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Summary report of the outcome of the public consultation on the

Review of existing VAT legislation on public bodies and tax exemptions in the public interest

(14 October 2013 – 25 April 2014)

MAIN RESULTS

The public consultation attracted considerable attention, with almost 600 contributions received from a wide range of stakeholders (public bodies, national associations, tax advisors, academics, trade unions, non-profits, business entities, etc.), even though, owing to the nature of the consultation, participation was highest among public bodies, most particularly from Germany and Austria.

The replies to question 1, which essentially asked respondents about their views on the functioning of current VAT rules regarding the public sector, clustered around two views, with one group (mainly composed of public bodies) assessing the current system as not requiring significant reform, and another one (including the majority of private business) characterising the current system as lacking neutrality and arguing for comprehensive reform. Respondents favouring reform identified output distortions as a serious problem and argued that public bodies are increasingly inclined to offer goods and services in direct competition to the private sector, whereas public sector bodies generally found the current distinction between taxed and non-taxed supplies appropriate and highlighted their links with their social purpose and the public interest. Respondents opposing fundamental reform disagreed that significant output-side distortions exist and argued that the differences in treatment between public and private operators were justified.

On input-side distortions many respondents with different background highlighted this as a fundamental problem. Respondents also highlighted problems regarding cooperation between bodies that are out of scope or tax exempt and complained about disproportionate compliance costs for small sales and the lack of harmonisation or complexity of current rules.

On reform measures, since the evaluation of the current situation was quite different, respondents also expressed a wide range of views on whether and which reform measures are necessary, ranging from fundamental reform to the status quo. Not surprisingly, those that assessed more negatively the current status quo were generally in favour of the more ambitious reform options and vice versa. However, even many contributors who generally support the status quo think that selective amendments are needed. The proposals, however, go in very different directions, aiming at an extension or a limitation of taxation. The consultation reports in detail about the responses given to a series of technical points on reform options.

1. BACKGROUNG

On 14 October 2013 the Directorate General Taxation and Customs Union launched a public consultation on its website on the 'review of the existing VAT legislation on public bodies and the tax exemptions in the public interest'[1].

1 http://ec.europa.eu/taxation_customs/common/consultations/tax/2013_vat_public_bodies_en.htm

According to the Commission's Communication on the future of VAT of 6 December 2012[2], the review and revision of the VAT rules for the public sector is one of the priority areas of the European Commission's work to create a simpler, more efficient and more robust VAT system in the EU. The Commission committed itself to promote a gradual approach towards taxation. A future legislative proposal 'would concentrate on activities with a greater degree of private sector involvement and a heightened risk of distorted competition'[3]. This is one of the measures mentioned in the Communication, which would lead to a more efficient VAT system by broadening the tax base.

The Council, in its May 2012 conclusions on the future of VAT concurred with the need to examine in further detail the present EU rules on the application of VAT in the public sector, in so far as there is competition between the public and private sectors.[4]

In preparation of an Impact Assessment on this issue, the Commission launched the Public Consultation to give all interested stakeholders a further opportunity to express their views.

The closing date for submitting replies to the Consultation was postponed from 14 February 2014 to 25 April 2014. A few replies arrived with a short delay; they were also accepted.

2. THE OUTCOME IN FIGURES

The participation in the public consultation was very high.

A total of **584** contributions were received, out of which 312 or *53%* are from public bodies, 110 or 19% from entities registered in the Transparency Register of Interest Representatives and 162 or *28%* from non-registered entities. Since public bodies were grouped separately the last two groups do not include public bodies.

Due to the subject of the consultation, the share of replies received from public bodies was very high (53%). However, it should be noted that the vast majority of contributions from this group were submitted by public bodies from Germany (ca. 60%) and Austria (ca. 29%). This depends on the fact that in these two Member States many public bodies, such as municipalities, rural districts etc., chose to contribute to the public consultation directly, rather than channelling the reply through the national associations representing public bodies, as was more often the case in other countries. A large number of these replies were similar or identical.

The second largest share of contributions was submissions from national associations, accounting for 158 (or 28%) of all submissions, followed by replies from European associations (28 or 5%). Business took part in the consultation through contributions from individual business entities (29 contributions from SMEs, large companies and multinational companies), and also through national or European associations representing business.

The contributors had different backgrounds and originated from a wide range of sectors. Apart from contributors who are not directly concerned by the VAT rules which were the

2 COM(2011)851 final
3 Point 5.2.1. of the Communication.
4 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130257.pdf

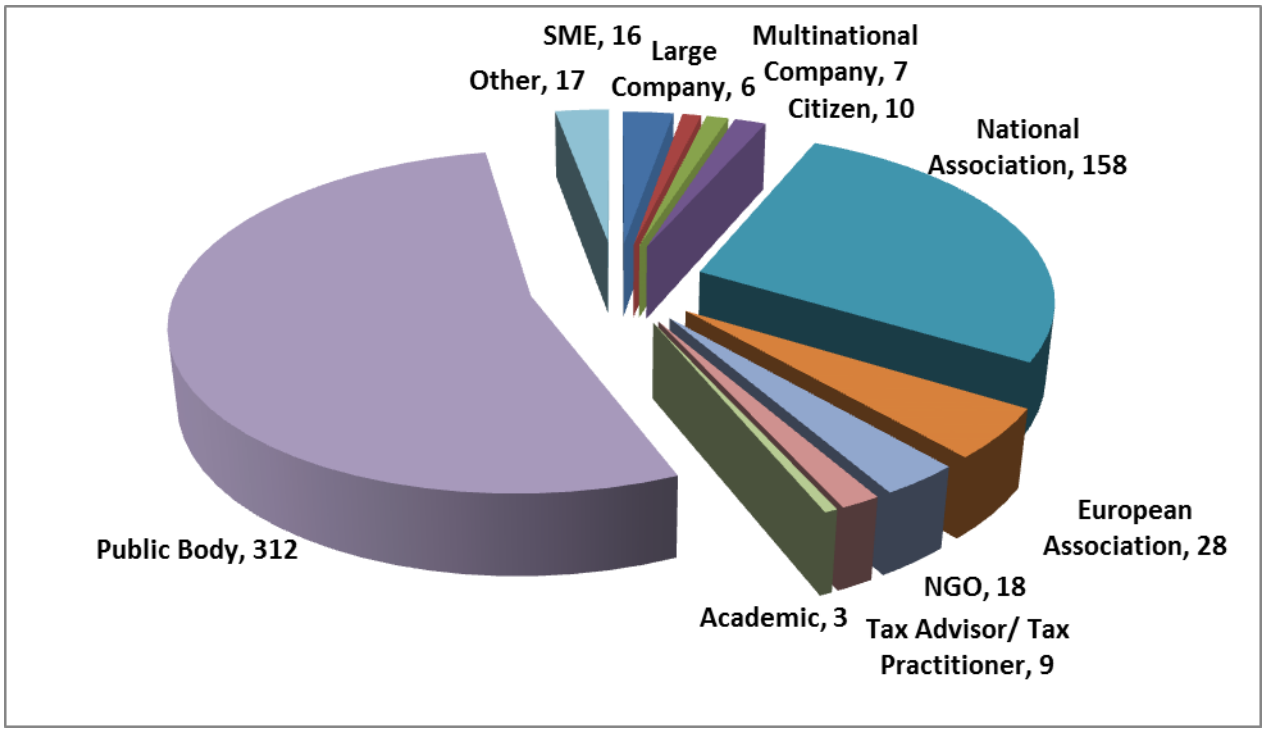
subject of the public consultation (such as tax advisors, academics, trade unions), a large group of respondents were entities carrying out activities that are either treated as tax exempt pursuant to Article 132 of the VAT Directive, or out of scope pursuant to Article 13 of the VAT Directive, or associations representing such entities. Most notable in this respect were, for instance, local authorities, social security institutions, non-profit organisations (NPOs), health care institutions, and entities which are active in the area of culture or education. In addition, there were many contributions from business entities carrying out similar or identical activities, but to which Articles 13 or 132 of the VAT Directive do not apply (e.g. businesses active in waste/sewage management).

The summary below only reflects the arguments as they have been put forward by the respondents. The Commission services have refrained in this summary from commenting upon or adding any counter-arguments.

The contributions contained a large variety of comments and proposals. This report focuses first of all on those comments and proposals which concern Articles 13 and 132 of the VAT Directive.

A complete overview of all replies per profile of the respondent is shown in Figure 1 below.

