ACCOUNTANCY EUROPE.

VAT RATES

Greater flexibility for Member States

Factsheet

FACTS.

TAX

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HIGHLIGHTS

From 1 January 2025 Member States will have more flexibility to set Value Added Tax (VAT) rates in their country below the standard rate.

A wider range of goods and services will be allowed to benefit from reduced rates, if the Member State so wishes. This is to reflect policy areas vital for Europe – the fight against climate change, the digitalisation of the economy and lessons learnt from the Coronavirus crisis.

While this is not likely to create significant distortions of trade between Member States, the EU VAT landscape will become more complex for businesses transacting across multiple Member States. This could particularly impact small and medium-sized enterprises (SMEs).

It is important that accountants are aware of these potential changes before their introduction and keep up to date with changes in other Member States where their clients may also operate.

INTRODUCTION

On 7 December 2021 the European Council approved the European Commission's VAT rates proposal nearly 4 years after it was first introduced. The compromise text shows some significant changes from the original proposal and the annex.

Compared to the current Directive, the new rules give Member States a potentially significant degree of additional flexibility to set VAT rates lower than the standard rate, which is currently 15%. It has also modernised the list of goods and services to which these reduced rates can be applied to reflect the:

- increased digitalisation of goods and services
- need to promote green products and energy sources
- changes to what are considered essential medical products in light of the Coronavirus crisis.

PURPOSE AND AUDIENCE

This factsheet is a high-level summary of the legislative proposal as adopted and is targeted at readers who have a working knowledge of the European VAT system. Readers should consult the source documents for more detail. National transposition will likely be significantly different between Member States as these revisions to the VAT Directive increase flexibility. Readers should consult the local law when transposed.

IMPLEMENTATION DATES

The compromise text needs to be considered by the European Parliament. Following the adoption of the Parliament's non-binding opinion, the compromise text will be added to the Official Journal by the Commission. The text will then come into effect 20 days after being published in the Official Journal.

Member States are obliged to transpose the amending Directive by 31 December 2024. The provisions then come into effect on 1 January 2025.

Should Member States choose to exercise their option to use the expanded provisions of Annex III, by adopting the 'grandfather clause provisions', this would also come into effect from 1 January 2025.

THE IMPACT

It is up to Member States to decide if they wish to broaden the scope of goods and services to which a reduced VAT rate (or exemption with credit) can be applied.

At this stage, it is too early to predict:

- how many Member States will take advantage of this additional flexibility
- the degree to which each Member State will use the additional flexibility to the maximum
- which policy objectives will be followed,

especially considering the constraints on public finances that paying for the Coronavirus crisis has imposed on governments.

SME IMPACT

There are no specific provisions directed at SMEs in the amending Directive.

Many SMEs are likely to welcome measures introduced by national governments that reduce VAT rates in their sector. This will help increase sales if the price savings are passed on to customers or increase profits if they are not.

However, this could also mean increased complexity for SMEs engaged in cross-border trade within the EU, especially for B2C supplies.

Member States have the possibility to introduce more reduced rates on more lines of goods and services than before. There will likely be little convergence on such rates, at least initially. Consequently, businesses will need to be aware of potentially a greater number of VAT rates applicable to their product lines when selling across Europe.

Although this will affect all businesses, it will be a particular burden on smaller entities. It will expand the need for such businesses to consider their call for those measures as increased computerisation and automation of their sales procedures and using online platforms as selling intermediaries.

MAIN PROVISIONS

CHANGES TO GOODS AND SERVICES THAT CAN BE SUBJECT TO REDUCED RATES

An expanded positive Annex III to the VAT Directive now replaces the Commission's proposed 2018 negative Annex IIIa list (i.e., listing the goods/services where reduced rates could not be applied). Annex III has been tailored to be line with other key EU policy objectives. The most notable changes to Annex III are:

