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Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 2006/112/EEC with regard to certain temporary provisions  
concerning rates of value added tax**

{SEC(2007) 910}

(presented by the Commission)

## EXPLANATORY MEMORANDUM

### 1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

In its Communication to the Council and the European Parliament on VAT rates other than VAT standard rates<sup>1</sup>, the Commission has launched a broad debate on the use of reduced rates in order to identify a sustainable way forward which could be acceptable by all Member States and provide a step forward for the EU. This Communication reports on the main results of the study carried out for the Commission by Copenhagen Economics<sup>2</sup>. The study mainly examined the impact of reduced VAT rates and of derogations in this field, not only for locally supplied services, but also more globally, notably in terms of economic growth, employment and the functioning of the internal market. The effects on income distribution, the informal economy and on compliance costs for businesses were also taken into consideration

Considerable time will be needed in order to identify the suitable way forward. In the meantime, it is important to avoid that some Member States would be obliged to modify the VAT rates currently applicable on their territory, before clear lines have been agreed by the Council on the use of rates other than the standard rate.

- **General context**

The study conducted by Copenhagen Economics concludes that a single VAT rate is by far the best policy choice from a purely economic point of view. A move towards more uniform rates has thus considerable advantages. However, there may be specific benefits from operating with reduced VAT in carefully targeted sectors.

In its Communication, the Commission points out that although reduced rates, as they divert from the standard rate, appear to create distortions from an economic perspective and may affect fiscal neutrality, in reality they are applied to a greater or lesser degree in all but one Member State.

This is done not only on the basis of general provisions which apply to all Member States, but also on the basis of different temporary derogations granted to particular Member States. These exceptions derogate either from the level of the rate fixed by the rules (zero rates, super reduced rates of less than 5%), or they concern supplies which should be taxed at the standard rate (as the intermediary rates, the so-called parking rates set at a minimum of 12 %) or they can derogate to both. Whereas the derogations granted during the last enlargement have precise deadlines, the earlier ones are allowed until the entry into force of the "definitive system" for intra-Community transactions<sup>3</sup>. As the definitive system has never been adopted - and will not be adopted in the foreseeable future - these transitional arrangements stay in force, until a new unanimous decision of the Council. In the case of the Member States which joined the

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<sup>1</sup> COM(2007)380 final

<sup>2</sup> Copenhagen Economics ApS, Nyropsgade 13/1, DK-1602 Copenhagen

<sup>3</sup> Directive 2006/112/EC of 28.11.2006. OJ L 347 of 11.12.2006, p.1. See Title VIII, chapter 4 (special provisions applying until the adoption of definitive arrangements) and chapter 5 (temporary provisions).

EU after the 1st January 1995 the temporary derogations resulting from the accession negotiations apply for a more limited period of time, i.e. in many cases till the end of 2007.

## ASSESSMENT BY THE COMMISSION

Some derogations are covered by the general provisions on reduced rates or may be covered by the outcome of the political debate on the scope and level of the reduced rates. However, the Council will need time to reach a global agreement: there is practically no realistic prospect that this could be reached before end 2007. This means that some Member States would see their derogations expire whilst others would continue to benefit from them. This difference in treatment provides unequal opportunities to Member States without any substantial justification and, due to this unfair character, would certainly create unacceptable tensions.

In the light of these considerations, most of the derogations coming to an end soon should be temporarily prolonged until the end of 2010, i.e. the expiry of the minimum of 15% for the standard rate and of the experiment on the application of reduced VAT rates to certain labour-intensive services.

Derogations cannot, however, be prolonged where they conflict with a smooth functioning of the internal market and/or with other Community policies (e.g. derogations regarding coal, coke, fuel, oil) or where they already are covered by general provisions on rates (e.g. district heating). On the other hand, for the sectors bound to be at the core of the discussions in the Council, such as the restaurants or the housing sector, or the question concerning the continuation of a zero rate for food and pharmaceuticals, derogations could be prolonged. This selective extension aims at avoiding that Member States currently applying derogations would have to modify the level of their rates this year and then be allowed to come back to their present rates. This would allow the European institutions till the end of 2010 to develop further a coherent approach in the field of VAT rates.

