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SECRÉTARIAT GÉNÉRAL

Direction A – Greffe

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**REGULATORY SCRUTINY BOARD OPINION**

**Proposal for a Council Directive amending Directive 2006/112/EC  
as regards rates of value added tax**

{COM(2018) 20}  
{SWD(2018) 7}  
{SWD(2018) 8}



Brussels,  
Ares(2017)

## Opinion

**Title: Impact Assessment /Reform of VAT rates**

**Overall 2<sup>nd</sup> opinion: POSITIVE WITH RESERVATIONS**

### (A) Context

The Commission adopted on 7 April 2016 an Action Plan on VAT. It set out ways to modernise the VAT system to make it simpler, more fraud-proof and business-friendly. This proposal to modernise the VAT rates policy is one of the main follow-up initiatives. Other initiatives include:

- a definitive VAT system for intra-EU cross-border trade based on the principle of taxation in the Member State of destination;
- a comprehensive simplification of VAT for SMEs; and
- a proposal to enhance VAT administrative cooperation between the Member States.

In line with the European Council conclusions of 17-18 March 2016, this impact assessment considers ways to update the rules on VAT rates to give more flexibility to Member States in setting rates. It is closely linked with a proposal to put in place a definitive VAT system, based on the principle of taxation in the country of destination.

### (B) Main considerations

**The Board acknowledges improvements and clarifications made in the resubmitted impact assessment report.**

**However, the report still contains serious shortcomings that need to be addressed. As a result, the Board expresses strong reservations and gives a positive opinion only on the understanding that the report shall be comprehensively adjusted in order to integrate the Board's recommendations on the following key aspects:**

- (1) It is not clear on what grounds the report states that “the Commission policy course is now firmly oriented towards the pursuit of flexibility in setting VAT rates, rather than harmonisation”. This seems inconsistent with the views of most stakeholders and the conclusions of the ECOFIN Council.**

- (2) It is not clear why the only way to ensure equality of treatment of Member States is by extending on a permanent basis all derogations. It actually prejudices the preferred option.**
- (3) The report downplays other important specific objectives, such as minimizing complexity and costs – notably for businesses as requested by the Council – or protecting VAT revenues from erosion.**
- (4) The definition of the baseline has been modified in the resubmitted report and is now confusing.**
- (5) The report does not consider sub-options within the two polar options of extending all derogations to all versus introducing a minimal negative list to which the standard rate applies.**
- (6) The comparison of the options does not adequately take into account the risks associated to complexity, legal uncertainty and litigations, business costs and tax erosion. It does not provide a sufficient basis for a preferred option.**

### **(C) Further considerations and adjustment requirements**

(1) The report needs to clarify whether and on what grounds it can assert that “the Commission’s policy course is now firmly oriented towards the pursuit of flexibility in setting VAT rates rather than harmonisation”. It should explain how this is consistent with the 25/05/2016 ECOFIN conclusions (welcoming increased flexibility only on existing reduced and zero rates), the 09/11/2016 ECOFIN conclusions (considering that “further harmonisation in the area of VAT relating to cross-border transactions is needed and should be continued to be carried out”), the 24/11/2016 EP Resolution (considering that “a simple system for VAT which demands fewer exemptions is necessary”) and the majority view of all stakeholders (in favour of maintaining the simplicity of the VAT system and limit rate differences, even if this limits the room for manoeuvre of Member States).

(2) The baseline should be revised to include the introduction of the definitive VAT system, based on the destination principle. It cannot be argued that the proposal on VAT rates is not conditional upon the adoption on the definitive VAT system, while justifying at the same time the case for further rate flexibility by the establishment of the definitive regime based on the destination principle. As a “no-policy-change” scenario, the baseline could also include the continuation of the 15% minimum for the standard rate and the temporary extension of all existing derogations (especially if this is deemed necessary for the adoption of the proposal on the definitive VAT system).

(3) The report has to align the specific objectives with the Council conclusions and make them more balanced across flexibility for Member States, equal treatment, preservation of the single market, avoiding distortions to competition, avoiding rise in business costs and preserving a sufficient degree of harmonisation. Extending the effect of derogations on a permanent (rather than on a temporary) basis and for all (instead for only those Member States requesting it) has to be properly motivated rather than considered as an objective in itself.

(4) The report should better justify the use of Art 113 TFEU as a legal basis for the measures envisaged under the proposed options.

(5) The envisaged options continue to be based on a “lowest common denominator” perspective, with no effort to design other (sub-)options. Such an approach should be reconsidered especially since the report concludes that the proposed options are not acceptable to Member States anyway. The report must include and assess more (sub-)options regarding, for example, the number of reduced rates (for instance, limiting them to three, as envisaged in the VAT rates study) and/or the type of safeguards (for instance, keeping an average 5% minimum rate, envisaging different formulations of the budgetary safeguard or extending derogations only when necessary and on a temporary basis). Option 2 defines the negative list based on a minimalist approach. It does not consolidate current practice like for derogations under option 1. Therefore the report has to consider possible extensions of the negative list as sub-options to option 2.

(6) The report should elaborate on the risk analysis. Most of the potential negative impacts on the single market (distortions of competition, increased complexity and business costs, legal uncertainty and litigations) , or on budget revenues depend on the potential actions Member State are likely to take once they have more freedom to set VAT rates. The report should present a more thorough risk analysis, assessing in a systematic way the likelihood of the identified risks and the proposed risk mitigating measures. The comparison of the options should better reflect these dimensions. The report should be comprehensive on costs and refer to the administrative costs of setting up the web portal to support the implementation of options.

