



## **Consultation paper**

# **Review of existing VAT legislation on public bodies and tax exemptions in the public interest**

### **Note**

**This document is being circulated for consultation to all parties concerned by the plan to review the current VAT rules on the public sector (including the special rules for public bodies and the tax exemptions in the public interest) set out in the Communication on the future of VAT adopted by the Commission in December 2011.**

**The sole purpose of this consultation is to collect relevant evidence and information from stakeholders to help the Commission develop its thinking in this area.**

**This document does not necessarily reflect the views of the European Commission, and should not be interpreted as a commitment by the Commission to any official initiative in this area.**

The stakeholders concerned are invited to submit their comments no later than 14 February 2014.

**-Please note that the consultation period has been extended until 25 April 2014!-**

## 1. IDENTIFICATION OF THE STAKEHOLDER

The Commission services would be interested in receiving contributions from all interested stakeholders on the issues described below. In order to analyse the responses, it will be useful to group the answers by type of respondent. For this reason, you are kindly requested to complete the following form.

<ul style="list-style-type: none"><li>• <b>You are included in one of the following groups:</b><ul style="list-style-type: none"><li><input type="checkbox"/> Multinational enterprise</li><li><input type="checkbox"/> Large company</li><li><input type="checkbox"/> Small and medium sized enterprise (SMEs)<sup>1</sup></li><li><input type="checkbox"/> National Association</li><li><input type="checkbox"/> European Association</li><li><input type="checkbox"/> Non-Governmental organisation (NGO)</li><li><input type="checkbox"/> Tax advisor or tax practitioner</li><li><input type="checkbox"/> Citizen</li><li><input type="checkbox"/> Academic</li><li><input type="checkbox"/> Public body</li><li><input type="checkbox"/> Others. Please specify .....</li></ul></li><li>• <b>Name of your organisation/ entity/ company</b> .....</li><li>• <b>Country of domicile</b> .....</li><li>• <b>Brief description of your activity or your sector</b> ..... .....</li></ul> <p><b>Please note: The contributions will be published on the website of DG TAXUD. Without publication their content will not be taken into account. If the contributor objects to the publication of his personal data on the ground that such publication would harm his or her legitimate interests the contribution may be published in anonymous form (see also point 8. of this document).</b></p> <ul style="list-style-type: none"><li>• <b>Do you confirm your agreement to have your response to the consultation published along with other responses?</b><ul style="list-style-type: none"><li><input type="checkbox"/> Yes</li><li><input type="checkbox"/> No</li></ul></li><li>• <b>Do you agree to the publication of your personal data?</b><ul style="list-style-type: none"><li><input type="checkbox"/> Yes</li><li><input type="checkbox"/> No</li></ul></li></ul>
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1 According to the Commission Recommendation (2003) 361 of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (its Annex, Title I, Article 2), SMEs are defined as enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million. Within the SME category, a small enterprise is defined as an enterprise which employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million, and a microenterprise is defined as an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

## **2. INTRODUCTION AND BACKGROUND**

The VAT treatment of public bodies and the exemptions in the public interest has raised a number of concerns and criticisms over the years.

Whilst, in general, nearly all types of economic activity fall within the scope of VAT and are generally taxed, certain supplies provided by public bodies are considered as non-taxable for VAT purposes even if they qualify as an economic activity according to general VAT principles. Some other activities carried out in the public interest are exempted from VAT. These rules date from the 1970s when many of these services were only provided by public bodies. It is questionable whether these rules are still appropriate. Increasing privatisation and the opening up (or deregulation) of activities which were traditionally the exclusive reserve of the public sector have led to distortions of competition between public and private operators engaged in similar activities. Moreover, public-private partnerships which are increasingly used for a range of activities (e. g. infrastructure projects) were not envisaged when the legislation was drawn up.

The issue of the VAT treatment of the public sector was one of the subjects in the public consultation launched by the European Commission on the basis of the Green Paper on the future of VAT<sup>2</sup> and - following this consultation - subject to the Commission's Communication on the future of VAT<sup>3</sup> according to which the review and possible revision of the VAT rules on the public sector is one of the priority areas of the European Commission's further work to create a simpler, more efficient and more robust VAT system in the EU.

