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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.7.2008  
COM(2008) 428 final

2008/0143 (CNS)

Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 2006/112/EC as regards reduced rates of value added tax**

(presented by the Commission)

{SEC(2008) 2190}

{SEC(2008) 2191}

## EXPLANATORY MEMORANDUM

### **1. CONTEXT OF THE PROPOSAL**

#### **1.1. Grounds for and objectives of the proposal**

Based on the study on reduced VAT applied to goods and services in the Member States of the European Union presented by Copenhagen Economics (hereafter "the CE study"), the Commission on 5 July 2007 adopted a Communication on VAT rates other than standard VAT rates (COM(2007) 380) (hereafter "the 2007 Communication"), which explores ways forward in the field of reduced VAT rates, as the starting point of a broad political debate in the other EU Institutions and with all stakeholders. All relevant views collected on this issue will serve to initiate a sustainable and well balanced proposal in the medium term on the future scope of VAT reduced rates.

In parallel with this on-going debate, the Commission hereby tables a limited legislative proposal amending the provisions of Directive 2006/112/EC of 28.11.2006 (hereafter "the VAT Directive") relating to urgent issues, which do not require any substantial additional study other than that referred to in its Communication and detailed in the Commission staff working document (SEC(2007) 910). This proposal should be regarded as a first action concerning reduced VAT rates.

The Commission's objective is to ensure equal opportunities for Member States as well as more transparency, consistency and a smooth functioning of the internal market as regards reduced VAT rates for locally supplied services including labour-intensive services and restaurant services. Some technical adaptations are also included in this proposal.

#### **1.2. General context**

The 2007 Communication builds on the need for simplification, the proper functioning of the internal market, the reduction of compliance costs and for coherence. Against this background, the debate on an in-depth revision of the scope of reduced VAT rates at EU level has only started including a debate in the Council on the efficiency and effectiveness of reduced rates for boosting specific policy objectives. Therefore, further time is still needed in order to gather all the elements to be taken into account as well as the input by the other EU institutions and stakeholders. Only on this basis will it be possible to identify a suitable and sustainable way forward.

Similarly, the appropriateness of allowing the application of a reduced rate to energy saving materials and to other environmentally beneficial products or services (notably energy saving and energy efficiency related services such as inspections, energy audits and energy performance certifications) is currently being examined by the Commission in accordance with the request formulated by the European Council in March 2008. The Commission will present the results of its analysis, accompanied by relevant proposals and recommendations in the autumn together with proposals to

address the appropriateness of eliminating reduced rates for environmentally prejudicial products such as pesticides.

A more in depth review of the whole structure of VAT reduced rates will be carried out subsequently.

In the meantime, the Commission considers it is important to tackle the most urgent issues. These are legal and political problems which have arisen either because of divergent interpretations of the directive or because of a lack of a level playing field for all Member States as regards the possibility for Member States to apply reduced rates in those areas where the proper functioning of the internal market is not affected. In particular, on the basis of the analysis made in the CE study, the Commission considers that there is room to grant more autonomy and certainty to the Member States in setting reduced rates for certain local services in line with the efforts to improve the business environment for SMEs, which is one of the priority action areas under the Lisbon strategy for growth and jobs, and in particular the Small Business Act.

Therefore, this proposal essentially covers the main temporary provisions expiring at the end of 2010 concerning local services for which the CE study provides sufficient material for an impact assessment. It thus proposes permanent, updated provisions on the labour-intensive services listed in Annex IV of the VAT Directive which expire on 31 December 2010. It also proposes the addition of certain other locally supplied services, including restaurant services, to the current Annex III of the VAT Directive (list of the goods and services eligible for a reduced rate). The technical adaptations included in this proposal concern either legal drafting improvements, clarifications, updating to take account of technical progress or removal of current inconsistencies.

### **1.3. Assessment by the Commission**

The CE study concludes that moving towards a more uniform VAT rates structure has considerable advantages from a purely economic point of view. Carefully targeted reduced VAT rates may, nevertheless, provide specific benefits, in particular in terms of economic growth: they can induce consumers to shift activities from DIY (do it yourself) and the "underground" economy to the formal economy. Moreover, when applied to locally supplied services, they are of no concern for the functioning of the internal market. There are also arguments to introduce reduced VAT rates in sectors employing many low-skilled workers in order to permanently create jobs for such workers.

