SELECTED VAT ISSUES

Tax Strategy Group – TSG 17/06

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Introduction

1. This paper reviews the Value-Added Tax (VAT) rates and structures, provides options for change and looks at VAT developments at EU and domestic level. In 2016, VAT accounted for approximately €12,440 million or 26% of the overall tax yield to the Exchequer. The estimate for the VAT yield in 2017 underpinning the Summer Economic Statement is €13,135 million.

VAT Rating and Structure

2. Ireland operates the following VAT rates:

- standard rate of 23% applies to 51% of activity, including cars, petrol, diesel, alcohol, tobacco, electrical equipment and CD/DVDs.
- reduced rate of 13.5% applies to 25% of activity, including fuel used for heat or light, construction, housing, labour intensive services and general repairs and maintenance.
- reduced rate of 9% applies to 13% of activity, including hotel and holiday accommodation, restaurant services, and various entertainment services.
- 4.8% rate applies to livestock by registered farmers.
- zero rate accounts for 11% of activity and applies to most food, children's clothes and shoes, and oral medicines.
- exempt services, such as transport, water, education, financial services, schools and hospitals, services provided by charities, etc.

3. Irish VAT law must comply with the EU VAT Directive, which directs that Member States must apply a standard VAT rate of 15% or more, and can apply up to two reduced VAT rates of more than 5%. Ireland applies the 23%, 13.5% and 9% VAT rates in this context. Member States may also retain historic VAT rate treatment where such VAT rating was in place on and from 1 January 1991. Ireland's 4.8% super-reduced rate and the zero rate (Article 110), and most of the activity applying at the 13.5% rate (Article 118), fit into this category. The historical VAT rates cannot apply to new goods and services that were not charged at those rates in 1991, and they cannot be reapplied to goods and services currently applying at those rates where the rate is increased. A similar condition applies to some exempt services, such as transportation and water, under a derogation from 1978.

Recent Developments

Recent VAT changes

4. Recent changes to the VAT rates and thresholds include:

- Jobs Initiative May 2011 – introduction of 9% rate for tourism-related services.
- Budget 2012 – increase in standard VAT rate from 21% to 23%.
- Budget 2013 – increase in cash basis threshold from €1 million to €1.25 million; flat-rate farmer addition reduced from 5.2% to 4.8%.
- Budget 2014 – increase in cash basis threshold from €1.25 million to €2 million; flat-rate farmer addition increased from 4.8% to 5%; retention of 9% VAT rate.
- Budget 2015 – flat-rate farmer addition increased to 5.2%; place of supply rules came into effect 1 January 2015- e-services now charged VAT in the Member State of the consumer.
- Budget 2016 – 9% VAT rate retained.
- Budget 2017 – flat-rate farmer addition increased to 5.4.

International Comparisons

Ireland's VAT Rates in comparison with EU/UK

5. As of 1 January 2017, 23 of the 28 EU Member States have a standard VAT rate of 20% or higher and the average standard rate in the EU is 21.5%. Ireland has the joint 7th highest standard VAT rate in the EU. Since the economic crisis, the vast majority of Member States have increased their VAT rates. The standard rate VAT differential between Ireland and the UK has narrowed from a high of 6.5 percentage points in 2009 to 3 percentage points since January 2012.

6. At 13.5%, Ireland has the 4th highest reduced VAT rate in Europe, however we apply reduced rates to an extensive range of activity relative to other Member States. In addition, Ireland, along with the UK, applies the zero rate to a sizable proportion of economic activity.

7. There have not been many changes to EU Member State VAT rates in the past year. Romania reduced their standard rate from 20% to 19%, effective from 1 January 2017, while the Czech Republic added a 10% reduced rate to books, baby nutrition and pharmaceutical goods from 1 March 2017.

