	24 [-]	10	10	25	10	5 [-]	22	21	3	27	18	[-] 21	10	8	[-] 6	19	9.5	20	24	25	20
Arrangements for the taxation of gold																												
Ingots and bars	[ex] 21	20	[ex] 21	[ex]	[ex] 19	[ex] 20	[ex] 23	[ex]	[ex] 0 21	[ex] 20	[ex] 25	[ex] 22	[ex]	[ex] 21	[ex] 21	[ex] 17	[ex] 27	0	21	[ex]	[ex] 23	[ex] 23	[ex]	22	[ex]	24 0	[ex] 25	[ex] 20 0

Coins (currency)	[ex] 21	20	[ex] 21	[ex]	19 7 [ex]	[ex]	[ex]	[ex]	[ex] 0 21	[ex] 20	[ex] 25	[ex] 22	[ex]	[ex] 21	[ex] 21	[ex] 17	[ex] 27	[ex]	0	[ex] 20	[ex] 23	[ex] 23	19	[ex]	[ex]	24 0	[ex] 25	[ex] 20 0
Jewellery, gold plate, medals, tools	21	20	21	25	19 7	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23	19	22	20	24	25	20
Services supplied by lawyers	21	20	21	25	19	20	23	24	21	20	25	22	19	21	21	17	27	18	21	20	23	23 6	19	22	20	24	25	20
Taxation of works of art, collector's items and antiques																													
Works of art, collector's items and antiques	21 [m]	20	21 [m]	25	19 [m]	20	13.5 23 [m]	24 [m]	21	20 [m]	25 [m]	22	5 [m]	21	21	17 [m]	27 [m]	18	21	20 [m]	23 [m]	6 23 [m]	19	22 [m]	20 [m]	24 [m]	25	20
Rate on importation (Article 103 of the Directive 2006/112/EC)	6	20	15	25	7 19	20	13.5	24	10	5.5	25	10	5	21	21	8	27	5	6	13	8	6 23	19	9.5	20	10 24	12	5
Supplies by creators and occasional sales (Article 103(2) of the Directive 2006/112/EC)	6	20	21	25	7 19	20	13.5	24	10	5.5 10	N/A	10	N/A	21	21	8	27 [-]	18	6	13	8	6	19	9.5	20	10	12	20

V. Geographical features of the application of VAT in the EU

DENMARK
The Faeroe Islands and Greenland are not part of the European Union; consequently, VAT (according to the VAT Directive 2006/112/EC) is not applicable on these territories.

GERMANY
For VAT purposes, the country does not include the island of Heligoland or the territory of Büsingen.

GREECE
According to Article 120 of the VAT Directive, Greece may apply rates up to 30% lower than the corresponding rate applied in the mainland to the following islands: Chios, Cyclades, Dodecanese, Lesbos, Northern Sporades, Samos and Samothrace. The lower rates currently applied in the Greek Islands are 4%, 9% and 17%. The following islands are excluded from the application of these lower rates: Thira, Mykonos, Naxos, Paros, Rhodes, Skiathos (since 01/10/2015); Syros, Andros, Tinos, Milos, Kea, Antiparos, Sifnos, Karpathos, Alonissos, Thassos and Skiros (since 01/06/2016); Skopelos, Amorgos, Ios, Kythnos, Serifos, Sikinos, Anafi, Kimolos, Folegandros, Irakleia, Donoussa, Thirasia, Schinoussa, Koufonisia, Dilos.

SPAIN
For VAT purposes, the country does not include the Canary Islands, Ceuta and Menilla.

FRANCE
Special rates apply in Corsica and the overseas departments (DOM):
a) Corsica
0.90%: the first performances of some shows, sales of live meat and charcuterie animals to persons not liable to pay tax;
2.10%: some goods supplied in Corsica and some services to which the reduced rates are applicable in mainland France;
10%: certain work on immovable property, agricultural equipment, certain supplies of furnished lodging, and sales for consumption on the premises, sales of electricity supplied at low voltage;
13%: petroleum products;
The standard rate applicable in Corsica is the same as in the rest of the country: 20%.

b) DOM
In the overseas departments, but not French Guiana and Mayotte,

a reduced rate of 2.10% and a standard rate of 8.5% are applicable and the rates of 1.05 % and 1.75 %, respectively (on the first performances of certain shows and certain sales of animals for slaughter and meat).

c) Monaco

Goods and services supplied to or from the Principality of Monaco are regarded as having been supplied to or from France.

ITALY

The following territories are excluded from the scope of VAT: Livigno, Campione d'Italia and the territorial waters of Lake Lugano.

CYPRUS

Transactions originating in, or intended for, the United Kingdom Sovereign Base Areas of Akrotiri and Dhekelia are treated as transactions originating in, or intended for, the Republic of Cyprus. The application of the acquis is suspended in those areas of the Republic of Cyprus in which the government of the Republic of Cyprus does not exercise effective control.

AUSTRIA

A special rate of 19% applies in Jungholz and Mittelberg.

PORTUGAL

Special rates apply in the Azores and Madeira:

a) In the Azores

4%: reduced rate;

9%: reduced rate / parking rate; 18%: standard rate;

b) In Madeira

5%: reduced rate;

12%: reduced rate / parking rate; 22%: standard rate.

FINLAND

The Åland Islands are excluded from the scope of VAT.

UNITED KINGDOM

Goods and services supplied to or from the Isle of Man are regarded as having been supplied to or from the United Kingdom.

