TSG 07/07

General VAT Issues

Introduction

1. This paper reviews VAT issues under three headings:

- The VAT rating structure and scope for changing VAT rates;
- Domestic budgetary issues; and,
- Developments at EU level.

Annual VAT Revenue

2. VAT is the single largest source of revenue within the Irish tax system. As VAT is a tranaction tax the yield grately depends on the level of economic activity and consumer spending from which it derives. In 2006, VAT accounted for approximately €13,451 million or 29.5% of the overall tax yield to the Exchequer.

1. VAT Rates and Structure

3. The structure and scope under which Member States can apply VAT to goods and services are determined by EU law. Ireland operates three rates of VAT[1]:

- **Zero-rate** which generally applies to most food, childrens' clothes and shoes, and oral medicines accounts for 8% of goods and services subject to VAT. While it is possible to retain the zero rating for goods and services that were in place on 1 January 1991, no new zero VAT rates can be introduced.
- **Reduced rate** of 13.5 per cent applies mainly to domestic fuels, labour intensive services and general repairs and maintenance and accounts for 48% of goods and services subject to VAT. Member States may have up to two reduced VAT rates of not less than 5 per cent for a specified number of goods or services which are set out in Annex III of the VAT Directive.
- Member States have the option of maintaining, at a reduced rate of not less than 12 per cent, any items not listed in Annex III, provided they carried the reduced rate on 1 January 1991. These items are considered to be 'parked' and Ireland's parked rate equates to our reduced rate of 13.5%. Domestic fuels, restaurant services and labour intensive services are examples of parked items.

[1] Ireland also applies a VAT rate of 4.8% but this is limited to livestock sold by registered. Unregistered farmers are also allowed to apply an addition of 5.2% to the sells price of all produce. This reduces administrative burden on small farmers.

- **Standard rate** of 21 per cent applies to the remainder of goods and services accounting for almost 44% of goods and services including cars, electrical equipment and CD/DVDs. Under the VAT Directive Member States may set the standard VAT rate not lower than 15% - there is political agreement that the standard rate of VAT applying in each Member State does not exceed 25%.

4. Services provided by charities, non profit organisations and certain financial services are **exempt** from VAT. In general, Government Departments and local authorities are also exempt. Such suppliers do not generally charge VAT on the services they provide and cannot reclaim VAT incurred on the goods and services they purchase.

Options for changes to VAT Structure and Rates

Scope for changes to the zero rating

5. Under EU rules we can retain the zero rating of items which were zero rated on 1 January 1991 but cannot introduce any new zero rates. It is possible to move existing zero rated items to either the reduced rate, provided they are listed in Annex III, or to the standard rate. However, once moved, it would not be possible to revert them to the zero rate.

Introduction of a second reduced VAT rate

6. It is only possible to introduce a reduced rate in respect of the list of goods and services set out in Annex III of the VAT Directive. The Directive requires that any second reduced rate has to be a minimum of 5 per cent. The goods and services in Annex III include certain foods, medicines, supply, construction and alteration of housing, and newspapers and periodicals.

7. The list of goods and services listed in Annex III is not exhaustive (copy attached Appendix 1) . However, we have already taken advantage of some of the options in Annex III to introduce a reduced rate in respect of some goods and services, while others have been retained at the standard rate. If the items which are currently at the standard rate but listed in Annex III were reduced from 21% to 13.5%, it would cost €158m in a full year of which foodstuffs would account for €118.3m**;** pharmaceuticals (i.e. non oral medicines) €34.8m**;** and, periodicals €4.9m.

8. The introduction of a second reduced rate would lead to campaigns for further VAT reductions on goods and service at the current reduced rate or at the standard rate if permissible under EU law. It is worth noting that construction, which makes up almost 29% of VAT revenue, is subject to the reduced rate. In addition, the introduction of a second reduced rate would represent a fundmental restructing of the VAT system, making what is current considered to be administratively complex even more so.

Changing the Standard Rate of 21 per cent

9. The standard rate of VAT was reduced from 21 per cent to 20 per cent in the 2001 Budget and increased to 21 per cent in the 2002 Budget. There are a number of issues to consider in determining whether there should be any change in the standard rate.