Figure 1: Replies by type of respondent

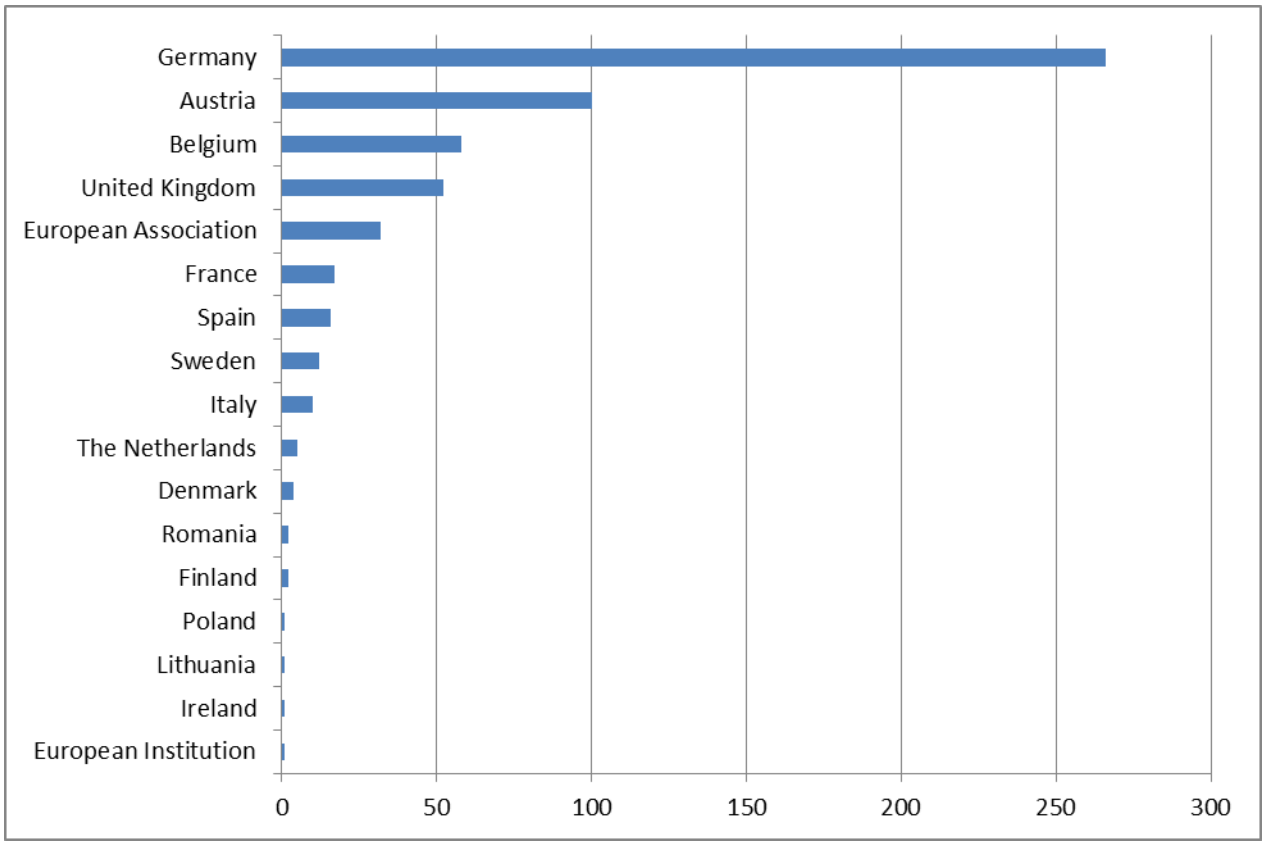


Source: Commission Services

550 out of the total number of 584 replies originated from 15 of the EU Member States. This number does not include European associations which were not attributed to a specific country even if the headquarter is in Brussels. The greatest number of submissions originated from Germany (266), followed by those from Austria (100), Belgium (59) and the United Kingdom (53).

An overview of the replies per country is given in Figure 2 below. Further details are given in the Annex to the document.

Figure 2 Replies by country of origin



Source: Commission Services

The Commission has published on its website all submissions, with the exception of those who specifically requested not to be disclosed. The contributions of respondents who did not agree to the publication of their personal data were published in anonymous form.

3. ANALYSISI OF THE REPLIES

3.1. Evaluation of the current rules

Question 1

- **What is your evaluation of the current VAT regime as regards the public sector (including special rules for public bodies, Article 13, and tax exemptions in the public interest, Article 132-134 of the VAT Directive)?**

- **What are in your opinion the main problems of the current rules?**

- **Are there any distortions of competition (output and input side)? If so, how and in which sector do they occur?**

- **Is the complexity of the current rules and the lack of harmonisation causing problems? Please give specific examples.**

- **What is their impact on compliance costs?**

- **Are the problems identified only of a national nature or do they constitute an obstacle to the smooth functioning of the Internal Market?**

- **If you are an entrepreneur how do the current rules affect your business?**

Question 1 asked respondents for their views on a wide range of different issues related to the functioning of the current VAT rules as regards the public sector. The replies have been varied, however, two main clusters of opinion emerged: one first group stressed that the current system, characterised by a special treatment of public bodies acting as public authorities (Article 13 of the VAT Directive) and tax exemptions for specific activities in the public interest (Article 132 of the VAT Directive) is sensible and its general structure does not need to be amended significantly. According to the other group, a comprehensive reform of the current system is needed and should be at least a long-term objective because the current rules are not appropriate and are characterised, for example, by a lack of neutrality.

3.1.1. General evaluation

Opinion 1: Current systematic is appropriate

The first group encompasses in particular those entities to which the special rules pursuant to Article 13 apply, treating them as out of scope, and/or which carry out tax-exempt activities pursuant to Article 132 of the VAT Directive, for instance public bodies (e.g. local authorities), social security institutions, NPOs etc. The vast majority of these entities indicated that they were against any reform according to which currently non-taxed activities would be taxed. In the view of many of these entities, the existing legal framework has proven its worth and is appropriate for ensuring an equal tax treatment of private and public bodies, where both operate under the same conditions.

These respondents stressed that the current rules are justified because the entities whose activities are covered by Article 132 and Article 13 of the VAT Directive pursue social objectives and serve a mission of general interest. The current rules are needed to keep the services in question (e.g. health care) affordable and accessible for citizens. This is especially important for socially disadvantaged persons. Since poorer households spend a greater proportion of their income on buying goods and services that are exempt from VAT than wealthier ones, poorer households would be disproportionately affected by an increase in the VAT liability.

Many contributors – including individual contributors from business – stressed the importance of NPOs complementing the work done by public authorities, e.g. in the area of education, culture or sports, and which play a key role as facilitators of social cohesion within EU societies. The current tax exemptions of which NPOs benefit are considered to be essential to their continued existence and to keeping the commitment in volunteer activities.

Individual business representatives stressed the positive function of the tax exemptions in the public interest in limiting the financial burden for social security institutions, and thus for those who have to contribute to the social security systems: employer and employee.

In the cultural domain, it was mentioned that there is rarely a situation of competition between public and private entities. Public and private bodies rather work alongside each other, and create a multiplication effect. A strong public sector would also result in a strong private sector.

However, many contributors who were generally in favour of keeping Articles 13 and 132 of the VAT Directive highlighted the negative cost impact from non-deductible VAT on investments related to non-taxed outputs, or on social sector entities which do not carry out supplies for a consideration at all.

A large number of respondents, in particular public bodies, stated that there are situations where the taxation of outputs is even excessive under the current regime, e.g. when it comes to cooperation between bodies whose activities are not taxed (see point 3.1.2.3.) or to small sales carried out by public bodies (see point 3.1.2.4.).

Opinion 2: A fundamental change of the current system would be preferable

On the other hand numerous contributors, including the majority of business representatives, regard that the current rules are outdated as they do not reflect changes in the conditions of competition between public and private operators. In this context it was mentioned that public bodies are increasingly active as economic operators (e.g. in relation to financial and insurance services, different forms of consultancy, recruitment services, career guidance etc.). Moreover, the private sector is now actively involved in sectors that used to be the privileged domain of public bodies (e.g. energy, public transport, waste management, healthcare, social care and education). Furthermore, several respondents noticed that public bodies and private companies are increasingly involved in public-private partnerships, a situation for which the current rules are regarded as not fit for purpose.

These respondents considered the current rules not to be neutral because they lead to significant distortions on the input and output side. Furthermore, rules are characterised by a lack of harmonisation, complexity and seen as imposing a great burden on tax administrations and taxable persons. In particular, Article 13 was considered a serious obstacle to the operation of a free and fair market, disadvantaging private service providers competing alongside public bodies in the same market and reducing economic efficiency and welfare.

These contributors asked for a more fundamental change of the current system, i.e. an extension of taxation with only a very limited use of exemptions. There should be at least a level playing field between different operators carrying out the same activity, which is currently not the case.

3.1.2. Distortions of competition

3.1.2.1. Output side distortions

Opinion 1: A major problem

According to the group of contributors who asked for a more fundamental change, distortions on the output-side are a major problem.

These contributors complained that there is a differentiated treatment of the performance of the same activity, depending on the public or private nature of operators. Where private

operators might be more competitive excluding the VAT aspect, they would often appear to be more expensive due to being subject to VAT. Private businesses suffer from a competitive tax disadvantage particularly when they compete with public institutions supplying the same type of goods and services to end-customers who do not have the right to deduct input VAT. This VAT treatment also penalises the recipients of public services, because the de facto exclusion of private companies from a certain market may result in inefficiencies and unnecessarily high charges for services.

It was reported by several respondents that public bodies are increasingly inclined to offer more goods and services in direct (and unfair) competition e.g. through intra-municipal entities or NPOs. Public bodies not taxed for the activities in question purportedly employ private-sector advertising methods and marketing techniques on an increasing scale to recruit new clients. Examples mentioned in this context are data centres or waste/sewage management services run jointly by different municipalities in the legal form of a separate public body, for instance a special purpose association. It was alleged that the activities of these bodies go beyond their original purpose with services being offered to customers other than their members, while benefiting from an out-of-scope treatment pursuant to Article 13 of the VAT Directive.

Another example brought up by several respondents is the craft/construction business. Companies in this area purportedly suffer from competition by local authorities who, in the form of intra-municipal cooperation, provide construction works for the public sector free of VAT and thereby effectively exclude private companies from public procurement. Potentially beneficial public-private partnerships are made unworkable by such a situation.