V. ***The evolution of VAT rates applicable in the Member States***

MEMBER STATES AND DATES	REDUCED RATE	STANDARD RATE	INCREASED RATE	PARKING RATE
Belgium				
01/01/1971	6	18	25	14
01/01/1978	6	16	25	-
01/12/1980	6	16	25 |	-
01/07/1981	6	17	25 |	-
01/09/1981	6	17	25 |	-
01/03/1982	1 | 6	17	25 |	-
01/01/1983	1 | 6	19	25 |	17
01/04/1992	1 | 6 | 12	19.5	-	-
01/01/1994	1 | 6 | 12	20.5	-	12
01/01/1996	1 | 6 | 12	21	-	12
01/01/2000	6 | 12	21	-	12
Bulgaria				
01/04/1994	-	18	-	-
01/07/1996	-	22	-	-
01/01/1999	-	20	-	-
01/01/2007	7	20	-	-
01/04/2011	9	20	-	-
Czech Republic				
01/01/1993	5	23	-	-
01/01/1995	5	22	-	-
01/05/2004	5	19	-	-
01/01/2008	9	19	-	-
01/01/2010	10	20	-	-
01/01/2012	14	20	-	-
01/01/2013	15	21	-	-
01/01/2015	10 | 15	21	-	-
Denmark				
03/07/1967	-	10	-	-
01/04/1968	-	12.5	-	-
29/06/1970	-	15	-	-
29/09/1975	9.25	15	-	-
01/03/1976	-	15	-	-
03/10/1977	-	18	-	-
01/10/1978	-	20.25	-	-
30/06/1980	-	22	-	-
01/01/1992	-	25	-	-
Germany				
01/01/1968	5	10	-	-
01/07/1968	5,5	11	-	-
01/01/1978	6	12	-	-
01/07/1979	6.5	13	-	-
01/07/1983	7	14	-	-
01/01/1993	7	15	-	-
01/04/1998	7	16	-	-
01/01/2007	7	19		
Estonia				
1991	-	10	-	-
1993-	-	18	-	-

2000-2008	5	18	-	-
01/01/2009	9	18	-	-
01/07/2009	9	20	-	-
MEMBER STATES AND DATES	**REDUCED RATE**	**STANDARD RATE**	**INCREASED RATE**	**PARKING RATE**
Ireland				
01/11/1972	1 | 5,26 | 11.11	16.37	30.26	-
03/09/1973	1 | 6,75 | 11.11	19.5	36.75	-
01/03/1976	10	20	35 | 40	-
01/03/1979	1 | 10	20	-	-
01/05/1980	1 | 10	25	-	-
01/09/1981	1,5 | 15	25	-	-
01/05/1982	1,8 | 18	30	-	-
01/03/1983	2,3 | 23	35	-	-
01/05/1983	2,3 | 5 | 18	23 | 35	-	-
01/07/1983	2 | 5 | 18	23 | 35	-	-
01/05/1984	2 | 5 | 8 | 18	23 | 35	-	-
01/03/1985	2,2 | 10	23	-	-
01/03/1986	2,4 | 10	25	-	-
01/05/1987	1,7 | 10	25	-	-
01/03/1988	1,4 | 5 | 10	25	-	-
01/03/1989	2 | 5 | 10	25	-	-
01/03/1990	2,3 | 10	23	-	-
01/03/1991	2,3 | 10 | 12,5	21	-	12.5
01/03/1992	2,7 | 10 | 12,5 |	21	-	16
01/03/1993	2,5 | 12,5	21	-	12.5
01/01/1996	2,8 | 12,5	21	-	12.5
01/03/1997	3,3 | 12,5	21	-	12.5
01/03/1998	3,6 | 12,5	21	-	12.5
01/03/1999	4 | 12,5	21	-	12.5
01/03/2000	4,2 | 12,5	21	-	12.5
01/01/2001	4,3 | 12,5	20	-	12.5
01/03/2002	4,3 | 12,5	21	-	12.5
01/01/2003	4,3 | 13,5	21	-	13.5
01/01/2004	4,4 | 13,5	21	-	13.5
01/01/2005	4.8 | 13.5	21	-	13.5
01/12/2008	4.8 | 13.5	21.5	-	13.5
01/01/2010	4.8 | 13.5	21	-	13.5
01/07/2011	4.8 | 9 | 13.5	21	-	13.5
01/01/2012	4.8 | 9 | 13.5	23	-	13.5
Greece				
01/01/1987	3 | 6	18	36	-
01/01/1988	3 | 6	16	36	-
28/04/1990	4 | 8	18	36	-
08/08/1992	4 | 8	18	-	-
01/04/2005	4,5 | 9	19	-	-
15/03/2010	5 | 10	21	-	-
01/07/2010	5,5 | 11	23	-	-
01/01/2011	6,5 | 13	23	-	-
20/07/2015	6 | 13	23	-	-
01/06/2016	6 | 13	24	-	-
Spain				
01/01/1986	6	12	33	-
01/01/1992	6	13	28	-
01/08/1992	6	15	28	-
01/01/1993	3 | 6	15	-	-

01/01/1995	4 | 7	16	-	-
01/07/2010	4 | 8	18	-	-
01/09/2012	4 | 10	21	-	-

MEMBER STATES AND DATES	REDUCED RATE	STANDARD RATE	INCREASED RATE	PARKING RATE
France				
1/01/1968 (1)	6	16.66	20	13
1/12/1968 (1)	7	19	25	15
01/01/1970	7.5	23	33.33	17.6
01/01/1973	7	20	33.33	17.6
01/01/1977	7	17.6	33.33	-
1/07/1982 (2)	4 | 5,5 | 7	18.6	33.33	-
01/01/1986	4 | 5,5 | 7	18.6	33.33	-
01/07/1986	2,1 | 4 | 5,5 | 7 |	18.6	33.33	-
17/09/1987	2,1 | 4 | 5,5 | 7 |	18.6	33.33	28
01/12/1988	2,1 | 4 | 5,5 | 7 |	18.6	28	-
01/01/1989	2,1 | 5,5 | 13	18.6	28	-
08/09/1989	2,1 | 5,5 | 13	18.6	25 | 28	-
01/01/1990	2,1 | 5,5 | 13	18.6	25	-
13/09/1990	2,1 | 5,5 | 13	18.6	22	-
29/07/1991	2,1 | 5,5	18.6	22	-
01/01/1993	2,1 | 5,5	18.6	-	-
01/08/1995	2,1 | 5,5	20.6	-	-
01/04/2000	2,1 | 5,5	19.6	-	-
01/01/2012	2,1 | 5,5 | 7	19.6	-	-
01/01/2014	2,1 | 5,5 | 10	20	-	-