On this basis, the Commission concludes that there are good reasons to include local services in the list of goods and services eligible for a reduced VAT rate. It thus proposes to include in Annex III all the categories of Annex IV, which by virtue of Article 107 are local and not likely to cause distortion of competition, and to extend the scope of reduced VAT rates to some other services which are local because of their basic characteristics. The place of supply rules ensure their taxation at the place of consumption, they cannot be supplied from a remote location, they are largely directed to the local market of final consumers and the supplier and customer are located in a geographically limited area. . The proposed changes to the Directive will also make it possible for Member States to apply reduced VAT rates to renovation and repair work aiming at increased energy-saving and efficiency.

#### **1.4. Existing provisions in the area of the proposal**

The exercise involves changes to Title VIII (Rates) of the VAT Directive.

#### **1.5. 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. In particular it aims at ensuring the proper functioning of the Internal Market. This proposal also forms part of the Small business Act adopted on 25 June 2008. Although it is not aimed exclusively at SMEs, it will have a positive effect for them, since the sectors at issue include many SMEs and the proposal will give legal certainty on the continued application of VAT reduced rates in these sectors.

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

#### **2.1. Consultation of interested parties**

A public consultation of all interested parties was launched. Public and businesses were mainly targeted but some national authorities also responded.

In general, the consultation did not reveal arguments which are not already covered by or which are relevant for the purposes of the impact assessment. Moreover, there were almost no relevant data assessing the positive or negative effects of reducing VAT rates for the various sectors for which a reduced rate is claimed. The majority of replies support the Commission's analysis in its consultation paper and the addition to Annex III of locally supplied services, including the labour-intensive services currently covered by Annex IV, restaurants, housing and some potential technical adaptations. They also largely support the 2 step approach envisaged by the Commission, consisting in dealing quickly with the urgent issues, and to continue the broad debate launched in 2007 on a more global and sustainable solution for the future concerning the scope of VAT reduced rates. A detailed summary report of the results of the public consultation will be published as soon as possible.

This consultation was conducted over the internet from 11/03/2008 to 12/05/2008. The Commission received more than 550 responses. The results will be available on [http://ec.europa.eu/taxation\\_customs/common/consultations/tax/article\\_4850\\_en.htm](http://ec.europa.eu/taxation_customs/common/consultations/tax/article_4850_en.htm)

#### **2.2. 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.

#### **2.3. Impact assessment**

This proposal is a priority initiative in the 2008 Commission Legislative and Work Programme. The need to present a proposal relating to urgent issues called for a proportionate impact assessment strictly focusing on these issues. The problems identified with the current rules mainly relate to political and legal constraints and the policy options set out in the impact assessment reflect this situation.

The following policy options were assessed from an economic, social and environmental perspective:

- (1) No policy change.
- (2) The current provisions including the option for Member States to apply reduced rates to certain labour-intensive services (listed in Annex IV) is made permanent and available for all of them.
- (3) The list of these labour-intensive services eligible for reduced rates is extended to a number of other similar (small) locally supplied services for private households only.
- (4) The list of these labour-intensive services is extended to a number of similar (small) services for some other non-commercial customers, such as repair, maintenance and cleaning of places of worship, cultural heritage and historical monuments
- (5) Member States have the option to apply reduced rates to restaurant services.
- (6) Member States can also apply reduced rates to the construction and (significant) alteration of private dwellings and to the supply thereof.
- (7) Member States can also apply reduced rates to the construction and significant renovation and alteration of some non-commercial buildings (such as places of worship, cultural heritage and historical monuments) and to the supply thereof.

The impact assessment report (SEC(2008) 2190) and its executive summary (SEC(2008) 2191) is accessible on the website of DG Taxation and Customs Union. In summary and without taking account of the budgetary impacts on Member States, which are for them to assess in the first place, overall preference goes to including options 2, 3, 5 and 6 in the proposal.

The Commission carried out an impact assessment listed in the Work Programme, whose report will be accessible on [http://ec.europa.eu/taxation\\_customs/taxation/vat/key\\_documents/legislation\\_proposed/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/key_documents/legislation_proposed/index_en.htm).

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

#### **3.1. Summary of the proposed action**

By amending the current Annex III of the VAT Directive, this proposal provides for a general possibility for all Member States to apply reduced VAT rates to certain locally supplied services, including labour-intensive services and restaurant services. Some technical adaptations are also included in this proposal.

### **3.2. Legal basis**

Article 93 of the Treaty.

### **3.3. 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 the VAT Directive. 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.