To prepare the ground for a possible future legislative initiative in this area the European Commission launched two economic studies and had discussions in January 2013 with Member States within the Group on the future of VAT and with VAT experts within the VAT expert Group; furthermore a Fiscalis stakeholder conference on this issue was held in Italy in April 2013.

In the context of the preparation of an impact assessment on this issue, the European Commission is launching this public consultation to give all interested stakeholders a further opportunity to express their views on this issue.

It is important to point out that at this stage no decision has been taken as regards the principle and context of a future legislative proposal. This consultation is essentially of a technical nature.

## **3. CURRENT EU LEGISLATIVE FRAMEWORK**

Generally, every supply is taxable for VAT purposes if it is carried out for consideration closely linked to the supply (Article 2 of the VAT Directive<sup>4</sup>) and qualifies as an economic activity within the meaning of Article 9 of the VAT Directive.

There are special rules for public sector activities which deviate from this general rule.

### **3.1. Article 13 of the VAT Directive – Public bodies acting as public authorities**

Article 13 of the VAT Directive contains special rules for public bodies where they engage in transactions as a public authority. Where this occurs, the public body will generally not be

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2 Green Paper on the future of VAT: towards a simpler, more robust and efficient VAT system (COM(2010)695)

3 COM(2011)851 final of 6.12.2011

4 Council Directive 2006/112 EC of 28/11/2006 on the common system of value added tax (OJ L347)

considered to be a taxable person for VAT purposes. Therefore services performed as a public authority by a public legal entity are outside the scope of VAT (first subparagraph of Article 13(1)). These kinds of supplies will only be subject to VAT – according to the general rule described above - if either the treatment of the public body as a non-taxable person would lead to "significant distortions of competition" (second subparagraph of Article 13 (1)), or if the relevant activity concerns an area listed in Annex I of the VAT Directive, provided that those activities are not carried out on such a small scale as to be negligible (third subparagraph of Article 13 (1)).

Additionally, Member States are authorized to consider certain exempt activities undertaken by bodies governed by public law as activities in which those bodies act as public authorities, thereby treating them as being out of scope of VAT (Article 13(2) of the VAT Directive).

### **3.2. Articles 132-134 of the VAT Directive – Tax exemptions in the public interest**

In addition to this, Article 132 of the VAT Directive contains a list of exemptions for certain activities in the public interest (which are not necessarily restricted to supplies by public authorities); this concerns e.g. medical care, education, public broadcasting, public postal services, culture etc.

Taking into account the aforementioned points (point 3. – 3.2.), the VAT treatment of the public sector has resulted in three categories of activities for public bodies:

- taxed,
- within the scope of VAT but exempt, and
- outside the scope of the tax.

Finally, in several Member States, public bodies, which have no right of input VAT deduction in so far as the input-supply is related to non-taxed outputs, are compensated fully or partially for the VAT they pay through a mechanism set up outside the VAT system (e.g. a VAT Compensation Fund).

### **3.3. Main problems under the current system**

The following shortcomings of the current VAT rules applicable to the public sector have been identified:

#### **Lack of neutrality**

The current rules are not fiscally neutral because distortions of competition can occur on the output and input side.

Distortions of competition on the **output side** can arise because the same activity may be taxed if carried out by a private body but not taxed if carried out by a public body.

Despite the distortion of competition clause according to the second subparagraph of Article 13 (1) of the VAT Directive many contributors to the public consultation on the Green Paper complained that a private entrepreneur who is experiencing unfair competition from a public sector body would often have no readily accessible legal mechanism to formally raise this issue with the tax authorities or the courts.

Additionally output side distortions are not only a problem linked to Article 13 but also linked to the tax exemptions in the public interest pursuant to Article 132 of the VAT Directive. When the exemption clause refers not only to public bodies, Member States often have a wide discretion to determine which private entities can benefit from the exemption; the objective reason why one provider is included but not another is often not easy to identify and raises legal disputes. In addition, certain exemptions (public broadcasting and postal services) have been drafted without any reference to anything other than public providers<sup>5</sup>.

