

European Commission Green Paper on the Future of VAT – Towards a simpler, more robust and efficient VAT system

EFC & DAFNE Joint response

30 May 2011, Brussels

The European Foundation Centre (EFC) and the Donor and Foundation Networks in Europe (DAFNE) have since 2001 come together to research the impact of VAT and other taxes on the work of public benefit foundations and to make representations to the EU institutions and governments on behalf of the sector. The EFC and DAFNE have over the past years joined forces with the European Charities Committee on VAT (ECCVAT) and both organisations (EFC and DAFNE) have become members of ECCVAT. ECCVAT will submit a separate contribution to this consultation.

General comments:

1. EFC and DAFNE welcome this consultation, the opportunity to comment on the recent Green Paper on the future of VAT and the attempt by the European Commission to launch a broad-based debate with all the stakeholders on the evaluation of the current VAT system.
2. Our contention is that a series of improvements should continue to be made to simplify the VAT system and to make it fairer particularly with regard to irrevocable VAT costs that charities including public benefit foundations face.
3. We urge the Commission to give serious consideration to the unique position of public benefit foundations as the consultation process progresses and in making recommendations on the future of VAT not to overlook their impact on the foundation sector – and the diverse communities that it serves, including deprived, disadvantaged populations.
4. EFC and DAFNE are concerned that public benefit foundations have been effectively ignored in the Green Paper's analysis of the VAT system. The consultation document makes a number of references to removing exemptions without considering the impact of such a move on public benefit foundations and their beneficiaries. The removal of exemptions and reduced rates could have dire financial consequences for European civil society. EFC and DAFNE are, however, encouraged by indications in the Green Paper that "subsequent initiatives following that Communication would be based on thorough impact assessments" and hopes that throughout this process the position of public benefit foundations will be given proper consideration through an impact assessment.
5. EFC and DAFNE welcome the Green Paper's commitment to reduce unnecessary bureaucracy in the VAT system. The simplification of the VAT system is well overdue and will improve the efficiency the system to the benefit of all stakeholders.

Charities in the European VAT system – the current position

The European VAT system has long caused problems for foundations and charities because many of the services that they provide are either exempt under EU law or are outside of the scope of VAT because they are provided free of charge. In both cases this means that the charity or foundation cannot charge VAT and so cannot recover the VAT on its expenditure.

This inability to recover the VAT that is spent on purchases reduces the resources that they have available to spend on their charitable purposes. This has been a long-running issue for the sector, particularly in a time of general recession when foundations and charities are under pressure from government to increase the level of front-line services that they can support and offer. It is also of considerable concern that a foundation or charity can spend a much greater percentage of its turnover on VAT than does the average commercial organisation. In some cases, VAT can account for as much as 15 per cent of voluntary income and is usually well in excess of 10 per cent.

The European Foundation Centre (EFC) mapped how much money public benefit foundations lose on VAT. The results of the EFC survey so far indicate that €40 million is lost annually on VAT expenses by 33 EFC members alone, see

<http://website/EUAdvocacy/EU%20Communiqu%20%20Briefings/befc0907.pdf>. It is not possible to calculate the loss on VAT for the whole foundation sector, but it should be taken into consideration that these 33 EFC members are a tiny representation of the estimated 110.000 public benefit foundations in Europe. In addition, some concrete case studies have been put together to illustrate how the VAT loss affects individual foundations:

<http://www.efc.be/Legal/Documents/VATCaseStudiesMar09.pdf>

Response to the questions outlined in the consultation

Q3. Do you think that the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality, and if not, why not?

There are currently VAT obstacles in a number of Member States in relation to public authorities commissioning services. See Q.33 – Option 3 for a proposed solution to this problem using national rebate schemes.

Q6. Which of the current VAT exemptions should no longer be kept? Please explain why you consider them problematic. Are there any exemptions which should be kept and, if so, why?

We are concerned about the *Green Paper's* assessment of the future of the current VAT exemptions. We agree that some of the exemptions currently in place might be reviewed in the light of IT developments. However, many of the current exemptions are still essential to the continued existence of charities and other public bodies in the public interest.