### **3.4. Proportionality principle**

The Proposal complies with the proportionality principle for the following reasons:

The present Proposal extends the scope of reduced rates to some new categories. It maintains the current option for Member States to apply reduced VAT rates. It therefore imposes no obligation.

Given its limited scope, 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.

### **3.5. Choice of instruments**

Proposed instrument: Directive.

Other means would not be adequate for the following reason:

This Proposal modifies provisions concerning reduced VAT rates already enacted in a Directive.

## **4. BUDGETARY IMPLICATION**

The proposal has no implication for the Community budget.

## **5. ADDITIONAL INFORMATION**

### **5.1. Correlation table**

The Member States are required to communicate to the Commission the text of national provisions transposing the Directive as well as a correlation table between those provisions and this Directive.

### **5.2. Review/revision/sunset clause**

The proposal does not include a sunset clause.

### **5.3. Detailed explanation of the proposal**

Consistent with the positive conclusions of the CE study on the usefulness in applying reduced rates to locally supplied services where such measures are very well targeted and specific market conditions are fulfilled, the Commission proposes to permanently incorporate locally supplied services including labour-intensive services, restaurant and services related to the housing sector and some other immovable properties into Annex III. Some other legal improvements are also included.

#### **Ad Article 1:**

- (1) Article 101: since the Commission has already presented an assessment report as requested, this provision is obsolete and it is therefore deleted.
- (2) Article 102(1): improvement to the wording of this provision is made in order to take into account technological evolution and adapt to the terminology used in other EU legislation.
- (3) Chapter 3 of Title VIII (Articles 106 to 108) (labour-intensive services): The provisions set out in this Chapter concern the experimental temporary measure (until end of 2010) of the application of reduced rates on labour-intensive services. These provisions will become obsolete once these are permanently incorporated into Annex III (new categories 10a and 21 to 23). This Chapter is therefore deleted.
- (4) to (11) Article 114(1), second subparagraph, Articles 115, 116, 117(1), 123, 125(2), 128(2) and (4) and 129(1) and (2): Given the incorporation of restaurant services and housing in Annex III (categories 10 and 10a for the housing and category 12a for restaurant services), they no longer need to be included in the derogations provided for in these provisions.
- (12) Annex III: This Annex has been revised to integrate locally supplied services including the labour-intensive services set out in Annex IV and restaurant services for which the 2007 Communication concludes that there is no potential detriment to the smooth functioning of the internal market. Some adaptations have also been made mainly in the interests of rationalisation and simplification through the necessary corrections and clarifications as well as some technical drafting improvements. The amendments made are as follows :

- Technical drafting adaptations:
  - Category 3 (pharmaceutical products): Precise and slightly enlarge that category in order to clearly cover both feminine sanitary protection and children's nappies by using a generic wording.
  - Category 4 (equipment for the disabled): Updating to technical progress. Current category 4 covers only medical equipment, aids and other appliances normally intended to alleviate or treat disability. The concept of disability is broad enough to encompass serious or chronic illness as well. However, equipment or apparatus specially designed or adapted for the disabled (e.g., Braille keyboards, specially adapted cars, etc.) are not eligible for the reduced rate even though they reply to the same needs. The Commission therefore proposes including them in category 4.
  - Category 6 (books, etc.): The current wording covers only books on paper support. For reason of neutrality, an extension is necessary in order to also cover books that are on CD, CD-ROMs or any similar physical medium that predominantly reproduce the same information content as printed books. Thus, only recordings that fundamentally reproduce the written text in a book are covered. A recording that includes supplementary material such as games, search functions, links to other material and similar, apart from the text read aloud, continues to be subject to the normal VAT rate.
  - Category 8 (reception of radio and television broadcasting services): these services are taxable supplies, not the reception thereof: these words have consequently been deleted.
  - Category 9 (supply of services by writers, etc.): As royalties are not services for VAT purposes, but the consideration for certain services, the text has been rephrased.
  - Category 16 (supply of services by undertakers, etc.): In order to separate the object of the definition of the reduced rate from the quality of the supplier it is proposed to link it to the kind of service provided and to rather refer to funeral undertaking services.
  - Category 18 (street cleaning, waste treatment, etc.): The scope of this category is too narrowly defined with the result that services of a very similar nature are treated differently as regards rates. For instance, whereas street cleaning and household refuse collection are eligible for the reduced rate, there is no reference to sewer services. Likewise, the reduced rate may apply to waste treatment, but not to recycling. It is proposed to remove these inconsistencies. The reference to the bodies in Article 13 has been eliminated as it is redundant to restate what is already regulated in that provision.
- Extension of an existing category