As regards the **input side** there is distorted competition due to the fact that input VAT is not deductible if the relevant input supply is related to non-taxable or tax-exempt outputs. This leads to cascade effects, self-supply bias and a disincentive to invest or to outsource even where services could be provided more efficiently by a private entity if the VAT aspect was irrelevant. Inefficiencies are created in the production and delivery of services by the public sector because spending decisions are often based on VAT aspects rather than on real economic factors.

### **Complexity and lack of harmonisation**

Complexity derives, for instance, from the difficulty in determining the VAT status of the supply and the deductibility of input VAT because activities of public bodies can be taxed, taxable but exempt or non-taxable. Furthermore, there are often no clear definitions of activities covered by the exemptions in the public interest. As a result, it is often difficult to assess the conditions under which an entity's activity might benefit from exemption.

Complexity and a lack of harmonisation is caused, for instance, by the fact that there is room for interpretation in determining whether the output of an entity is done by a public body acting as a public authority, or not. It derives particularly from the respective national public law as to what is a public body and when it acts "as a public authority". There is no EU approach to those activities that public bodies engage in as public authorities. Additionally, Article 13 (2) of the VAT Directive provides an option for Member States to regard exempt activities as out of scope which also decreases harmonisation.

Furthermore, some of the exemptions listed in Article 132 (1) of the VAT Directive leave a wide discretion to Member States to determine the (private) entities which may benefit from the tax exemptions in the public interest; additional complexity and lack of harmonisation is created by the option for Member States in Article 133 to make the granting of certain exemptions listed in Article 132(1) to bodies other than those governed by public law dependent on additional conditions.

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<sup>5</sup> In its judgment of 23/04/2009, C-357/07, TNT Post UK Ltd., the Court of Justice of the European Union (CJEU) has clarified that a public postal service provider is any provider of universal postal services irrespective of whether it qualifies as a public or a private body.

## 4. COMMISSION INITIATIVES UNTIL NOW

This chapter provides a review of the work which has been previously carried out with respect to a review and possible amendment/improvement of the VAT rules concerning the public sector.

### 4.1. Legislative proposal on postal services

In 2003 the European Commission came forward with a proposal to amend the (former) Sixth VAT Directive<sup>6</sup> regarding the VAT treatment of the postal sector, with the objective to tax postal services and sales of postage stamps.<sup>7</sup> After several years of negotiations in Council, no consensus was reached on this proposal and the Council agreed in December 2010 that the only realistic way forward was the status quo. As a consequence the Commission has withdrawn this proposal.<sup>8</sup>

### 4.2. The future of VAT – The Commission’s Communication and Council conclusions

The review of the provisions as regards VAT in the public sector must be also seen in the context of the general review of the VAT system which has been carried out.

As mentioned above the review of the VAT rules as regards the public sector was subject to the public consultation on the Green Paper<sup>9</sup> from December 2010, according to which the vast majority of private stakeholders expressed their view that a reform of VAT in the public sector is needed whereas public stakeholders were often of the opinion that a different treatment of private and public bodies is justified and that the current rules should be kept<sup>10</sup>. A summary of the contributions to the public consultation on the Green Paper can be found on the Commission's website.<sup>11</sup>

Considering the outcome of the public consultation and the discussions with Member States in the Group on the future of VAT in its meeting on 3 October 2011, **the Commission committed itself in its Communication of 6 December 2011 to promoting a gradual approach towards taxation. A future legislative proposal "would concentrate on activities with a greater degree of private sector involvement and a heightened risk of distorted competition"**.<sup>12</sup> This is one of the measures mentioned in the Communication which should lead to a more efficient VAT system by broadening the tax base.

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6 Sixth Council Directive of 17/05/1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (77/388/EEC), OJ L 145

7 COM(2003)234

8 OJ 2013-C109, p. 7, 8

9 Green paper on the future of VAT: towards a simpler, more robust and efficient VAT system (COM(2010)695)

10 Other specific issues, such as the treatment of inter-municipal cooperation, have recently also been raised with the Commission in this context.