(1) Up to 1.1.1970, the VAT rates were applicable to a price inclusive of VAT itself. As from 1.1.1970, the
(2) 4% rate 1.7.1982 to 1.1.1986 was provisional.

Croatia				
01/08/1998	-	22	-	-
01/11/1999	0	22	-	-
01/01/2006	0 | 10	22	-	-
01/08/2009	0 | 10	23	-	-
01/03/2012	0 | 10	25	-	-
01/01/2013	5 | 10	25	-	-
01/01/2014	5 | 13	25	-	-
Italy				
01/01/1973	6	12	18	-
01/01/1975	6	12	30	18
18/03/1976	6	12	30	18
10/05/1976	6 | 9	12	30	18
23/12/1976	1 | 3 | 6 | 9	12	30	18
08/02/1977	1 | 3 | 6 | 9 | 12	14	35	18
03/07/1980	2 | 8	15	35	18
01/11/1980	1 | 2 | 3 | 6 | 9 |	14	35	15 |
01/01/1981	2 | 8	15	35	18
05/08/1982	2 | 8 | 10 | 15	18	38	20
19/04/1984	2 | 8 | 10 | 15	18	30 | 38	20
20/12/1984	2 | 9	18	30	-
01/08/1988	2 | 9	19	38	-
01/01/1989	4 | 9	19	38	-
13/05/1991	4 | 9 | 12	19	38	-
01/01/1993	4 | 9	19	-	12
01/01/1994	4 | 9	19	-	13
24/02/1995	4 | 10	19	-	16
01/10/1997	4 | 10	20	-	-

17/09/2011	4 | 10	21	-	-
01/10/2013	4 | 10	22	-	-
01/01/2016	4 | 5 | 10	22		
Cyprus				
01/07/1992	-	5	-	-
01/10/1993	-	8	-	-
MEMBER STATES AND DATES	**REDUCED RATE**	**STANDARD RATE**	**INCREASED RATE**	**PARKING RATE**
01/07/2000	5	10	-	-
01/07/2002	5	13	-	-
01/01/2003	5	15	-	-
01/08/2005	5 | 8	15	-	-
01/03/2012	5 | 8	17	-	-
14/01/2013	5 | 8	18	-	-
13/01/2014	5 | 9	19	-	-
Latvia				
01/05/1995	-	18	-	-
01/01/2003	9	18	-	-
01/05/2004	5	18	-	-
01/01/2009	10	21	-	-
01/01/2011	12	22	-	-
01/07/2012	12	21	-	-
Lithuania				
01/05/1994	-	18	-	-
01/08/1994	9	18	-	-
01/01/1997	-	18	-	-
01/05/2000	5	18	-	-
01/01/2001	5 | 9	18	-	-
01/01/2009	5 | 9	19	-	-
01/09/2009	5 | 9	21	-	-
Luxembourg				
01/01/1970	4	8	-	-
01/01/1971	2 | 5	10	-	-
01/07/1983	3 | 6	12	-	-
01/01/1992	3 | 6	15	-	-
01/01/1993	3 | 6	15	-	12
01/01/2015	3 | 8	17	-	14
Hungary				
01/01/1988	0 | 15	25	-	-
01/01/1993	0 | 6	25	-	-
01/08/1993	10	25	-	-
01/01/1995	0 | 12	25	-	-
01/01/2004	5 | 15	25	-	-
01/01/2006	5 | 15	20	-	-
01/09/2006	5	20	-	-
01/07/2009	5 | 18	25	-	-
01/01/2012	5 | 18	27	-	-
Malta				
01/01/1995	5	15	-	-
01/01/1999	5	15	-	-
01/01/2004	5	18	-	-
01/01/2011	5 | 7	18	-	-
Netherlands				
01/01/1969	4	12	-	-

01/01/1971	4	14	-	-
01/01/1973	4	16	-	-
01/01/1976	4	18	-	-
01/01/1984	5	19	-	-
01/10/1986	6	20	-	-
01/01/1989	6	18.5	-	-
01/10/1992	6	17.5	-	-
01/01/2001	6	19	-	-
01/10/2012	6	21	-	-

MEMBER STATES AND DATES	REDUCED RATE	STANDARD RATE	INCREASED RATE	PARKING RATE
Austria				
01/01/1973	8	16	-	-
01/01/1976	8	18	-	-
01/01/1978	8	18	30	30
01/01/1981	8 | 13	18	30	30
01/01/1984	10	20	32	32
01/01/1992	10	20	-	-
01/01/1995	10	20	-	12
01/01/2016	10 | 13	20	-	13
Poland				
05/07/1993	7	22	-	-
04/09/2000	3 | 7	22	-	-
01/01/2011	5 | 8	23	-	-
Portugal				
01/01/1986	8	16	30	-
01/02/1988	8	17	30	-
24/03/1992(1)	5	16	30	-
01/01/1995	5	17	-	-
01/07/1996	5 | 12	17	-	-
05/06/2002	5 | 12	19	-	12
01/07/2005	5 | 12	21	-	12
01/07/2008	5 | 12	20	-	12
01/07/2010	6 | 13	21	-	13
01/01/2011	6 | 13	23	-	13

(1) On 24 March 1992 Portugal abolished the zero rate. All goods and services previously zero-rated are now taxed at 6%.