Numerous respondents stressed that output side distortions were not only due to Article 13, whose treatment of public bodies as out-of-scope is considered too extensive, but also of the tax exemptions in the public interest pursuant to Article 132 of the VAT Directive. Many tax exemptions are only granted if they are carried out by a specific kind of operator, for instance, by a public body or an NPO. In addition, Member States enjoy discretionary power in determining which kind of providers may benefit from a tax exemption. This might lead to substantial distortions of competition. The criteria according to which one professional group benefits from a tax exemption, while another does not are often difficult to understand; furthermore, specific professionals might benefit from a tax exemption in one Member State, but not in another one.

Finally, several respondents noted that competition is also distorted when public and private providers compete to obtain a contract on open markets where both are liable to VAT, since the public provider could benefit from cross-subsidies. Furthermore, current rules allow tax planning for public authorities to get into the scope of VAT by using a special purpose vehicle, not meeting the criteria of being ‘public body’ (e.g. a company 100% owned by a municipality), in order to benefit from input-VAT deduction in the investment phase. Later on, the respective activity would be brought back out of scope; an example mentioned in this context is the re-municipalisation of waste management services.

Apart from the examples mentioned above, respondents referred to many other areas where output distortions of competition, due to an unequal VAT treatment of different kind of operators, might occur, such as the welfare sector, culture, broadcasting, education, health care, long-term care services, postal services, sport, provision of parking spaces, catering, energy efficiency etc.

Opinion 2: A negligible problem

According to the opposite opinion, which was also held by a large group of respondents, output-side distortions are not a major problem. The requirement to treat situations equally should apply only if the situations in themselves are equal.

These respondents argued that the differentiation between private and public bodies is justified because the respective activities and the legal framework for these activities are not comparable. Public bodies are financed to a certain extent by public funds and are obliged to fulfil specific tasks in the public interest in a way that is sustainable and affordable to the customer. Their activities are characterised by the strict requirement that costs are covered and no profit is realised. This also applies to many entities which benefit from the tax exemptions in the public interest, e.g. NPOs. Commercial enterprises, however, are characterised by their profit orientation; in contrast to public bodies, they concentrate on lucrative markets, regions and specific customers. Individual respondents noted that there is a distortion of competition to the detriment of public bodies/local authorities, because global players with an extraordinary market power are allegedly increasingly active in domains which traditionally qualify as activities in the public interest.

Many respondents stressed that in accordance with Article 13(1) of the VAT Directive public bodies are only deemed to be out of scope if the activities they carry out relates to their obligations as a public authority. The recipient of a service carried out by a public body acting in its function as public authority (typically the citizen), is often obliged to accept such a service due to a legal or administrative order; even if a public body entrusted the carrying out of its statutory duties to third parties, this would not alter the fact that it is the public body which has the obligation towards the citizen to fulfil these duties. Any private enterprise engaged in such an activity would therefore only be acting as an agent of the public body.

Respondents highlighted that Article 13 of the VAT Directive should encompass only those activities which are specific to, and reserved for, the public sector. Consequently, the crucial factor for determining whether or not an activity is taxable is not the status of the service provider, but rather the type of activity, i.e. whether or not a public body is acting as a public authority. This should not include activities carried out under the same legal conditions as those under which private economic operators provide services of this type. Where this occurs, the same rules as for private providers should already apply today to public bodies without limitation. The neutrality requirement would be guaranteed by the distortion of competition clause pursuant to the second subparagraph of Article 13 (1) of the VAT Directive.

3.1.2.2. Input-side distortions

Another fundamental problem mentioned is the possible input-side distortions caused by the non-deductibility of input VAT if the relevant input-supply is related to non-taxed outputs. This issue has been raised by numerous respondents with different backgrounds, e.g. business representatives but also entities which currently benefit from the tax exemptions in the public interest (e.g. charities).

A large number of these respondents stressed that – in line with the remarks provided in the consultation paper – the non-deductibility of input VAT leads to cascade effects, self-supply and a disincentive to invest. These respondents noted that spending decisions in the public

sector are often based on VAT aspects rather than on real economic factors, creating inefficiencies in the production and delivery of services. Several respondents complained that cascade effects lead to higher costs for recipients of services who qualify as taxable persons and would generally be entitled to deduct input VAT. A large number of contributors argued that current rules create a strong disincentive for public bodies to outsource even where services could be provided more efficiently and at lower cost by another entity. Business representatives, in particular, stressed that the obstacles to outsourcing create massive barriers to the development of business in the EU. Although some respondents noted that often VAT outsourcing decisions are also driven by other aspects than VAT, several contributors cited statistics showing that the proportion of outsourcing is significantly higher in areas where the issue of non-deductible VAT is completely irrelevant.

Many respondents stressed that irrecoverable input VAT causes a high financial burden in various domains, e.g. in the research sector or in social security systems. This was one of the core problems identified by many charities/NPOs. The large and growing burden of irrecoverable VAT reportedly limits the ability of charities/NPOs to respond to the increasing social demands being placed on them, especially against the background of the economic crisis which has led to an increase of VAT rates in certain Member States. As a consequence, the problems with non-deductible VAT faced by charities/NPOs have even worsened and put the sector under significant financial constraints.

A large number of other sectors were mentioned where input-side distortions play an important role, for instance catering, energy efficiency, waste management, health etc. An example put forward by some contributors is public hospitals where investment backlogs (e.g. related to energy efficiency measures) could be significantly decreased if these hospitals could deduct the input-VAT.

Several respondents complained that national compensation schemes set up to mitigate the problem of input-VAT distortions, are often incomprehensible, arbitrary and entail even more complexity. They could furthermore lead to distortions to the detriment of tax-exempt entities not included in such a scheme.

3.1.2.3. Cooperation between bodies that are out of scope or tax exempt

One issue related to the distortions of competition issue and raised by a large number of contributors was the VAT treatment of the cooperation respectively assistance services between entities performing out-of-scope or tax-exempt activities.

Numerous contributors, in particular those carrying out such activities, stressed that these assistance services should not be taxed either if they serve tax-exempt or out-of-scope purposes. In contrast, many representatives of business were of the opinion that such services must be taxed; a special treatment would not be justified.

Entities which might be affected are e.g. municipalities, church organisations, research facilities or university hospitals which cooperate with the respective faculty of medicine of their university.

Opinion 1: Cooperation should be facilitated

A focal point was the VAT treatment of intra-municipal cooperation which was raised by numerous public bodies not exclusively but in particular from Germany and Austria.

Examples for such cooperation are the following supplies, each carried out for consideration:

1. Personnel seconded by one municipality to a special purpose association founded by different municipalities, of which the seconding municipality is a member;

2. Letting of a gym by one municipality to another, which is used for school sport;

3. The provision of facilities for sewage disposal by one municipality to another;

4. A data centre run by one municipality and used by others.

Respondents argued that such cooperation is not treated consistently throughout the EU. They complained that even if the cooperation is based on public law it might be qualified – according to national jurisdiction – as a taxable activity with the argument that there is a potential distortion of competition. They think that it is necessary to clarify that a cooperation or assistance service between public bodies related to the activities in which they engage as public authorities are out of scope and could not lead to a 'significant distortion of competition' pursuant to the second subparagraph of Article 13(1) of the VAT Directive. The relevant supplies would only be done with the purpose of fulfilling the tasks as a public body in the most proper and economic way by reducing costs for the citizens and not aiming at a profit for the specific public body. Taxation of assistance services would entail massive problems for maintaining the services in the public interest, in light of demographic change.

In this context, many respondents noted that, according to the treaties and the European Charter of Local Self Government, the EU must not hamper intra-municipality cooperation. They also referred to public procurement law, which purportedly recognises that public-public cooperation is out of scope of the market and therefore does not entail any potential distortion of competition. To ensure coherence among EU legislation the concept of competition pursuant to Article 13 of the VAT Directive, should be adjusted to that deriving from the EU procurement law for so called 'In-house awards'.

The issue of cooperation between entities performing non-taxed activities was not only raised in the context of Article 13 but also in relation to Article 132 of the VAT Directive. Several respondents claimed that provisions like Article 132(1)(f) of the VAT Directive which aim at facilitating cooperation are often interpreted too narrowly. The term 'directly necessary' in Article 132(1)(f) of the VAT Directive was cited as an example.[5]

[5] According to Article 132(1)(f) of the VAT Directive Member States shall exempt from VAT – under certain conditions – the supply of services by independent groups of persons, who are carrying on an activity which is exempt or out of scope from VAT, for the purpose of rendering their members the services directly necessary for the exercise of that activity.

Opinion 2: Preferential treatment not justified

In contrast, other respondents, in particular business representatives, were of the opinion that services to assist other public bodies in carrying out their official duties (e.g. within an intra-municipality cooperation) should not come under the official remit of the public body providing support and must therefore be subject to VAT. Activities and transactions may only be treated as non-taxable for VAT purposes if they are performed by public bodies for, or as part of, the performance of their own official duties.

Several respondents argued that public-public partnerships distort competition to the detriment of private entities (see also above point 3.1.2.1.). Some respondents reported that such partnerships steadily expand their area of operation. One example mentioned in this context are special-purpose associations in Germany.

The VAT advantage is, allegedly, deliberately exploited when choosing the organisational form of a public-public partnership. These entities purportedly behave on the market like a private company. They are said to increasingly advertise that their activities are not taxed. Furthermore, individual respondents noted that the market share gained in this manner would have been awarded without any procurement procedures. Such unfavourable competitive conditions reportedly affect companies from other Member States, which would like to offer their supplies in Member States where public-public cooperation as described exist.

Some respondents claimed that public procurement law does not allow to conclude on any specific VAT treatment.

Finally, several respondents stressed that a situation where the VAT advantage favours public bodies providing public services themselves, would conflict with the Commission's desire to promote public-private partnerships.