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[http://ec.europa.eu/taxation\\_customs/resources/documents/common/consultations/tax/future\\_vat/summary\\_vat\\_greenpaper.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/consultations/tax/future_vat/summary_vat_greenpaper.pdf) see under Q3

12 Point 5.2.1. of the Communication

The Council, in its May 2012 conclusions on the future of VAT concurred with the need to examine in further detail the present EU rules on the application of VAT in the public sector, in so far as there is competition between the public and private sectors.<sup>13</sup>

#### **4.3. Studies by Copenhagen Economics**

Before making a possible proposal, the Commission initiated an economic study to analyse the impact of the current VAT rules applicable to the public sector, to identify options for alternative rules and to assess their impact. The aim was to reduce VAT distortions and achieve a level playing field. The study which was carried out by Copenhagen Economics was finalized in March 2011 and can be found on the Commission's website.<sup>14</sup>

Additional work in relation to this study – a "complementary study" - was finalised in January 2013.<sup>15</sup>

Compared to the study of 2011 the complementary study now includes:

- the postal sector in its economic model,<sup>16</sup>
- a methodological improvement from a better assessment of the tax base,
- variants of previously identified reform options,
- a separate economic analysis of the sectors economically modelled in an option according to which Article 13 would be deleted while the tax exemptions in the public interest would be kept (waste/sewage management, broadcasting, postal services); this was done in order to enable an informed decision on the final list of sectors to be taxed which would make it possible to assess the impact of a limited sectorial reform, for instance by extending the list in Annex I of the VAT Directive or/and by the deletion of certain tax exemptions.

**The most important economic results deriving from the complementary study are summarised in the tables which are attached to this consultation document.**

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13 [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/130257.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130257.pdf)

14 [http://ec.europa.eu/taxation\\_customs/common/publications/studies/index\\_en.htm](http://ec.europa.eu/taxation_customs/common/publications/studies/index_en.htm)

15 The final report of 10 January 2013 can be found under the following link:

[http://ec.europa.eu/taxation\\_customs/resources/documents/common/publications/studies/vat\\_public\\_sector\\_exemptions\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector_exemptions_en.pdf)

16 The economic model of the study is now based on the economically most significant public core services: health, education, culture, broadcasting, waste management and postal services.

Although the CJEU clarified the scope of the tax exemption for postal services (see judgment of 23/04/2009, C-357/07, TNT Post UK Ltd.), the present situation is often described as unsatisfactory by stakeholders. The postal sector has been included in the model in order to be able to take an informed decision on how a possible future initiative relating to VAT exemptions for activities in the public interest should affect this sector.

**It must be stressed that both the complementary study and the study of 2011 provide the view of Copenhagen Economics and are mere contributions to the discussion process; they do not provide the view of the European Commission and do not prejudge the content of a possible Commission proposal on this issue.**

#### **4.4. Feedback on study results**

As mentioned before, the issue of VAT in the public sector (including the study results) was discussed with Member States in the Group on the future of VAT and with VAT experts within the VAT Expert Group in January 2013; furthermore there was a Fiscalis stakeholder conference in April 2013 which took place in Mestre/Italy with representatives of Member States' tax administrations but also about 70 stakeholders from outside the tax administrations.

Many VAT experts and stakeholders representing private entities identified Article 13 of the VAT Directive as a source of distortions of competition and a disincentive to contracting out. Furthermore, the lack of harmonisation was mentioned as a significant obstacle for intra-community trade. There was no common view on how to overcome the problems of the current system. Several participants expressed their preference for a full taxation option. On the other hand concerns were expressed that such a solution could entail negative consequences e.g. on charities, the health sector or the budget of municipalities. Member State representatives generally opposed an EU wide refund system and are – at this stage – reluctant to go for a full taxation option. However, most of them supported a further examination of other solutions suggested in the Copenhagen Economics' studies.

### **5. THE DIFFERENT REFORM OPTIONS**

The following reform options are currently discussed and briefly described below:

- 1) Full taxation of public bodies and activities in the public interest (see point 5.1.)
- 2) Full compensation of input VAT ("Refund System") at EU level (see point 5.2.)
- 3) Deletion of special rules relating to public bodies (Article 13 of the VAT Directive), while keeping all or most of the current exemptions in the public interest (see point 5.3.)
- 4) Sectorial reform (see point 5.4.)
- 5) Possible (additional) selective amendments of the current rules as described under point 5.5.

