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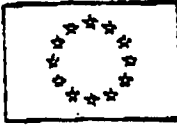
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Til underretning for Folketingets Europaudvalg frem-
sendes vedlagt Kommissionens meddelelse til Det Europæ-
iske Råd om reduceret moms for visse serviceydelser.

Paul Nyrup Rasmussen



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 12.11.1997
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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Job creation: Possibility of a reduced VAT rate on labour-intensive services for an experimental period and on an optional basis.

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Combating unemployment is on the top of the European agenda and the Commission is dedicated to this task as the "priority of the priorities". In the tax area the Commission has already tabled important initiatives which are aimed directly at employment creation as well as the improvement of the single market thus contributing indirectly to employment:

- the proposal for the taxation of energy products¹ suggests that energy tax revenues should be used to compensate for reducing non-wage labour costs,
- the tax package² aimed at tackling harmful tax competition will help prevent the tax burden from falling disproportionately on the least mobile factors such as low skilled labour,
- in the longer term, our strategic programme for introducing the new common system of VAT³ should also be an incentive to job creation through a major simplification of the present arrangements for all businesses, with particular beneficial aspects for SME's.

All these initiatives follow the basic Commission approach that the best means of boosting employment in the fiscal area is a budgetary neutral reduction of non-wage labour costs. The Commission remains convinced that a targeted reduction in social security contributions is likely to be a more effective instrument for employment creation than a reduction in VAT rates and recalls that there are other instruments of taxation which have already been shown to be effective in tackling unemployment. All of these measures can be taken without any changes in Community law. As these are areas where Member States exercise their own competence, the Commission can only urge each Member State to explore these possibilities in their efforts to create employment.

However, several Member States and various associations have expressed interest in reducing VAT rates for labour intensive services. They have addressed themselves to the Commission because this would require a change in Community law. The Commission has, therefore, looked carefully at the possibilities in the field of VAT against the background of its discussions with Member States, the European Parliament and the Economic and Social Committee about the question if and to what extent VAT can be used as a tool for job creation.

¹ COM(97) 30.

² COM(97) 493.

³ COM(96) 328.

Recognising the ongoing efforts of Member States to meet the Maastricht criterion on budget deficits; the wide-spread concerns about tax fraud and the increasing risks of harmful tax competition, the Commission recommends that Member States exercise extreme prudence when introducing any measure which impacts significantly on revenue collection. Moreover, any measure carries some risk of negative impact on the Single Market. For these reasons, a cautious approach to modifying the VAT system is desirable, introducing only a time-limited experiment.

Therefore, the Commission would consider allowing, on an experimental basis, the possibility of a reduced VAT rate - instead of the standard rate - to supplies of certain services identified as being labour-intensive. The reasoning behind this move is twofold:

- Firstly, a reduced VAT rate should result in lower consumer prices and thus stimulate the demand for those services employing low-skilled labour and which are particularly labour-intensive. This would address the big potential for job creation in these, typically only locally operating businesses.
- Secondly, the VAT mechanism does not function particularly well in sectors which have few deductible VAT inputs and where most of the customers are private consumers. In this case VAT is part of the price and the consumer can easily avoid paying this part in agreement with the service provider. A reduced VAT rate would therefore reduce the stimulus for joining (or staying) in the black economy.

The positive effects of VAT relief on job creation are not undisputed. There are studies both in favour and against the application of reduced VAT rates for boosting employment and the Community-wide discussion in this respect is to some extent controversial. In principle, the Commission has some doubts about the idea of using VAT rates as a policy tool for attaining specific economic objectives such as higher employment or improved protection of environment. The basic Commission approach in this respect is explained in more detail in the report from the Commission to the Council and to the European Parliament in accordance with Article 12(4) of the Sixth VAT Directive on the scope of reduced VAT rates⁴.

However, the problem of unemployment is, of such an importance that testing the functioning of a targeted VAT relief on labour-intensive services is worth the effort. Every reasonable contribution in this respect is worth investigating, even if there is no guarantee of its success. Moreover, the Commission is aware that some Member States wish to make use of a targeted reduction in VAT rates and it does not want to stand in the way when Member States would like to use innovative measures for employment creation. The Commission is also of the opinion that in some business sectors reducing VAT would indeed help to recuperate some of the activities concerned from the black economy.

⁴ COM(97) 539.

Such a measure should, however, as all fiscal measures, respect the fundamental principle of tax neutrality. This principle is crucial in order to avoid cross-border distortions of competition which are incompatible with the Single Market but also in order to avoid sectoral distortions which lead to economic inefficiencies. Member States have repeatedly recognised the principle of tax neutrality and reaffirmed their desire to achieve a single market.