3.1.2.4. Disproportionate compliance costs in the case of small sales

Another issue which was raised by numerous public bodies is the disproportionality of compliance costs in the case of small sales. This refers to activities which a public body (e.g. a municipality) carries out in competition with other – private – operators in addition to its core activities as a public authority. The respondents stated that turnovers would be so small that the effect on the competition of these low-volume services is purely theoretical.

Examples:

- Royalties for printed information materials of municipal authorities and advisory bodies
- Revenue from the use of copying machines within the premises of a public authority
- Revenue of schools from school festivals
- Revenue from the sale of family studbooks at the registry office
- Revenue from photo booths

These respondents stated that dealing with all the tax issues related to such small sales, e.g. determining the related amount of input tax deduction, has proven extremely time consuming and entails disproportionate compliance costs, so that taxing these transactions is unjustified.

3.1.3. Lack of harmonisation/Complexity

Numerous contributors stressed that the current system is too complex and characterised by a lack of harmonisation.

Many respondents share the view that the current system is complex due to the difficulties in determining the VAT status of the supply and the deductibility of input VAT because the activities of public bodies can be taxed, taxable but exempt or non-taxable.

Furthermore, a large number of contributors throughout the different sectors argued that the current rules create significant boundary issues. Numerous respondents stated that Article 13 as well as Article 132 of the VAT Directive are subject to different Member State interpretations and national implementations or are not properly transposed into national law. In this regard, it was also criticised that the Articles 132 and 133 grant discretion to Member States to determine which entity could benefit from a tax exemption and which could not. In addition to this, individual respondents considered Article 13(2) of the VAT Directive which allows Member States to place activities out of scope as an obstacle to reaching harmonisation. Besides, numerous contributors complained about the lack of clear definitions of or guidance in how to interpret key notions such as 'public authorities', 'significant distortions of competition' or 'economic activity'. Another issue which was raised by several respondents is the problem in assessing whether or not an activity was carried out for consideration.

The non-consistent application of Articles 13 and 132 throughout the EU would cause legal uncertainty and administrative burdens on a massive scale for taxable persons. Furthermore, it would be a source of litigation which is reflected by a large number of court cases in this regard.

On the other hand several contributors, in particular from the public sector, thought that the discretion which is granted to Member States in determining the scope of the tax exemptions or the deviating application of Article 13 and Article 132 due to different national interpretations based on the national legal framework is justified. This would guarantee a good balance between VAT law and national social law or national health systems etc. Furthermore, some respondents pointed to the fact that services in the public interest are financed through different funding mechanisms throughout the EU; an activity might be carried out for consideration in one Member State but (fully or partly) financed by a general subsidy in another. National peculiarities or the diversity among Member States would need to be adequately reflected by the VAT regime. The principle of subsidiarity has to be respected in this regard.

3.1.4. Compliance costs

Numerous contributors agreed that the complexity of the current system and its lack of harmonisation entail excessive compliance costs. Due to the complexity of the current rules and their lack of conceptual clarity, the risk of a wrong VAT assessment of a certain transaction would be very high. As a result, businesses face either the cost of external advice

or the risk of reassessment by the tax authorities (including interest). In particular, the methods of calculating the right of deduction could be highly complex when a body carries on a combination of VAT exempt and taxed transactions. Very complex input-VAT corrections could be needed if the split ratio changes from one year to the other. Several respondents complained that obtaining the information necessary to ensure compliance with the VAT law of other Member States is very time consuming and costly.

Several other contributors did not consider the compliance costs to be significant because the current system is well established and stakeholders are familiar with it.

3.1.5. Impact on the internal market

There was no common view on the impact on the functioning of the internal market.

A certain number of contributors stated that distortions have only occurred at national level. It is claimed that public bodies, for instance, often compete with local companies only so that the internal market is not affected. For the cultural sector it was remarked, for instance, that there are thousands of micro, small and medium-sized organisations, so the size of their activities is not such that it would impact the internal market.

Many others, however, stressed that the current rules have a significant and harmful impact on the functioning of the internal market. The inconsistency of the VAT rules among Member States reportedly causes difficulties particularly when engaging in cross-border activities. The requirement for business, in particular SMEs, to familiarise themselves with the VAT regulations applying in each Member State creates a barrier to EU-wide trade. Several respondents stated that lack of harmonisation causes distortions of competition among entities – independently of their legal form – which are active on an EU-wide basis, because these entities might be subject to a different VAT regime depending on the Member States in which they are located (e.g. in the postal sector). The fact that specific professionals might benefit of a tax exemption in one Member State but not in another Member State was felt to limit the free movement of professionals and therefore entails unequal competition among professionals of different EU Member States.

Many respondents noted that the lack of neutrality, e.g. due to a diverging VAT treatment of public bodies, might prevent companies which are active on an international basis from becoming active on a specific national market (e.g. in the waste management sector).

3.2. Distortion of competition clause

Question 2

- **Do you think the distortion of competition clause pursuant to the second subparagraph of Article 13(1) of the VAT Directive and the existing case law from the Court of Justice of the European Union in this respect have been efficient enough in preventing distortions of competition between public and private providers on the output side?**

- **Does the national legislation of your country provide for a legal mechanism according to which a private entrepreneur who is experiencing unfair competition from a public sector body could formally raise this issue with the tax authorities or the courts?**

3.2.1. Efficiency of the distortion of competition clause

The evaluation of the distortion of competition clause pursuant to the second subparagraph of Article 13(1) of the VAT Directive is very different.

Opinion 1: Competition clause in general sufficient

Numerous contributors, in particular public bodies, considered the distortion of competition clause sufficient in tackling distortions of competition if public and private entities work under the same conditions. If they do not work under the same conditions there would be no reason to assume that there is distortion of competition.

Many of these contributors think that the concept of competition and its interpretation is rather too broad, resulting in an overly hasty assumption that there is distortion of competition to the detriment of a private body. Extending taxation by applying a very narrow interpretation of what constitutes significant distortions of competition could result in negative social consequences. In this context respondents often refer to cooperation or assistance services between public bodies, related to their statutory tasks, where the assumption of a distortion of competition is felt to be unjustified (see above point 3.1.2.3.). Another aspect which has been put forward relates to small sales by public bodies which are not carried out in their function as public authority. Such supplies should not be considered entailing a significant distortion of competition (see above point 3.1.2.4.).

Opinion 2: Competition clause not sufficient

On the other hand a very large group of contributors, including several business representatives, thought that the distortion of competition clause and the existing case law from the Court of Justice of the European Union have not been sufficient to prevent distortions of competition between public and private providers on the output side.

Many contributors complained that there are no clear criteria for determining when competition is distorted. They claim that there is a huge difference in the way the rules are applied in practice in the different Member States, creating distortions and problems in particular for companies active on an EU-wide basis. Several respondents noted that although there are court rulings on the interpretation of the term ‘significant distortion of competition’, these rulings are not sufficiently specific to allow for practical application. The question of whether or not there is a distortion of competition is felt to remain one of the most significant sources for litigation in the field of VAT.

Furthermore, several respondents called for a not too narrow interpretation of the concept of competition. Any assessment of whether there is a market and competition for certain activities needs to be decided independently of the legal assignment of responsibility. Even if a public body is, according to national public law, responsible for fulfilling a public task, there could nevertheless be a market and a competition situation between private and public bodies, so long as the public body is entitled to outsource a specific activity to a private body. This would apply even if the activity concerned remains a statutory task of the public body and the private entity is active only on the basis of an administrative concession. Several respondents argue that this evaluation could be derived from EU and national case law, and that the VAT Directive ties the out-of-scope treatment pursuant to Article 13 to the activity and not to the task or duty.

3.2.2. Legal action

It was reported that various Member States have set up a legal mechanism, by which a private entrepreneur who is experiencing unfair competition from a public sector body can formally raise this issue with the tax authorities or the courts. For Germany, for instance, it was reported that private bodies have the right to receive information as regards the situation of taxation of a public body if certain conditions are met; the private body may also start legal proceedings before a tax court in order to claim a distortion of competition to its detriment.

For Italy, Romania, Poland and Sweden, for instance, it was reported that no proper legal means are available. For other Member States the information provided was contradictory.

The evaluation of whether the existing legal instruments are sufficient was quite different. Some respondents considered the legal means sufficient for private entities to enforce their rights. Another group of respondents took the view that the existing legal procedures are not sufficient because they would be costly, long, uncertain and difficult to be supported by sufficient evidence. Respondents also commented on the difficulty in starting a court procedure when the company has pending contracts with the same public body whose tax status is subject to the court case. Companies would fear that they will not be considered in the future in the awarding of public contracts; an anonymous complaint procedure might help in this regard.

3.3. Reform Measures

Question 3

- **What are your views on the different reform options or reform measures mentioned in this document (including a possible sectorial reform); do you have a preference for any particular option and any particular variant mentioned in relation to the different options and why?**

- **Is there any option which should be excluded and why?**

- **Do you have any additional ideas or proposals?**

Since the evaluation of the current legal situation is quite different there is also a wide range of views on whether reform measures are necessary and if so, which should be envisaged for amending the current VAT treatment of the public sector.

The views range from keeping the current rules as they are to fundamental reform. However, even the vast majority of contributors who generally support the status quo think that selective amendments are needed. The proposals, however, go in very different directions, e.g. aiming at an extension or a limitation of taxation.

