Tax strategy Group

TSG 15/07

Selected VAT Issues

Introduction

1. This paper reviews the VAT rating and structure, provides options for change and looks at VAT developments at EU level. In 2014, VAT accounted for approximately €11,153 million or 27% of the overall tax yield to the Exchequer. The estimate for the VAT yield in 2015 underpinning the Stability Programme fiscal forecasts is €12,025 million.

I. VAT Rating and Structure, and Scope for Change

VAT Rating and Structure

2. Ireland operates the following VAT rates:

- standard rate of 23% applies to 36% of activity, including cars, petrol, diesel, alcohol, tobacco, electrical equipment and CD/DVDs.
- reduced rate of 13.5% applies to 36% of activity, including fuel used for heat or light, construction, housing, labour intensive services and general repairs and maintenance.
- reduced rate of 9% applies to 16% of activity, including hotel and holiday accommodation, restaurant services, and various entertainment services.
- 4.8% rate applies to livestock by registered farmers.
- zero rate accounts for 12% of activity and applies to most food, children's clothes and shoes, and oral medicines.
- exempt services, such as transport, education, financial services, schools and hospitals, services provided by charities, etc.

Ireland's VAT Rates in comparison with EU/UK

3. As of 1 January 2015, 24 of the 28 EU Member States have a standard VAT rate of 20% or higher and the average standard rate in the EU is 21.6%. Ireland has the joint 7th highest standard VAT rate in the EU. Since the economic crisis, 24 of the 28 Member States have increased their VAT rates, with 20 Member States increasing their standard rate. The standard rate VAT differential between Ireland and the UK has narrowed from a high of 6.5 percentage points in 2009 to 3 percentage points since January 2012.

4. At 13.5%, Ireland has the 5th highest reduced VAT rate in Europe, however we apply reduced rates to an extensive range of activity relative to other Member States. In addition, Ireland, along with the UK, applies the zero rate to a sizable proportion of economic activity.

Recent VAT changes

5. Recent changes to the VAT rates and thresholds include:
   - Jobs Initiative May 2011 - introduction of 9% rate for tourism-related services;
   - Budget 2012 - increase in standard VAT rate from 21% to 23%;
   - Budget 2013 - increase in cash basis threshold from €1m to €1.25m; flat-rate farmer addition reduced from 5.2% to 4.8%

- Budget 2014 – increase in cash basis threshold from €1.25m to €2m; flat-rate farmer addition increased to 5% from 4.8%; retention of 9% VAT rate
- Budget 2015 – 9% VAT rate retained as part of overall tax code; flat-rate farmer addition increased to 5.2%; place of supply rules came into effect 1 January 2015- e-services now charged VAT in the Member State of the consumer.

Options for changes to VAT

Options for reform of the VAT structure and rates

Option 1: Increasing or decreasing VAT rates

6. The cost of increasing or decreasing the VAT rates by 1% is outlined as follows. These are full year figures and would be ($1/6^{th}$) lower in the first year because VAT is paid two months in arrears.

Rate	1% increase/decrease
9% Reduced rate	+/- €128m
13.5% Reduced rate	+/- €288m
23% Standard rate	+/- €286m

Option 2: Moving zero rated items to the higher rates

7. The following illustrates the estimated yield to Exchequer where goods at the zero rate are charged to VAT at various rates (however, once moved, it would not be possible under EU VAT law to revert them back to the zero rate).

Zero rate increased	Yield
0% to 5%	€451m
0% to 9%	€813m
0% to 13.5%	€1,219m
0% to 23%	€2,076m

Option 3: Restructuring the VAT system on a revenue-neutral basis

8. Restructuring the VAT system on a revenue neutral basis costs as follows:

Rates being merged	Revenue neutral rate
zero, 9%, 13.5% and 23%	14.7%
9%, 13.5% and 23%	16.6%

Option 4: Streamlining VAT rates

9. Streamlining the VAT rates structure along the lines of the scenarios below would yield:

New Streamlined Rates	Yield	Change
0%, 5%, 15% and 25%	+€490m	items at 0% rate to 0% items at 9% rate to 5% items at 13.5% rate to 15% items at 23% rate to 25%
5%, 15% and 25%	+€2,224m	items at 0% to 5% items at 9/13.5% rates to 15% items at 23% rate to 25%

Concerns regarding changes to VAT rates

10. The only VAT rate change provided for in the Programme for Government was in respect of the increase in the standard rate and this was implemented in Budget 2012. Increasing VAT rates may negatively affect inflation (all rates), employment (9% and 13.5% rates), the less well-off (0% and 13.5% rates) and cross-border trade (0% and 23%). However, there is a general trend among EU Member States for VAT rate increases. Any reform of the zero rate would be best undertaken in conjunction with similar changes in the UK or with compensatory expenditure measures for those less well off (which has been proven very difficult to achieve).