#### **5.1. Option 1: The full taxation Model**

The full taxation model can be introduced in two basic alternative ways.

##### ***Model 1 - Taxation dependent on consideration***

According to the first model which is based on leading principles of the current EU VAT system and on which the study focused, every activity carried out by a public body (or a private body currently carrying out tax exempt activities in the public interest) would be liable to VAT if the activity is done for consideration closely linked to the respective supply and qualifies as an economic activity within the meaning of Article 9 of the VAT Directive. This means output supplies would be taxable only if e. g. a special fee is charged. However, where supplies are funded



e. g. through general subsidies or other comparable sources, these would not be taken into account. Institutions that are not carrying out supplies for consideration and whose activities do not qualify as economic activities in the meaning of Article 9 of the VAT Directive would still remain non-taxable.

The economic impact identified by the study and summarized in the tables (which are annexed to this document) for the full taxation option only relates to this first Model.

### ***Model 2 - Taxation independent of consideration***

In an even more ambitious alternative, activities of public bodies could be treated as taxable even when they are not carried out against consideration (so called "deemed supplies"). Such a system already exists in New Zealand.

Both models would mean in practice taxing sectors such as waste management or sewage, but also education, health, culture etc. (provided such activities are carried out against consideration in the first model). In model 2 however, even activities entirely financed by global subsidies (e.g. police, fire department...) would be subject to VAT.

### ***Implementation***

For the implementation of the full taxation option, in both alternatives, Article 13 and the exemptions in the public interest (Articles 132-134) would need to be deleted. Additionally, the second model requires a significant change of the present VAT system: For instance, the determination of the conditions under which supplies are taxable and the definition of the tax base would have to be revisited.

### ***Variants of model 1***

The complementary study presents the full taxation option according to Model 1 in two variants: **Variant 1** is based on the assumption that supplies carried out within the sectors concerned would be subject to the standard VAT rate. According to **variant 2** those supplies would be subject to the reduced VAT rate.

### ***Expected impact and first assessment***

According to the study only the full taxation option entails a significant economic impact and would be – from an economic point of view – the preferable solution. Public revenues would – according to the complementary study - increase by up to EUR 80 billion in variant 1 and by up to EUR 50 billion in variant 2. Since the aim of a possible reform is not necessarily to achieve higher revenues the study proposes that the revenue increase could be used for a general reduction of the standard tax rate of 10,44% in variant 1 and 6,6 % in variant 2. The full taxation option could additionally lead to an increase of GDP of up to 0,34% in variant 1 and 0,32% in variant 2. However both variants would lead to a loss of public jobs which could be compensated by private job creations – at least - in the medium or long term.

The full taxation option would significantly reduce distortions of competition; input side distortions would remain to a certain degree because activities carried out not for consideration would remain out of scope (in Model 1, the EU-Model). Boundary issues, e. g. whether a certain activity is governed by public or private law, whether or not there is a potential distortion of competition would no longer arise.

On the other hand positive revenue effects could be offset - to a certain degree - by higher costs for social security systems (because of a higher price of health services). In addition the study refers to a significant risk of tax avoidance because it would be possible to avoid VAT even in the full taxation model through a switch from fee-for-service budgeting and remuneration systems towards general subsidies (not closely linked to the supply carried out) which according to the current rules would not qualify as consideration. This could - according to the study - only be avoided by the introduction of the New Zealand Model (Model 2). Another issue is the question of how to deal with so called public core activities - judiciary (supplies carried out against court fees) or e.g. the issue of a new passport (against fees). Would it be acceptable as a consequence of the full taxation option to tax such public core activities? Or is a tax exemption for public core activities still needed in order to avoid such a consequence?

Since the full taxation option requires a significant amendment of the present VAT system and would have a negative impact on public employment, increases in prices of public goods and services, budgets of social security institutions, high changeover costs etc., it would be very difficult to implement in the EU.