Some contributors stated that the more fundamental reform proposals presented by Copenhagen Economics only focus on the interest of private market players. Trade unions, in particular, stated that competition should not only focus on the lowest costs but also on the best quality, including fair income and professional and social security. The Copenhagen Economics study was felt by some to not properly take into account that an extension of taxation and an outsourcing of certain services would entail a worsening of working conditions and unsafe working contracts, and the quality of public goods would deteriorate.

Some respondents argued that the reform options presented do not consider the social, economic and cultural diversity in Member States.

Another large group of respondents stressed that any reform should lead to a situation where economic activities of a similar nature are treated equally, irrespective of the nature of the supplier. The VAT rules should not play any role in the choice made by public bodies for the insourcing or outsourcing of contracts. In this regard many contributors within this group think that there should be a broad extension of taxation or at least a gradual move towards more taxation; some contributors think that this could be a process at the end of which there might be a full taxation system. Many contributors think that in so far as exemptions are kept, they should apply equally to every kind of supplier.

3.3.1. Full Taxation

Opinion 1: Rejection of this option

A large share of respondents rejected both variants of the full taxation option. This group encompassed, inter alia, the vast majority of public bodies and entities active in the social area and currently benefitting from the tax exemptions in the public interest (e.g. social insurance or social security institutions, NPOs, churches etc.), but also some business representatives.

- **Higher costs and negative social consequences**

They argue that taxation of the supplies which are currently not taxed because of Article 13 and Article 132 would considerably increase the prices for citizens who are not able to deduct any input VAT and hamper access to services in the public interest (e.g. healthcare). Since a considerable amount of public sector costs is related to personnel costs, the right to deduct the input VAT would not be sufficient to compensate the disadvantages created by the taxation of outputs. Thus, as several respondents noted, any extension of taxation would be to the detriment of consumption because it would reduce the real disposable income of citizens. In this regard economically disadvantaged citizens would be much more affected than higher-income individuals.

In this context, many municipalities noted that even higher tax revenues at State level stemming from full taxation could not prevent them from increasing the prices for public goods deriving from a deletion of Article 13 of the VAT Directive, because their share of the total VAT revenue is limited.

Some health care providers argued that tax liability at the standard VAT rate could lead to a reduction in the revenue of hospitals, if the payments from the health insurance would remain at the current level; VAT liability would force Member States to adapt their national policies on public health, in particular funding mechanisms and insurance schemes.

Some respondents noted that a deletion of Article 132 of the VAT Directive would significantly increase the costs for the social security insurance. For Germany it was mentioned that taxation at the standard VAT rate of former tax-exempt services might entail additional costs of up to EUR 34 billion per year. This would result in higher contributions by employers and employees to the social insurance and, thus, have a negative impact on the economy.

In addition, many respondents referred to the negative consequences an abolishment of the tax exemptions in the public interest would have for the non-profit sector and the commitment to volunteer activities. Several charity representatives stated that full taxation could only be sustained by them if it were introduced in a way that was fiscally neutral, i.e. by allowing them to charge at an appropriate super-reduced rate that, in conjunction with the right of input VAT deduction, would not entail a higher financial burden. Even if full taxation were introduced in such a way, however, it would not solve the problem for entities that do not charge for their services such as search and rescue organisations. Since these entities would not be entitled to an input VAT deduction even in the case of full taxation, costs might increase due to a possible broader taxation of inputs.

For the entities whose activities are currently not taxed because of Articles 13 and 132 of the VAT Directive, the introduction of VAT would imply a heavy administrative burden and compliance costs. Doctors, for instance, would need to get familiar with the entire VAT system or they might need to employ accountancy services, buy IT equipment such as software for accountancy, spend time to complete and submit VAT declarations and so on.

- **Legal issues**

Many municipalities stated that the implementation of full taxation and the deletion of Article 13 of the VAT Directive which is necessary for this, would contradict the treaties. According to this view, the EU treaties grant the EU legislative competence as regards the harmonisation of VAT only insofar as this is necessary to ensure the establishment and the functioning of the internal market and to avoid distortions of competition. Since the distortion of competition clause in the second subparagraph of Article 13(1) properly reflects this, the abolishment of Article 13 of the VAT Directive to the detriment of users of public services or to the detriment of local self-government would go beyond the competence granted by the treaties. These respondents also contended that it would not be sensible to replace the criterion 'significant distortion of competition', whose structure has by now been largely defined through the case law of the Court of Justice of the European Union and the respective national courts, by the criterion 'economic activity', which would require a great deal of interpretation and whose structure would need to be clarified afresh by the courts. This would lead to legal uncertainty and possibly even more complexity.

Several respondents noted that demarcation issues and, thus, the problem of complexity, would not be eliminated in the full taxation model based on the current EU VAT system. Although the question of whether or not there is a distortion of competition would no longer occur, the taxability is still dependent upon the question whether or not a certain supply is carried out for consideration. Input-side distortions would remain to a certain extent because an input VAT deduction would still not be granted if there is no output for consideration.

Some respondents commented on the New Zealand model which, according to them, would be a complete break with the current system. It was also stated that many issues would remain unclear with this model e.g. the determination of the tax base.

Opinion 2: A preferred solution

Many other contributors from different categories, however, think that the 'full taxation' – model offers an adequate solution in order to achieve an equal treatment of different kind of bodies when carrying out activities of a similar nature. This model would purportedly be

'future-proof', because it automatically ensures a level playing field in a changing relationship between the public and the private sectors. It would be the best way to reduce significantly distortions of competition. Due to the deductibility of input VAT, offers by any operator, public or private, would be assessed solely on the basis of their professionalism and efficiency, which would lead to a more sensible allocation of public funds.

Social frictions could be mitigated by the possibility to tax currently tax-exempt services in the public interest at a reduced or super-reduced rate applicable for every kind of operator. Several contributors who are in favour of a full taxation option think that there should be an exception for genuinely official activities, e.g. the activities related to judiciary, police, tax authorities, customs service or defence. Those activities should remain non-taxed.

To overcome the problems of input-side distortions related to entities which do not carry out activities for consideration, some individual respondents proposed that public bodies, charities etc. should be entitled to deduct input VAT or to obtain a refund in all cases. They should be treated as deemed taxable persons if they are financed by budget allocations, subsidies or grants.

Some contributors referred to the issue that current income (e.g. licence fees of public broadcasters) could be considered to be a general subsidy. In such a case it does not qualify as consideration for VAT purposes. Against this background the full-taxation model in its second variant (the 'New Zealand Model') would be the preferred solution.

Several contributors think that the implementation of a full taxation model should be a long-term goal and a gradual way towards taxation is the right approach for the immediate future. They acknowledge that the political resistance would currently be very high and adjustments in other areas/in the social and financial structures, e.g. as regards the financing models of health systems, would be necessary in order to prevent a harmful increase of consumer prices. Cost increases for citizens could be avoided, for instance, by a move towards more direct subsidies.

3.3.2. Deletion of Article 13 while keeping tax exemptions in the public interest

The next option suggested – the deletion of Article 13 of the VAT Directive while retaining and modernising the tax exemptions in the public interest pursuant to Article 132 of the VAT Directive – was rejected by the vast majority of respondents from public bodies.

These contributors noted that many of the arguments against the implementation of full taxation would also apply to this limited option. A deletion of Article 13 of the VAT Directive would go far beyond what is needed to prevent distortions of competition. The distortion of competition clause pursuant to the second subparagraph of Article 13(1) is considered sufficient in this regard. A deletion would create more costs for social insurance institutions and thus to employers and employees contributing to the social insurance. Prices for services in the public interest would increase. For UK local authorities it was noted that such a measure could be sustained if accompanied by a refund system; in addition the range of exemptions would need to be extended, ensuring that genuine public interest activities which previously benefitted from the out-of-scope treatment under Article 13 do not become liable to VAT.

On the other hand, many of the contributors who are in favour of a full taxation option consider this option as the second-best choice. Many contributors, in particular from business, consider Article 13 of the VAT Directive to be a significant obstacle for intra-EU trade. An abolishment of this provision would guarantee that public and private providers are treated equally if carrying out similar activities. In addition, the remaining tax exemptions would need to be amended to the effect that they would be granted independently of the type of supplier so that only the nature of the supply is decisive. In this respect the option would have a distinct advantage compared to the current rules due to the level playing field between the different kinds of operators that it would bring. However, problems on the input side would remain to a large extent.

3.3.3. Refund system

There are also different views on the third option, the implementation of an EU-wide refund system within the VAT system.

Numerous contributors with different backgrounds expressed their scepticism towards such a solution.

Several respondents stressed that the current refund schemes have been implemented outside the VAT system and were designed along the needs of the respective Member States. Since the Commission has no competence for measures of financial compensation, compensation schemes should remain at the discretion of the Member States and not be regulated by EU law. Furthermore, several respondents pointed out that the implementation of refund mechanisms could be problematic, in particular, in federal states like Germany. This would require an amendment of the (constitutional) allocation of the tax revenue to the different state levels (federation, federal states, municipalities). Apart from that, some contributors stated that a refund scheme would entail a high administrative burden, costs and tax losses for the state budget. It would not solve problems on the output side, which could even increase.

Entities which currently benefit from a refund scheme however stated that such schemes should be kept because they are essential for their way of financing. This has been stressed, in particular, by several public bodies located in the UK. Several contributors were interested in the extension of the existing refund mechanisms by expanding the scope of entities which are entitled to a refund, e.g. extending the scope of the UK refund scheme for public bodies to cover other operators performing activities in the public interest.