THE GREEN DEAL - REDUCING GREENHOUSE GAS EMISSIONS AND POLLUTION

- point (11) introduces the termination date of 1 January 2032 for applying reduced rates and exemptions with credit to supplies of chemical pesticides and chemical fertilisers
- point (18) now includes 'waste recycling'
- point (19) now includes household appliances repairs
- point (10c) is **added** to include solar panels supply and installation for private and public housing and for other buildings used for activities in the public interest
- point (22) is **added** and includes the supply of:
    - electricity, district heating and cooling and biogas produced by certain feedstock
    - highly efficient low emissions heating systems
    - natural gas and firewood – until 1 January 2030
- point (25) is **added** to include bicycles supply and rental including electric bicycles

THE DIGITAL TRANSFORMATION – DEMATERIALISED GOODS AND SERVICES

- point (6) now includes the electronic supply of books, newspapers and periodicals unless they consist predominantly of video or music content
- point (7) now includes access to live streaming of shows, theatres, concerts, etc and other cultural events
- point (8) now includes webcasting of broadcast radio and television and also internet access services provided as part of a national digitalisation policy
- point (13) now includes live streaming of sports events and physical exercise classes

UPDATING THE LIST OF SUPPLIES OF MEDICAL GOODS AND SERVICES IN ANNEX III

- point (3) now includes absorbent hygiene products with 'sanitary protection' changed to 'female sanitary protection'

- point (4) now includes the supply, rental and leasing of medical appliances, devices, items, aids and protective gear – including health protection masks normally intended for use in health care or for the use of the disabled

OTHER CHANGES TO ANNEX III

- point (10) is expanded to include letting of residential property
- point (10a) includes construction and renovation of public buildings and those used in the public interest – construction, reconstruction and repairs of private housing is moved to point (10)
- point (11a) is **added** for supply of live equines and related services
- point (23) is **added** for the supply of live plants, cut flowers etc
- point (24) is **added** for the supply of children's clothing
- point (26) is **added** for the supply of works of art, antiques etc as listed in Annex IX, parts A, B and C
- point (27) is **added** for supplies of legal services to employees, the unemployed and under Member State legal aid schemes
- point (28) is **added** for tools etc intended for use in rescue or first aid equipment provided to public bodies and not-for-profit organisations for civil protection purposes
- point (29) is **added** for navigational aids and life-saving services

INCREASED FLEXIBILITY FOR MEMBER STATES IN SETTING VAT RATES

SUMMARY

Member States have the **option** to apply the following reduced rates:

Type of Rate	Rate Limit	Number of Annex III Points	Change to existing rules?	Change to 2018 proposal?	Expiry date
'Normal' rates under Art. 98					
Reduced Rates: Up to 2 reduced rates for all points in Annex III	Not below 5%	24	Only the number of Annex III points	Only the number of Annex III points	1/1/2030 fossil fuels etc 1/1/2032 for chemical pesticides etc
Super reduced rates & exemptions with credit No more than 2 of either (or a combination of both): • super-reduced rate for Annex III points (1) to (6) & (10c) • exemption for Annex III points (1) to (6) & (10c)	Below 5%, above 0% 0% (exempt) with right of input tax recovery	Total of 7 – • either at the super-reduced rate or • exemption with credit • or a combination of both	Yes	Only the number of Annex III points	1/1/2030 fossil fuels etc 1/1/2032 for chemical pesticides etc
Rates 'grandfathered' under Article 105a(1)					
Super reduced rates & exemptions with credit For Annex III points **other than** (1) to (6) & (10c)	Below 5%	To be reduced to a total of 7 points (including points (1) to (6) & (10c) by 1/1/2032	Yes	Yes	1/1/2030 fossil fuels etc 1/1/2032 for chemical pesticides etc
Reduced rates For items **not** in Annex III	Not below 12%	Not applicable	Yes	Yes	1/1/2030 fossil fuels etc. 1/1/2032 for chemical pesticides etc
Super reduced rates & exemptions with credit For items **not** in Annex III	Below 12%	Not applicable	Yes	Yes	1/1/2030 fossil fuels etc 1/1/2032 for all other points

REDUCED RATES

From 1 January 2025. Member States can have up to two *reduced* rates with a minimum of 5%. This is unchanged from the current rules and from those proposed in 2018. However, Member States can only apply this rate up to a maximum of 24 points (i.e., categories of goods and services) in the expanded Annex **III**. This is a new restriction compared to the current rules and the 2018 proposal.

