



Local & Regional
Europe

VAT and tax exemptions on public bodies

“No taxation without representation”

CEMR draft response to the European Commission consultation on the review of existing VAT legislation on public bodies and tax exemptions in the public interest

April 2014

CEMR Key Messages

1. **Current VAT rules** that are in place regarding the public sector, including articles 13 and 132-134 of the VAT directive 2006/112 EC **are in general working quite well**.
2. We want to emphasise that the **diversity of the tax regimes reflects the diversity of the EU Member States** with important historic, political and economic specificities of the countries. Those specificities and their reasons of existence should not be ignored, nor should the Commission try to propose a harmonised model.
3. **National VAT arrangements (eg. exemptions at source or refund systems)** that are already in place in many Member States have proven to be beneficial and working well. These systems must remain at the discretion of each Member State to decide whether to employ or not.
4. The European Commission has not provided evidence regarding the distortion of competition, and we believe that she should concentrate on real cases of intra-Member States competition. **Further clarification concerning the criteria of the distortion of competition is necessary**, in particular in cases, in which public authorities do not execute their services on their own but in cooperation with each other or other public entities (e.g. intercommunal cooperation).
5. **We oppose the full taxation model** as proposed by the Commission, and in general, services of general interest should not be forced under VAT.
6. The abolition of article 13 and the modernisation of article 132 are in our opinion **not necessary**, as both of these function well. We would be in favour of keeping article 13 as the exemption from VAT duties for public bodies in article 13 is much broader.
7. It is **too early to discuss a sectorial reform**; we question the selection of the sectors proposed by the Commission. SGEIs should be excluded from sectorial reforms. In any case, a sectorial reform should not lead to liberalisation of SGEIs.
8. The option to tax, **if left up to Member States to decide** is also a feasible option, but should be studied further to foresee possible outcomes of the model.
9. We would like to remind the European Commission that the initial objectives of this VAT reform have been the prevention of fiscal fraud and tax evasion.
10. Any reflection about changes of the VAT system should **involve representatives from local and regional government**, since they are seriously affected by any change or modification.

Introduction and General Comments

1. The Council of European Municipalities and Regions (CEMR) is the European umbrella organisation and largest association of local and regional governments in Europe. Its members are over 50 national associations of towns, municipalities and regions from 41 countries. Together, these associations represent some 150,000 local and regional authorities in Europe.
2. For many years, CEMR has been advocating that the European Union legislation should fully respect the principle of local and regional self-government as it is explicitly recognised in the Lisbon Treaty (Art. 4 TEU) and the protocol on services of general interest as well as the principles of subsidiarity and proportionality (art. 5 TEU) and the related protocol.
3. In the past years, we have the impression that the Commission has been rather overly market-focused without really trying to understand the specificities of local and regional authorities and the conditions how they organise their services.
4. The current system for the VAT treatment of public bodies can be complex, but that complexity is justified by the special and unique role of public bodies in delivering services in the public interest. They are – unlike private sector providers – funded largely through taxation and democratically accountable to the taxpaying electorate.
5. We would strongly urge the Commission in any proposed change to the VAT system to consider the fundamental objective of ensuring that VAT does not impose a burden on genuine public interest activities. We believe that the ability of public service providers to recover VAT incurred should be a question more fundamental to the consultation than perceived output-side distortions where private sector operators provide similar services.
6. We do not question the concept of the internal market and the need for an EU taxation system to facilitate cross-border transactions in the internal market, and we understand the European Commission's role as guardian of the application of the EU Treaties and legislation. However, we want to highlight that the Commission's role is to avoid distortion of competition between the Member States, not within the Member States. That remains a task of the central government and administration.
7. Most local government activities are eminently local and therefore do not obviously distort intra-EU trade. We wish to recall that the European Commission in its 2008 consultation on the "review of existing legislation on VAT reduced rates" expressed the view that locally supplied services are by their very nature largely provided directly to final consumers and therefore unlikely to distort competition in the internal market.
8. It may be necessary to state that local and regional authorities have the task to provide basic services to their citizens and that they try to organise them in the way they consider being the best, taking into considerations all relevant elements in their particular circumstances. It is not their main objective to distort competition, but to spend public money in a way that it would be to the benefit of their citizens.
9. Very often local authorities supply services in areas where the private sector is not interested as it is not viable in an economic sense. This is in particular the case in remote local communities where services provided by local authorities are necessary for the survival and wellbeing of those areas and their citizens. Full VAT taxation would increase the costs for citizens, the civil society and non-profit organisations.
10. We question the argument of a 'potential' EU trade impact and miss sufficient empirical proof that would illustrate the lack of cross-border transactions being the result of

a non-harmonized VAT system across the EU. CEMR considers impact assessments on only a limited number of countries not to be a substantial basis for changes as addressed in the consultation document.

