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**Opinion Statement of the CFE  
on the review of existing legislation on VAT reduced rates**

**Prepared by the CFE Fiscal Committee**

**Submitted to the European Commission**

**In January 2013**

*CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 32 professional organisations from 24 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).*

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- 1 The European Commission's Consultation Paper reviewing VAT reduced rates highlights three guiding principles that should be taken into account when considering whether changes should be made to the supplies that are eligible for reduced rates. These are:
  - (i) whether the reduced rates impact on the proper functioning of the internal market;
  - (ii) whether the goods and services should be discouraged on other policy grounds;
  - (iii) whether the reduced rates result in distortions of competition with other similar goods and services.
- 2 If reduced rates are a material obstacle to the proper functioning of the internal market that would be a compelling reason for removing them. However, the review observes that the Copenhagen Economic Study and subsequent consultations do not indicate that there is any material evidence that suggests that this is the position. One case where there was a problem related to radio and television broadcasting service from Luxembourg. However, this problem will disappear from 1 January 2015 due to the changes in the place of supply rules.
- 3 The VAT exemptions and reduced rates clearly complicate the administration of the VAT system and can generate economic distortions. For these reasons, looking at the VAT system in isolation, it would be ideally desirable to keep them to a minimum. However, the VAT system cannot be looked at in complete isolation, so consideration also needs to be given to the political, social and economic impact of any changes. In so far as reduced rates are retained for these reasons, the CFE can see a case for seeking to harmonise reduced rates in so far as this is possible.
- 4 Particularly at a time of general economic difficulty, considerable caution should be taken in removing reduced rates, which could have the consequence of increasing public hostility to the European Union among the general public. This is especially the position because such increases are regressive and are likely to particularly impact on the less affluent sections of society. In many cases it is precisely for this reason that the reduced rates were introduced in the first instance.
- 5 The Mirrlees Review in the UK has suggested that the use of reduced rates to benefit the poor is questionable and that it is better to give benefits to the poor through the social security system. Even assuming this is correct, any removal of reduced rates will clearly need to be linked to a review to the benefits system. Problems may be caused by the fact that tax authorities

frequently have little understanding of the benefits system. These difficulties will no doubt be increased if there are cross-border issues, for example in relation to cross-border workers.

- 6 While the prejudice caused by a removal of reduced rates may be compensated for by increased welfare benefits, increasing the rate of VAT on necessities will increase the number of individuals who need to receive welfare benefits. This, in turn, will increase not only the costs of providing the benefits but also the administrative costs of providing them, because the benefits will need to be provided to more people. If new targeted benefits are introduced, the increasing number and complexity in the benefits that are provided will also complicate the administration of the social security system. This may not be regarded as a very attractive course at a time when many states are seeking to reduce public expenditure. Even if benefits are increased, the regressive nature of the changes will also inevitably mean that the changes will impact particularly harshly on individuals of relatively modest means who fall just outside the benefits system.
- 7 It is also important to observe that consumers are already suffering from increased prices for energy. To impose VAT at the standard rate on top of these price rises will further compound the financial difficulties that these price changes are already causing. This, in turn, is likely to cause considerable political opposition to any changes. The political and social pressures that these price increases are causing is evident in the United Kingdom, where there has been a gradual increase in the duties on petrol to encourage increased energy efficiency. However, in the light of recent increases in global fuel prices and considerable public opposition to further price increases, the Chancellor of the Exchequer in his December 2012 Autumn Statement agreed that further planned increases in duty would not be implemented.
- 8 The removal of reduced rates on energy are likely to engender similar public hostility. Indeed when VAT was originally introduced on gas in the United Kingdom in 1994 it was originally proposed that the rate would be increased from 8% to the standard rate. However, public opposition resulted in the rate being subsequently reduced to 5% in 1997. There was also considerable hostility to proposals to modify some of the reduced rates in the United Kingdom in the spring of 2012, with media outrage being directed at issues such as the imposition of a “pasty tax”. This opposition resulted in significant modifications being made to a number of the proposals. Similar public hostility can be expected against proposals to modify many of the reduced rates. If any increases are instigated by the European Union, that fact will be exploited by political parties seeking to encourage public hostility to the European Union.
- 9 The Consultation Paper suggests that there are a number of reduced rates that it may be desirable to abolish or modify on public policy grounds. We would make the following observations:
  - (i) Energy, water and waste: the removal or reduced rates on these necessities is likely to be politically controversial. This is particularly true for energy, given the significant recent increases in the costs of energy. The fact that businesses can recover any VAT charged as input tax means that VAT increases are unlikely to encourage conservation by business. In so far as any changes are being made with that objective, other tax charges are likely to be more appropriate. The main impact of any increases in VAT is therefore going to be on relatively poor families. This brings into serious question whether there is any merit in any changes. If any changes occurs, they will need to be