There were also a relatively large number of contributors which are in favour of the introduction of a refund mechanism at EU level, e.g. by the introduction of zero rates. An EU-wide refund system would be more transparent and less complex than multiple national schemes. This could be of benefit for the whole economy because it would help to tackle input-side distortions and, in particular, promote outsourcing decisions. A refund scheme would ensure that investment needs are met in a timely, efficient and cost-effective manner. The vast majority of these contributors supporting the implementation of an EU-wide refund scheme, e.g. charities, favour the first variant of the option, under which all of the current exempt or non-taxable services would qualify for a refund of their input VAT expenditure, independently of whether they are public or private bodies. Some contributors think that services in the public interest not made for consideration should be included. Others think that a refund should only be granted if the relevant input is related to (concrete) output supplies made for consideration.

Even if an implementation within the VAT system were not envisaged, individual respondents stated that they would welcome a renewed recommendation and encouragement by the Commission to Member States on the extended use of national refund schemes.

3.3.4. Sectorial reform

The sectorial reform is a compromise solution which numerous contributors with different backgrounds could support, i.e. both those who refuse a fundamental change of the current rules and those who are in favour of fundamental reform. Many of the contributors looking for a more fundamental reform noted that a sectorial reform might have its advantages at least on a short-to-mid-term basis, even though in the long term a more comprehensive reform should be considered. A large group of respondents, however, most of them public bodies, stated that lack of neutrality cannot be linked to any specific sector and thus no sector can be identified which would qualify for a sectorial reform. They therefore see no need for any amendment on EU level.

Several contributors remarked that this approach would create problems in terms of determining which sectors need to be reformed. Indeed, there is no common view on which sectors should be targeted.

Several respondents referred to the fact that distortions of competition as the crucial criteria might vary across Member States and would need to be carefully assessed. In this context some respondents stated that at least those supplies, which are typically or occasionally offered cross-border, should be regulated in a standardised manner within the EU and would be appropriate candidates for a sectorial reform. Services that are only offered locally should be integrated if there are private and public suppliers who are taxed differently (for instance: parking, sewage and waste disposal). Several contributors stressed that in each sector with different kind of operators an equal VAT treatment should be guaranteed not only as regards the question of whether or not a body carries out taxed supplies but also as regards the application of reduced and standard VAT rates. Others stated that any activity requiring significant capital investment or which entails supplies being made to taxable business should be integrated.

Several respondents stressed that every candidate for a sectorial reform would need a careful impact assessment and the involvement of the stakeholders concerned. In addition, it would need to be checked whether targeting a specific sector does not contradict other EU objectives.

3.3.5. Additional reform proposals

In the following there is a selection of additional proposals which each were put forward by a certain number of respondents.

3.3.5.1. Clearer definitions

Numerous contributors from different backgrounds strongly asked for greater consistency and harmonisation of the definitions of the terms used in Articles 13 and 132 of the VAT Directive (e.g. as regards terms like ‘public body’ and ‘public authority’). A large number of respondents asked the Commission to provide better guidance to Member States.

3.3.5.2. Redrafting of Article 13

Another selective amendment which was proposed was a redrafting of Article 13 of the VAT Directive. However, the suggestions put forward on how this could be done go in opposite directions.

Restriction of the scope of Article 13

A large number of contributors who do not qualify as public bodies think that the scope of the preferential treatment of public authorities pursuant to Article 13 of the VAT Directive should be restricted. Several respondents stressed that only core government tasks which are not economic and for which no market exists should be treated as out-of-scope. This would concern e.g. police, justice or statutory social systems. Article 13(1) should not be applied to those activities which – in actuality – can also be exercised by a private entity. In this context, many contributors stressed that the meaning of the term 'competition' in the second subparagraph of Article 13(1) of the VAT Directive should be clarified and interpreted broadly. Assistance services between public bodies (e.g. so called intra-municipal cooperation) should not be privileged. When determining a competitive situation, only the content of the activity must be taken into account. Legal assignments and obligations to perform a particular activity should not play a restrictive role when assessing the competitive situation. It is crucial that the competition test should not only be the competition in a market but also the competition for a market.

Some individual contributors were of the opinion that it should be at the discretion of Member States whether or not they make use of the treatment as out-of-scope pursuant to Article 13(1) of the VAT Directive.

Many contributors asked for a more effective procedure to address distortions of competition with the tax administrations and the courts. According to several contributions the complainant should be able to remain anonymous towards the public body whose competitive advantages are subject to the complaint, in order to avoid any subsequent repercussions on the relationship between the complainant and the public body.

Extension of the scope of Article 13(1)

Another group of respondents, predominantly consisting of public bodies, asked for an extension of the scope of Article 13(1) of the VAT Directive.

- **Cooperation between public bodies**

One issue which was raised by this group is the VAT treatment of cooperation or assistance services between public bodies (see above point 3.1.2.3.). These respondents propose that activities in this context should not be taxed if they are not subject to a tendering procedure. They asked to align VAT law with the treatment of in-house granting according to European public procurement law. Following from this, assistance services with respect to the services that public bodies are obliged to provide as a public authority should not entail 'significant distortions of competition' if the following conditions are all met:

- The cooperation partners commonly exercise statutory tasks.

- The cooperation takes place (i) on the basis of a public law agreement or (ii) by means of a jointly supported body under public law, over which the parties involved have considerable influence.

- The cooperation is long-term (e.g. more than three years).

- The services are provided in accordance with cost covering principles.

- The recipient of the services has considerable possibilities to influence the provision of the services.

- The service provider provides the services largely with its own personnel and physical resources. The provision of services through (private) subcontractors may only take place in very limited peripheral areas.

- **Disproportionate compliance costs in the case of small sales**

Another issue raised by many respondents are small sales which are carried out by public bodies in competition with other – private – operators (see above point 3.1.2.4.). Due to proportionality considerations it was proposed to implement an activity and revenue-based threshold of e.g. EUR 100 000 per year in accordance with the de minimis rule in EU State aid law. For turnovers below this threshold there should be a presumption of no significant distortion of competition. Such a low turnover is considered too small to have any negative impact on competition and trade between Member States. Such a measure could significantly reduce compliance costs.

Article 13(2)

Individual contributors think that Article 13(2) could be deleted. Such a measure would simplify the rules in this area. According to another individual opinion the option granted by Article 13(2) of the VAT Directive to Member States to treat otherwise exempt activities undertaken by a public body as outside the scope of VAT should be made mandatory.

3.3.5.3. Redrafting of tax exemptions

Numerous contributors stressed that to tackle distortions of competition and achieve a level playing field for the different operators across the EU, the various tax exemptions in the public interest pursuant to Article 132 of the VAT Directive should be redrafted to the effect that they are only dependent on the nature of the supply and not on the kind of supplier. Several contributors are of the view that the tax exemptions should be more narrowly drafted and their scope more precisely defined. Contributors from the catering sector, for instance, think that catering should not be considered to be part of education or health services or to be ‘closely related’ thereto in the meaning of the relevant tax exemptions within Article 132 of the VAT Directive.

Many contributors are of the opinion that cooperation between tax-exempt entities should be facilitated. For this reason, the scope of Article 132(1)(f) and (k) of the VAT Directive should

be extended. For instance, it is proposed to extend the scope of Article 132(1)(k) from the supply of staff to cover any kind of assistance services.

Respondents made numerous proposals on how to more clearly define the scope of specific – existing – tax exemptions; it would go beyond the scope of this report to mention them all in detail.

Some respondents called for an extension of the catalogue of tax exemptions pursuant to Article 132 of the VAT Directive with respect to activities carried out by mountain and lowland rescue teams respectively the equipment purchased by these organisations. Since sea rescue services would currently benefit from a wide-ranging VAT exemption, such a measure would also help to streamline and simplify the VAT Directive. One of these contributions was (also) submitted on behalf of numerous UK-based search and rescue organisations and private individuals. Some of these contributors also asked – in addition – for a tax exemption on the purchases of defibrillators used by charities, sports clubs and community groups.

3.3.5.4. New regulation on input tax deduction

Many public bodies from Germany stressed that the way to allocate inputs to taxed or non-taxed outputs is very complicated and entails high compliance costs. They proposed that services received by a public body both for its economic and for its non-economic activities should be allowed to be allocated entirely to the economic area of activity of the public body, whenever their share of economic activity is at least 10%, thereby opening up for unlimited input VAT deduction. On the other hand the input VAT deduction would be compensated by a 'self-supply VAT' or a deemed taxable supply of goods and services (so called 'Eigenverbrauch') in relation to those inputs which are used for non-taxable/non-economic purposes.

3.3.5.5. Problem of irrecoverable VAT for charities

Several charity representatives suggested that the Commission should reconsider, in order to mitigate the problem of non-recoverable input VAT for charities, the idea of introducing within the VAT scheme the discretion for Member States to introduce a reduced rate of output tax on supplies made to charities incurred strictly in the course or furtherance of their charitable purposes. The advantage of this approach would be that it would also take into account the situation of foundations that do not charge for the goods or services they provide.

3.3.5.6. Research institutions

Another proposal was submitted by several German research institutions. They argue that the EU objective to create a European research area requires and justifies a privileged treatment of research institutions. Research institutions as defined in the 'Community' framework are purportedly not in free competition within the scope of their main activities, because they do not provide outputs to concrete 'end consumers', but rather to the general public, and do not themselves consume inputs, unlike private 'end consumers'. This would justify creating a new 'neutral' sphere whereby research institutions performing their main activities would be removed from the scope of VAT. This could be achieved by the introduction of a new paragraph 3 in Article 9 of the VAT Directive, that would exclude research institutions (fulfilling specific requirements) from the scope of the VAT Directive for activities not in

competition with third parties, and a new Article 105a according to which goods and services provided to research institutions would be taxed at a zero rate.