10. A decrease of one per cent in the standard rate would have a full year cost of about €447 million. This revenue would be lower in the first year because of the pattern of VAT payments and also if transitional provisions were introduced. Such a reduction would reduce the CPI by 0.455 per cent. It is not clear however that the standard rate reduction was passed on in full when the standard rate was previously reduced in 2001 thus diminishing the possible beneficial inflation effect. A reduction may create some buoyancy and encourage some further consumer spending, thus offsetting part of the cost to the Exchequer of such a reduction. There would also be some limited benefits for those segments of the e-commerce sector who sell digital services to private consumers within the EU.

11. On the other hand, an increase in the standard rate to 22 per cent would raise in the order of €447 million in a full year but increase the CPI by 0.455 per cent. Such a move would make us one of the countries with the highest standard rate in the EU and further widen the differential with the UK standard VAT rate to 4.5 percentage points. A higher standard VAT rate may also act as a motivation for a creation of VAT avoidance schemes. Increases in indirect taxation may have a greater impact on the less well-off because more of their income is consumed.

Changing the reduced rate of 13.5 per cent

12. An increase in the reduced rate by 1 per cent to 14.5 per cent would yield some €503 million in a full year and add 0.184 per cent to the CPI. This figure would be significantly less in the first year because of the pattern of payments and if transitional measures were applied.

13. Previous experience has shown that when a VAT rate is increased, some retailers use this opportunity to further increase prices above the 1 percentage point increase. This would add to the effect on inflation.

14. As previously stated increases in indirect taxes act as a motivation shadow economy activity. Also such increase have a greater impact on the less well-off.

15. It would also be possible to lower the reduced rate, though the existing 'parked' rate provisions would prevent such a reduction below 12 per cent for certain goods and services. A reduction to 12.5% from 13.5% would cost approximately €503 million in a full year and reduce the CPI by 0.184% if passed on in full.

2. Domestic VAT Issues

VAT Registration thresholds

16. Traders established in the State and making supplies in the State are obliged to register for VAT where certain turnover thresholds are exceeded or are likely to be exceeded in any continuous period of twelve months. Under EU law, with which Irish VAT law must comply, Member States may only increase thresholds in line with inflation. The current thresholds which where increased last year are: €35,000 in the case of a person supplying services and €70,000 in the case of a person supplying goods.

17. The following considerations arise:

- If thresholds were increased in line with the Consumer Price Index, this would result in the €35,000 threshold being increased to €38,311 and the €70,000 threshold being increased to €76,622. The costs involved would be €8.1m and €19.4m respectively, amounting to a total cost of €27.5m in a full year. This would remove 3,555 businesses from the VAT net.
- Ireland has the third highest registration thresholds in the EU, after the UK (stg £64,000) and France - some Member States have no registration thresholds and require all firms to register irrespective of their turnover.

Programme for Government (VAT classification of Environmental Goods and Services)

18. Extract from Programme for Government: *"The current VAT classifications will be examined with a view to reducing the rate of VAT applied to certain environmental goods and services from 21% to 13.5%."*

19. The scope for changing VAT rate applicable to any good or service is determined by EU law. Only those goods and services listed in Annex III of the VAT Directive can have the reduced VAT rate applied to them. Therefore the scope for applying a reduced rate to a good or service is based on whether that good or service is listed in Annex III. In addition, it is not possible under EU VAT law to introduce measures that would create a distortion of competition between similar goods or services based on an environmental benefit. Therefore any reduction would have to be applied to similar non-environmental goods and services.

20. It is worth pointing out that France and in particular the UK are seeking changes to the VAT Directive that would allow for preferential treatment of environmental goods and services. However, it should be noted that these two countries have committed themselves to nuclear power which would mean that nuclear power could be one of the supplies provided at a lower rate of VAT under any new EU law. To date, no work has been carried out on this issue at EU level and as such it is unclear what the scope of such a review would be.

21. As required by the Programme for Government it is necessary to examine what scope is available to reduce the VAT applied to environmental goods and services from 21% to 13.5%.

Review of farmers' flat rate addition (unregistered farmers)

22. The flat-rate scheme is a practical method to compensate unregistered farmers, on an overall basis, for the VAT incurred on their business inputs. This is achieved without applying the normal VAT rules on registration, record-keeping and returns. The tax compliance burden for farmers participating in the scheme is minimal and, in addition, the State is relieved of a significant administrative burden.