Furthermore, budgetary consolidation should not be jeopardised and the Commission strongly recommends that Member States taking part in this experiment should ensure that compensatory measures, either by reducing expenditure or by increasing revenues, are taken to ensure budget neutrality.

Any measure running contrary to these basic principles could be counter-productive for the creation of employment. The Commission recognises that introducing this measure runs the risk of causing some distortion in the neutrality of the tax but considers that the importance of job creation is sufficient for the measure to be introduced as an experiment with its effects being closely monitored.

It follows from the foregoing that any VAT reduction should be designed as an experiment which is limited both in time and in scope. Thus it will be possible to evaluate, whether or not in a given period of time and for a selected business sector jobs were created and, if so, whether this was done efficiently.

On this basis, the Commission would consider coming forward with a draft directive allowing Member States wishing to do so to apply reduced VAT rates to a limited range of local, labour-intensive services. The measure could be designed along the following lines:

• The services identified should be:

- genuinely labour intensive,
- supplied directly to consumers,
- principally those using low skilled labour,
- predominantly local (in order to avoid the problem of cross border trade distortion), and
- those where there is the strongest link between reduction in prices and additional demand and employment.

It is also desirable to keep the budgetary impact of the test low (the total revenue corresponding to the receipts out of 1 percentage point of the VAT standard rate may, for instance serve as an indicative upper limit), to limit the test's coverage in order to keep the experiment verifiable and at the same time avoid both distortions of competition and major fiscal disadvantages for the general Community VAT system and for businesses generally.

- Member States will have the possibility to choose whether or not they want to run such an experiment.
- Both in terms of the scope and the reduced rate the proposal must avoid distortions of competition. The Commission will check the risk of such distortions both ex-ante and continuously while the test is running.
- The period of application is limited to three years (1 July 1998 - 30 June 2001) and expires automatically.
- Under these guidelines, the Commission suggests that the following categories are likely to offer the best opportunity for job creation and that Member States could choose from within them:
 - repair services on movable tangible property (including bicycles but excluding other means of transport);
 - renovation and repair services on residential housing (except new construction);
 - leisure parks, cleaning services, laundries and domestic caring services such as home help, care of the young, disabled, elderly or infirm.

The supply of goods is in any event to be excluded from the application of the reduced rate.

- The reduced VAT rate which Member States may apply is the rate referred to in Article 12(3)(a) of the Sixth VAT Directive 77/388/EEC. The "transitional" VAT rates laid down in article 28 (1), (2) of the Sixth VAT Directive are thus excluded from being applied to the labour-intensive services in question.
- The effectiveness and the efficiency of the measure in terms of real employment creation will be followed closely and assessed after the three-year period of application on the basis of all available statistical and economic evidence.
- A Member States wishing to use the experimental test has to notify the Commission of this intention by 1 March 1998 at the latest. The Commission will then, after consultation of the VAT Committee, decide whether or not the conditions for the test scheme, i.e. namely with a view to the time limit, the scope of the test, the absence of distortionary effects, the respect of art. 12 (3) and the ex-post evaluation, are met and whether the requested authorisation can be granted.

Given the overriding importance of guaranteeing the functioning of the Single Market and to limit any negative effect on the neutrality of the tax the Commission shall be in a position to revoke, with immediate effect, the authorisation granted to a Member State whenever distortions of competition arise which are due to the application of a reduced VAT rate to the specified services. Such distortions may arise either between similar activities to which different rates apply within a Member State or between the same or similar activities in different Member States where a reduced rate is applied in only one of them. Prior to its decision the Commission has to consult the authorised Member State as well as any other Member State concerned by the distortion of competition.

If after the test the overall assessment of the measure in terms of efficient and effective job creation proves positive, the Commission will have to assess whether or not such a measure should then be included in the harmonised VAT system.

Concluding, it is important to note that this experiment fits perfectly well to the overall Commission approach as set out in the Commission guidelines for employment⁵. In particular, the recommendations on reducing the cost of unskilled labour through fiscal measures and on the mobilisation of local players are taken up in a concrete initiative. By tackling the black economy, the measure is also designed to achieve an improved functioning of the labour market. Thus, a coherent Community strategy on employment is guaranteed.

The Council is invited to express its support for the suggested approach. The Commission will decide, also in light of the reaction of the employment summit, whether to propose an amendment to the Sixth VAT directive along the lines of this communication.

⁵ COM(97) 497.