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Proposal for a

COUNCIL DIRECTIVE

amending Directive 77/388/EEC as regards the possibility of applying on an experimental basis a reduced VAT rate on labour-intensive services

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. Combating unemployment is at the top of the European agenda. The special European Council on employment, held in Luxembourg on 20 and 21 November 1997, concluded that each Member State would look into whether the VAT rate on labour-intensive services not exposed to cross-border competition should be reduced. In its "Vienna Strategy for Europe", the European Council of 11 and 12 December 1998 included promoting employment, economic growth and stability among the four issues of prime concern to European citizens where rapid and effective action was required. The purpose of this proposal is to follow up the conclusions of that European Council¹ so as to enable those Member States which so desire to experiment with reduced VAT rates on labour-intensive services which are not exposed to cross-border competition.
2. The Commission has already considered this option in its communication to the Council "Job creation: Possibility of a reduced VAT rate on labour-intensive services for an experimental period and on an optional basis"².
3. The reasoning behind this initiative is twofold:
 - First, a reduced VAT rate should result in lower consumer prices and thus stimulate demand for labour-intensive services. This would take advantage of the enormous potential for job creation in the businesses concerned, which, typically, operate only locally.
 - Second, 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 it by reaching an agreement with the service provider. A reduced VAT rate would thus reduce the incentive to join (or remain in) the black economy.
4. As the Commission pointed out in its communication, the initiative could, however, have a negative impact on tax neutrality and on the smooth functioning of the single market. In addition, the positive effects of VAT relief on job creation (in particular, the actual impact of the rate reduction on consumer prices) are not undisputed. The Commission takes the view that the best way of promoting employment is to continue with the policy of reducing all charges on the labour factor, especially in relation to low-skilled and low-paid work.

¹ See point 35 of the Presidency's Conclusions.

² Communication of 12 November 1997 (SEC(97) 2089 final).

5. However, the problem of unemployment is such that those Member States wishing to do so should be allowed to experiment with the operation and impact of a reduction in the VAT rate on labour-intensive services. This experiment should though be both optional and limited in time. It should also be monitored on an ongoing basis to ensure that its implementation by a Member State respects compliance with the fundamental principle of tax neutrality. Cross-border distortions of competition and distortions at sector level which lead to economic inefficiency must be avoided. Lastly, in addition to the impact on employment, the budgetary impact of the experiment should be examined to ensure that it is effective.
6. It is also desirable to place tight restrictions on the scope of this measure and to ensure that it remains verifiable and limited. However, the follow-up to the 1997 communication has demonstrated that it is particularly difficult to draw up in advance a restrictive list of services for which this reduced rate could apply. The Commission therefore takes the view that it is better to lay down the conditions that must be met by the services likely to benefit from such a measure. Without prejudice to the individual assessment to be carried out as part of the envisaged Council authorisation procedure, the services likely to meet those conditions and to offer the best job-creation potential could be, for example, repair services on movable tangible property, certain environmental services, domestic care services such as home help and care of the young, elderly or disabled, and renovation and repair services in old residential buildings or listed buildings of historical interest.
7. Given that the envisaged measure will be optional, the Commission and the other Member States will have to be provided with systematic, detailed information by those Member States taking part. In addition, especially in view of the real risks of distortions of competition, the authorisation procedure in the Council, acting unanimously, will enable the Commission and the Member States to vet any applications made. Lastly, given the importance of ensuring the smooth functioning of the single market and the need to limit any negative effects on tax neutrality, the Commission should be empowered to propose appropriate measures to the Council with a view to bringing to an end any harmful consequences a reduced rate might have on competition, either within the Member State concerned or between Member States. The Council will act on these proposals by qualified majority, similar to the procedure laid down in Article 101 of the Treaty. This procedure is designed to allow the derogation from the general rule (standard rate) to be withdrawn in the interests of the Community and, where applicable, of other Member States which have been harmed by the introduction, by one of them, of the reduced rate. The standard rate will then apply automatically, and the Member State which benefited from the distortion of competition will not be able to use its veto.

8. Given the experimental nature of the proposed measure, an overall assessment of its effectiveness, both in terms of job creation and in terms of efficiency within the harmonised VAT system, should be carried out in those Member States taking part. On the basis of these reports and its own experience, the Commission will draw the appropriate conclusions and put forward any proposals that appear necessary.

COMMENTS ON THE ARTICLES

Article 1

The purpose of this Article is to insert in Article 28, a new paragraph 6 introducing an authorisation procedure by the Council, acting unanimously, for those Member States wishing to apply a reduced rate for certain local labour-intensive services. In view of this measure's experimental nature, it should be restricted for Member States to a fixed three-year period beginning on 1 January 2000 and ending on 31 December 2002 so that it can then be assessed and the appropriate arrangements made. It should also be made subject to strict conditions to ensure that it remains verifiable and limited.