11. Any proposed change being eventually put forward by the Commission needs to provide detailed proof that an EU wide regulation would be able to effectively address such intra-EU trade distortions.
12. We recall that in its Communication “A Budget for Europe 2020”, the European Commission had proposed “a new own resource system based on a financial transaction tax and a new VAT resource”. With their decision on the Multi-Annual Framework (2014-2020), the Member States did not follow this direction.
13. CEMR is concerned that the Commission is in favour of shifting the taxation system from labour to VAT, and we believe that given the diversity of taxation systems in the EU, this is a major political issue that needs an in-depth debate.
14. VAT recovery is a relevant source of income for local and regional authorities; changes in the current recovery schemes would have a knock on effect on the domestic taxation arrangements in the Member States and would require changes in existing territorial equalisation systems. These are sensitive issues considering the political and fiscal upheaval it would create, clearly outweighing any theoretical gain aimed at by the Commission.
15. We call on the Commission to include the public sector, and in particular local and regional government, in any impact assessment or pre-legislative consultation exercise as well as in future stakeholder dialogue meetings regarding VAT legislation in order to make more balanced judgements.
16. We have noted that there presently exists an **unbalanced over-representation of industry and the private sector** in the various working structures of stakeholder dialogue regarding VAT questions. Out of 26 appointed members of the VAT expert group to the European Commission, none of these organisations represent local and regional government¹. There were also no representatives from local and regional government out of the 15 speakers and panellists during the 2013 Tax Forum².

¹http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/expert_group/veg-members2013.pdf

²http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/conferences/taxforum2013/list_speakers.pdf

Survey questions

Q 1: General evaluation of the current rules

- We consider that the current rules regarding the VAT regime as regards the public sector, providing the rules are properly applied and enforced, are in general working well. The specific rules for public bodies, article 13, have been well established and are functioning properly. We can say the same concerning articles 132-134 of the VAT directive.
- Keeping articles 132-134 of the VAT directive are of great importance to local government, keeping services such as social, health care, and educational services free from VAT rules. As these are considered to be services in the public interest, it is vital not to increase costs for citizens, as the imposition of VAT would do in this case.
- Whilst the Commission claims that a lack of harmonisation and complexity poses a problem for a properly functioning VAT regime, we see this diversity as a natural effect of a diversified Union of Member States. This diversity has not been proven thus far to cause any undesired effects vis-à-vis cross-border transactions and a properly functioning internal market.
- VAT considerations directly affect cooperation between public bodies that want to share services, whether through municipal companies or inter-municipal cooperations. According to protocol 26 of the Lisbon Treaty, Member States have a wide discretion on how they provide, commission and organise services of general economic interest. We believe that the European VAT taxation should not favour any changes in the fundamental structures of the Member States. This could be the case if the common provision of services through inter-municipal cooperation becomes subject of VAT when self-provision is VAT-exempt.

Q 2: Distortion of competition clause:

- The European Commission has not provided evidence of complaints regarding the distortion of competition. Without any evidence it makes it very hard to understand the reasoning behind the argument.
- Further clarification concerning the criteria of the distortion of competition is also necessary in cases, in which public authorities do not execute their services on their own but in cooperation with each other or other public entities (e.g. intercommunal cooperation). Due to demographic change and the need to reduce public costs, public authorities cooperate in areas that lay within their competences. These forms of public cooperation have to be exempted from VAT rules and cannot be treated any different than cases where the authorities fulfil their duties on their own.
- We must reiterate the necessity of maintaining Article 13 in force, and that any future reforms must be in the general interest of public authorities, allowing them to provide genuine public interest activities without taxing VAT.
- Furthermore, we consider the assumption – applied by the European Commission and the CJEU - that there might be a private competitor providing the public service, a theoretical threat, which should not be the basis for EU legislation.

- CEMR believes that the Commission should concentrate on real cases of intra-Member States competition.
- Furthermore, we have seen that the distortion of competition clause pursuant to the second subparagraph of Article 13(1) of the VAT Directive and existing case law from the Court of Justice of the European Union is a universal problem, affecting public as well as private actors attempting to resolve distortion of competition disputes. Current examples of problems that arise within the clause can be taken from Sweden's current road-parking dispute, where both public and private actors find themselves not knowing who to consult when a distortion of competition takes place.
- The problem could perhaps be resolved through an eventual applicability annex, where it is prescribed how to correctly proceed when there is a suspicion of distortion of competition taking place.
- Any change that will be introduced should not be applied in retrospective, but only as of the entry into force of the new provision.