Romania				
01/07/1993	-	18	-	-
01/01/1995	9	18	-	-
01/02/1998	11	22	-	-
01/01/2000	-	19	-	-
01/01/2004	9	19	-	-
01/12/2008	5 | 9	19	-	-
01/07/2010	5 | 9	24	-	-
01/01/2016	5 | 9	20	-	-
01/01/2017	5 | 9	19	-	-
Slovenia				
01/07/1999	8	19	-	-
01/01/2002	8.5	20	-	-
01/07/2013	9.5	22	-	-
Slovak Republic				
01/01/1993	5	23	-	-
01/08/1993	6	25	-	-
01/01/1996	6	23	-	-

01/07/1999	10	23	-	-
01/01/2003	14	20	-	-
01/01/2004	-	19	-	-
01/01/2007	10	19	-	-
01/05/2010	6 | 10	19	-	-
01/01/2011	10	20	-	-
Finland				
01/06/1994	5 | 6 | 12	22	-	-
01/01/1995	6 | 12 | 17	22	-	-

MEMBER STATES AND DATES	REDUCED RATE	STANDARD RATE	INCREASED RATE	PARKING RATE
01/01/1998	8 | 17	22	-	-
01/10/2009	8 | 12	22	-	-
01/07/2010	9 | 13	23	-	-
01/01/2013	10 | 14	24	-	-
Sweden				
01/01/1969	2,04 | 6,38	11.11	-	-
01/01/1971	3,09 | 9,89	17.65	-	-
01/06/1977	3,54 | 11,43	20.63	-	-
08/09/1980	3,95 | 12,87	23.46	-	-
16/11/1981	3,67 | 11,88	21.51	-	-
01/01/1983	3,95 | 12,87	23.46	-	-
01/07/1990	4,17 | 13,64	25	-	-
01/01/1992	18	25	-	-
01/01/1993	21	25	-	-
01/07/1993	12 | 21	25	-	-
01/01/1996	6 | 12	25	-	-
United Kingdom				
01/04/1973	-	10	-	-
29/07/1974	-	8	-	-
18/11/1974	-	8	25	-
12/04/1976	-	8	12.5	-
18/06/1979	-	15	-	-
01/04/1991	-	17.5	-	-
01/04/1994	-	17.5	-	8
01/01/1995	8	17.5	-	-
01/09/1997	5	17.5	-	-
01/12/2008	5	15	-	-
01/01/2010	5	17.5	-	-
04/01/2011	5	20	-	-

Source: Commission website

9.6. Technical document presented to the GFV by the Commission

EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax Administration
Value Added Tax

Group on the future of VAT
18th meeting – 28 April 2017

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GROUP ON THE FUTURE OF VAT

GFV Nº 057

Technical options for the 2017 Commission proposal on 'Reform of rules on VAT rates'

Background

The rules on rates set by the VAT Directive were agreed in 1992 as a basis for introducing an origin-based VAT system. Since 2012, however, the EU has abandoned the objective of an origin-based system and has instead been working on introducing a definitive VAT system based on the alternative destination system. Destination systems, by nature, require much less alignment in taxation levels and, consequently, less stringent rules on VAT rates. For this reason, in the Action Plan on VAT of 7 April 2016, the Commission outlined two options for modernising rules on VAT rates to bring them fully into line with a destination-based VAT system and to allow Member States more flexibility in setting VAT rates. The first option would result in a proposal to extend and regularly review Annex III of the VAT Directive (the list of goods and services eligible for reduced rates), whereas the section option would result in an outright abolition of Annex III.

On 25 May 2016, in the conclusions[85] of the meeting on the Action Plan on VAT[86], the Council took note of the direction of action proposed by the Commission with regard to VAT rates and of its intention to make a legislative proposal in 2017, proposing a reform to give more freedom to Member States in setting up rates and proposing two options. In addition, the Council welcomed the intention of the Commission to present a proposal for increased flexibility for Member States, so that they could benefit from the existing reduced and zero rates in other Member States, while warning that a sufficient level of harmonisation in the EU remains required and the adopted solution has to be carefully balanced to avoid distortion of competition, a rise in business costs and a negative impact on the functioning of the single market.

Purpose of the document

The Commission plans to present a legislative proposal on reforming the VAT rates system in the autumn 2017. While the choice of a rates system ultimately depends on political preferences, the Commission would like to consult Member States' tax administrations on a number of design elements which are more technical in nature. This technical paper aims at providing a basis for such a discussion at the meeting of the Group on the Future of VAT.

General direction of reform

The legislative proposal should address two issues:

1) What is the right level of restrictions, if any, to the Member States' freedom in setting VAT rates?

2) Which new rules should replace the derogations to the VAT rates that will expire upon the changeover to the definitive VAT system?

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[85] See http://www.consilium.europa.eu/en/press/press-releases/2016/05/25-conclusions-vat-action-plan The Council on the same date also approved the Commission's proposal for prolonging temporarily the duration of the obligation to respect a 15% minimum standard rate of VAT until the end of 2017.

[86] https://ec.europa.eu/taxation_customs/sites/taxation/files/com_2016_148_en.pdf

Problem 1: Constraints set by the general rules

The VAT Directive sets out general rules framing Member States' freedom to set VAT rates. Currently, a 'standard' VAT rate of a minimum rate of 15% has to be applied to all taxable supplies of goods and services. However, Member States can choose to tax certain goods and services specifically listed in the Annex III of the VAT Directive using one or two different 'reduced' VAT rates, set at no less than 5%. Member States are not allowed to extend the scope of the reduced rates to goods and services not covered by Annex III.