- Category 10 is modified and Category 10a is added to cover more broadly the housing sector. This amendment consists of a rationalisation and extension of Member States' option to apply reduced rates in the housing sector by removing the limitation to housing "provided as part of a social policy" and adding repair, maintenance and cleaning of housing (currently categories 2 and 3 of Annex IV). This possibility of applying a reduced VAT rate is also extended to services carried out on places of worship recognised by the Member State concerned and on cultural heritage and historical monuments, given their genuine cultural importance. These changes are unlikely to create distortion of competition to the internal market: the place of taxation of services relating to immovable property is always at the place where the property is located. All providers of property-related services are therefore subject to the same conditions as regards rates regardless of the Member State in which they are established.
  
- New categories
  - Category 12a (restaurant and catering services): This addition is made to offer an equal treatment to all Member States but also because the supply of restaurant and catering services fulfil the same criteria as the other locally supplied services added. To assure consistency with category 1 concerning foodstuffs, the supply of alcoholic beverages is, however, excluded. As derogation to the principle "a single rate for a single transaction" that should apply in case of restaurant services, the exclusion of these beverages seems expedient to avoid a standard VAT rate applied to alcoholic beverages bought as such and a reduced VAT rate applied when they make up part of a restaurant service. The nature of the services concerned and the rules applicable to the place of taxation mean that the risk of relocation is minimal. Moreover, accommodation in hotels and similar establishments is already included in Annex III. The addition of restaurant and catering services can therefore be considered to be a justified rationalisation and provides equal opportunities to all Member States.
  
  - Categories 19 to 23 (locally supplied services): The insertion of services other than labour-intensive services but of similar nature is necessary for reasons of coherence and equal treatment. To ensure legal certainty it is, however, appropriate to list the services concerned.
  
- (13) Annex IV (labour-intensive services): With the deletion of Chapter 3 of Title VIII (Articles 106 to 108), this Annex also needs to be deleted. The substance of its provisions is now covered by Annex III.

**Ad Articles 2 to 4:**

- Articles 2, 3 and 4: These are final provisions.

Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 2006/112/EC as regards reduced 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>1</sup>,

Having regard to the opinion of the European Parliament<sup>2</sup>,

Having regard to the opinion of the European Economic and Social Committee<sup>3</sup>,

Whereas:

- (1) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax<sup>4</sup> authorises Member States to apply one or two reduced rates which may not be lower than 5% and are applicable only to a restrictive list of supplies of goods and services.
- (2) In its Communication on VAT rates other than standard VAT rates<sup>5</sup> presented to the Council and the European Parliament in 2007, the Commission considered that a new legal framework for reduced value added tax (VAT) rates should lead to the rationalization and simplification of the present system, without prejudice to the possibility for more flexibility to be given to Member States to adopt reduced rates, in particular to locally supplied services. In response to this Communication, a broad debate was launched in the Council, the European Parliament and with other stakeholders.
- (3) While this debate is yet to be concluded, there is a need to already address some urgent and important issues in order to ensure equal opportunities for Member States as well as more transparency, consistency and a smooth functioning of the internal market. To avoid prejudging the outcome of the ongoing debate, the action taken should however be limited in scope.

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<sup>1</sup> OJ C , , p. .

<sup>2</sup> OJ C , , p. .

<sup>3</sup> OJ C , , p. .

<sup>4</sup> OJ L 347, 11.12.2006, p. 1. Directive last amended by Directive 2008/8/EC (OJ L 44, 20.2.2008, p. 11).

<sup>5</sup> COM(2007) 380 final of 5 July 2007

- (4) In that Communication, it was concluded that different VAT rates applied to locally supplied services pose no real detriment to the smooth functioning of the internal market. It is therefore appropriate to allow all Member States the possibility to apply reduced VAT rates to services such as labour-intensive services covered by the temporary provisions applicable until the end of 2010, services related to the housing sector and to the personal care and restaurant services. These changes will make it possible for Member States to apply reduced VAT rates to renovation and repair work aiming at increased energy-saving and efficiency.
- (5) As a general principle, a single rate is applied for a single transaction. Since alcoholic beverages are already excluded from the category of foodstuffs, allowing reduced VAT rates for alcoholic beverages under the coverage of restaurant and catering services would create inconsistencies and would offer possibilities of circumvention. It is therefore appropriate to exclude such beverages from that category.
- (6) It is necessary to include technical adaptations in order to clarify, update to technical progress or remove current inconsistencies. In particular, these adaptations should give the same possibility to apply a reduced VAT rate to all absorbent hygiene products (including baby nappies) and to audio books, CD's, CD-ROMs or any physical support that predominantly reproduce the same information content as printed books.
- (7) Certain provisions related to derogations have been included in the list of supplies of goods and services to which a reduced rate may be applied and are now obsolete. They should therefore be deleted.
- (8) Directive 2006/112/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