3.4. Relevant sectors for a sectorial reform

Question 4

In case a sectorial reform would be the way forward, Copenhagen Economics has modelled the sectors postal services, broadcasting, waste management and sewage. Other sectors such as air traffic control, access to roads and parking areas could be potential candidates as well.

- **Do you agree with this list?**

- **Which other sectors should in your view be selected for such a review? Why?**

As for many other questions of the questionnaire, views are quite varied also on the list of sectors which could be considered for a sectorial reform. The sectors postal services and waste/sewage management received the most attention in this regard.

Numerous contributors, predominantly public bodies, do not agree with the list. They argue that it contains activities which private companies could not exercise under an equal legal framework compared to public bodies. They do not see any necessity for an amendment of EU law (see above point 3.3.4.).

In contrast, a large amount of contributors agree with the list. They think that it contains sectors where a non-justified differentiation in the VAT treatment depending on the nature of the operator exists and where, therefore, massive distortions of competition could be identified. The Commission was also called to extend the list to other sectors where distortions of competition have been identified.

3.4.1. Waste/Sewage management

The VAT treatment of waste/sewage management is different across the EU, which is also reflected by the contributions. For Sweden it was referred to the fact that all activities are already taxed today independently of the nature of the operator. In other countries there might be a different VAT treatment depending on whether or not a specific service is performed by a public authority or a private body.

Opinion 1: Against taxation

Many respondents, particularly public bodies, referred to the fact that in many Member States (e.g. Germany) waste disposal related to private households and waste water treatment are statutory duties of the municipalities, which reportedly cannot be transferred to private third parties. Even if a municipality entrusted the carrying out of such duties to third parties who then would act as an agent of the municipality, the final responsibility would remain with the municipality, which has the obligation towards the citizens to fulfil these duties.

According to these respondents, the principle of neutrality cannot be violated in such a situation because public and private operators operate under conditions that are not comparable. In this context it was also referred to the fact that – contrary to private operators

– a public body would have no competence to become active beyond a specific territory. Furthermore there would be no unequal treatment from the viewpoint of the final consumer (the citizen) because it is ensured that he has to pay no VAT in either case.

Many respondents argued that full taxation of this sector would entail higher fees due to an off-loading of the tax-related costs onto the citizen. Individual respondents asserted that the right to deduct the input VAT cannot compensate for the VAT on the output; in this regard it was referred to the fact that former investments would not qualify for input VAT deduction even though the amortization related to them would be part of the calculation of the fees. Some respondents argued that higher costs due to taxation would diminish the current standards of service. Several respondents noted that an increase of the fees for waste and sewage management would also increase the financial burden for tenants of residential and business premises. Thus, the social acceptance of such a measure would be low.

On the other hand, some public providers referred to their disadvantageous cost structure compared to private companies e.g. in terms of higher administrative or personnel costs (due to special social responsibility). The cost advantage of the VAT exemption would be fully equalised as a result of this, so that private providers' complaints of a competitive disadvantage due to the VAT liability could not be seen as justified. Reality would show, it is claimed, that contracting out decisions do not depend on VAT factors as, despite the unequal VAT treatment, many municipalities have outsourced waste collection to private companies.

Several respondents stated that in many Member States the waste and sewage management system has proved its effectiveness and, therefore, there is no need to change the existing economic and tax-related regulatory framework. To meet with the subsidiarity principle, waste and sewage management needs to remain within the responsibility of local and regional authorities. This also applies to the question of whether or not these services should be liable to VAT.

Opinion 2: Pro taxation

In contrast, many respondents, inter alia private providers active in the environmental sector, strongly advocated taxation of the waste and sewage management, arguing that there is no justification for an unequal VAT treatment between public and private operators.

Sweden was put forward as an example that waste/sewage management can be fully taxed independently of the nature of the provider without losing any quality in the service or having other detrimental effects on citizens.

These respondents asserted that the VAT issue is a crucial factor when public waste disposal authorities come to decide whether they will provide the disposal services themselves or in cooperation with other public waste disposal authorities, or outsource them to a private third party. A decision to outsource to a private operator might be prevented because the waste disposal authority would not be entitled to deduct the (input) VAT charged by the private company, even though the service provided by a private waste disposal company might be more efficient and economical.

Several respondents also noted that because of their VAT benefits, public entities responsible for guaranteeing disposal would increasingly take the provision of disposal services which

they previously outsourced to private disposal companies back into their own hands ('remunicipalisation').

Furthermore, the private providers of waste management services complained that the VAT advantage was deliberately exploited by waste disposal authorities when choosing the organisational form of a public-public partnership. Such partnerships would act like commercial companies but allegedly have won their market share not by fair competition, and without any procurement procedures. This situation would also negatively affect private operators active on an EU-wide basis.

These contributors stressed that there could be competition situations even if the final responsibility for certain services is, according to national public law, only with a public body. It would be sufficient for public waste disposal authorities to be allowed to delegate their responsibility to private law entities, so that they could, finally, make use of the market mechanism and competition to perform the task. For Germany it was mentioned that currently private waste disposal companies, which are taxed for their services, are commissioned by public waste disposal authorities to dispose of the refuse from around 60% of the population. In such a situation it would not be justified to describe a task as being 'specific and reserved' for the public waste disposal authorities.

In addition, one respondent stated that there might also be direct competition situations because under public law an activity could be carried out as a public authority task by a public body (currently not taxed for VAT purposes), but also by a private entity in the fulfilment of an original task which was not only allocated by delegation (to be taxed for VAT purposes). This, for instance, in Germany would apply to the disposing of sorted waste for recycling from private households.

Furthermore, some respondents referred to the fact that public waste disposal authorities would compete with private companies in deregulated areas of waste management, where both would supply taxable services (e.g. the disposal of commercial and packing waste). There might be cross-subsidies from the fee-based official sector (e.g. waste management for private households), which would be used to finance bids and services in the deregulated sectors, aimed at gaining the upper hand against private competitors. These distortions of competition would be exacerbated by the tax advantage enjoyed by the (supposedly) official domestic waste disposal service.

Some respondents argued that a VAT liability for waste/sewage management services which are currently not taxed would not necessarily entail higher charges. The fact that a VAT liability would result in the right of input VAT deduction, for instance, must be taken into consideration as well. During investment phases the input VAT may even exceed the VAT payable. This might also create scope for reducing charges. Costs for recipients who are commercial companies might be lower due to their right to deduct the input VAT. In addition the liability to tax would motivate waste disposal authorities to outsource which would enhance efficiency and innovation.

Finally, some respondents stated that a possible increase of fees could be prevented or at least significantly mitigated by the application of reduced rates.

3.4.2. Postal services

A relative large number of responses were related to the postal sector reflecting different positions regarding its VAT treatment.

Opinion 1: The current exemptions should be removed or restricted

The first group of contributors call for an abolishment of the current tax exemption for public postal services or (at least) for a harmonisation of its application at EU level limiting the scope.

The respondents who asked for a removal of the tax exemption, are – inter alia – postal operators who do not qualify as universal service operators in the Member State where they are located. They are of the opinion that the removal is necessary in order to create a level playing field for all operators. Since the unequal VAT treatment of postal services allegedly undermines the full market opening, the tax exemption would be in conflict with the EU Third Postal Directive.

These contributors refer to the fact that customers with no right to deduct the input VAT would rather ask for a service delivered by the universal service operator. The current exemption for universal service operators would create different submarkets related to those services which qualify as universal postal services, where the universal service operators get competitive advantages over the others. The differentiated VAT treatment could not be justified and would violate the principle of fiscal neutrality. The broader the scope of the universal services has been defined in the respective Member State, the more significant this problem would be.

Several contributors complained that the exemption is not applied uniformly by Member States and that the CJEU jurisprudence has not lead to a uniform interpretation as regards the scope of the tax exemption. It is claimed that there is no uniform definition of universal postal services and no uniform interpretation of the term ‘public postal services’. Apart from discriminations on the national market, this situation purportedly leads to legal uncertainties and crucial distortions of competition at EU level, which are harmful for the functioning of the internal market. Such differences, for instance, may give incentives to locate print and mail production to Member States with broader use of the universal service provider (hence broader VAT exemption) for cross-border distribution even if true economic efficiency would suggest otherwise. Respondents with different backgrounds stressed that harmonisation in this respect is important and urgently needed, because the current postal market is one of declining volumes facing an increase of e-substitution.

Several respondents are of the opinion that an equal VAT treatment of all postal services independently of the nature of the operator would contribute to developing efficiency in the postal sector and benefiting customers through increased choice, better quality of the service and more affordable tariffs. Contributors from Sweden but also from other Member States referred to the Swedish example, where no VAT exemption exists. The market, postal regulation and individual operators have adjusted to the neutral VAT taxation. Customers are said to have experienced more customer-orientated products, higher quality and lower prices. There has been no indication that a standard VAT rate applied to all postal services has been or would be undermining the quality, accessibility or affordability of the universal postal services in Sweden. A reintroduction of the VAT exemption for public postal services in

Sweden as required by the Commission would lead to de facto monopolies to the benefit of universal service operator in parts of the market and significantly weaken the market position of other providers. This would jeopardise the successful outcome of the EU postal reform on the Swedish market, following which barriers to entry the market were significantly reduced.

To avoid any social frictions, one contributor suggested the introduction of a single standardised reduced VAT rate for all operators and all services. This would create a level playing field for competition whilst protecting social users and VAT-exempt customers from substantial price rises.