23. The scheme sets out a percentage amount, known as the flat-rate addition, which is applied to the price being paid to unregistered farmers when they are selling to VAT-registered businesses (co-ops, meat factories etc.). The VAT registered business can treat the flat-rate amount as a normal business input in its VAT return.

24. The flat-rate refund is reviewed each year in the run up to the Budget and is calculated in accordance with criteria laid down in the VAT Directive; in particular, the refund must be struck on the basis of macro-economic data (i.e. agricultural inputs and outputs) for flat rate farmers alone for the preceding three years.

25. In the context of the partnership agreement, Towards 2016, it was agreed to conduct a review of the methodology underpinning the calculation of the farmer's flat rate. The overall objective is to ensure that the methodology properly reflects developments in the farming sector since the methodology was last reviewed in 1988. The methodology has been clarified and some elements of the calculation underpinning it have already been amended. The review is ongoing and as a result, in Budget 2007, the farmer's flat rate addition was increased from 4.8% to 5.2%. It is envisaged that the review will be complete in time for Budget 2008.

Review of VAT on Property Transactions

26. The Revenue Commissioners, over 2005 and 2006, carried out a review of the current system of applying VAT on property transactions. The review recommends significant changes to the system. The Minister for Finance accepted that the complexity of this area of taxation needs to be addressed, and decided in the context of the 2007 Budget that given its importance to engage in a wide consultation process with interested parties before deciding on any changes which might appropriately be implemented in the 2008 Finance Act.

27. Submissions have been received from interested parties and the consultation process is ongoing. A separate paper on VAT on Property Transactions will be presented to the Tax Strategy Group meeting planned for 23 October.

Charities

28. Irish Charities Tax Reform Group's (ICTRG) campaign for the introduction of a refund of VAT paid on inputs by charities and not-for-profit bodies is ongoing. Charities are exempt from charging VAT on the goods and services they provide and cannot claim VAT deductions on the goods and services they purchase. It is not possible under EU law to change the current VAT treatment of charities.

29. The European Commission has indicated that there is nothing in EU VAT law to prevent national Governments providing grants to compensate charities or indeed other groups, for the irrecoverable VAT which they have incurred. To date, the only EU Member State to introduce a scheme providing partial compensation for a limited number of charities for VAT incurred on input costs is Denmark. To be eligible under the Danish scheme charities must already be approved bodies under the Danish equivalent of our tax relief on donations scheme. Approximately 750 charities in Denmark benefit from the scheme. In comparison, over 1,900 organisations have to date been approved under the Irish donations relief scheme. Under the Danish scheme educational institutions are not eligible for compensation.

30. It is likely that the introduction of any grant system in lieu of VAT paid by registered charities in Ireland would undoubtedly lead to other exempt bodies such as schools, hospitals and sporting organisations, many of which are already registered as charities, seeking to benefit from such a system of refunds. The Revenue Commissioners currently recognise over 7,100 bodies as established for charitable purposes and thereby exempt from tax. Given the number of charities that are currently registered we would be concerned at the potential cost to the Exchequer which would result from the introduction a formal grant mechanism compensating charities and non profit organisations for VAT paid on their expenses. These exempt bodies are already receiving considerable Exchequer funding.

31. Even if funds were available for grant-aiding charities and other voluntary groups, it is not clear that the most appropriate use of Exchequer funds would be to relieve charities and voluntary organisations of VAT as opposed to supporting their activities, or similar type activities otherwise provided, using other criteria which would provide for a more focused approach. It would also provide an opportunity to influence activity in the sector in delivering on specific public policy priorities.

3. VAT Developments at EU Level

Overview

32. At EU level, four issues currently dominate the VAT agenda:

- The 'VAT Package' consisting of the 'Place of Supply' proposal and supporting elements within the 'one-stop-shop' proposal. In June 2007, the ECOFIN Council reached political agreement on certain aspects of the VAT Package and signalled its intention to adopt the complete package by December 2007. The package deals with cross-border business-to-business (B2B) and certain business-to-consumer (B2C) services and its adoption will ensure that VAT accrues to the Member State of the consumer.

- The fight against VAT fraud and specifically 'carousel' fraud.

