

CHANGES IN VAT RATES DURING THE ECONOMIC CRISIS

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Abstract

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To solve the current economical crisis, there are used various tools of economic policy. Some of them are changes in taxes, particularly changes in the value added tax due to its importance.

Value added tax is the most harmonized tax in the single internal market of the European Communities. Although community law defines the basic legal constraints of VAT rules in individual countries, the Council Directive 2006/112/EC on the common system of value added tax, as amended, leaves some areas open for the Member States. One of the main characteristics of VAT is its tax rates which are – while maintaining specified minimal borders – in competency of Member States.

Paper illustrates and evaluates the changes in tax rates of individual Member States during the economic crisis and points to their context and consequences.

Value added tax, community law, reduced tax rate, EC (EU) directives, economic crisis

Value added tax has been the only common indirect tax in all member states of the European Union since 1 January 1987.

At the time of signing the Roman agreements, indirect tax systems were various in member states, then added value tax was used only in France¹ and other five states, who were the former signatories to establishment contracts, used a cascade system of the value added tax.

Having a small connection amongst national economies, it did not really matter which type of indirect tax the respective state chose for its tax system. Both single and multiple duplicate or non duplicate form of indirect tax can fill up incomes of public budgets by its revenues.

Decision-making if indirect tax in member states should be unified and which indirect tax system should be used during integration was definite. Both, conclusions of the special working group es-

tablished by the Committee in 1960², and Fiscal and Financial Committee appointed by the Committee, confirmed that member states have to cancel cumulative tax systems of indirect taxation and introduce value added tax. If more forms of indirect taxes including value added tax would be kept, performing the joint trade the member states would have to apply a complicated European system of mutual refunds, whereas the control over their successful performance would be very difficult, if not impossible and based mostly on a mutual trust amongst states (more details in ŠIROKÝ, 2010, pp. 121–124).

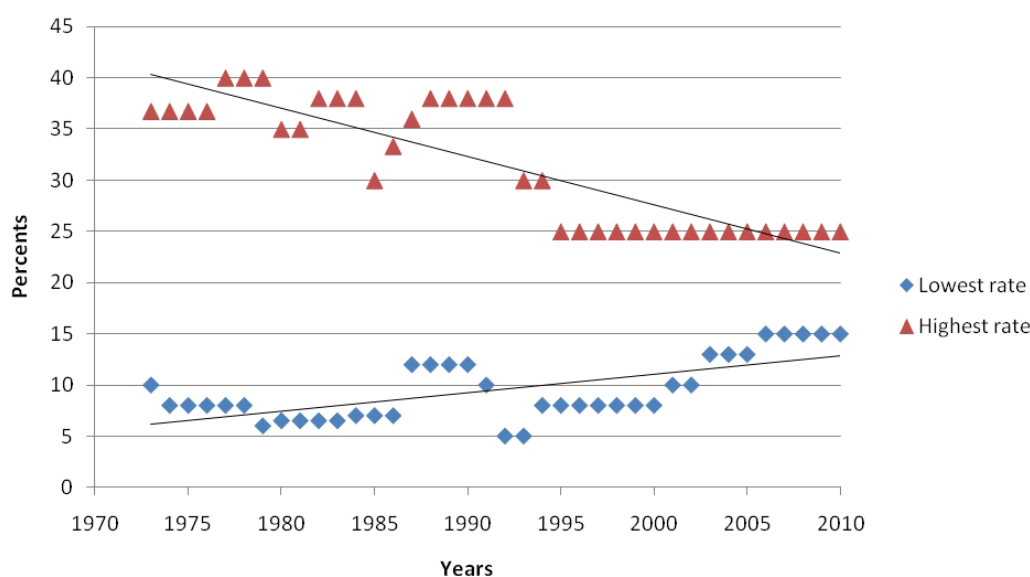
According to the 67/227/EEC Directive³ (so-called the First Directive), introduction of the value added tax is necessary by these reasons⁴: (i) establishment of the common market with a fair economic competition which has the same characteristics as the internal market; (ii) using of turnover tax legal regulations, which do not disrupt conditions of the

1 Since 1954, value added tax under the name Tax sur la valeur ajoutée, had been introducing by economist Maurice Lauré, its mechanism differed from current one a little bit.

2 „The EEC Reports on Tax Harmonization“

3 All of the Community laws are sourced from Eur-lex.

4 For characteristics of value added tax, see SCHENK, OLDMAN, 2007, pp. 121–128.



1: Variation range of standard VAT rates in the European Union during the period of 1973–2010

Source: own calculations

economic competition; (iii) elimination of factors, which can disrupt conditions of the economic competition; (iv) accomplishing the aim of cancelling import taxation and returning export taxation in trade amongst member states; (v) value added system reaches the biggest simplicity and neutrality when the tax is collected as generally as possible; (vi) using value added tax with similar goods in each country brings the same tax burden and (vii) when using value added tax in international trade, the amount of goods tax burden is known.