- **Existing provisions in the area of the proposal**

The exercise involves the implementation of Article 123 to 130 of Directive 2006/112/EC.

- **Consistency with the other policies and objectives of the Union**

The current proposal is fully in line with established EU VAT policy as well as other policies and objectives of the EU.

This proposal aims at a prolongation, for practical reasons, of some derogations coming to an end as from 31.12.2007, for practical reasons: to give enough time to the Council to decide on the future scope and level of reduced rates. It is part of this global exercise which will have to be in line with the main policies and objectives of the Union, in particular those relating to the Lisbon strategy. On the basis of a study carried out by an independent economic think-tank which had to assess the impact of reduced rates on locally-supplied services, notably in terms of job creation, economic growth and the proper functioning of the internal market, this exercise aims at bringing consistency in the field of reduced VAT rates.

Moreover, the proposal at issue does not prolong derogations that conflict with the proper functioning of the internal market and/or with other Community policies (e.g. derogations regarding agricultural input, or, coal, fuel, etc. that are contrary to energy and environmental objectives).

## **2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT**

- **Consultation of interested parties**

Not relevant.

- **Collection and use of expertise**

There was no need for additional external expertise. The study conducted by Copenhagen economics on the reduced rates is a sufficient basis.

- **Impact assessment**

This proposal for a Directive only prolongs the current situation for a limited period of time.

The study conducted by Copenhagen economics on the reduced rates provides sufficient elements for the impact assessment.

## **3) LEGAL ELEMENTS OF THE PROPOSAL**

- **Summary of the proposed action**

To prolong until 31/12/2010, on selective basis, the derogations granted in the field of VAT rates to the Member States which joined the EU after the 1st January 1995.

- **Legal basis**

Article 93 of the Treaty.

- **Subsidiarity principle**

The subsidiarity principle applies insofar as the proposal does not fall under the exclusive competence of the Community. The objectives of the proposal cannot be sufficiently achieved by the Member States for the following reasons.

The Community has already laid down harmonised provisions on the application of VAT reduced rates, namely in Council Directive 2006/112/EC. These provisions may only be amended or extended by a Community act and the legislations of the Member States cannot deviate from the harmonised rules.

For the reasons outlined above, only Community action can achieve the objectives of the proposal and ensure equal treatment of citizens in the European Union. The proposal therefore complies with the subsidiarity principle.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reasons.

The Directive authorises some Member States to continue to derogate to the normal rules in the field of VAT rates. It therefore imposes no obligation.

Given the limited scope and duration of the prolongation, the measure is proportionate to the aim pursued. The directive involves no financial cost to the Community. Although reduced rates of VAT may involve a reduction in revenue for States, they place no financial burden on economic operators, and consumers should, in principle, benefit from the continued reduction in rates, in so far as this will be reflected in final prices.

- **Choice of instruments**

Proposed instruments: directive.

Other means would not be adequate for the following reason(s).

This Proposal extends the period of application of derogations already enacted in a Directive.

#### 4) **BUDGETARY IMPLICATION**

The proposal has no implication for the Community budget.

#### 5) **ADDITIONAL INFORMATION**

- **Review/revision/sunset clause**

The proposal includes a sunset clause.

- **Detailed explanation of the proposal**

Ad Article 1

Derogations which already are covered by general provisions on rates are not prolonged: this concerns derogations on natural gas, electricity and district heating (Article 102) and firewood (Article 122) granted to CZ and EE.

Derogations which conflict with other Community policies are not prolonged: this concerns derogations regarding coal, coke, fuel and oil granted to EE.

Derogations which conflict with the smooth functioning of the internal market are not prolonged: this concerns the derogation concerning a super reduced rate for agricultural inputs granted to PL. It should be noted that the reduced rate permitted under Annex 3 can be applied to such supplies.

Derogations to which the Member States concerned have already renounced are not prolonged, as they are obsolete. This concerns HU and SK.