## **5.2. Option 2: Refund system**

This option would provide a refund of input VAT in cases in which the input supplies are used for the purposes of non-taxable activities pursuant to Article 13 or tax exempt activities pursuant to Articles 132-134. Eight Member States have already put in place such compensation schemes and operate them outside the scope of VAT legislation. These schemes are, however, very different from each other for instance as regards the activities and the bodies which can benefit from them. The study proposes a uniform solution within the European Union which would apply to all public bodies and other providers of activities in the public interest (private bodies including non-profit making organisations). This could be done outside the VAT system (by Member States all implementing national refund schemes) or - as the study proposes - inside the VAT system (e. g. by introducing zero-rates).

### *Variants*

The complementary study examines this option in two different variants. According to the **first variant** all of the current exempt or non-taxable services would qualify for a refund of their input VAT expenditure. In the **second variant**, the study assumes that a refund would only be available for health, education, public administration and cultural services.

### *Expected impact and first assessment*

According to the study a uniform solution within the EU could entail additional costs of about EUR 134 billion in variant 1 and EUR 132 billion in variant 2. Of the total costs of EUR134 billion, EUR 6 billion are related to charities, EUR 29 billion to other - private - entities, and EUR 99 billion to public entities. These expected costs are rather substantial at a time of financial consolidation, although they could be compensated by lower public subsidies to the beneficiary entities.

An EU-wide refund system could solve the problem of input side distortions. On the other hand distortions on the output side and many other problems mentioned before would remain. An existing distortion of competition on the output side e. g. between a public body (which is not regarded as a taxable person pursuant to Article 13) and a private competitor (who is liable to tax) could increase even further, for instance in the sector of waste management.

It should finally be stressed that such an option does not automatically require new EU legislation, as it can be implemented today by Member States outside the VAT system (VAT compensation schemes).

### **5.3. Option 3: Deletion of Article 13 while keeping the tax exemptions in the public interest**

This option ensures an equal treatment of public and private bodies by a deletion of Article 13 of the VAT Directive. Article 132 would however be maintained and modernized; in this context it could be examined whether current exemptions e.g. for public broadcasting or postal services are still appropriate. If necessary, some of the currently non-taxable activities falling under Article 13 could be treated as exempt pursuant to a new Article 132. Additionally, one could consider that the exemptions should only be dependent on the nature of the supply ("in the public interest") and not on the characteristics of the supplier (i.e. no distinction between public and private providers). This option is a compromise between the present provisions and the full-taxation option. Activities which are currently not taxable because they are covered by Article 13 would become taxable (provided that the activity is carried out for consideration and qualifies as an economic activity). This could affect e.g. services such as waste management, sewage, air traffic control, parking and road tolls and crematoriums.

#### *Variants*

Also this option is presented by the complementary study in two variants: **Variante 1** is based on the assumption that supplies carried out in the sectors concerned are liable to the standard VAT rate. According to **variant 2** those supplies would be liable to the reduced VAT rate.

#### *Expected impact and first assessment*

The complementary study describes the economic impact based on the assumption that waste-management, broadcasting and postal services would be taxed under this option (which presupposes that additionally to Article 13, the tax exemptions for public broadcasting and public postal services would have to be deleted). A deletion of Article 13 would of course affect other sectors but they are too small to be included in the economic model.

According to the study the Option 3 could entail a limited fall of public employment which could be compensated by private job creations. The general economic impact is much more limited than in the full taxation option and will finally be dependent on the exact list of tax exempt activities which would be kept.

Many of the pros and cons mentioned for the full taxation option also occur in this option but to a lesser extent. The fact that the determination of the applicable VAT regime would only be dependent on the character of the supplies and not on the legal structure of the supplier would be a clear legal improvement and could remove many distortions of competition especially on the output side. However, suppliers carrying out exempt activities and non-taxable supplies (those which are not performed for consideration) would still suffer from the impossibility to deduct input VAT and distortions on the input side (creating e.g. a disincentive to outsource and invest).

#### **5.4. Option 4: Sectorial reform**

Whilst maintaining the general principles of Articles 13 and 132 of the VAT Directive, it could be envisaged to limit the reform to those sectors where distortions of competition can clearly arise between public and private entities or/and those which usually are associated with high investments costs.