#### *Article 1*

Directive 2006/112/EC is amended as follows:

- (1) Article 101 is deleted;
- (2) in Article 102, the first paragraph is replaced by the following:

"Member States may apply a reduced rate to the supply of natural gas, electricity and heat or cooling supplied through heating or cooling networks, provided that no risk of distortion of competition thereby arises.";
- (3) Chapter 3 of Title VIII is deleted;
- (4) in Article 114(1), the second subparagraph is replaced by the following:

"The Member States referred to in the first subparagraph may also apply such a rate to children's clothing and children's footwear.";
- (5) Article 115 is replaced by the following:

*"Article 115*

Member States which, at 1 January 1991, were applying a reduced rate to children's clothing or children's footwear may continue to apply such a rate to the supply of those goods or services.";

- (6) Article 116 is deleted;
- (7) in Article 117, paragraph 1 is deleted;
- (8) Article 123 is deleted;
- (9) in Article 125, paragraph 2 is deleted;
- (10) in Article 128, paragraphs 2, 3 and 4 are deleted;
- (11) Article 129 is deleted;
- (12) Annex III is amended in accordance with the Annex to this Directive;
- (13) Annex IV is deleted.

*Article 2*

Member States shall forthwith communicate to the Commission the text of the laws, regulations and administrative provisions they adopt in the field covered by this Directive 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.

*Article 3*

This Directive shall enter into force on the 1 January 2011.

*Article 4*

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council  
The President*

## ANNEX

Annex III to Directive 2006/112/EC is amended as follows:

- (1) Points (3) and (4) are replaced by the following:
  - "(3) pharmaceutical products of a kind normally used for health care, prevention of illnesses and as treatment for medical and veterinary purposes, including products used for contraception and absorbent hygiene products;
  - (4) medical equipment, aids and other appliances normally intended to alleviate or treat disability, for the exclusive personal benefit of the disabled, and apparatus and electrical, electronic or other equipment and means of transport, specially designed or adapted for the disabled as well as the leasing or hiring and the repair of such goods;"
- (2) The following point (4a) is inserted:

"(4a) children's car seats;"
- (3) Point (6) is replaced by the following:

"(6) supply, including on loan by libraries, of books (including brochures, leaflets and similar printed matter, children's picture, drawing or colouring books, music printed or in manuscript form, maps and hydrographic or similar charts, as well as audio books, CD, CD-ROMs or any similar physical support that predominantly reproduce the same information content as printed books), newspapers and periodicals, other than material wholly or predominantly devoted to advertising;"
- (4) Points (8), (9) and (10) are replaced by the following:
  - "(8) radio and television broadcasting services;
  - (9) supply of services by writers, composers and performing artists, including those remunerated by means of the royalties due to them;
  - (10) supply and construction of housing;"
- (5) The following point (10a) is inserted:

"(10a) supply of services consisting in the renovation, repair, alteration, maintenance and cleaning of housing and of places of worship and of cultural heritage and historical monuments recognised by the Member State concerned;"
- (6) The following point (12a) is inserted:

"(12a) supply of restaurant and catering services excluding the supply of alcoholic beverages;"
- (7) Points (16), (17) and (18) are replaced by the following:

- "(16) supply of funeral undertaking services or cremation services, and the supply of goods related thereto;
- (17) supply of medical and dental care and thermal treatment in so far as those services are not exempt pursuant to points (b) to (e) of Article 132(1);
- (18) supply of services provided in connection with street cleaning, purification and recycling of waste water, sewage, refuse collection and waste treatment, or waste recycling and services leading to reuse;"
- (8) The following points (19) to (23) are added:
- "(19) supply of gardening or landscaping services and maintenance of gardens;
- (20) minor repair of movable tangible property including bicycles and tricycles of all types but excluding all other means of transport;
- (21) cleaning and maintenance services of movable tangible property;
- (22) supply of domestic care services, such as home help and care of the young, elderly, sick or disabled;
- (23) personal care of the kind provided in hairdressing salons and personal grooming establishments."