We would therefore urge the Commission to make a concerted effort to seek properly to evaluate the value, extent of use and importance to sector of the existing social and other societal exemptions. EFC and DAFNE are concerned that the *Green Paper* contemplates the removal of many exemptions without proper consideration of the impact on those charities that rely on them.

The *Green Paper*:

- suggests that 'the continued relevance of many of the existing exemptions is questionable';
- proposes that the tax base should be broadened by reducing the number of exemptions to make VAT 'more efficient and more neutral and offers a valid alternative to increasing VAT rates';

- argues that in the EU, ‘the standard rate covers only about two thirds of total consumption, with the remaining one third subject to different exemptions or reduced rates’; and
- concludes that the exemptions could be seen as an obstacle to the efficiency of the VAT system and even ‘contrary to the principles of VAT as a broad based tax’.

The VAT Directive distinguishes between exemptions for certain activities in the public interest – eg for social, educational and cultural reasons – and exemption for other activities – eg because of technical concerns about applying VAT to the underlying transactions (financial services and gambling activities) or interference with other taxes (transactions related to immovable property).

This distinction is very important for charities and foundations that primarily benefit from the first type of exemption in the public interest. These ‘social exemptions’ are extremely valuable to charities and foundations.

Q13. Which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?

Council Regulations ensure consistency, whereas Directives offer flexibility – and there are advantages and disadvantages to both. However, where law-making affects cross-border activities, inconsistency introduces complexity and potential double taxation. It would therefore be preferable for those laws which affect cross-border transactions to be laid down in Regulations rather than through Directives. Using Regulations should ensure tax equality and reduce the burden imposed by the complexity of inconsistent interpretations in different states.

There are evidently problems in the implementation of some EU VAT Directives. One mandatory exemption, Article 132 (1) (f), which relates to cost-sharing, has been incorrectly implemented in some Member States (Germany) and in others not implemented at all (the UK). While the Commission can refer a failure to implement such legislation to the European Court of Justice, any infringement proceedings that result are often protracted and expensive. In situations where there is a mandatory provision in EU VAT law it may therefore be useful for it to be laid down in a Council Regulation instead of a Directive.

Q14. Do you consider that implementing rules should be laid down in a Commission decision?

AND

Q15. If this is not achievable, might guidance on new EU VAT legislation be useful even if it is not legally binding on the Member States? Do you see any disadvantages to issuing such guidance?

We would welcome the provision of additional guidance on new EU VAT legislation. Any attempt to simplify the learning process through guidance would be useful. Sector-specific guidance would also be helpful, as would guidance that is accessible by those who are not tax experts.

Q16. More broadly, what should be done to improve the legislative process, its transparency and the role of stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?

We believe that the legislative process could be enhanced by involving targeted groups of stakeholders at the drafting and implementation phases of the legislative process.

Q33. Which issues, other than those already mentioned, should be addressed in considering the future of the EU VAT system? What solution would you recommend?

We are opposed to the abolition of the current system of exemptions and the introduction of a full taxation model. From our perspective, the main goal should be to reduce the input VAT costs that foundations face (VAT paid on costs that are attributable to the delivery of the service/product). We could only consider the removal of exemptions and the introduction of a full taxation model an option if it was optional and coupled with reduced output rates, see below.

Option 1: Solution at EU level: Recover/reduce input VAT costs through change of VAT Directive

The main goal should be to reduce the input VAT costs that foundations face (VAT paid on costs that are attributable to the delivery of the service/product).

Preferred scenario: Reduced rate on supplies to public benefit organisations

All types of public benefit foundations would benefit from a reduced rate on supplies to public benefit foundations: This would imply an extension of the reduced rate permitted in Point 15 of Annex 3 of the VAT Directive to cover supplies to public benefit organisations as well as supplies by public benefit organisations. The advantage of this approach is that it would also take into account the situation of foundations that do not charge for their goods/services. Furthermore, this option was proposed by the European Commission to the Council of Ministers back in 1991 and was only narrowly rejected by three Member States.

Alternative scenario: Recovering input VAT related to exempt and “outside the scope” supplies

Exempt supplies: In the case of VAT exempt supplies (where the foundation charges for the goods or services supplied e.g. goods and services in the areas of health, sport, cultural services, education, vocational training, protection of children, etc) this could be achieved by the creation of additional categories of “zero-rate supplies” with no VAT included in the final price paid by the consumer.