Options for assisting Small to Medium Businesses

11. In addition to the options for reform of the structure and rating of the Irish VAT system, the following are two options for changes to the VAT system that would assist small to medium enterprises.

Option (i): Increasing the cash receipts basis threshold

12. Businesses with an annual turnover of €2m or less can opt to account for VAT on a cash receipts basis, where VAT is not required to be paid until payment for the supply is received. Currently, a total of 163,000, or 66% of all businesses, are benefitting from the scheme. It should be noted that the threshold was increased from €1m to €2m between Budgets 2013 and 2014. The impact of increasing the cash basis threshold to various levels is as follows:

New threshold	Once-off Cost to Exchequer	No of additional businesses benefitting
€2.25m	€18m	296
€2.5m	€34m	533
€2.75m	€49m	726
€3m	€64m	909

Option (ii): Increasing the VAT registration thresholds

13. Small businesses with a low turnover can opt to be exempt from VAT thereby avoiding the administrative burden that VAT registration entails. The current thresholds are €37,500 for services and €75,000 for goods, in a 12 month period. It would be possible to increase the thresholds broadly in line with inflation to €40,000/€80,000 at a cost of €34 million in a full year. Such an increase would remove around 3,100 businesses from the VAT net. Any increase

in the thresholds above these levels would require a derogation and agreement by all 28 Member States.

Pre-Budget Proposals regarding VAT

14. Several submissions received included VAT related proposals:

- Chambers Ireland and the Construction Industry Federation propose applying the 9% reduced rate to residential construction.
- IBEC advocate maintaining the 9% reduced rate for the tourism sector. They are also seeking to apply the 9% reduced rate for construction of student accommodation and active retirement housing for a period of two years.
- The Irish Creamery Milk Suppliers Association have proposed applying a lower VAT rate for certain farm expenses such as accountant's fees and mobile phone bills. They are also seeking the introduction of a VAT refund scheme for the VAT charged on safety equipment and clothing currently charged at the standard rate.
- KPMG submitted a proposal to introduce a zero VAT rate in Ireland for non-EU "in suspension" goods to ease the VAT administration burden associated with dealing in "off lease" non-EU aircraft and parts for the industry in Ireland bringing the treatment in line with France, Germany, UK and other Member States.
- In the context of the public consultation process on Tax and Entrepreneurship the following VAT related proposals were received:
    - The Small Firms Association are seeking the introduction of a minimum threshold for MOSS registration. They are also advocating an increase in the cash basis accounting threshold to €2.5 million.
    - KPMG advocate that VAT refunds be provided monthly rather than bi-monthly to assist cash flow.
    - Deloitte are seeking a reduced VAT rate for start-up companies. This is not possible under EU law.

Charities Working Group

15. In April 2015, the Minister for Finance agreed to a proposal from the Irish Charities Tax Reform Group (ICTR) to establish a working group comprised of the ICTR, Revenue and Department of Finance officials to assess options for a VAT refund scheme applying to fundraised income only.

16. The Group's Terms of Reference committed to providing a report on the various options to the Minister for consideration in the context of Budget 2016 deliberations.

II. VAT Developments at EU Level

(a) Dossiers currently under review

Vouchers

17. The vouchers proposal is designed to modernise the VAT rules on vouchers, which are

increasingly sophisticated and can take many forms including prepaid telephone credit, tear-off coupons giving discounts, or electronic codes giving an entitlement to goods or services. The dossier is technically complex and has involved a lengthy and difficult negotiation process. This file was very close to being agreed during the recent Latvian Presidency and Ireland will strongly support Luxembourg's efforts in gaining agreement on this file during their Presidency.

Standard VAT Return

18. This proposal advocated a business friendly initiative to standardise VAT return forms across the EU with a view to reducing the administrative burden on companies operating in the Single Market. The proposal sought to ensure a simple structure, standardised information, and deadlines for VAT declarations across the EU. It proved very difficult to reach agreement on this dossier because of the huge divergence in current reporting requirements among Member States. Of all Member States, Ireland's VAT return form requires the least amount of information to be submitted. Member States were anxious to continue collecting the information captured by their current domestic VAT returns and agreement could not be reached. This file was dropped by the Commission shortly before the end of the Latvian Presidency as it was not possible to reach agreement between Member States.

Impact of Place-of-Supply Rules for Electronically Supplied Services from 2015

19. On 1 January 2015, new EU VAT rules came into effect changing the place where VAT is chargeable in respect of all supplies of telecommunications, broadcasting and e-services to consumers. VAT on these services is now chargeable where the consumer is located instead of where the supplier is located. This ensures that the VAT goes to the Member State in which the services are used. The Budget 2015 estimate of €100 million in respect of these changes was based on two specific and immediate VAT inflows into the Irish Exchequer directly resulting from the new rules. The first element was the VAT revenue shifting from Luxembourg in respect of services bought by Irish consumers from Luxembourg-based suppliers. The second was VAT revenue shifting from the UK Exchequer in respect of TV broadcasting services currently provided from the UK to Irish consumers. This estimate of €100 million is on target for 2015.