Options: complying with Programme for Government commitments

Option 1: Consider introducing a 9% VAT rate on residential construction

8. *“Consistent with our existing deficit reduction targets, we will ask the Oireachtas to consider the merits of a temporary targeted reduction of the rate of VAT from 13.5% to 9% on new, affordable houses and apartments, both public and private, timed to generate the maximum impact on supply and to target principally the purchasers of affordable homes.” page 25*

9. In the context of Budget 2017, the Oireachtas Committee on Housing and Homelessness reviewed the costs of construction including VAT, in the light of the Programme for Partnership Government commitment. In their June 2016 Report, they recommend that the Housing Agency annually review construction costs but did not recommend that the VAT rate on new residential property be reduced. It was decided a more effective aid to home purchases was through the income tax system and the Help to Buy incentive was introduced to this effect. One of the main policy aims of the Help to Buy incentive is to assist a first-time purchaser fund the deposit required to purchase or self-build a new house or apartment to live in as their home. The other main aim of the policy is to help encourage the building of additional new properties. By restricting the initiative solely to new dwellings and new self-builds, it is anticipated that the resulting increase in demand for affordable new build homes should encourage the construction of an additional supply of such properties.

Option 2: Work with EU to reform difficulties faced by community re VAT rates on certain products e.g. defibrillators

10. *“We recognise the difficulties faced by community groups in relation to VAT rates on certain products (e.g. defibrillators). While this is an EU competency we will work with our EU counterparts in seeking to reform this area.” page 43*

11. Any changes to VAT rates outside of what is currently permitted by the EU VAT Directive must be negotiated at EU technical working groups and ultimately agreed by the EU Council of Finance Ministers. The EU Commission published an Action Plan on the future of VAT on 7th April 2016 “Towards a single EU VAT Area - Time to decide”, which sets out the Commission’s pathway for modernising the VAT system. A proposal looking at VAT rate policy across the EU is due to be published in September 2017.

12. This may offer Member States more flexibility in the future in determining VAT rates applicable to goods and services, including defibrillators.

13. While specifically referencing "defibrillators", the Programme commitment refers to "certain products" that pose difficulty for community groups. At its broadest interpretation this could be viewed as a rebate of all VAT incurred by community groups and charities. Such a measure would be very costly to the Exchequer.

Option 3: Retain 9% VAT rate on Tourism

14. *"We will work towards achieving the ambitious tourism policy goals set for 2025. These include increasing revenue from overseas visitors to €5 billion, growing employment in the tourism sector to 250,000 (from 200,000 currently) and increasing the number of visits to Ireland to 10 million. We will do this through the national tourism policy and through specific measures like the maintenance of the 0% Airport Travel Tax and the retention of the hugely successful 9% VAT rate on tourism related services, providing that prices remain competitive." Page 45/6*

15. Revenue's most recent estimate for reverting the reduced 9% VAT rate back to 13.5% is that it would bring in extra revenue of €491 million. The estimated cost to the Exchequer of the reduced 9% VAT rate, since its introduction in 2011 to end 2016 is €2.2 billion.

16. Ireland's 9% rate is among the lowest VAT rates in the EU on hotel accommodation and restaurants. Ireland has the 5th lowest VAT rate on restaurants in the EU, along with Romania and Cyprus. In addition, Ireland's VAT rate on hotel accommodation is the 8th lowest in the EU, along with Romania, Lithuania, Cyprus, Estonia and Bulgaria.

17. Towards the end of 2016, Dublin was the most expensive city in Ireland for a hotel room, with a room costing on average €147 per night. This is followed by Killarney at €140, Cork at €112 and Galway at €103. In terms of the UK and Ireland, Dublin was the fourth most expensive after London (€177), Bath (€167), and Oxford (€157). For the rest of the world, Dublin was the tenth most expensive city for hotel prices of cities surveyed. The most expensive city in November 2016 for a hotel room was New York (€288), followed by San Francisco (€236). In fifth place sat Copenhagen at €184.[1]

[1] Trivago Hotel Price Index November 2016, using average Sterling to Euro exchange rate for November 2016.