As already mentioned, the legal framework restricting Member States' autonomy in setting VAT rates was consistent with the objective of achieving a VAT system based on the origin principle, which is no longer current, and faces an already extensive *de facto* adoption of the destination principle. The design of the rates system needs to take this change into account.

The study on VAT rates, whose draft version has been distributed ahead of the meeting, has not found evidence of any meaningful risk for distortion to the Single Market from the operation of different levels of VAT rates. As such, the current constraints to Member States' tax policies are arguably not fully justified with regard to the subsidiarity requirement set by Article 113 TFEU ('adopt provisions for the harmonisation of legislation concerning turnover taxes […] to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition').

Although current rules on VAT rates do provide Member States with a wide room for manoeuvre, they nevertheless set significant constraints to their action. This is demonstrated by two phenomena: first, the frequent requests for changes in the VAT Directive in the direction of extending the scope for reduced, super-reduced or zero rates (by way of example, just in the last two years such requests were put forward in three different domains) and second, the large number of infringements to the VAT directive in the domain of VAT rates. These derive from the fact that several Member States, owing to the time required to obtain changes in the VAT Directive or the inability of the Council to agree on such changes, take the shortcut of directly introducing changes in their national VAT legislation, introducing VAT rates that they know are contrary to EU law.

Problem 2: Derogations from the general rules

The simple general rules on rates were considerably complicated by the granting of a multitude of derogations upon adoption of the Directive in 1992. These derogations allow specific Member States to apply reduced rates lower than 5% (super-reduced rates and also zero rates) or to apply specific reduced rates of a minimum of 12% (parking rates) to specific goods and services and most of them will expire with the adoption of a definitive VAT system.

One should add that, apart from the issue of their expiry, derogations undermine the simplicity and coherence of the EU VAT system and contradict the principle of equal treatment. There has also been pressure from some Member States to grant further derogations from the system, as highlighted by the so-called 'tampon tax' controversy.

The forthcoming legislative proposal should address both of these issues. It should be noted however that no extension of rate flexibility is planned in the case of supplies that are still taxed under special schemes operating on the origin principle.

Technical direction of reform

The Commission identified increased flexibility as the guiding principle to address the first problem (constraints) and equal treatment of Member States as the guiding principle for the second problem (derogations).

Possible Dimensions of flexibility

Flexibility dimension 1: Extension of Annex III

While option 2 would abolish Annex III altogether, Option 1 is based on extending and regularly reviewing the supplies covered by Annex III. This raises the question of a) how to extend the Annex; and b), how to review it.

a) How to extend annex III

As indicated in the Action Plan on VAT, an extension of Annex III should at least take into account technological and economic developments. A first step in that direction was made recently with the Commission's proposal to enable Member States to apply a reduced VAT rate to electronically supplied publications.

The identification of the changes to be made to Annex III should take into account Member States' suggestions and could be based on the two following criteria:

a) Changes to adapt the Annex to technological, economic or social developments;

b) Changes to address ambiguous terminology (e.g. 'social housing');

Council recommendations call for adaptations to be carried out maintaining a sufficient level of harmonisation and preventing unjustified increases in compliance costs for businesses. Increases in compliance costs could be mitigated by the foreseen extension of the MOSS and by the introduction of a web portal providing accurate, timely and binding information on the reduced VAT rates in place in each Member State. Harmonisation could be introduced by defining goods that can benefit from a reduced VAT rate on the basis of the Combined Nomenclature; this would also decisively cut rate identification costs for businesses.

What categories of Annex III require adaptation, in the view of Member States? What criteria should be used to identify priorities?

Process:

The Action Plan does not specify which process to follow for the extension and especially the successive regular review of the contents of Annex III. Experience shows that negotiations in the Council on the basis of a Commission proposal can be long and difficult and tie up the Council Working Party on Tax Questions on technical questions that might easier be addressed in the preparation of a proposal. It seems that the Group on the Future of VAT could be an appropriate forum to discuss and prepare regular updates of Annex III.

Which arrangements would the Member States favour for the updating of Annex III? How should the process be defined? At what intervals should the regular review of Annex III take place?

Flexibility dimension 2: number of rates

Currently the general rules provide for a standard rate and a maximum number of two reduced rates; *de facto*, however, derogations provide for some Member States to apply many more different rates (typically three-four, but five in the case of Ireland, counting zero rates).

While a more VAT rates allow Member States more flexibility, the recent study by PWC has found that an increase in the number of VAT rates could lead to an exponential rise in business compliance costs and to a similar increase in the cost for public administration. On the other hand, cutting the number of rates is politically sensitive. The maximum number of VAT rates applied in the EU is five, but 21 Member States apply three or less VAT rates[87].

Do the Member States desire more flexibility concerning the number VAT rates? What should be the maximum number of VAT rates allowed?

Flexibility dimension 3: level of minimum rates

The floor to rates fixed in the directive was directly linked to the avoidance of distortion in an origin system but this justification falls away, in most cases, in a destination system. An EU-level floor to rates may limit lobbying activities by sectors hoping to get more favourable treatment, but the absence of minimum rates in itself cannot generally lead to a rise in business costs or, except in special cases, to distortion of competition in a destination based VAT system.

The justification for the current minimum of 15% for the standard VAT rate, which will expire by the end of 2017, appears particularly doubtful from an economic perspective. Apart from the absence of any distortion risk, lowering the standard VAT rate below 15% is from the current perspective an unrealistic scenario looking at the standard rates currently applied by Member States (17% to 27%) and their fiscal constraints. Given the expiration of this provision, as of 2018 Member States would only be restricted to apply a standard VAT that is higher than the reduced rates.

