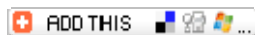


Analysis & Commentary: VAT - More Or Less

TLP

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It emerged this week that it was Germany's turn to be the spanner in the works of EU consensus, when its government derailed proposals for lower rates of VAT to be imposed on 'labour intensive' services.

Such proposals have been thrown around for several years now, but in July of this year, amendments were proposed to the VAT Directive, to allow member states the flexibility to impose lower rates on sectors including restaurant services, some types of repair, cleaning and maintenance services, domestic and personal care, and gardening, to name but a few. Locally supplied services would also benefit from lower VAT rates under the proposals, which were introduced as part of the planned Small Business Act.

The issue was really first brought to a head with the 2004 accession of the Czech Republic, Poland, Cyprus, Malta and Slovenia, all of which had lower VAT rates on certain types of services in place when they joined the EU, and, under a decision made in December 2007, have been permitted to retain the lower rates until 2010.

Commenting in July 2008 on the plans – strongly supported by French President Nicolas Sarkozy, in addition to the 'new' (well, 'old new' at least...) EU member states – László Kovács, Commissioner for Taxation and Customs Union explained that:

"I propose generalising the optional application of reduced rates in sectors where there is sufficient evidence that no real distortions to the Internal Market will occur. I want to provide certainty about the application of reduced rates beyond 2010 for labour intensive sectors and provide all Member States with the same options."

He went on to argue (but seemingly not compellingly enough) that: "There is no reason why restaurant services, for example, should be allowed to benefit from a reduced rate in one half of the European Union but not in the other half."

Speaking this weekend, following the failure by European finance ministers to reach agreement on the issue, German Finance Minister Peer Steinbrueck revealed that Germany was "downright sceptical" about the merits of the plan, and believed that it would have little beneficial impact for consumers, arguing that whether the reduced rates would be passed on to consumers was "completely open".

Those in favour of cutting VAT in certain areas, such as President Sarkozy, leader of a notably restaurant-dense country, argue that such a move could help to boost consumption, thereby providing a much needed shot in the arm to ailing economies.

Arguments against such cuts include that put forward by Steinbrueck at the weekend, when he expressed Germany's fear of what reduced VAT rates "would lead to," arguing that governments

which chose not to lower VAT rates would soon be under pressure to do so to match those rates in neighboring countries.

Austria and Denmark expressed reservations too, clearly also fearing the lower tax revenues which could result from such cuts, and the knock-on effect for their finances. Indeed, some have argued that VAT rates actually need to be increased, in order to shift the burden of tax from corporate and labour taxes to consumption taxes. An EU VAT Tracker recently released by VAT compliance service provider, TMF stressed the desirability of such a course of action, but bemoaned the fact that the credit crunch appears to have stalled its progress.

Commenting on the results revealed by the tracker, Richard Asquith, head of TMF's Global VAT Network, observed that:

"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."

He added: "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."

Despite the failure of the ECOFIN meeting to agree a way forward on VAT at the weekend, however, French Finance Minister, Christine Lagarde warned Steinbrueck and the other dissenters that the issue would be revisited in October, stating darkly that: "We are not burying anything at all."

With the French heading the EU until the end of the year, perhaps we can look forward to the issue being revisited in November as well. And December.