SUPER-REDUCED RATES

Member States are also permitted one *super-reduced* rate of below 5% and an *exemption with credit* (i.e., no output VAT with a right to recover input VAT). This is a change to the current rules and is consistent with the 2018 proposals. However, the *super-reduced* rate and *exemption with credit* can only be applied to a combined maximum of 7 items/points in the expanded Annex **III**. This is a new restriction compared to the current rules and the 2018 proposal.

The *super-reduced* rate and *exemption with credit* can only be applied to the following points of Annex **III**:

- point (1) – foodstuffs, live animals, seeds and plants etc
- point (2) – supply of water
- point (3) – medical and veterinary pharmaceutical products
- point (4) – medical equipment
- point (5) – passenger transport and electric vehicles
- point (6) – books, newspapers and periodicals
- point (10c) – supply and installation of solar panels
- any other points of Annex **III** provided for in Article 105a(1) (see below).

Reduced and *super-reduced* rates and the *exemptions with credit* cannot be applied to electronically supplied services other than those listed in Annex **III** under points (6), (7), (8) and (13) (broadly, periodicals and books, admission to shows, television and radio broadcasts and sporting events, respectively).

The place of supply of activities that are streamed or made virtually available to non-taxable persons is their normal place of residence.

'GRANDFATHERING' EXISTING REDUCED, SUPER-REDUCED RATES & EXEMPTIONS

The new Article 105a(1) permits the 'grandfathering' of existing *reduced and super-reduced* rates or *exemptions with credit* extant at 1 January 2021.

Member States can continue to apply *super-reduced* rates and *exemptions with credit* to the supply of goods and services **other** than those in points (1) to (6) and (10c) of Annex **III**, mentioned above.

For goods and services **not** covered by Annex **III**, Member States are allowed to continue applying *reduced*, *super-reduced* rates and *exemptions with credit* as follows:

- reduced rates not lower than 12% can still be applied indefinitely (apart from those concerning fossil fuels and pesticides, see below)
- reduced rates lower than 12%, *super-reduced* rates and *exemptions* can still be applied until 1 January 2032 or until adoption of the *definitive arrangements*, whichever is earliest

By 1 January 2032 Member States shall reduce the total number of *super-reduced* rates to 7 points in total (i.e., including both 'normal' and 'grandfathered' rates) but shall be free to determine to which Annex **III** points they will continue to apply those *reduced rates* and *exemptions*.

For all the above derogations, the *reduced rates* and *exemptions* in respect of **fossil fuels** and others with a similar impact on greenhouse gas emissions (such as **peat** and wood used as **firewood**) must cease to be applied by 1 January 2030.

Additionally, the *reduced rates* and *exemptions* for **chemical pesticides** and **chemical fertilisers** must cease to be applied by 1 January 2032.

Member States that wish to continue to benefit from derogations covering the above must communicate the main provisions to the VAT Committee within three months after this amending Directive enters into force.

All other Member States may also take advantage of any derogations that are communicated to the VAT Committee, under the same conditions that applied in the originating Member State on 1 January 2021. If Member States opt to apply these rates, they must adopt the main provisions into national law and communicate these to the VAT Committee within eighteen months after this amending Directive enters into force.

OTHER CHANGES

Apart from the 'grandfather' clause, the final agreed proposal is no longer linked to the adoption of the definitive VAT system – unlike the initial proposal of 18 January 2018. This link was originally considered necessary by the Commission to avoid the risk of VAT rate competition between Member States. However, the change to the destination basis for VAT on the B2B supply of goods has made such rate competition largely ineffective.

The compromise text mentions the issue but there are no specific measures to prevent such tax competition. Restricting the *super-reduced* rate and *exemption with credit* to goods and services fulfilling basic needs and public policy is expected to reduce the potential for harmful VAT competition between Member States.

The compromise text has also dropped the requirement in the 2018 proposal that Member States maintain a minimum weighted average rate of VAT exceeding 12%.

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