- VAT and Financial Services on which a public consultation was conducted by the European Commission between March 2006 and June 2006 and for which legislative proposals are expected by end 2007;

- Restructuring of the Reduced VAT Rates regime. In July 2007, the EU Commission launched a political debate on reduced rates with a view to developing legislative proposals by end 2008. XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

33. Further information on each of the four areas is provided below.

34. Ireland is currently the subject of three VAT infringement processes. These are described further below (paragraphs 59-63).

The VAT Package

35. The VAT Package involves two complex and inter-related proposals, the "Place of Supply" proposal (see Appendix 2), the supporting "one-stop-shop" proposal (see Appendix 2), and an associated strategy/timetable for their implementation. The overall objective is to simplify administrative arrangements for cross-border traders.

36. The "Place of supply" is the centrepiece of the package and deals with new rules for cross-border business-to-business (B2B) and business-to-consumer (B2C) services which will, in general, shift the place of taxation to where services are consumed, replacing the existing rules

based on the location of the supplier. The 'one-stop-shop' online facility providing cross-border traders with an online VAT registration, declaration and VAT refund facility is key to the operation of the new B2B and B2C rules.

37. At the June 2007 meeting, the ECOFIN Council reached political agreement on the B2B aspects of the "place of supply" proposal and called for further discussions to resolve matters concerning B2C arrangements in respect of telecom, broadcasting, electronic and maritime services. In doing so, the Council confirmed its intention to formally adopt the VAT package before 31 December 2007 on the basis that the overall package would enter into force by 1 January 2010 at the latest.

38. As a practical measure, the Council also agreed on the use of an interim/mini "one-stop shop" facility in anticipating a more comprehensive facility at a later date.

39. Ireland is supportive of the VAT package as the new B2C rules in particular hold benefits for Irish companies selling services to consumers electronically over the Internet as the generally lower VAT rates operating in other Member States would apply to such services.

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VAT Fraud

41. VAT fraud and specifically "carousel" or "missing trader" fraud continues to be a major concern for a number of Member States. The development of a strategy to tackle VAT fraud dominated the German Presidency and, as a result of the outcome of the ECOFIN Council meeting of 5 June 2007, the matter continues as a priority under the Portuguese Presidency.

42. At its meeting of 5 June 2007, the ECOFIN Council emphasised that tax fraud, especially in the field of indirect taxation, must be tackled effectively and decisively in the interests of honest entrepreneurs and Member State budgets. The EU Commission is due to report by end-2007 on its findings in respect of the potential enhancement of conventional anti-fraud solutions delivering increased co-operation and information exchange between Member States; and, on its examination of more far-reaching measures including the taxation of intra-community supplies and the introduction of a general "reverse charge" mechanism.

43. Carousel fraud occurs by exploiting the zero-rated VAT supply of goods between member states for the purpose of tax evasion. It involves the consignment of high value, low volume goods, typically computer processing units (CPUs) or mobile phones, through a chain of companies in two or more Member States of the EU. The goods often travel back and forth continuously between Member States. The sole purpose of these transactions is defrauding the Revenue authorities of the VAT payable on the goods in the country of eventual destination.

44. The UK has recently been granted a derogation enabling the reverse charge to be applied to mobile phones, a popular vehicle up to now for fraudsters. The reverse charge approach makes the business customer, and not the supplier, liable to pay VAT to the Revenue. It would ensure that no payments or repayments would take place along the supply chain.

45. Germany, along with Austria, have sought to apply the reverse charge to all internal supplies over €5,000 (Austria: €10,000) i.e. as a horizontal measure. XXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX the ECOFIN Council have requested the EU Commission to analyse the effects of such an option on the internal market and to submit its findings by end-2007. Competitive issues as well as concerns regarding the potential for migration of fraud to Member States not applying the reverse charge and the emergence of new risks of fraud arise in this context.

46. While Ireland shares the concerns of other Member States regarding fiscal fraud, we are of the view that a pragmatic approach should be adopted and solutions should not create barriers for business, or result in significant administrative burdens for Revenue authorities. Current instruments offer opportunities for information exchange and these should be exploited and perhaps enhanced, including increased co-operation with third countries.

