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Opinion Statement FC 4/2014 of the CFE
on VAT legislation on public bodies and tax exemptions
in the public interest

Prepared by the CFE Fiscal Committee

Submitted to the European Commission

in April 2014

CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 32 professional organisations from 25 European countries (21 EU member states) with 180,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.

CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE's comments outlined below. For further information, please contact Mr. Piergiorgio Valente, Chairman of the CFE Fiscal Committee, Petra Pospíšilová, Chairwoman of the Indirect Tax Sub-Committee, or Rudolf Reibel, Fiscal and Professional Affairs Officer of the CFE, at brusselsoffice@cfe-eutax.org.

Sincerely yours,

Confédération Fiscale Européenne

The CFE thanks the Commission for the opportunity to participate in the public consultation¹.

The CFE reiterates the observations that it has already made in its reply to the VAT Green Paper consultation of May 2011².

1. General evaluation of the current rules:

Questions:

- What is your evaluation of the current VAT regime as regards the public sector (including special rules for public bodies, Article 13, and tax exemptions in the public interest, Article 132-134 of the VAT Directive)?**
- What are in your opinion the main problems of the current rules?**
- Are there any distortions of competition (output and input side)? If so, how and in which sector do they occur?**
- Is the complexity of the current rules and the lack of harmonisation causing problems?
Please give specific examples.**
- What is their impact on compliance costs?**
- Are the problems identified only of a national nature or do they constitute an obstacle to the smooth functioning of the Internal Market?**
- If you are an entrepreneur how do the current rules affect your business?**

Answers of CFE:

- There is legal uncertainty due to the fact that the current list of VAT exempt operations is based on a stand still provision and on the observation supported by economic analysis of

¹ http://ec.europa.eu/taxation_customs/common/consultations/tax/2013_vat_public_bodies_en.htm

² <http://www.cfe-eutax.org/sites/default/files/CFE%20Opinion%20Statement%20on%20the%20VAT%20Green%20Paper.pdf>

the consequence of the rules. In this regard it is important to observe that there were no significant discussions about the scope and the economic rationale of the exemptions when the directives were first drafted.

- The methods of calculating rights of deduction can be highly complex when a body carries on a combination of VAT exempt and taxable operations. On capital investments subject to the capital goods scheme the process is further complicated by the need to undertake capital goods scheme adjustments over time. An absence of harmonisation of VAT exemptions combined with the total freedom that Member States and to some extent businesses enjoy to select rules for determining how to attribute input tax to supplies (e.g. Case C-496/11 - *Portugal Telecom*) results in a lack of neutrality. Some members of the CFE Fiscal Committee consider that the freedom to select rules for determining how to attribute input tax to supplies should be regarded as a state aid.
- The way in which the recoverable input tax is calculated makes it very difficult for entities performing simultaneously taxable, VAT exempt and out of the scope activities to prepare budgets. This is because it not only requires account to be taken of income but also the extent to which it is taxable, exempt or out of the scope. For budgeting purposes, when determining the cost of an investment it is not only necessary to know the price paid but also the extent to which any input tax is recoverable. The complex nature of the formula for calculating the pro-rata and/or direct attribution therefore causes problems in preparing budgets, because it makes it difficult if not impossible to precisely calculate the recoverable input tax.
- The current system leads to irrecoverable input tax being incurred as a cost of outsourcing, unless the member state effectively reimburses any VAT incurred.
- It is unsatisfactory that taxes have to be raised to fund irrecoverable input tax on investments by public bodies or bodies that are state funded.
- The current system enables aggressive tax planning (un)officially approved by the tax authorities and intending to hide the budget deficit of some Member States.
- The status of subsidies for VAT purposes causes the following difficulties:
 1. Clarification is needed as to which extent subsidies should be regarded as third party consideration for supplies.
 2. Further clarification on the treatment of subsidies is required when calculating the pro rata. This issue received some consideration from the Court in Case C-204/03 *Commission v. Spain* and Case C-243/03, *Commission v. France*.

Q2: Distortion of competition clause:

- Do you think the distortion of competition clause pursuant to the second subparagraph of Article 13 (1) of the VAT Directive and the existing case law from the Court of Justice of the European Union in this respect have been efficient enough in preventing distortions of competition between public and private providers on the output side?

- Does the national legislation of your country provide for a legal mechanism according to which a private entrepreneur who is experiencing unfair competition from a public sector body could formally raise this issue with the tax authorities or the courts?

- Whether a subsidy or other payment is structured in a form that results in it being consideration for supplies has an impact on whether or not it is included in the pro-rata and therefore on the ability to recover input tax, and therefore on the costs after adjusting for any input tax recoveries.
- Tax authorities are frequently more flexible with public controlled entities than with private entities (e.g., when determining the time of taxable events for publicly controlled entities, or when giving approval for tax saving structures that could be considered as an abuse of law if undertaken by other taxable persons, etc).
- It can be difficult and costly for private bodies to rely on distortion of competition as ground for challenging the availability of the exemption for public bodies.

Q3: Reform measures:

- *What are your views on the different reform options or reform measures mentioned in this document (including a possible sectorial reform); do you have a preference for any particular option and any particular variant mentioned in relation to the different options and why?*
- *Is there any option which should be excluded and why?*
- *Do you have any additional ideas or proposals?*

- Zero rating would be the preferred option and is effectively the same as the system of VAT exemption with full deduction of input VAT that some member states already effectively allow some public authorities and which they find works very satisfactorily although the zero rating will not be restricted to a limited group of public bodies. However, it is to be noted that it does not enable the recovery of input tax on supplies where there is no consideration, so it may still be desirable to have special provisions for such services.
- In the absence of zero rating, a super reduced rate of 2-6% that could compensate for the current non deductible input tax. It would be essential for the rates to be very low since otherwise any benefits to the VAT system will be at the cost of increasing complexity to the social welfare system. This course is also less attractive than zero rating because it is likely to result in disputes about whether payments should be regarded as consideration for supplies;
- If exemptions are to be retained, a refund scheme in relation to VAT input tax incurred on investments should be compulsory in order to avoid distortions in the decision making process relating to such investments.

Q4: Sectorial reform:

In case a sectorial reform would be the way forward, Copenhagen Economics has modelled the sectors postal services, broadcasting, waste management and sewage. Other sectors such as air traffic control, access to roads and parking areas could be potential candidates as well.

- *Do you agree with this list?*
- *Which other sectors should in your view be selected for such a review? Why?*

- Any activity requiring significant capital investment, supplying goods or services to taxable business or that operates in more than one country should be a candidate for possible

reform. Indeed the Sixth Directive in 1977 recognised that activities should be taxed if they caused significant distortions of competition.

Q5: Option to tax:

- Do you think that an option to tax as regards tax exempt activities either by taxable persons or Member States should be considered?

- An option to tax is only possible for sectors not performing any cross-border activities
- In cross-border situations, unless it applies in all member states, permitting an option to tax is likely to cause distortions of competition that disturb the internal market.