
The European Foundation Centre (EFC) Legal Committee has prepared this position paper on the issue of Value Added Tax (VAT) and public benefit foundations building upon the 2009 EFC VAT survey, expert resources and previous discussions with EFC members.

Executive summary:

- The current VAT system leads to considerable VAT costs for public benefit foundations, which reduces the resources that they have available for their public benefit purposes.
- The EFC is calling for a fairer VAT treatment of public benefit foundations. The EFC considers a reduction of input VAT either through a change of the VAT Directive or national refund schemes as the best policy options to achieve this.
- The EFC welcomes the European Commission's review of the taxation of public bodies and the future of the social exemptions in the VAT Directive. The EFC considers this as an opportunity to push for a fairer VAT system for public benefit foundations. The review of the EU VAT Directive should in no case worsen the taxation burden for public benefit organisations (be it direct or indirect taxation). The EFC will closely monitor the EU plan with regard to VAT, feed in data and present its opinion as to how to improve the situation.
- The EFC will continue to act in partnership with Donors and Foundations' Networks in Europe (DAFNE) and the European Charities' Committee on VAT (ECCVAT).

1. The current situation – foundations lose on VAT

The EFC is of the opinion that the current VAT system creates a series of problems for the foundation sector. Public benefit foundations must pay irrecoverable VAT costs, since they are in most cases treated by the VAT system as the final consumer. They often provide services that are either exempt under EU law or are outside of the scope of VAT because they do not charge for their services. In both cases, this means that a foundation cannot charge VAT and so cannot recover the VAT on its expenditure. This reduces the resources that foundations have available for pursuing their public benefit purposes. More information on how public benefit foundations suffer under the current VAT system can be obtained from the 2008 joint information note of the EFC, the European Charities' Committee on VAT (ECCVAT) and the Charity Tax Group (CTG), see <http://www.efc.be/Legal/Documents/VATInformationNoteMay2008.pdf>

Against this background, the EFC mapped how much money public benefit foundations lose on VAT and has been reviewing how a fairer VAT treatment of public-benefit foundations could be reached, which would allow them to maximise the public benefit impact of their work. 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%20Communiquus%20%20Briefings/befc0907.pdf>.

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>

2. EFC opinion on how to improve the situation

The EFC is calling for a fairer VAT treatment of public benefit foundations to allow them to maximise the public benefit impact of their work. Given that public benefit foundations have a vital role in supporting public-benefit activities across Europe, the tax system should take this into consideration and help to maximise the resources that foundations can use to address public benefit needs in Europe. Several options have in the past been discussed to reduce the unfair VAT burden for public benefit foundations. The EFC Legal Committee favours the following two scenarios:

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). Given that public benefit foundations operate in different ways, some of the suggested solutions would only benefit certain types of organisations and a combination of different solutions, such as those outlined below, would be required for the whole foundation sector to receive a fairer VAT treatment:

- **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.).

Drawback: All the above scenarios would require unanimous agreement of all 27 Member States, since they imply a change of the VAT Directive. In addition, Member States are very reluctant to discuss VAT rates, as the last set of negotiations on this topic were very difficult and revealed wide differences of opinion between the Member States. The specific drawback of introducing a notional input tax credit for certain outputs provided free of charge, is that in practice the nature of many outside the scope services makes it difficult to put a value on them where they are provided for free and there is no comparable commercial equivalent.

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.

Drawback: The introduction of such refund schemes depends on the willingness of every Member State government to fund this and given the current economic climate, it is unlikely that governments will want to commit to such expenditure.

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 is of the opinion that Member States should be encouraged by the European Commission to implement existing reliefs fully and consistently.

The EFC does not support a mandatory “**full taxation model**” or a replacement of all social exemptions. The EFC 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.

3. European Commission plans on VAT

For a number of years the Commission has been planning to review the taxation of public bodies and the future of the social exemptions in the VAT Directive and has recently started this review:

- In 2009, the European Commission Directorate General Taxation and Customs commissioned **a study** to assess the current situation and the impact of potential solutions to existing problems related to the VAT treatment of public interest organisations and activities. Copenhagen Economics, the EC contracted body for the survey, is due to complete the exercise by the end of 2010. The EFC and ECCVAT have provided data and information for the study.
- In parallel to the Copenhagen Economics study, the European Commission has announced a Green Paper which will look at the VAT system more generally (i.e. not just in relation to the VAT treatment of public bodies and public interest bodies) to further stimulate the debate on VAT. The EC will launch a **consultation** for all stakeholders at the end of 2010.
- A **policy proposal** is envisaged for 2011. Knowing that legislative changes on tax matters require a unanimous decision of the Member States, negotiations may be laborious.

The European Commission currently **foresees three types of options** to address the issue of the VAT treatment of public interest activities as presented during the EFC Foundation Week, in June 2010:

- I. The first option is to make **fundamental changes to current VAT rules**, which could include
 1. widening the scope of VAT to cover most activities, **so-called “full taxation model”**. The issue of reduced and super reduced VAT rates would need to be reviewed
 2. removing existing social exemptions or
 3. allowing exemption with a right to deduct VAT.
- II. Another more limited reform could be to
 1. clarify the scope of existing exemptions and encourage full implementation of them or
 2. **introduce the option for taxable persons to be either exempted or taxed**, an approach which was tested for financial services.
- III. A third option is to find **a solution outside the VAT system**. i.e. Member States could extend their refund schemes to public benefit organisations – so-called **national refund schemes**.

The EFC welcomes the European Commission’s review of the taxation of public bodies and the future of social exemptions in the VAT Directive. The EFC considers this as an opportunity to push for a fairer VAT system for public benefit foundations. The review of the EU VAT Directive should in no case worsen the situation for public benefit organisations (be it direct or indirect taxation). The EFC will closely monitor the EU plan with regard to VAT, feed in data and present its opinion as to how to improve the situation.

4. Work in partnership – the third sector coalition on VAT

The EFC has joined forces with the Donors and Foundations' Networks in Europe (DAFNE) and the European Charities' Committee on VAT (ECCVAT) to call for fair VAT treatment of public-benefit foundations in the context of the Commission's action in this area.

ECCVAT and representatives of foundations and associations interested in the issue meet regularly to review the latest developments from the European Commission on VAT, create synergies and build a coalition among non-profit organisations to ensure that their views will be given due attention in the EC study and ensuing public consultation. ECCVAT takes the lead to ensure steady information flow between the organisations involved.

Further details on VAT and foundations can be found at: <http://www.efc.be/Legal/Pages/VATissues.aspx>