20. However, there is an additional source of revenue that D/Finance & Revenue were unable to estimate at the time. As a result of the change, businesses are required to register and account for VAT in every Member State in which they supply such services to consumers or, alternatively, to avail of the optional special scheme known as the Mini One Stop Shop (MOSS). The MOSS scheme is a simplification scheme which allows a business engaged in those supplies to register in a single Member State, to file a single quarterly return and pay its VAT liability for all Member States through a web portal in the Member State of registration. The return details and payments are transferred by the Member State of registration to the relevant Member States of consumption with the Member State of registration retaining a percentage of the VAT collected. The percentage retained is 30% during 2015/6 and 15% during 2017/8.

21. The total VAT received from other Member States through the MOSS scheme in relation to supplies to consumers in Ireland for H1 2015 along with VAT retained by Revenue amounted to €75 million. This would suggest a full year outturn of €150 million, which is in addition to the €100 million already embedded in the Budget 2015.

Report of the Commission Expert Group on Taxing the Digital Economy

22. In May 2014, the Commission Expert Group on Taxing the Digital Economy published its Report. In the area of VAT, the Report recommends that all business to consumer (B2C) supplies of goods should be charged to VAT in the place of the consumer and not the place of the supplier, to avoid distortions of VAT competition. This would involve removing the distance sales threshold for supplies of low value intra-Community goods, and also removing the €22 VAT exemption threshold for imports from outside the EU, so that all goods are charged to VAT in the Member State of the consumer. In this context, the Report also recommends that the Mini One Stop Shop (where a business can deal with just one Member State to comply with its VAT obligations in all the Member States where it makes supplies) should be extended, over time, to encompass all B2C supplies of goods and services. In addition, the Report recommends simplification of Member States VAT rating structures.

23. VAT and the digital economy will be discussed at the upcoming international seminar, hosted by Revenue Commissioners "Modernising VAT for cross-border E-Commerce" in September, the discussions will focus on the overview of policy surrounding the issue and also the future of VAT in a digital economy.

EU Commission Review of Reduced VAT Rates

24. The European Commission put forward a Communication on the future of VAT in December 2011, with the objective of delivering a future VAT system tailored for the Single Market. As part of this process a public consultation process was undertaken in late 2012 to review reduced rates of VAT. Legislative proposals may emerge from the consultation, possibly in 2016, however, previous attempts to restructure the VAT rate system have not been successful, as most Member States wish to retain their existing zero and reduced rates. The Commission's long term objective is for VAT rate harmonisation in order to reduce distortion of competition among Member States. Changes to VAT being taxed at the place of consumption and not the place of the supplier should go some way to reducing this distortion.

Developments in relation to cases against Ireland at the ECJ

25. ECJ Case C-108/11 concerned Ireland's application of a 4.8% VAT rate to supply of horses, greyhounds and certain insemination services, and to the hire of horses, which was deemed by the Court in March 2013 to be in breach of the EU VAT Directive. In order to comply with this judgement, Finance (No. 2) Act 2013 contained measures to change Irish VAT law. Following a consultation process with the sector, Section 66 of the Finance (No. 2) Act 2013 was commenced with effect from 1 January 2015 by Statutory Instrument 498 of 2014. The title of this Order is the Finance (No. 2) Act 2013 (Tax Treatment of Horses and Greyhounds) (Commencement) Order 2014.

August 2015

Appendix 1

LIST OF VAT RATES APPLIED IN THE MEMBER STATES
(1 January 2015)

Member States	Zero	Super	Reduced	Standard	Parked
Belgium	0	-	6 / 12	21	12
Bulgaria	-	-	9	20	-
Czech Republic	-	-	10/15	21	-
Denmark	0	-	-	25	-
Germany	-	-	7	19	-
Estonia	-	-	9	20	-
Greece	-	-	6.5 / 13	23	-
Spain	-	4	10	21	-
France	-	2.1	5.5 / 10	20	-
Croatia	-	-	5 / 13	25	-
Ireland	**0**	**4.8**	**9 / 13.5**	**23**	**13.5**
Italy	0	4	10	22	-
Cyprus	-	-	5 / 9	19	-
Latvia	-	-	12	21	-
Lithuania	-	-	5 / 9	21	-
Luxembourg	-	3	8 / 14	17	12
Hungary	-	-	5 / 18	27	-
Malta	0	-	5 / 7	18	-
Netherlands	-	-	6	21	-
Austria	-	-	10	20	12
Poland	-	-	5 / 8	23	-
Portugal	-	-	6 / 13	23	13
Romania	-	-	5 / 9	24	
Slovenia	-	-	9.5	22	-
Slovakia	-	-	10	20	-
Finland	0	-	10 / 14	24	-
Sweden	0	-	6 / 12	25	-
United Kingdom	0	-	5	20	-
Average			**6 / 10.6**	**21.6**	