Another solution would be for foundations to have the **option of taxing** the exempt services they supply, as is already permitted in some instances (land and financial services, but presently only at the discretion of the member states). This would allow input tax recovery. The maximum benefit would be obtained if the outputs were to be taxed at a (super) reduced rate.

Outside the scope activities: In the case of supplies outside the scope of VAT (in particular where the foundation does not charge for its goods/services – for example, it might be a pure grant-making foundation) the system should permit a recovery by foundations of input tax attributable to these activities. This could be achieved by the introduction of Input Tax Credits (e.g. giving a notional input tax credit for certain outputs provided without charge, such as rescuing people at sea or on mountains, medical treatment for the homeless etc.).

Option 2: Solution at national level: national rebate/refund schemes

As an alternative to advocating for amendments to the VAT Directive, EU countries could introduce national VAT compensation refund schemes under their domestic laws. Most Member States have introduced domestic schemes to refund the VAT input costs of their local government and public bodies even where these authorities compete with public benefit foundations in the provision of certain services. Such schemes depend on calculating and paying a matching grant equivalent to some or all of the VAT incurred by the public benefit foundation on expenditure outside the VAT system. National governments often claim they have little flexibility on VAT and are limited by EU law, but it is clear that EU law does not prevent national governments from compensating foundations for irrecoverable VAT. Indeed this has been confirmed by a number of statements from EU Commissioners. The EFC is of the opinion that there should be a formal statement from the EU addressed to each Member State that refund schemes are not in breach of EU rules. The Danish government introduced a national refund scheme for public benefit organisations in 2004, which illustrates the potential for similar schemes in other Member States.

Reasons not to support the introduction of a mandatory “full taxation model” and replacement of all exemptions for public benefit foundations:

If none of the above options at EU or national level could be implemented, the EFC and DAFNE are of the opinion that Member States should be encouraged by the European Commission to implement existing reliefs fully and consistently.

The EFC and DAFNE do not support a mandatory “**full taxation model**” or a replacement of all social exemptions. The EFC and DAFNE would only support the idea of public benefit foundations entering the VAT system, if it was an optional system. Foundations should have the option of taxing the exempt services they supply but should not be forced to do so. Even if reduced rates of VAT were introduced in relation to public benefit foundations, it would appear that supplies would still have to be delivered by public benefit foundations at a higher price.

A replacement of all exemptions would only be acceptable if the VAT rate could be reduced to such an extent that it would have a fiscally neutral effect, as otherwise the removal of all exemptions could lead to a significant increase in the VAT burden for some organisations.

European Foundation Centre

The European Foundation Centre (EFC), founded in 1989, is an association of over 200 public-benefit foundations and corporate funders active in philanthropy in Europe and beyond. Our goal is to strengthen independent funding in European philanthropy using four key approaches. We foster a legal and fiscal environment where foundations can thrive. We analyse and recount what foundations are doing. We reinforce the philanthropic sector by setting standards and building capacity. And we promote collaboration among foundations and with other stakeholders, to advance the public good. All members back the EFC Principles of Good Practice, which reinforce good practice and transparency.

www.efc.be

The Donors and Foundations' Networks in Europe (DAFNE)

DAFNE is a formal network bringing together 22 donors and foundations networks from across Europe. Each of these individually serves public benefit foundations and other grantmakers at national level. With a collective membership of over 6,000 foundations, DAFNE underpins the individual activities of its members by strengthening collaboration between the national associations and providing a platform for exchange of knowledge. The secretariat of DAFNE is hosted by the European Foundation Centre (EFC).

Belgium: [Network of Belgian Foundations](#)
Bulgaria: [Bulgarian Donors Forum](#)
Czech Republic: [Czech Donors Forum](#)
Finland: [Council of Finnish Foundations](#)
France: [Centre Français des Fondations](#)
Germany: [Bundesverband Deutscher Stiftungen](#)
Hungary: [Hungarian Donors Forum](#)
Ireland: [Philanthropy Ireland](#)
Italy: [Associazione di Fondazioni e di Casse di Risparmio \(ACRI\)](#)
The Netherlands: [Vereniging van Fondsen in Nederland](#)
Norway: [Stiftelsesforeningen](#)
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