This could concern sectors where the respective activities are currently out of scope according to Article 13 but also sectors where the relevant activities are tax exempt pursuant to Article 132 of the VAT Directive. Sectors which meet these requirements could be removed from Article 132 or/and added to Annex 1 of the VAT Directive which contains an exhaustive list of those activities which shall be taxed even when they are carried out by public bodies acting as public authorities.

#### ***Expected impact and first assessment***

The advantage of such a measure is that a general change of the VAT system would not be needed. Distortions of competition in specific sectors (input and output side) would however be reduced significantly. On the other hand, such an approach would not solve the general problems described earlier and does not provide for a mechanism for future economic developments (new areas open to competition). However, the latter problem could be mitigated by the implementation of a new provision in Annex I of the VAT Directive according to which the list of taxed activities in Annex I could be updated through secondary legislation.

For a sectorial reform the complementary study provides for the relevant data for the sectors waste/sewage management, broadcasting and postal services (**variant 1:** taxed at standard rate; **variant 2:** taxed at reduced rate).

#### **5.5. Selective amendments of the current rules**

Besides the reform options described above, selective changes in the current system (whilst maintaining the general principles of Articles 13 and 132) could be considered which also could be carried out in connection with reform options mentioned before (e. g. a sectorial reform), for instance:

##### ***- Clearer structure of Article 13, e g. deletion of Article 13(2)***

The deletion of Article 13(2) of the VAT Directive would simplify the rules applicable in this area. Activities which clearly qualify as economic activities, even if they are exempt under Article 132 and carried out by public bodies could not fall out of the scope of VAT. This would ensure the effective application of the provisions concerning taxable persons (including e.g. Article 44 and where appropriate Article 27). In practice, this would avoid that the place of supply rules are affected by national options to treat e.g. a hospital as a non-taxable person.

##### ***- Review of Articles 132-134***

Without removing the specific rules in Article 13 of the VAT Directive, it could be envisaged to streamline and modernise Articles 132-134. Apart from the taxation of currently tax exempt activities according to the sectorial reform as described above exemptions could be amended in a way that they are only dependent on the character of a supply and not on the character of the supplier.

**- Option to tax**

(1) In addition e. g. to a sectorial reform as described above, one could think about the introduction of an option to tax for **taxable persons** carrying out tax exempt supplies.

This would be advantageous if higher input VAT is incurred in comparison to the output VAT because large investments are undertaken or the consideration received for a supply is lower than the true cost of its provision (provided that such an activity qualifies as "economic" within the meaning of Article 9).

Such an option to tax would certainly make the current system even more complex but could be economically sensible in certain tax exempt areas which usually have high investment costs (e. g. operation of hospitals); such an option could help to reduce the barrier of contracting out e. g. in the health sector and could also be interesting for charities.

(2) Another possibility would be to introduce an Option-to-tax for **Member States** (not for taxable persons) by allowing Member States to tax activities currently exempt in the public interest (at standard rate – variant 1 – or at reduced or super-reduced rate – option 2). This could offer the advantage of moving a step further towards reducing the scope of VAT exemptions, which would help Member States in the current process of fiscal consolidation (variant 1). This could also offer advantages in replacing distortive exemptions by taxation at a small rate in a way which would be budget neutral (variant 2). However, such a measure could entail a significant decrease of harmonisation and could create new obstacles to intra Community trade.

## 6. QUESTIONNAIRE

**Q1: General evaluation of the current rules (see point 3):**

- 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?

**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?

**Q3: Reform measures (see point 5):**

- 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?

**Q4: Sectorial reform (see point 5.4.):**

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?

**Q5: Option to tax (see point 5.5.):**

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

## 7. SOME IMPORTANT MESSAGES ABOUT THIS CONSULTATION

Stakeholders are invited to reply to those questions that are of concern to them. Figures and concrete examples of e. g. distortions of competition within the internal market or specific problems encountered due to the current VAT rules or – in contrast – examples why the current rules could be justified would be highly appreciated.

As already indicated above, it is important to keep in mind that this public consultation is part of the assessment process and that no policy decisions have been taken at this stage.

## 8. FINAL OBSERVATIONS

It is important for contributors to identify clearly: name, address, e-mail, activity, other information and, in the event of representative organisations, the level of representation.

It is important to read the specific privacy statement on how your personal data and contribution will be dealt with on the consultation website.