18. For 2017 and 2018, the cities with the highest occupancy rates are forecast to be Dublin and London. Dublin is expected to be 83% occupied, with London expected to be 82%. Previously, the revenue per available room (Rev PAR) for Dublin was expected to grow by 9.1%, but the actual growth in 2016 was 16.1%.[2]

Options: reform of the VAT structure and rates

Option 4: Increasing or decreasing VAT rates

19. The cost of increasing or decreasing the VAT rates by 1% is outlined as follows. These are full year figures and would be (1/6th) lower in the first year because VAT is paid two months in arrears.

Rate	1% increase/decrease
9% Reduced rate	+/- €109m
13.5% Reduced rate	+/- €200m
23% Standard rate	+/- €410m

Option 5: Moving zero rated items to the higher rates

20. The following illustrates the estimated yield to Exchequer where goods at the zero rate are charged to VAT at various rates (however, once moved, it would not be possible under EU VAT law to revert them back to the zero rate).

Zero rate increased	Yield
0% to 5%	€452m
0% to 9%	€814m
0% to 13.5%	€1,221m
0% to 23%	€2,081m

Option 6: Restructuring the VAT system on a revenue-neutral basis

21. Restructuring the VAT system on a revenue neutral basis costs as follows:

Rates being merged	Revenue neutral rate
zero, 9%, 13.5% and 23%	16.196%
9%, 13.5% and 23%	18.231%

[2] Standing out from the crowd, European cities hotel forecast for 2017 and 18, March 2017, PwC

Option 7: Streamlining VAT rates

22. Streamlining the VAT rates structure along the lines of the scenarios below would yield:

New Streamlined Rates	Yield	Change
0%, 5%, 15% and 25%	+€685m	items at 0% rate to 0% items at 9% rate to 5% items at 13.5% rate to 15% items at 23% rate to 25%
5%, 15% and 25%	+€2,230m	items at 0% to 5% items at 9/13.5% rates to 15% items at 23% rate to 25%

Concerns regarding changes to VAT rates

23. Increasing VAT rates may negatively affect inflation (all rates), employment (9% and 13.5% rates), the less well-off (0% and 13.5% rates) and cross-border trade (0% and 23%). Any reform of the zero rate would be best undertaken in conjunction with similar changes in the UK or with compensatory expenditure measures for those less well off (which has been proven very difficult to achieve).

Options: assisting Small to Medium Businesses

24. In addition to the options for complying with the Programme for Government commitments and reform of the structure and rating of the Irish VAT system, the following are two options for changes to the VAT system that would assist small to medium enterprises.

Option 8: Increasing the cash receipts basis threshold

25. Businesses with an annual turnover of €2 million or less can opt to account for VAT on a cash receipts basis, where VAT is not required to be paid until payment for the supply is received. Currently, a total of 169,000, or 67% of all businesses, are benefitting from the scheme. It should be noted that the threshold was increased from €1 million to €2 million between Budgets 2013 and 2014. The impact of increasing the cash basis threshold to various levels is as follows:

New threshold	Once-off Cost to Exchequer	No of additional businesses benefitting
€2.25m	€31m	828
€2.5m	€57m	1495
€2.75m	€103m	2045
€3m	€148m	2520

Option 9: Increasing the VAT registration thresholds

26. Small businesses with a low turnover can opt to be exempt from VAT thereby avoiding the administrative burden that VAT registration entails. The current thresholds are €37,500 for services and €75,000 for goods, in a 12 month period. It would be possible to increase the thresholds broadly in line with inflation to €40,000/€80,000 at a cost of €12 million in a full year. Such an increase would remove around 5000 businesses from the VAT net. Any increase in the thresholds above these levels would require a derogation and agreement by all 28 Member States.

VAT Developments at EU Level

Commission's VAT Action Plan

27. The Commission Communication on an Action Plan on VAT "Towards a single EU VAT Area - Time to decide" was adopted on 7 April 2016 and sets out the Commission's pathway for modernising the VAT system. This includes:

- a definitive system of VAT
- modernised VAT rates policy
- anti-fraud measures – long and short term
- removing VAT obstacles to cross-border e-commerce/SME package

28. The current VAT system is complex and fragmented, which makes it vulnerable to fraud. One of the aims of the definitive regime is implementing the destination principle – taxing cross-border supplies in the country of destination and not the country of supplier. To assist this change, the VAT Action Plan proposes to extend the One-Stop Shop

arrangement to all cross-border supplies (whereby businesses account for all their EU VAT obligations to a tax authority in just one Member State)[3].