In contrast, the current minimum of 5% for reduced rates could be maintained in a definitive VAT system, but the fact that, thanks to derogations, rates lower than 5% have in the past applied to all categories[88] of Annex III, sheds doubt on the 'potential distortion' argument supporting this.

[87] The latter are the Member States that do not apply super-reduced or zero rates. It seems therefore appropriate to adjust the maximum number of VAT rates in case super-reduced and zero rates should be granted to all Member States.

[88] Except to the supplies that were added to Annex III in 2009.

What are Member States' views on the need for a minimum rate level, and what should this level be?

Flexibility dimension 4: granting existing derogations to all Member States

The Council welcomed the intention of the Commission to present a proposal for increased flexibility for Member States, so that they could benefit from the existing reduced and zero rates in other Member States.

By definition, granting to all Member States what is already applied in one or more Member States cannot harm the functioning of the internal market, if the internal market is functioning under the current arrangements. It would solve the problem that the current temporary provisions will expire with the entry into force of definitive VAT arrangements. The alternative solution, phasing derogations out, has not worked in the past except upon accession. This pleads in favour of extension of derogations to all Member States. On the other hand, some of the derogations are highly particular provisions, and their inclusion in Annex III would be technically difficult.

Do Member States favour extending derogations to all Member States or phasing them out? Should the derogations be introduced in a new Annex III, which would include zero and super-reduced rates?

Timing of entry into force of the new rules

The new rules on rates could enter into force on the same date as the definitive system, but this is not a necessity. For example, the changes in Annex III could enter into force earlier if there is an urgent need to address obsolete provisions, but a choice could also be made in favour of avoiding a too frequent disruption of the VAT system. Similarly, the new rules on derogations could enter into force at a different time from the new rate rules, e.g. to give sufficient adaptation period for a phase-out or extension, or to avoid burdening operators with too many changes at the same time.

Do Member States favour implementation on the same date for all changes to rate rules, including derogations, or should there be different times for entry into force? If so, what elements should enter into force later?

Possible elements of the options

A common feature of both options would be the restriction of the number of VAT rates and the difference between the two options would be the scope of Annex III. The level of rates to be fixed depends on the choice by Member States and is independent from the preferred option.

Commission services' views on possible elements of option 1 (extension of Annex III)

Updating Annex III to what Member States apply in practice would require a broader definition of existing categories of Annex III, e.g. to allow a reduced rate for the letting of medical equipment as part of category 4, for the construction of buildings as part of categories 10 and 10a and for minor repairs other than those listed in category 19. Furthermore, new categories could be added to Annex III, e.g. internet access services.

Another area could concern reduced rates for electronically supplied services apart from e-publications, which have an analogue counterpart included in Annex III, notably telecommunication and broadcasting services.

On the other hand, there are also demands to allow for the applications of zero rates for products that are already included in Annex III, e.g. sanitary protection products and demands to allow for zero rates for supplies that are not even included in Annex III, e.g. live-saving and rescue equipment, energy saving materials and tissues and cells.

Therefore, option 1 needs to follow a structured approach. First the scope of Annex III needs to be determined and in a second step minimum rates would need to be determined for each specific category of the extended Annex III.

Granting existing derogations to all Member States

Parking, super-reduced and zero rates according to Title VIII, Chapter 4 (temporary provisions) mostly relate to categories included in Annex III, but Annex III would have to be extended in order to grant all derogations of Chapter 4 to all Member States.

An extension of Annex III (and the possibility to apply rates lower than 5%) would provide Member States currently applying super-reduced and zero rates with legal certainty, given that the CJEU in Case C-596/10 ruled that super-reduced rate cannot be applied to supplies that were not included in Annex III of the VAT Directive.

On the other hand, an extension of Annex III is technically complex, because existing super-reduced and zero rates are sometimes limited and targeted VAT subsidies. The narrow scope of such derogations could even lead to disputes with regard to fiscal neutrality once they are added to Annex III.

An additional problem arises in cases where the conditions for the applications of super-reduced and zero rates refer to national provisions outside the VAT system, specific national institutions or regional rates. There is no possibility to include such conditions in EU VAT law as general provisions. They can only be granted on a permanent basis in a definitive VAT system or expire.

Finally, when Member States agreed on the scope of Annex III in 1992, they could not agree to include all points of Annex X also in Annex III and some points were only partially included in Annex III. This leads to a situation where several Member States may be infringing the VAT Directive by applying a reduced rate to services included in Point 10 of Annex X (passenger transport), but which are not included in Annex III.

In addition, Annex X in connection to Articles 371 to 390c will expire upon the adoption of the definitive VAT system. It allows Member States to continue to exempt certain supplies under the conditions applied on 1 January 1978 and some of these exemptions are *de facto* zero rates. The Commission could propose to enlarge the scope of Annex III, if categories of Annex X are only partially included in Annex III and to add to Annex III the points of Annex X, where the exemptions are still applied and *de facto* constitute zero rates. This could also include a change of the place of supply rules for passenger transport services in-line with a Commission proposal from 1993 and Article 393 of the VAT Directive.

Commission services' views on possible elements of option 2 (abolishing Annex III)

Under option 2 Annex III would be abolished. The minimum of 15% for the standard rate would expire and also the minimum of 5% for reduced rates could be abolished with the aim of granting existing derogations to all Member States and provide Member States will full flexibility in setting VAT rates.

However, also under option 2 the number of reduced rates would need to be limited in order to reduce the risk of frequent changes in the level of rates and limit the rise in compliance costs.