VAT on Financial Services

47. In May 2006, the European Commission launched a public consultation on modernising VAT for financial and insurance services. This was a direct response to the judgement by the European Court of Justice in March 2005 in the Andersen case concerning the VAT treatment of outsourced 'back office' services in the insurance industry.

48. Under the Andersen judgement the Court ruled that the outsourcing of "back office" services by insurance companies, does not qualify as an insurance related service as performed by insurance brokers and insurance agents within the meaning of the VAT Directive. Outsourced 'back office' services do *not* qualify for an exemption from VAT and are therefore liable to VAT at the standard rate (i.e. 21%). Examples of the "back office" services involved include acceptance of applications for insurance; handling of amendments to contracts and premiums; issuing, management and rescinding of policies; management of claims; and, information technology management.

49. Outsourcing is an increasing feature within the financial services industry and has become important in enabling particularly small companies who need to access such services in order to sustain development. However, these and other behaviours to achieve cost reductions coupled with the opening up of the market to competition and cross-border arrangements present difficulties regarding whether such arrangements come within the general VAT exemption for financial services currently provided for within the Directive.

50. Although the Andersen case concerned services provided in the Netherlands, the ECJ ruling has an impact across all EU Member States. The implication of the judgment for Ireland is that the Irish VAT exemption for insurance-related services in the First Schedule to the Value-Added Tax Act 1972, as amended, is currently too broad. Implementation of the ECJ ruling would lead to VAT becoming chargeable on certain outsourced insurance-related services currently provided to insurers. Where insurers use these outsourced services to provide exempt insurance services within the EU, VAT incurred on such services would not be recoverable.

51. Pending the outcome of the Commission's consultation under which proposals may emerge by end-2007, the Revenue Commissioners have advised the financial services industry that, as regards insurance related services provided in Ireland, the provisions of the exemption in the current Irish legislation will continue to apply.

52. We have engaged extensively with the Financial Services/Insurances services industry during the Commission's consultation process and continue to do so. The EU Commission is expected to make legislative proposals by end 2007.

Reduced VAT Rates

53. On 5 July 2007, the European Commission launched a political debate on reduced VAT rates with the stated objective of simplifying current EU legislation governing these rates. The debate was launched on foot of the publication by the Commission of a report on reduced VAT rates carried out by Copenhagen Economics. The EU Commission intends bringing forward legislative proposals in respect of reduced VAT rates by end 2008. The Portugese Presidency is dealing with reduced rates as a priority and intends holding a debate on the issue at ECOFIN in November 2007.

54. The report on reduced VAT rates was requested by the ECOFIN Council on 14 February 2006 following the demise of the Commission's earlier (2003) attempt to restructure the VAT system. Specifically, the Council called for an examination of the impact of reduced rates focusing on locally-supplied services[2], including restaurant services, in terms of job creation,

[2] With the exception of restaurant services, the services in question are governed by an experimental reduced rate

economic growth and the proper functioning of the internal market.

55. However, in its examination the Commission adopted a broader approach going beyond locally-supplied services in analysing reduced rates in general and taking into account the effects on income distribution, the informal economy and on compliance costs for business.

56. The Commission's communication has strong resonances with its 2003 proposal when it sought unsuccessfully to abolish individual Member State derogations, zero-rates and other reduced rate arrangements in favour of common treatment across the Community. In addition, it is also suggesting that reduced VAT rates be applied to areas for which VAT exemptions are currently available, for example, cultural/educational services and public transport services. Ireland avails of such exemptions.

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VAT Infringements

59. Ireland is currently the subject of three infringement processes. In the first case, concerning the VAT treatment of services provided by public bodies, especially Local Authorities under Infringement No. 2004/4804, the Commission decided in December 2006 to refer the case to the European Court of Justice. The two remaining processes which are expected to be withdrawn by the Commission on foot of our response in Finance Bill 2007 concern: the VAT treatment of certain services, referred to as 'Fourth Schedule' services received by public bodies under Infringement No 2006/2246; and, the VAT treatment of bad debts arising under hire purchase agreements under Infringement No. 2006/4608.

