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Inflation Concerns Hit European VAT Increases

Friday, 05 September 2008

The latest TMF EU VAT Tracker highlights the impact of the credit crunch and increasing inflationary worries on plans for VAT rate increases. In a bid to stay competitive for global business investment, EU states have been looking in recent years to shift the burden of tax from business-related taxes (e.g. corporate and labour taxes) to consumption taxes, such as VAT. The most dramatic example of this was Germany's 2007 3% VAT increase to 19%.

However, the recent financial market turmoil and re-emergence of international inflationary pressures have put the brakes on this strategy. TMF's EU VAT Tracker, which plots the average GNP-weighted VAT rate across the European Union, highlights this change.

2007 showed an increase from 18.6 % to 19.2% in the Tracker. Going into 2008, intense debate around increases in France, Greece and others, following Germany's move, indicated that the Tracker would make a further leap to 19.9% by the end of 2008.

However, the fears of adding to inflationary pressure with such rises appear to have now reduced this likelihood. Portugal introduced a sudden 1% cut in June. Last month, the Netherlands retreated from plans to increase its standard VAT rate from 19% to 20% in January 2009 due to worries about the impact of such a rise on the economy. This means the Tracker 2008 forecast has now leveled out at 19.2%.

"It seems amazing how quickly this situation has turned around. Just six months ago it was an article of faith amongst government officials and business tax leaders that EU VAT rates were on the increase. Indirect tax increases, as part of the tax burden shift, were seen as a vital tool to regain lost economic competitiveness from emerging economies. With the reappearance of inflation this year, this route is been closed off for the foreseeable future. - Richard Asquith, head of TMF's Global VAT Network, said

It is not just the EU hit by this – the issue is global. Other countries, such as Japan, have backed off from potential VAT increases. The UAE has now also cooled on its enthusiasm to launch a Goods & Services Tax regime (similar to VAT) in 2009."