As mentioned before, a potential increase in business costs could be also mitigated by the foreseen extension of the MOSS, by a web portal providing accurate, timely and binding information on the reduced VAT rates in place in each Member State, and by an obligation to define goods that can benefit from a reduced VAT rate on the basis of the Combined Nomenclature[89]. A link in the national VAT law to the Combined Nomenclature already exists in several Member States and these Member States are invited to elaborate on their experience.

In addition, a list of products that cannot be subject to reduced VAT rates could be established as a safeguard. This list would at least include services that are taxed at the place of establishment of the supplier and supplies under a special VAT scheme and possibly other supplies which may be at greater risk for distortions in light of their characteristics.

To conclude, one key advantage of option 2 is that the issue of derogations would be easily solved by abolishing Annex III and minimum rates. Under option 1 equal treatment of Member States would be difficult to achieve, because existing parking, super-reduced and zero rates are sometimes targeted VAT subsidies with a narrow scope.

Questions to the delegates

The delegates are invited to comment on:

1) Extensions of Annex III
2) Extending the number of rates
3) Duration and level of minimum rates
4) Granting derogations to all Member States
5) Timing of entry into force of the new rules
6) Elements of option 1
7) Under option 1, how to extend and to regularly review Annex III
8) Elements of option 2
9) Under option 2, measures to mitigate compliance costs.

[89] When declared to customs in the Union, goods must generally be classified according to the Combined nomenclature.

9.7. Economic impact of VAT infringements

No estimates of the economic impact of Member States infringing the VAT Directive are conducted prior to starting an infringement procedure, as unlawful provisions must be challenged irrespective of their size; as such, it is not possible to provide estimates for all infringement cases. Therefore, only rough estimates of the turnover involved can be formulated, for the cases where it was possible to identify sectoral turnover in statistics.

It must be stressed that the impact on turnover determined below is likely to be a substantial overestimate in most cases, because, as a rule, not all sales from a given sector will be affected.

Infringement cases on horses in Ireland

Bloodstock Sales at Public Auction	EUR 164.2 million
Export Sales at Public Auction	EUR 272.9 million

(Source: http://www.hri.ie/press-office/press-releases/2016-irish-thoroughbred-industry-statistics/)

Horse sector turnover in France: ~EUR 300 million in 2013 (source: DG BUDGET data)

Horse sector turnover in Italy: ~EUR 300 million in 2011 (source: DG BUDGET data)

The size of the distortion is represented by the following formula:

(1) $$D = T \cdot \Delta r \cdot S$$

Where T is the sectoral turnover, S is the % share of sectoral turnover affected, and Δr is the difference between the unlawfully applied rate and the lawful rate. S is typically an unknown parameter, but it cannot exceed 1, whereas Δr will depend on the circumstances of each case, but it cannot exceed the difference between the lowest applied rate in the country and the standard rate. For simplicity we assume the maximum value of the product $S\Delta r$ to amount to 0.1. This would give the following maximum turnover impacts:

IE: EUR 43.7 million

IT: EUR 30 million

FR: EUR 30 million

These values represent respectively 0.017%, 0.002%, and 0.0015% of 2015 GDP in the Member States considered[90] and 0.36%, 0.03% and 0.02% of 2015 VAT revenues.

CZ Diapers

Average per capita consumption of diapers per child for the first three years of life was 965 units in the Czech Republic in 2016[91]. Taking into account that in 2013 in the Czech

[90] Source: http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_10_a10&lang=en

Republic 107000 births were registered, the total market size of baby diapers is estimated at 310 million units. At 0.3 EUR/piece, the total market turnover can be roughly estimated at EUR 93 million. Applying formula (1) with a SΔr parameter of 0.1 yields an estimate of EUR 9.3 million. This is equivalent to 0.076% of 2014 VAT revenue.

Energy saving materials

GFCF on energy saving materials in all homes was estimated at GBP 148.5 million in 2010 in the UK (source: internal data by DG Budget). Applying formula (1) with an 0.1 value for $S\Delta r$ yields GBP 15.0 million, equivalent to 0.012% of VAT revenue.

Other estimated costs in terms of VAT revenue loss in GBP million, 2016 are as follows:

Reduced rate of VAT on children's car seats	25
Reduced rate of VAT on contraceptive products	15
Reduced rate of VAT on smoking cessation products	20
Reduced rate of VAT on women's sanitary products	40
Zero rate of VAT on cycle helmets	20

Source: https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs

In terms of the impact on VAT revenues, these amounts range from 0.012% to 0.03% of the total.

[91] Source: http://www.euromonitor.com/nappies-diapers-pants-in-the-czech-republic/report

9.8. Overview of risks

Risk	Option	Factors increasing	Factors decreasing	Overall assessment
Increase of complexity/ business costs	Option 1	The aggregation of many different provisions, some of which national, will yield a very complicated Annex III	The regular review in the VAT Committee may yield simplification of wording	Risk factors linked to a complication of provisions could prevail, leading to more complexity in the VAT Directive than at present.
	Option 2	Member States may introduce a substantial number of new reduced rate categories	The new CPA and the web portal provide a powerful tool for creating transparency on the applicable rate. This will allow operators to profit fully from the extension of the One-stop-shop introduced with the definitive regime.	Outcomes could vary from a deterioration to a substantial improvement depending on various circumstances. Overall, the simplifying effect of the web portal should prevail as easy looking up of the applicable rate makes the number of rates less relevant. This however depends on proper implementation of the CPA/web portal; Incomplete or improper implementation could lead to a short-run increase in complexity. The increase in complexity also depends strongly on how many new rates Member States will introduce.
	Sub-option 2a (with one less rate)	Similar to Option 2, but somewhat better given a lower total number of rates.		The combination of one lower rate and the introduction of the new CPA in the portal should offset or more than offset any possible negative effect of greater complication in Annex III.
	Sub-option 2b	Similar to Option 2 as the 5% minimum for the average rates does not reduce complication		As in Option 2, possible outcomes range from a deterioration to a clear improvement, depending on the implementation of the web portal and on Member States' actions.
	Sub-option 2c	Similar to Option 2 as the extended negative list would not reduce complication		As in Option 2, possible outcomes range from a deterioration to a clear improvement, depending on the implementation of the web portal and on Member States' actions.
Risk of litigation	Option 1	The increase in the range of reduced rates, and even more the new wording made indispensable by the inclusion of all derogations in Annex III, heighten the risk of litigation on the definition of the boundaries and, potentially, on fiscal	The regular review should provide greater opportunities for technical review of the norms	No improvement from *status quo* expected