60. The referral to the European Court of Justice under Infringement No. 2004/4804 arises

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scheme introduced in 1999 (under Annex K of the Sixth VAT Directive) and include small repair services, renovation of private dwellings, window/household cleaning services, domestic care services and hairdressing. Ireland does not participate in the scheme as the bulk of the services in question were reduced rated here.

out of a complaint by private multi-storey car-park operators and represents the Commission's response to our submission of 21 April 2005 arising from the Commission's Letter of Formal Notice of 14 December 2004 on the matter. While the complaint referred to car-parking which would include multi-storey and surface parking facilities, the Reasoned Opinion issued by the Commission in June 2006 is much wider in scope. It concludes that we have not correctly transposed Article 4(5) of the Sixth VAT Directive and thereby challenges Ireland's general exemption from VAT for services provided by local authorities. In our response, submitted to the European Commission on 4 September 2006, we challenged the Reasoned Opinion on the basis that Ireland has correctly interpreted the provisions of the VAT Directive as they relate to public bodies and also on the basis that the complaint against Ireland has been widened in scope.

61. Under Irish law, public bodies do not charge VAT on their services and cannot recover VAT on goods and services which they purchase. However, under EU law where such treatment leads to 'significant distortions of competition', they are not exempt and must charge VAT. In this regard, the Commission considers Irish law to be lacking regarding the interpretation of those aspects of the VAT Directive dealing with the VAT treatment of services delivered by local/public authorities where distortions of competition are likely to arise. In effect, the Commission want Ireland to amend Irish VAT law to include a test for distortion of competition, rather than rely on the current situation where the Minister can, by SI, apply VAT where he believes such a distortion arises.

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63. The Commission has not yet submitted the formal documentation in this case to the European Court of Justice.

64. The views of the Group are invited.

September 2007

Appendix 1

Annex III of the VAT Directive

LIST OF SUPPLIES OF GOODS AND SERVICES TO WHICH THE REDUCED RATES REFERRED TO IN ARTICLE 98 MAY BE APPLIED

(1) Foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; live animals, seeds, plants and ingredients normally intended for use in the preparation of foodstuffs; products normally used to supplement foodstuffs or as a substitute for foodstuffs;

(2) supply of water;

(3) pharmaceutical products of a kind normally used for health care, prevention of illnesses and as treatment for medical and veterinary purposes, including products used for contraception and sanitary protection;

(4) medical equipment, aids and other appliances normally intended to alleviate or treat disability, for the exclusive personal use of the disabled, including the repair of such goods, and supply of children's car seats;

(5) transport of passengers and their accompanying luggage;

(6) supply, including on loan by libraries, of books (including brochures, leaflets and similar printed matter, children's picture, drawing or colouring books, music printed or in manuscript form, maps and hydrographic or similar charts), newspapers and periodicals, other than material wholly or predominantly devoted to advertising;

(7) admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities;

(8) reception of radio and television broadcasting services;

(9) supply of services by writers, composers and performing artists, or of the royalties due to them;

(10) provision, construction, renovation and alteration of housing, as part of a social policy;

(11) supply of goods and services of a kind normally intended for use in agricultural production but excluding capital goods such as machinery or buildings;

(12) accommodation provided in hotels and similar establishments, including the provision of holiday accommodation and the letting of places on camping or caravan sites;

(13) admission to sporting events;

(14) use of sporting facilities;

(15) supply of goods and services by organisations recognised as being devoted to social wellbeing by Member States and engaged in welfare or social security work, in so far as those transactions are not exempt pursuant to Articles 132, 135 and 136;

(16) supply of services by undertakers and cremation services, and the supply of goods related thereto;

(17) provision of medical and dental care and thermal treatment in so far as those services are not exempt pursuant to points (b) to (e) of Article 132(1);

(18) supply of services provided in connection with street cleaning, refuse collection and waste treatment, other than the supply of such services by bodies referred to in Article 13.

Appendix 2

Further Information on EU Commission VAT Proposals

Place of Supply Proposal

1. In July 2005, the European Commission re-presented a proposal to change the place of supply (i.e. the place of taxation) rules governing VAT on cross-border services. The proposal sets out new rules for business-to-business (B2B) transactions and business-to-consumer (B2C) transactions and replaces the original Commission proposal of December 2003 which dealt solely with B2B services.

2. The overall objective of the proposal is to ensure that VAT accrues to the Member State of consumption. Regarding B2B services, the proposal generally puts the onus on the business customer to account locally for VAT for services received from another Member State. While many B2B services traded across borders are already taxed on this basis, the proposal makes this the main rule for determining the place of taxation.