Q 3: Reform measures

- We **oppose** the **full taxation** model as presented in **option 1**. We find it of great importance to keep services of general public interest such as social, health, education, and certain cultural services, free from taxation. A full taxation model would only increase costs for citizens without solving any issues of neutrality.
- We are **not in favour of a Europe-wide refund scheme** as proposed in **option 2**. Every Member State has its own unique complex taxation model. We have found that national VAT arrangements, such as refund-schemes or exemption at source, are methods to deal with VAT in the public sector and work quite well in the different countries.
- Countries such as Austria, Denmark, Finland, France, the Netherlands, Portugal, Scotland, Sweden, and the United Kingdom, and also Iceland all have implemented successful national VAT refund-schemes. However, the refund system can create problems in some states (e.g. Germany) because of the financial distribution among different public levels: the national, regional and local level. Therefore we believe that the diversity of the systems needs to be respected and that the Commission should not pursue a 'one-size fits all' solution.
- In accordance with the current framework, in which the European Commission has no competence with regard to national measures of financial compensation, the decision to foresee such a system has to remain a discretionary competence of the individual Member State.
- The competences of the Commission are restricted to matters regarding intra-EU cases where distortion of competition might take place and not the distortion of competition within the national markets of the respective Member States.
- Due to demographic change and the need to reduce public costs, public authorities cooperate in areas that lay within their competences. These forms of public cooperation have to be exempted from VAT rules and cannot be treated any different than cases where the authorities fulfil their duties on their own.

- The abolition of article 13 and the modernisation of article 132 that is proposed in **option 3** are in our opinion **not necessary**, as both of these function well. We would be in favour of keeping article 13. The only viable solution would be the integration of both articles into one, making sure that all elements contained in article 13 would be present in article 132.
- We consider **Option 4** with a sectorial reform to be **premature**; we question the selection of the sectors proposed by Copenhagen Economics. Furthermore, SGEIs should be excluded from sectorial reforms, and in any case, a sectorial reform should not lead to liberalisation of SGEIs.
- **The option for selective amendments of current rules**, whilst similar to options 3 and 4, **seem overly complicated** and would cause an already complex issue more difficult to comprehend.
- In conclusion, we have seen through vast experience that the national VAT arrangements, such as refund-schemes or exemption at source, not only protect public authorities from paying unnecessary tax but this scenario also ensures public authority neutrality when deciding on the provider of goods and services. Whatever future reforms may lie in store, **we find it of the greatest importance that national VAT arrangements remain a core principle in VAT legislation when dealing with local and regional authorities.**

Q 4: Sectorial reform

- CEMR considers a sectorial reform to be premature; in particular we don't agree with the suggested sectors, provided by Copenhagen Economics and we question the basis on which these sectors have been selected.
- In suggesting sectors, the Commission should distinguish between SGEIs and non-SGEIs. For example, waste management and sewage are mandatory tasks to be provided by local or regional authorities and exempted from VAT in some Member States. As stated above, local and regional self-government (art. 4 TEU) and the discretion of the Member States how they organise their services of general interest must be respected by the European Commission (protocol 26 of the TFEU). A modification of the VAT directive cannot overrule these provisions of the Treaties.
- However, the question of public or private provision of public services should not be an issue of VAT taxation. This is a political decision to be taken.
- Therefore, SGEIs should be excluded from sectorial reforms, and in any case, a sectorial reform should not lead to liberalisation of SGEIs.
- As mentioned above, there are different national VAT arrangements and in many cases Member States already enforce VAT neutrality through an option to tax within certain sectors mentioned, applying equal treatment to public and private actors. This eliminates any doubt regarding a possible distortion of competition, and does therefore not cause problems.
- We therefore believe that it is too early to discuss a sectorial reform and call on the Commission to provide an in-depth assessment of sectorial reforms. Such an assessment should examine in particular large sectors with a substantial impact on the

internal market and evaluate how these reforms would influence the quality of public services.

Q 5: Option to tax

- We feel that an option to tax **is a viable option** when considering public authorities acting in sectors that are usually not tax-exempt, and vice versa for the private sector. This would in turn eliminate neutrality and allow for competition to take place.
- The option to tax should, however remain under the disposition of Member States to decide whether this is appropriate or not, and should allow for flexibility.
- It is important to note that the VAT system would become more complex with an option to tax system. This needs to be taken into consideration.
- Finally, the CEMR would like to see if the option to tax could prove to be a sustainable and viable option by further studying the matter before reaching any conclusions on whether this method is an appropriate course of action or not.

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About CEMR

The Council of European Municipalities and Regions (CEMR) is the broadest organisation of local and regional authorities in Europe. Its members are over 50 national associations of municipalities and regions from 41 European countries. Together these associations represent some 150 000 local and regional authorities.

CEMR's objectives are twofold: to influence European legislation on behalf of local and regional authorities and to provide a platform for exchange between its member associations and their elected officials and experts.

Moreover, CEMR is the European section of United Cities and Local Governments (UCLG), the worldwide organisation of local government.

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