29. The Action Plan makes reference to future VAT proposals arising from the Plan's vision. These include:

Year	Description	Status
2016	Proposal for removing VAT obstacles to cross-border e-commerce, including e-publications	Published Dec 2016 – ongoing
2017	Reform of VAT rates	Due end Sep 2017
2017	Proposal for the definitive VAT system for cross-border trade (single European VAT area – first step)	Due end Sep 2017
2017	SME VAT package	Due end 2017
2017	Proposal to enhance VAT administrative cooperation and Eurofisc	Due end 2017

E-commerce Package

30. On 1 December 2016, the Commission published four proposals on VAT and e-commerce, the aims of which are to modernise VAT on e-commerce, as part of the Digital Single Market strategy and the VAT Action Plan. The internal market, globalisation and technological change have resulted in an explosive growth of cross-border electronic commerce within the EU and from third countries into the EU. The proposals aim to simplify and make more competitive the application of VAT to cross-border business-to-consumer supplies. This includes a move towards a VAT system based on destination (e.g. the location of the customer and not the supplier) and an expansion of the one-stop shop system to all business-to-consumer supplies. Significant progress was made on the proposals by the Maltese Presidency. The files will be a priority of the Estonian Presidency who hope to reach agreement before the end of 2017.

31. While this proposal related to cross-border business-to-consumer supplies, the Commission is due to publish a proposal by the end of September 2017 which will address the future of cross-border business-to-business supplies.

[3] The Mini One Stop Shop (MOSS) was introduced in 2015 in respect of telecom, broadcasting and electronic services only.

E-publications

32. Published as part of the e-commerce package, the e-publications proposal provides the option for Member States to apply a reduced VAT rate to all publications, regardless of whether supplied in printed form or electronically. The original proposal also provided the option for Member States to apply a zero rate or a super-reduced rate (below 5%) to all publications. While provision was made in the file for Member States to align their VAT treatment of printed and electronically supplied publications, it will remain optional for Member States to do so. For future-proofing, the proposal did not define what an e-publication was other that its content should not predominately consist of audio music or video. The current Presidency compromise text differs from the original proposal mainly in that it only extends zero and super-reduced VAT rating to those Member States who already apply such derogations to printed publications. The proposal was brought forward for agreement at ECOFIN on 16 July 2017, but was vetoed by the Czech Republic in anticipation of France blocking the generalised reverse charge mechanism proposal that they wanted to be agreed. It is unclear whether the incoming Presidency will revisit this file.

General Reverse Charge Mechanism

33. Reverse charge mechanism (RCM) is a mechanism whereby VAT is paid by the customer instead of the supplier, where there is a strong risk of the supplier not passing the VAT onto the tax authorities. As this is counter to the normal VAT system it is only permissible in specific risk sectors, such as construction, scrap metal and emissions trading. While RCM is known to counter fraud within a supply chain, a generalised RCM (GRCM) invites other forms of fraud and complexities. The Commission published a proposal for the introduction of a GRCM in December 2016 at the invitation of council, specifically the Czech Republic. The GRCM would be available to Member States experiencing massive carousel fraud on all invoices over €10,000. As with the e-publications file, the GRCM proposal was brought forward for agreement at ECOFIN on 16 July 2017, but was vetoed by France because the Czech Republic blocked the e-publications dossier. It is unclear whether the incoming Presidency will revisit this file.

VAT Rating

34. The VAT Action Plan 2016 proposed reform of the VAT rating structure in the light of the move towards a system where VAT is charged in the Member State of the consumer, and not the supplier, as the risk of VAT rating competition is minimised. The proposal is due to be published by September 2017 and is likely to address such areas as: a) whether reduced rates should be restricted or not, b) the maximum quantity of rates, c) whether derogations should be phased out or not, d) when the changes should be introduced, and e) what activity should have reduced-rate entitlement going forward.