In line with the specific privacy statement of this open public consultation, respondents should be aware that **contributions received will be published on the website of DG TAXUD** together with the identity of the contributor **unless the contributor objects to the publication of his personal data** on the grounds that such publication would harm his or her legitimate interests. In this case the contribution may be published in anonymous form. If the contributor refuses his contribution to be published that contribution will not be taken into account.

The results will be summarised in a report to be published on the same website. Feedback would also be presented in the impact assessment report and explanatory memorandum relating to a Proposal for a Directive if the Commission decided to pursue this avenue.

## Annex – Complementary study: main economic consequences of different reform options

### 1. Quantitative results

Category	Full taxation		Refund system		Deletion of Article 13 while keeping exemptions in the public interest		Deletion of Article 13 while keeping exemptions in the public interest, <u>variant 1</u>			Deletion of Article 13 while keeping exemptions in the public interest, <u>variant 2</u>		
	Variant 1	Variant 2	Variant 1	Variant 2	Variant 1	Variant 2	Only broadcasting taxed	Only postal sector taxed	Only waste disposal taxed	Only broadcasting taxed	Only postal sector taxed	Only waste disposal taxed
Change in GDP pct.-points (billion Euro)	0.34 (37.77)	0.32 (35.35)	0.02 (2.04)	0.02 (1.98)	0.01 (1.29)	0.01 (0.81)	0.00 (0.29)	0.01 (0.89)	0.00 (0.09)	0.00 (0.08)	0.01 (0.67)	0.00 (0.05)
Change in public sector employment, pct. Points (Thousand persons)	-1.14 (493.1)	-1.02 (422.2)	-0.58 (250.9)	-0.58 (249.8)	-0.17 (74.3)	-0.17 (74.9)	-0.03 (14.3)	-0.12 (53.4)	-0.02 (6.6)	-0.03 (11.6)	-0.13 (57.7)	-0.01 (5.8)
VAT rate calibration of revenue balance (billion Euro) *	-10.44 (80.38)	-6.60 (50.82)	17,80 (-134)	17,40 (- 132)	-0.49 (3.77)	0.04 (-0.31)	-0.11 (0.85)	-0.33 (2.54)	-0.05 (0.38)	0.06 (-0.46)	-0.02 (0.15)	0.00 (0.00)

\*This row shows the percentage by which the current VAT rates could be adapted in order to keep the revenues on the current level and (in brackets) the possible revenue effects of each option in billion Euro if the VAT rates would not be changed.



## 2. Qualitative Results

Category	Full taxation	Refund system	Deletion of Article 13 of the VAT Directive while keeping exemptions in the public interest
Distortion of competition	No distortion of competition	Distortions on output side	Distortions of competition both on input and output side
Barriers to market entry	No	Barriers to entry in supportive market (back office services) will be reduced	No
Level and structure of investment	Investment from public sector will be discouraged while private sector investment goes up	Investment and outsourcing are encouraged	Investment from private sector encouraged while public sector investment discouraged
Level and structure of employment	Shift from public sector to private sector	Shift from public sector to private sector	Shift from public sector to private sector
Efficiency in public service	More efficiency	More efficiency	More efficiency
Impact on tax revenues	Positive impact as taxes are levied on non-taxable /exempt public sector output	Loss. The loss is due to refunding input VAT to private entities and charities	Positive impact as taxes are levied on non-taxable /exempt public sector output
Welfare gains	Positive	Positive	Positive
Consumer prices	Go up as first round effect because taxes are added to public output	May go down as public production is carried out more efficiently and thereby cheaper	No to small increase in consumer price

Category	Full taxation	Refund system	Deletion of Article 13 of the VAT Directive while keeping exemptions in the public interest
Tax compliance cost	Low	Low (to medium)	Low
Impact on charities	Substantial increase in VAT paid by charities, if charities render their service against consideration	Positive as the VAT expenditure of charities will be eliminated	No impact
Risk of circumvention	Significant	No	Significant
Impact on SMEs	Positive as distortion of competition between public and private sector is removed	Positive as public sector's self-supply supportive activities will be reduced	Smaller positive impact as the supply bias of public sector will not be removed completely