(7) In order to facilitate sound decision-making by the political level, the different options should be more rigorously and transparently assessed. In case of a preferred option, the choice should also clearly distinguish and weigh out aspects related to its technical pertinence, its political feasibility and its respect of the integrity of the VAT system.

**(D) RSB scrutiny process**

**The lead DG shall ensure that the report is adjusted in accordance with the recommendations of the Board prior to launching the interservice consultation.**

Full title	Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax
Reference number	2017/TAXUD/007
Date of RSB meeting	18/10/2017



EUROPEAN COMMISSION  
Regulatory Scrutiny Board

Brussels,  
Ares(2017)

## Opinion

**Title: Impact Assessment on the Reform of VAT rates**

**Overall opinion: NEGATIVE**

### (A) Context

The Commission adopted on 7 April 2016 an Action Plan on VAT. It set out ways to modernise the VAT system to make it simpler, more fraud-proof and business-friendly. This proposal to modernise the VAT rates policy is one of the main follow-up initiatives. Other initiatives include:

- a definitive VAT system for intra-EU cross-border trade based on the principle of taxation in the Member State of destination,
- a comprehensive simplification of VAT for SMEs, and
- a proposal to enhance VAT administrative cooperation between Member States.

In line with the European Council conclusions of 17-18 March 2016, this impact assessment considers ways to update the rules on VAT rates to give more flexibility to Member States in setting rates. It is closely linked with a proposal to put in place a definitive VAT system, based on the principle of taxation in the country of destination.

### (B) Main considerations

**The Board gives a negative opinion, because the report contains important shortcomings that need to be addressed particularly with respect to the following key aspects:**

- (1) The specific objectives of the initiative solely focus on granting more flexibility to Member States in setting VAT rates, while the Council, the Parliament and the majority of other stakeholders have stressed the importance of simplicity of the VAT system and the importance of avoiding negative impacts on competition and the functioning of the single market.**
- (2) A wider range of EU objectives (e.g. simplicity in the VAT rates system and limitation of business costs) would require consideration of a broader set of options. The options that have been discarded in the impact assessment process are not well documented in the report. The report does not fully spell out the preferred option and underestimates associated costs and implementation challenges of applying a common classification of goods and setting up a web portal on VAT rates.**

**(3) The comparison of options appears biased towards the preferred option by downplaying litigation risks and ignoring other risks such as the violation of the tax neutrality principle.**

**(4) Overall, the report does not show that the preferred option is the most cost-effective one and does not justify the choice of option against the views of the clear majority of stakeholders.**

### **(C) Further considerations and adjustment requirements**

(1) The context of the proposal, being part of a VAT package with several complementary initiatives, needs to be better explained. This includes the envisaged legal instruments, sequencing (the two-staged approach) and interrelations between different proposals. The report should specify which components of the other proposals announced in the VAT Action Plan are considered a part of the baseline (and therefore interrelated) and which could possibly be considered on a stand-alone basis. The report should make clear in particular whether the options on VAT rates would have to be reconsidered if the related proposal on the definitive VAT regime is not adopted or is significantly altered during the legislative process.

(2) The range of specific objectives should be reviewed to better reflect the VAT Action Plan and recommendations by the ECOFIN Council and the European Parliament. It should also consider the importance of the proper functioning of the single market, of avoiding a rise in business costs and ensuring the simplicity of the system. Since the first general objective is “*to achieve an optimal balance between rate harmonisation and Member States tax sovereignty*” (p. 21), the specific objectives should also reflect the harmonisation dimension, or at least a simplification objective. Otherwise, the report should explain why the Commission has decided to move away from the political mandate of the Council, which considers that “*further harmonisation in the area of VAT relating to cross-border transactions is needed and should be continued to be carried out*” (ECOFIN Conclusions of 9 November 2016); and of the Parliament, which considers that “*a simple system for VAT which demands fewer exemptions is necessary*” (EP Resolution of 24 November 2016).

(3) Including additional specific objectives would require a wider range of options or a better basis for discarding some of them. It would also entail a more balanced comparison of the options, as it would include simplification as one of the criteria. Adding simplification as an objective would also reflect the majority view expressed by stakeholders in the open public consultation, which reflects a clear preference for the simplicity of the VAT system and the limitation of rate differences, even if this limits the room of manoeuvre of Member States.

(4) The report should complement the analysis of impacts to make the comparison of options more robust:

- It should analyse in greater detail the risks linked to the potential increase in complexity of the VAT system and the emergence of single market distortions due to increased differences in VAT rates among Member States.
- The report should explain why options are not assessed with respect to the

principle of VAT neutrality.

- The report should explain why the assessment of the risk of litigations does not reflect the conclusions of the study.
- The impact of the options on the revenue erosion should be properly assessed. Given that option 2 leads to a decrease in the implicit tax rate from 19% to 17.6% and that option 3 envisages a minimum implicit tax rate of 12 to 13%, the potential revenue erosion should be much larger in option 3 than in option 2.
- The mitigating measures – the creation of a VAT web portal and the use of a common classification of goods – need to be clearly reflected and assessed against their feasibility, cost and effectiveness.
- The process for proposing a negative list of products exempt from the reduced rates as a precaution against the potential single market distortions should be compared against the identified problems related to agreeing on the contents, updates and respect for the current Annex III of the VAT Directive.

*Some more technical comments have been transmitted directly to the author DG.*

**(D) RSB scrutiny process**

**The lead DG shall ensure that the report is revised in accordance with the above-mentioned requirements and resubmitted to the Board for its final opinion.**

Full title	Proposal for a council Directive amending Directive 2006/112/EC as regards rates of value added tax
Reference number	2017/TAXUD/007
Date of RSB meeting	12/07/2017