Derogations concerning the following points are prolonged:

- Reduced rates in sectors bound to be at the core of the discussions in the Council, such as the restaurants or the housing sector. This concerns CZ, CY, PL and SI.
- Zero rate or super reduced rates for food, books and pharmaceuticals. This concerns CY, MT and PL.

Articles 2, 3 and 4: final provisions.

Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 2006/112/EEC with regard to certain temporary provisions concerning rates of value added tax**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission<sup>4</sup>,

Having regard to the opinion of the European Parliament<sup>5</sup>,

Having regard to the opinion of the European Economic and Social Committee<sup>6</sup>,

Whereas:

- (1) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax<sup>7</sup>, provides for certain derogations in the field of VAT rates. Some of these derogations expire at a precise date, while others last until the adoption of the definitive arrangements.
- (2) In order to ensure more equality of treatment among Member States, derogations that do not conflict with a smooth functioning of the internal market and with other Community policies should be prolonged until the end of 2010, date of the expiry of the minimum of 15% for the standard rate and of the experiment on the application of a reduced rate to labour intensive services. By contrast, certain derogations should not be prolonged.
- (3) The derogations granted to the Czech Republic and Estonia for the supply of natural gas, electricity and district heating should not be prolonged because they are already covered by general provisions on reduced rates)
- (4) The derogation granted to Estonia for the supply of coal, fuel and oil should not be prolonged because it conflicts with other Community policies.

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<sup>4</sup> OJ C , , p. .

<sup>5</sup> OJ C , , p. .

<sup>6</sup> OJ C , , p. .

<sup>7</sup> OJ L 347, 11.12.2006, p.1. Directive as amended by Directive 2006/138/EC (OJ L 384, 29.12.2006, p.92).

- (5) The derogation allowing Poland to apply a super reduced rate to the supply of goods and services of a kind normally intended for use in agricultural production should not be prolonged because it conflicts with the smooth functioning of the internal market.
- (6) The derogations granted to Hungary and Slovakia should not be prolonged because those Member States have not applied or no longer apply a reduced rate.
- (7) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

#### *Article 1*

Directive 2006/112/EC is hereby amended as follows:

- (1) Article 123 is replaced by the following:

'Article 123

The Czech Republic may, from 1 January 2008 until 31 December 2010, continue to apply a reduced rate of not less than 5 % to the supply of construction work for residential housing not provided as part of a social policy, excluding building materials.'

- (2) Article 124 is deleted.
- (3) In paragraphs 1 and 2 of Article 125, "until 31 December 2007" is replaced by "from 1 January 2008 until 31 December 2010".
- (4) Article 126 is deleted.
- (5) In Article 127, "1 January 2010" is replaced by "31 December 2010".
- (6) Article 128 is replaced by the following:

'Article 128

1. Poland may, from 1 January 2008 until 31 December 2010 grant an exemption with deductibility of VAT paid at the preceding stage in respect of the supply of certain books and specialist periodicals.

2. Poland may, from 1 January 2008 until 31 December 2010 or until the introduction of definitive arrangements, as referred to in Article 402, whichever is the earlier, continue to apply a reduced rate of not less than 7 % to the supply of restaurant services.

3. Poland may, from 1 January 2008 until 31 December 2010, continue to apply a reduced rate of not less than 3 % to the supply of foodstuffs as referred to in point (1) of Annex III.

4. Poland may, from 1 January 2008 until 31 December 2010, continue to apply a reduced rate of not less than 7 % to the supply of services, not provided as part of a



social policy, for construction, renovation and alteration of housing, excluding building materials, and to the supply before first occupation of residential buildings or parts of residential buildings, as referred to in point (a) of Article 12(1).'

- (7) In paragraphs 1 and 2 of Article 129, "until 31 December 2007" is replaced by "from 1 January 2008 until 31 December 2010".
- (8) Article 130 is deleted.

## *Article 2*

### *Transposition*

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by ... at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

## *Article 3*

This Directive shall enter into force on the twentieth day following that of its publication.

## *Article 4*

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council*  
*The President*