3. For B2C services, the proposal maintains the general rule that the place of establishment of the supplier determines the place of taxation. However, the proposal provides for exceptions to this rule for certain services which can be supplied at a distance. In these cases, the proposal shifts the place of taxation to where the consumer is located. The distance services involved include electronically delivered services, telecommunications services, radio and television broadcasting services as well as distance teaching services.

4. Under the new rules, B2C services supplied electronically from Ireland to consumers in other Member States would benefit from the generally lower VAT rates applying in these Member States to be applied to such services. As a result, Irish companies delivering services over the Internet to private consumers in other Member States should gain significantly from the change in VAT rules. Examples of the types of services involved include the online supply of music, games and videos, software, and distance teaching services.

5. There is empirical evidence that companies are establishing or relocating in Member States with attractively low VAT rates so as to gain competitive advantage in selling to individual consumers throughout the EU. The new rules based on the place of consumption should reverse this trend and should enhance Ireland’s position as an attractive location for companies involved in delivering the types of services mentioned. Regarding distance services received (including TV broadcast services) by Irish consumers, these services will now become liable to Irish VAT rates irrespective of where they are sourced.

6. While the proposed new B2C rules would require Irish businesses to register and account for VAT in each Member State where they conduct business, the Commission's proposal on establishing an electronic "one stop shop" facility would allow traders to register online and account for VAT in their own Member State in respect of their Community wide supplies. The "one-stop-shop" is discussed below (paragraphs 10-12).

7. For B2B services traded cross-border, the new rules would significantly reduce the administrative burden on businesses operating cross-border. For example, Irish businesses providing services to businesses in other Member States would, in most cases, no longer be required to register and pay for VAT in those Member States. In addition, the new rules should reduce the existing need for Irish businesses to recover VAT incurred in other Member States under the Eighth VAT Directive procedures.

8. The proposal would also provide a solution to the potential problem of tax-based distortions which could arise in the case of the cross-border leasing of motor vehicles. For both B2B and B2C transactions the VAT treatment of short-term hiring of motor vehicles will be determined by the place where the vehicle is put at the disposal of the customer; and, the VAT treatment of the long-term leasing (i.e. over 30 days) of vehicles will, on the other hand, be determined by the place where the customer is established or normally resides.

9. The shifting of the place of taxation to the place of consumption raises additional concerns regarding the proper application of VAT to cross-border services and, in this regard, anti-avoidance provisions are to be strengthened under the proposal. This would be achieved through mechanisms for administrative co-operation and information exchange between Member States.

'One-stop-shop' Proposal

10. In November 2004, the Commission brought forward a complex dossier designed to ease the administrative burden imposed by existing VAT procedures on cross-border traders. Simplification of these procedures represents a key element of the European Commission's VAT strategy which recognises the need to modernise the VAT system in the interest of the smoother running of the internal market and promotion of cross-border trade.

11. Under the dossier, the European Commission sets out specific measures which it considers necessary to achieve these objectives. These measures include:

- A one-stop scheme, or one-stop-shop, enabling non-established cross-border traders to use a single VAT number for all supplies made throughout the EU and to make declarations online through a website operated by national tax authorities;
- An online VAT refund facility for cross-border traders;
- Harmonisation of the scope of goods and services for which Member States may apply

restrictions on the right to deduct or reclaim VAT on business expenses;

- Broadening the scope of the reverse charge mechanism under which the business customer is obligated to account for VAT locally in respect of certain business-to-business transactions with non-established suppliers;
- Introducing an optional maximum registration threshold of €100,000 for small traders;
- Simplifying the existing VAT rules regarding the distance selling of goods typically by phone or via the Internet to private consumers through the introduction of a single global threshold of €150,000 for all supplies made to consumers in Member States.

12. In general, Ireland is supportive of these proposals and particularly in the context of achieving a reduction in the administrative burden for businesses supplying goods and services cross-frontier. Streamlined VAT procedures should enhance efficiency, reduce administrative costs and encourage increased activity within the internal market. As discussed in the context of the VAT package, the one-stop-shop facility will ultimately enable new rules for cross-border business-to-consumer (B2C) services proposed under the place of supply proposal to be introduced.