

UK zero rates not under threat

Following certain press reports to the contrary, the head of the European Commission Representation in the UK has stated in a press release that the UK's zero rate of VAT (for items such as children's clothes and food) is not under threat as a result of the political debate launched by the Commission on ways to simplify current EU VAT legislation.

In a Communication adopted last week, the European Commission invited Member States and other stakeholders to submit their views on how best to simplify the VAT structures in the EU. The Commission believes that there is scope for more flexibility for Member States to apply VAT reduced rates to local supplies. However, this flexibility needs to be balanced to ensure the proper functioning of the Internal Market and to avoid disproportionate compliance costs for business.

The Commission acknowledges that reduced VAT rates are a politically sensitive issue and that most Member States consider the introduction of reduced rates as an important policy tool. However, it goes on to say that the subsidiarity principle has to be carefully balanced with the imperatives of a well functioning Internal Market and the need to ensure competitiveness of European business through a simple tax system. With these considerations in mind, the Commission considers that launching a broad debate in the Council, the European Parliament and the Economic and Social Committee to obtain all relevant views is essential before initiating a more far reaching proposal on reduced rates. The Commission considers this approach as the most effective way to develop a sustainable and well balanced proposal at the beginning of 2009.

Derogations for reduced rates granted to Member States which joined the EU before 1 January 1995 (such as the UK) are valid until the adoption of the definitive VAT system. However, many reduced rate derogations granted to the other Member States expire at the end of 2007 or in 2008. The Commission therefore proposes to extend until the end of 2010 these post 1995 derogations, providing they do not conflict with the smooth functioning of the Internal Market, with other Community policies or become obsolete. This planned prolongation aims at allowing time to design new common rules to apply after 2010.

The Communication issued by the EU detailing its intentions, is based on, and presents the results of, an economic study conducted by an independent 'think-tank', in addition to reflections on the possible way forward in the field of reduced rates. The main conclusion of the study is that from an economic perspective, a single uniform VAT rate (per Member State) would be the best policy choice. The study considers that this would slightly improve consumer welfare in comparison with the current situation; reduce distortions in the functioning of the Internal Market; and simplify the rules and thus reduce compliance costs for business. However, there may be specific economic benefits from operating a reduced rate in carefully targeted sectors. The study also stresses that other economic instruments (such as subsidies) might in some cases be more efficient than reduced VAT rates to achieve environmental, social, cultural and economic policies.

The study goes on to look at the potential social and economic impact of reduced VAT rates in sectors employing a large number of low skilled workers (such as restaurants and hotels); 'do-it yourself (DIY) activities and the diaper industry.

Depending on feed-back, in particular from the Council, the European Parliament and the Economic and Social Committee, the Commission hopes to be able to put forward legislative proposals by the end of 2008/early 2009. This would allow an adoption of the relevant legislative act by the Council, before the arrangements that currently allow Member States to apply reduced rates to certain labour-intensive services, expire at the end of 2010.

Initial press speculation had suggested that the debate launched by the Commission might signal the beginning of the end for the UK's zero rates. However, in the press release issued by the European Parliament, the head of the European Commission Representation in the UK, Reijo Kemppinen, is quoted as saying that there was never any threat to the reduced rates and that the aim of the exercise was to give more flexibility to Member States to apply lower rates (including zero rates), particularly for 'social purposes'.

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