

News Analysis: Crisis VAT Increases Sweep Europe; Is U.K. Next?

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COUNTRY DIGEST

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In a stark warning to all countries facing mounting debt, Croatia, Estonia, Latvia, and Lithuania are all imposing further VAT increases to help shore up their faltering finances. They join countries such as Ireland and Hungary that have been forced into recent crisis VAT increases, and a number of Western countries seem certain to follow. This includes the U.K., which may be looking at a 20 percent VAT within the next two years.

Globally, more and more countries are turning toward VAT to solve their fiscal problems, most notably the U.S., where President Barack Obama's healthcare reform may be the spur to push through VAT implementation.

Failed Strategies

Estonia, Latvia, and Lithuania had all undertaken extensive reforms in their financial systems, including the introduction of various flat rate tax systems under which income tax, corporate tax, and VAT rates were simplified at similar levels, with limited tax bands. VAT was set at 18 percent in all three countries on their succession to the European Union. Coming on the back of hugely expansionary economic policies, these advanced fiscal systems were widely praised as the way forward for countries seeking to attract foreign investment. However, the global economic meltdown seems certain to derail this strategy.

Faced with spiraling government debt and currency markets actively speculating on debt defaults, a number of countries have been forced into VAT increases. Leading the charge at the end of 2008 were Latvia and Lithuania, which raised their standard VAT rates by 3 percent and 2 percent, respectively. But it has become clear that those increases will not be sufficient. The parliaments of both countries have approved further increases, bringing rates as high as 23 percent. This will take both countries perilously close to the 25 percent EU VAT limit. (For prior coverage of the VAT increases in Latvia and Lithuania, see *Doc 2009-13207* or *2009 WTD 111-3*; and *Doc 2009-17947* or *2009 WTD 151-2*, respectively.)

Estonia last year resisted an increase but was forced into an emergency 2 percent increase on July 1 as its economic picture worsened. Croatia's snap 1 percent increase that took effect August 1 came after hard pressure from the IMF and financial markets. (For prior coverage of the VAT increases in Estonia and Croatia, see *Tax Notes Int'l*, June 22, 2009, p. 1015, *Doc 2009-15719*, or *2009 WTD 131-7*; and *Tax Notes Int'l*, Aug. 10, 2009, p. 425, *Doc 2009-17367*, or *2009 WTD 146-6*, respectively.)

A Warning for All of Europe

The Baltics will not be the last European country to face VAT increases. Ireland, another country suffering from a burst property bubble, increased its VAT by half a percentage point to 21.5 percent in late 2008. Hungary, whose population is saddled with euro mortgages that are becoming unworkable with the sinking forint, increased its VAT rate by a dramatic 5 percentage points to 25 percent on July 1. (For prior coverage of the Irish and Hungarian VAT increases, see *Doc 2008-26649* or *2008 WTD 245-1*; and *Tax Notes Int'l*, May 18, 2009, p. 568, *Doc 2009-10680*, or *2009 WTD 89-10*, respectively.)

While Poland has denied rumors of a planned VAT increase, German Chancellor Angela Merkel, facing a critical slowdown in Germany's much admired manufacturing export regime, has had to quash proposals from within her government to raise the VAT, although the upcoming elections may have influenced some lawmakers.

U.K. Creeps Toward VAT Increase

In the U.K., Conservative Party members are denying reports in *The Sunday Telegraph* that lawmakers are considering a plan to increase the VAT rate to 20 percent to slow skyrocketing government debt, which is expected to hit £120 billion in the next few years. But because it was the Conservative Party that introduced VAT into the U.K. and then increased it in the midst of a recession in the 1980s and again in the 1990s, that may be an implausible denial. ◆

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