VAT Developments at Domestic Level

Newsbrand Taskforce

35. In light of the changing media landscape, representatives of the Newspaper and Magazine sectors have been engaging with the Department since 2016 with a view to examining proposals to assist the industry in meeting the challenges of the modern media landscape. Among other things, they are seeking reductions in VAT, funding for training, graduate programs, restructuring and development. Communication with Department officials in this area is ongoing.

Charities

36. Following representations made by the Irish Charities Tax Reform Group (ICTR) over a number of years, the Minister for Finance agreed in 2014 to the formation of a Working Group to examine proposals to reduce the VAT burden on charities. The Report of the VAT on Charities Working Group was published in October 2015 ahead of the Budget, and set out the issues faced by Charities with regard to VAT and the options that could be used to address these issues. However, Budget 2016 contained no provisions for the sector.

37. In his Budget 2017 speech, the Minister announced that he had asked his officials to engage again with the Irish Charities Tax Reform Group with a view to reviewing the options published in the Report of the VAT on Charities Working Group. This process is ongoing.

Brexit

38. On 19 June, the EU-UK negotiations under Article 50 were officially launched. Until the UK formally withdraws from the Union, it will remain as a full Member, with all of its existing rights and obligations. Therefore in the short term, there will be no changes to the VAT treatment of trade between Ireland and the UK. A weak Sterling could however drive an increase in cross-border shopping, similar to what took place in 2009.

39. When the UK leaves the EU, it becomes a third country for VAT purposes and all supplies to and from the UK will change from intra-Community supplies/acquisitions to exports/imports. This will involve a substantial initial administrative burden for businesses with systems development issues to deal with changed practices, the review of existing legal contractual arrangements, business models, etc. EU simplifications, such as consignment stock and triangulation, which assist compliance in more complex supply chains will no longer be available to the UK and this will have a significant impact on the operations of Irish businesses engaging with UK businesses.

40. In addition, the UK will have a great deal more flexibility in relation to what level of VAT to charge on supplies. Reduced VAT rates in the UK could in turn lead to increased cross-border shopping, particularly if combined with a weaker sterling. All of this could lead to pressure to move on VAT rate here.

Gender and Equality Implications

41. There are no specific gender or equality implications with regard to VAT.

July 2017

Appendix 1

LIST OF VAT RATES APPLIED IN THE MEMBER STATES

(1 January 2017)

Member States	Zero	Super	Reduced	Standard	Parked
Belgium	0	-	6 / 12	21	12
Bulgaria	-	-	9	20	-
Czech Republic	-	-	10/15	21	-
Denmark	0	-	-	25	-
Germany	-	-	7	19	-
Estonia	-	-	9	20	-
Greece	-	-	6 / 13	24	-
Spain	-	4	10	21	-
France	-	2.1	5.5 / 10	20	-
Croatia	-	-	5 / 13	25	-
Ireland	**0**	**4.8**	**9 / 13.5**	**23**	**13.5**
Italy	0	4	5 / 10	22	-
Cyprus	-	-	5 / 9	19	-
Latvia	-	-	12	21	-
Lithuania	-	-	5 / 9	21	-
Luxembourg	-	3	8	17	14
Hungary	-	-	5 / 18	27	-
Malta	0	-	5 / 7	18	-
Netherlands	-	-	6	21	-
Austria	-	-	10 / 13	20	13
Poland	-	-	5 / 8	23	-
Portugal	-	-	6 / 13	23	13
Romania	-	-	5 / 9	19	
Slovenia	-	-	9.5	22	-
Slovakia	-	-	10	20	-
Finland	0	-	10 / 14	24	-
Sweden	0	-	6 / 12	25	-
United Kingdom	0	-	5	20	-
Average			**7.2 / 10.7**	**21.5**	