The second and third paragraphs list the conditions that services must meet in order to qualify for a rate reduction. The scope of this derogation should be clearly defined in order to limit the risks of any negative effects on the smooth functioning of the single market and tax neutrality.

The fourth paragraph spells out in detail the authorisation procedure set in place and the information to be provided by the Member States wishing to introduce the measure.

The fifth paragraph provides for the Commission to propose appropriate measures to the Council in the event of distortions of competition coming to light during the experiment. It should therefore be possible to respond to any problems arising from the optional implementation of these reduced rates and the risks of distortion of competition intrinsic to the measure. The Council will act on these proposals by qualified majority.

The sixth paragraph requires those Member States which implement the measure to draw up a detailed report on its operation and its impact on employment. In this way, the experiment can be assessed and conclusions drawn for the future.

Articles 2 to 4

These Articles set out the measures concerning the entry into force of the Directive.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99 thereof,

Having regard to the proposal from the Commission¹,

Having regard to the opinion of the European Parliament²,

Having regard to the opinion of the Economic and Social Committee³,

1. Whereas Article 12(3)(a) of Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment⁴, as last amended by Directive 98/80/EC⁵, provides that the Member States may apply either one or two reduced rates only to supplies of goods and services of the categories specified in Annex H to Directive 77/388/EEC;
2. Whereas, however, the problem of unemployment is so serious that those Member States wishing to do so should be allowed to experiment with the operation and impact - in terms of job creation - of a reduction in the VAT rate on labour-intensive services which are not currently listed in Annex H;
3. Whereas this reduced VAT rate is likely to reduce the incentive for the businesses concerned to join or remain in the black economy;

¹ OJ C

² OJ C

³ OJ C

⁴ OJ L 145, 13.6.1977, p. 1.

⁵ OJ L 281, 17.10.1998, p. 31.

4. Whereas, however, the introduction of a targeted reduction in the VAT rate could have a negative impact on the smooth functioning of the internal market and on tax neutrality; whereas provision should therefore be made for an authorisation procedure to be introduced for a full and clearly defined three-year period and for the scope of this measure to be made subject to strict conditions so that it remains verifiable and limited;
5. Whereas it is necessary to establish a procedure for vetting and monitoring authorisations granted in order to ensure that they remain compatible with the smooth functioning of the single market;
6. Whereas, since the objective is to eliminate distortions of competition within the Community, the appropriate measures, such as the withdrawal of an authorisation or the reduction of its scope must be taken by the Council, acting by qualified majority, in a manner similar to the procedure laid down in Article 101 of the Treaty;
7. Whereas, in view of the experimental nature of the measure, a detailed assessment of its impact in terms of job creation and efficiency should be carried out by the Member States which implement it;
8. Whereas the measure should be strictly limited in time and should end by 31 December 2002 at the latest,

HAS ADOPTED THIS DIRECTIVE:

Article 1

The following paragraph 6 is added to Article 28 of Directive 77/388/EEC:

- “6. The Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply for all of the period from 1 January 2000 to 31 December 2002 the reduced rates provided for in the third subparagraph of Article 12(3)(a) to labour-intensive services.

The services concerned must satisfy the following requirements:

- (a) they must be labour-intensive;
- (b) they must be provided direct to final consumers;
- (c) they must be mainly local and not likely to create distortions of competition.

The application of a reduced rate must not prejudice the smooth functioning of the internal market.

Any Member State wishing to introduce the measure provided for in the first paragraph shall inform the Commission before 1 September 1999 and shall provide it before that date with any relevant particulars, and in particular the following:

- (a) scope of the measure and detailed description of the services concerned;
- (b) particulars serving to show that the conditions laid down in the second and third paragraphs have been met;
- (c) particulars establishing that the measure is not likely to create distortions of competition;
- (d) particulars showing the budgetary cost of the measure envisaged;
- (e) particulars establishing a close link between the lower prices resulting from the rate reduction and the foreseeable increase in demand and employment.

If the Commission finds that the arrangements introduced by a Member State can no longer be maintained on the grounds that they are distorting competition, either between similar activities within the Member State concerned or between the same or similar activities in different Member States, it shall propose appropriate measures to the Council. The Council shall act on such proposals by qualified majority.

Those Member States authorised to apply the reduced rate referred to in the first paragraph shall, before 1 October 2002, draw up a detailed report containing an overall assessment of the measure's effectiveness in terms of job creation and efficiency.”

Article 2

Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 31 December 1999 at the latest. They shall forthwith inform the Commission thereof.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

Article 3

This Directive shall enter into force on the seventh day following that of its publication in *the Official Journal of the European Communities*.

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council
The President*