It was suggested by some individual contributors that if no abolishment of the VAT exemption can be agreed, an 'Option to Tax' by individual Member States should be implemented in the VAT Directive. They considered this measure to be a compromise that would enable Member States to promote a fair competition within their (national) postal market.

As a short-term measure, various respondents with different backgrounds, including some respondents who are generally in favour of keeping the VAT exemption, stressed that the VAT exemption for public postal services must be unambiguously and uniformly defined within a limited scope and applied in all Member States.

Opinion 2: The current exemption should be maintained

The other opinion according to which the current tax exemption should be maintained as it stands emerges – inter alia – from operators who are considered universal service providers in the Member States where they are located.

These contributors stated that the provision of universal postal services is not comparable to the provision of other postal services, because of the specific obligations placed on universal service operators. Accordingly, services provided by the universal service provider acting in that capacity cannot give rise to a violation of the principle of fiscal neutrality. Given the essential need to maintain a sufficient and equal access to postal services at reasonable prices, ensuring the financial sustainability of the universal postal service is of fundamental importance. Abolishing the tax exemption would increase the cost of postal services to users who cannot recover VAT. Therefore it is likely that this would further reduce demand for postal services and in turn make the system financially unsustainable.

Also, a private entity stressed that the VAT exemption for postal services is important for their business since the main channel of delivery of printed products to the final user is via postal services. If postal services were subject to VAT, then the costs in the print value chain would increase and the prices of printed products would also rise.

Several contributors stressed that an impact assessment should carefully assess the possible consequences of abolishing the tax exemption for public postal services and that this would need to include not only an economic analysis but also look at the multiplicity of market conditions and regulatory demands imposed by postal regulators both at EU level and in individual Member States. Also the e-substitution risk should be taken into account. Scepticism was expressed on the possibility that an abolishment of the tax exemption would allow for an economically sustainable provision of the universal postal service.

3.4.3. Broadcasting

There were some contributions commenting on the VAT treatment of the broadcasting sector including one European association representing public broadcasters and one commercial broadcasting company.

One part of these contributors, including the association representing public broadcasters, was of the opinion that taxation of public broadcasting, i.e. the non-commercial activities of public broadcasters, would be unjustified. No harmful distortion to the detriment of private operators is said to exist. Taxation of public broadcasting would entail higher charges to be paid by the citizens and the public acceptance thereof would be very low. EU and Member States' VAT rules were part of a system ensuring appropriate funding for the fulfilment of the respective national public service remit, and any changes to the specific VAT regimes would risk disrupting carefully balanced solutions. In addition some respondents referred to the 'Amsterdam Protocol' according to which it is up to the Member States to define the tasks of the public broadcasting and determine its way of financing. A decision at EU level entailing a VAT liability for the public broadcasting would contradict this agreement.

In contrast, several other respondents, including the commercial broadcasting company mentioned above, argue that a distinction between the different kinds of operators is not justified. The VAT regime would then not properly consider that the broadcasting market has changed towards participation of more and more commercial operators. The commercial broadcaster noted that the content of outputs and cost inputs of commercial and public broadcasters are substantially similar and they would compete in the same market for share of audience viewing. For the UK it was referred to the allegedly distortive effect of the national refund scheme, according to which public broadcasters like the BBC would be entitled to have a refund of their non-deductible input VAT although the outputs were non-taxable.

The commercial broadcaster stressed its concern that if there was no taxation along the lines of the full taxation option, model 2 (the 'New Zealand model'), public broadcasters might argue that the licence fee is a general subsidy not qualifying as consideration for VAT purposes. Safeguards would need to put in place to avoid this outcome.

3.4.4. Other sectors

Other sectors such as air traffic control, access to roads and parking areas could also be appropriate candidates for sectorial measures, according to several contributors. There were reports about distortions of competition e.g. in relation to access to parking. For Sweden it was referred to the fact that access to on-street parking is already today fully taxed.

Many other contributors, including many public bodies, disagree with an inclusion of these sectors.

Those respondents who referred to distortions of competition in specific sectors not explicitly mentioned in the questionnaire asked to integrate these sectors as well and add them to the list of activities mentioned in the Annex I of the VAT Directive or, if they are covered by a current tax exemption, to extend the tax exemption to every kind of operator. Sectors mentioned are e.g. catering, public passenger transport services, energy efficiency services, construction services, education etc.

3.5. Option to tax

Question 5

- **Do you think that an option to tax as regards tax exempt activities either by taxable persons or Member States should be considered?**

There is also no common view on the question of whether and in which way the right to opt for taxation should be implemented.

Some respondents were of the opinion that such a right would not attain the objective answer to the goal set. The objective should be to implement VAT rules which are truly neutral no matter the nature of the provider of the service.

A large number of contributors think that an option for taxable persons to tax should be considered. This could tackle input-side distortions and promote investments e.g. of municipalities or in the health and education sectors. However, due to the impact on Member States' budgets, some contributors noted that the decision of whether or not to implement a right to opt for taxable persons should remain with the Member States. Other contributors do not agree with an option to tax because this would lead to a decrease in harmonisation, an increase in complexity and additional costs for taxable persons. Individual contributors, however, think that in order to avoid too much complexity, the right to opt could be linked to a maximum amount.

Some respondents stressed the benefits of an option to tax if it was linked to the functioning of refund schemes. Its role would then be to allow 'wash-through' of otherwise 'sticking' VAT where the provider of contracted-out services to a public sector body able to recover VAT under a refund scheme makes exempt supplies, e.g. of health care or social welfare. This technique would be particularly helpful where refund schemes are restricted to public bodies only.

Numerous respondents are of the opinion that an option to tax for Member States would undermine the efforts to reach more harmonisation in the VAT system. In addition, taxation of certain sectors which are not taxed today would lead to higher costs for the social security system. Some others think that an option to tax for Member States would be acceptable if it was designed so as to be budget-neutral by the application of reduced or super-reduced rates; in this way, distortions of competition could be effectively tackled without having a detrimental social impact.

Others oppose options to tax generally, both for Member States and for taxable persons, because they significantly increase the complexity of the current system. Several respondents stated that an option to tax is only possible for sectors not performing any cross-border activities. In cross-border situations, unless it applies equally in all Member States, permitting an option to tax is likely to cause distortions of competition that negatively affect the internal market.

For Austria, some contributors referred to a current right to opt for NGOs and public bodies as regards certain tax-exempt activities. Such a right should be kept and extended.

4. FINAL OBSERVATIONS

The European Commission is grateful to all participants who took the time to make a submission. It highly appreciates the large amount of very substantial contributions and to get a feedback from stakeholders of a very different nature including those who are directly or indirectly affected by the provisions which were the subject of this consultation. It was very informative to analyse all the comments, reports and statistical data provided by respondents.

As indicated at the moment of its launching, this public consultation was of a technical nature. Although it would have gone beyond the scope of this report to integrate every kind of comment, proposal or statistic data, all the input provided by the stakeholders is important for the Commission's assessment of the current VAT rules for the public sector and its future work on this file.

ANNEX – STATISTICS

Table 1

COUNTRY	Total Number of Replies , by country and profile of respondent											
	SME	Large Company	Multinational Company	Citizen	National Association	European Association	NGO	Tax Advisor/ Tax Practitioner	Academic	Public Body	Other	TOTAL by country
Austria					10					90		100
Belgium	1	3		1	35					13	6	59
Denmark					4					1		5
Finland					2							2
France			3	1	13							17
Germany	11	1	1	1	53		5	2	1	185	6	266
Ireland				1								1
Italy					8			1		1		10
Lithuania									1			1
Poland								1				1
Romania	1							1				2
Spain					8		6			2		16
Sweden	1	1	1		7				1	1		12
The Netherlands		1			3					1	1	6
United Kingdom	2		2	6	15		4	4		17	3	53
European Level						28	3				1	32
European Institution										1		1
Total	**16**	**6**	**7**	**10**	**158**	**28**	**18**	**9**	**3**	**312**	**17**	**584**

Table 2

COUNTRY	Replies from Registered Entities, by type of respondent										
	SME	Large Company	Multinational Company	Citizen	National Association	European Association	NGO	Tax Advisor/ Tax Practitioner	Academic	Other	TOTAL by country
Austria					2						2
Belgium		2			9						11
Denmark											0
Finland					1						1
France			3	1	11						15
Germany			1		21		5	2	1	2	32
Ireland											0
Italy					2						2
Lithuania											0
Poland											0
Romania											0
Spain					5		2				7
Sweden					1						1
The Netherlands					2						2
United Kingdom			1		1		3	1		1	7
European Level						27	3				30
European Institutions											0
Total	**0**	**2**	**5**	**1**	**55**	**27**	**13**	**3**	**1**	**3**	**110**

Table 3

COUNTRY	Replies from Non-Registered Entities, by type of respondent										
	SME	Large Company	Multinational Company	Citizen	National Association	European Association	NGO	Tax Advisor/ Tax Practitioner	Academic	Other	TOTAL by country
Austria					8						8
Belgium	1	1		1	26					6	35
Denmark					4						4
Finland					1						1
France					2						2
Germany	11	1		1	32					4	49
Ireland				1							1
Italy					6			1			7
Lithuania									1		1
Poland								1			1
Romania	1							1			2
Spain					3		4				7
Sweden	1	1	1		6				1		10
The Netherlands		1			1					1	3
United Kingdom	2		1	6	14		1	3		2	29
European Level						1				1	2
European Institution											0
Total	**16**	**4**	**2**	**9**	**103**	**1**	**5**	**6**	**2**	**14**	**162**