		neutrality		
	Option 2	If Member States introduce too narrow reduced rates categories, there is a risk of inducing litigation on tax neutrality grounds.	Litigation on boundaries should be reduced by the removal of finalities from VAT categories (e.g. 'for social purposes'), which under the new CPA will be mostly based on product categories, and by a stronger alignment to customs definitions.	The overall effect will depend strongly on Member States' actions, which in turn may be influenced by political factors. As such, it is hard to come to a definitive conclusion. For cautionary reasons, we assume here a worsening of the risk of litigation from *status quo*.
	Sub-option 2a	As for option 2	Marginally less than for Option 2 on account of the lower number of rates	As for option 2
	Sub-option 2b	As for option 2		
	Sub-option 2c	As for option2		
Risk of revenue erosion	Option 1	The scope of goods and services for which reduced and super-reduced rates is widened. Sectors benefiting from reduced rates in other country will lobby for a similar treatment at home.	Past experience shows that the extension of a reduced rate is often offset by equivalent revenue-raising measures, commonly leading to an equivalent increase of the standard rate.	VAT is a central revenue-raiser in all countries and this role will not change. Thus, erosion is likely to be gradual and manifest itself through a higher standard rate or even in higher non-VAT revenues. Nevertheless, it is possible that as successive sectors are granted reduced rate treatment, VAT revenue may be somewhat affected in the longer run compared to *status quo*.
	Option 2	VAT rates can be applied on any supply not falling in the negative list. Sectors benefiting from reduced rates in other countries will lobby for a similar treatment at home. New merit good categories may be established.	As for option 1. In addition, the budgetary safeguard and of the negative list prevents revenue from falling below a certain threshold. The extension of the reduced rate to all supplies outside of the negative list might reduce pressure for granting individual sectors a favourable treatment.	Overall, some revenue erosion may occur over the long run due to the cumulative effect of an extension of reduced rates. This erosion will probably be limited by actions to offset the revenue erosion within and outside the VAT system.
	Sub-option 2a	Similar to option 2		As in option 2. Overall, some revenue erosion may occur over the long run due to the cumulative effect of an extension of reduced rates.
	Sub-option	Similar to option 2	Compared to option 2, the addition of a 5%	Overall somewhat lower risks than under option 2 on account of the

	2b		minimum for reduced rates provides an additional safeguard from revenue erosion. This safeguard may play an important role particularly in offsetting the impacts of zero-rating.	additional revenue safeguard.
	Sub-option 2c	Similar to option 2	Compared to option 2, the extended negative list provides an additional safeguard from revenue erosion. This safeguard may play an important role of granting flexibility only in so far as derogations are concerned.	Lower risks than under option 2 on account of the extended negative list.

10. GLOSSARY

Abbreviations:

B2B	Business-to-business
B2C	Business-to-consumer
CGE	Computable General Equilibrium
CN	Combined Nomenclature
CPA	Classification of products by activity
DG TAXUD	Directorate-General for Taxation and Customs Union
EC	European Community
EU	European Union
EUR	Euro
GFV	Group on the Future of VAT
MOSS	Mini One Stop Shop
MS	Member State
NACE	Statistical classification of economic activities
PwC	PricewaterhouseCoopers
TBE	Telephony, Broadcasting and Electronically Supplied Services
TFEU	Treaty on the Functioning of the European Union
TOMS	Tour Operators Margin Scheme
UK	United Kingdom
VAT	Value-Added Tax
VEG	VAT Expert Group

Administrative costs	Costs for tax administrations. Administrative costs for a tax administration will include costs relating to the following activities: processing VAT registrations, undertaking VAT audits, reviewing VAT returns, reviewing recapitulative statements, helpline and written query handling, and the implementation of new legislation.
Compliance costs	Costs for businesses. Compliance costs for businesses will include costs relating to the following activities: registration for VAT, completion of periodic VAT returns, dealing with a VAT audit, obtaining customer's VAT registration details, completing recapitulative statements, and obtaining proof of the intra-EU movement of goods.
Cross-border trade	Refers solely to intra-EU cross-border B2B trade. The terms 'trading across the EU', 'trading cross-border', 'trading in another Member State', 'doing business in other Member States' doing business across the EU', 'intra-EU transactions', 'intra-EU trade' refer to any situation where a business makes supplies of goods taxable in a Member State other than that in which he is established, acquires goods from a business established in another Member State or supplies goods to a customer established in another Member State.
Member States experts	Members of the GFV
Expert stakeholders	Members of the VEG
MTIC fraud	Missing Trader Intra-Community (MTIC) fraud
VAT Committee	Under Article 398 of the VAT Directive (Directive 2006/112/EC), the VAT Committee deals with the obligatory consultations required by certain Articles of that Directive. In addition, it examines questions on the application of the EU VAT provisions raised by the Chairman on his own initiative or at the request of a Member State. The VAT Committee is also a forum for the exchange of views in order to reach guidelines on a uniform application of common practices with regard to VAT provisions.