done in conjunction with changes to the relevant benefits system. However given this is within Member States' competence, the exercise will be complex and take some time to implement. If any changes are proposed, Member States should be given a long time-frame for their implementation.

- (ii) Housing: the Consultation Paper correctly observes that there is a particularly strong case for applying reduced rates for energy saving materials. However, there are also other compelling reasons for applying reduced rates to new housing. Housing is a basic social need and there is a shortage of housing in many areas of the Union. Housing is also frequently a very expensive item, particularly for poor families. Imposing VAT on residential housing at the standard rate is likely to make it even more difficult to ensure affordable provision of housing. Encouraging new construction is also likely to be a powerful motor for growth that may be particularly valuable given the current economic difficulties in large areas of the Union. Applying the standard rate to all construction work is likely to further dampen demand for new homes with a depressant effect on the economy. Indeed for this reason, rather than seeking to restrict reduced rates, there may be a powerful case for extending them, so that they apply to all construction works including works of repair and improvement to existing housing. In this regard it is important to note that, unlike many other supplies, most houses are not subject to tax because their supply is either exempt or outside the scope of taxation because the vendor is not a taxable person. The imposition of a standard rate of tax on new buildings will therefore result in significant distortions between the supply of new and old properties. The reduced rates reduce these distortions and are therefore desirable for that reason.

10 The Consultation Paper also questions whether some reduced rates result in distortions of competition with other similar goods and services. The Consultation Paper particularly focuses on books, newspapers and electronic communication. On this issue we would observe that:

- (i) in considering the reduced rates, account has to be taken of the exemptions for educational and cultural services and public radio and television broadcasters;
- (ii) a case can be made for having a reduced rate for some printed and on-line material as a way of promoting learning. This, in particular, applies to students but also to the population more generally;
- (iii) there is arguably a more compelling case for having reduced rates for printed material given the higher costs of production. Also printed material may be particularly important when trying to communicate with groups, including the poor, who may not have easy access to computers. However, there are equally objections that this is just protecting old methods of communication;
- (iv) especially with e-products, given the 2015 changes to the place of supply rules we also agree that there is a particularly strong case for seeking to harmonise the rules. We consider that it would ideally be desirable to more generally have harmonised rules in relation to such services. It is also difficult to see why exemptions that apply to radio and television broadcasting should not extend to on-line and cable broadcasting.

- 11 The reduced rating of transport supplies is only briefly touched on in the Consultation Paper. Having a zero rate for transport services has the benefit of avoiding the need to account for VAT in a number of different states and will therefore facilitate trade and social intercourse in the Union and therefore the objectives of the European Union. More generally it may also have the ecological benefit of discouraging the use of cars and encouraging the use of public transport.
  
- 12 It is finally worth observing that the consequences of introducing or removing reduce rates will frequently be influenced by competitions. In markets where there is strong competition, there is a greater likelihood that any changes will be passed on to customers. However, the consequences of removing reduced rating may not be identical to the consequences of introducing new reduced rates. When a reduced rate is introduced in place of a standard rate, businesses are likely to try and exploit the reduction by increasing their profits. However, if rates are increased, businesses will inevitably try to pass on the increased charges. This may mean that in some situations the benefits of introducing new reduced rates may be questionable. However, the inflationary consequences of withdrawing reduced rates are more probable. When considering distortions in competition it is also important to take account of exemptions and the fact that public bodies may not be subject to VAT when they provide similar services. In some instances the appropriate comparator will not be standard rated supplies but supplies that are either exempt of outside the scope of VAT.