However, realization of the Agreement on the Unified Using of Value Added Tax was not simple, there passed ten years from the Roman Agreements to the First Value Added Tax Directive and another ten years to the turning directive – the Sixth Directive 77/388/EEC (more details in TAIT, 1988, or TICHÝ *et al.*, 2006, pp. 91–97).

Implementation of the First Directive was only the first step to introduction of the harmonized value added tax. Although in its consequence the implementation of the Directive counted for introduction of the value added tax in all member states of the European Union, but there were practically nine relatively independent national tax systems of the value added tax in 1973.

These national systems were varied one state from each other by a different modification of agriculture production taxation, by scope and conditions of the tax exemption, returning import tax and mainly by different services taxation. These different condi-

tions resulted often in double taxation or vice versa in goods untaxed and it mainly resulted in services provided as cross-border.

Methods and Resources: VAT rates changes as a tool of fiscal policy

Importance of the value added tax increased even after its revenue became one of the European Union⁵ budget incomes.

Even because of this, during the process of further value added tax harmonization there was a problem standing before the Committee to unify the number of tax rates and the tax rate itself (or at least a zone in which tax rates would be moving). After complicated discussions, the basic model considered is the model with two types of tax rates: basic and reduced. Member states, which applied higher rates, were to abandon this practice. A development of the variation tax range in the European Union is demonstrated in the Fig. 1. Variation range is made for the standard and super-increased VAT rates.

Conclusions of the European Committee emphasises a necessity of harmonization of the member states approach to VAT rates and tax base in the way to consider mutual relationships amongst these countries for transparent and flexible one. In current situation, VAT rates are regarded as different ones and relatively very complicated⁶. However, basic principles are simple: goods and services, which are subjected to VAT, are taxed by 15% minimum and individual member states can apply reduced

5 Unified rate for revenues coming from VAT during the period of 2007–2013 is 0.30% from VAT unified harmonized basis of assessment, which is determined according to the rules of the Community. This basis of assessment does not go over 50% of GNI of each member state. For the period 2007–2013 the rate used on source of GNI is 0.225% for Austria, 0.15% for Germany and for Nederland and Sweden it is 0.10% (see 2007/436/EC Decision, Euratom)

6 More details in EUROPEAN COMMISSION, 2005.

VAT rate to goods and services listed in a special list, but this rate is not less than 5%.

These simple principles are complicated by higher number of derogations, which were granted to some member states during discussions prior the 92/77/EEC Directive or so-called Act of Accession⁷. The European Union wants to contribute to the simplification of the European tax legislation by setting VAT unified rate for every single member state and by eliminating reduced rates. VAT reduced rates are considered as minority ones and their total contribution according to the studies performed they do not respond to the practice application costs⁸.

It also results from the economic model stated in this study⁹, that unified rate will head towards to the moderate increase in favour of the consumer in comparison with its current situation, distortions in running of the European Union internal market will be reduced and the simplification of the rules will head towards the total reduction of trade harmonization costs.

However, the study does not presume a complete freeing from reduced rates of all market segments. It is proved, that in absolutely specific cases, i.e. specific local services offered, VAT rates can stimulate an economic growth by induction of the customer demand for these local services offered. VAT reduced rates are also recommended for sectors with an absolute predominance of the labour¹⁰ which is less qualified, where job vacancies are still created. But at the same time, it is emphasized, that other than economic tools (i.e. subsidies) can contribute to achieving environmental, social, cultural and economic goals more efficiently than VAT reduced rates. The same conclusion is made in other studies, which during decision making emphasize a necessity to take into account local specifics of the existence of the single or multiple VAT rate and existence of suitable economic instruments which are focused on target groups¹¹.

Just the analysis of using reduced VAT rates, respectively its changes during the period of the economic crisis and a further scope of the possible use of reduced rates in individual EU member states is the aim of this paper. The text should show a different approach to the use of VAT rates changes as a possible tool for decreasing negative impacts of the economic crisis. The period observed is a period from 1 January 2008 to 1 July 2010.

The main method of the paper is an analysis of legislative directives from the area of the Community Law, its comparison and research of relevant legal directives. The other methods used are comparison, deduction and synthesis.

Results 1: Possibilities of using reduced rates

With effect from 1 January 1993 the 92/77/EEC Directive introduced minimum limits of tax brackets: (i) 15% for basic (standard) rate and a (ii) 5% for one to two reduced rates.

Prolonging of minimum rates was last made by the 2005/92/EC Directive, which prolonged the period by 31 December 2010. Currently (on 31 October 2010) there is a semi-finished directive, which should prolong this period by 31 December 2015.

Currently (on 31 October 2010), in the area of rates, the member states are bounded only by this scope and the particular rates level is within their authority. At the same time, the basic regulation in the area of VAT, the 2006/112/EC¹² Directive about a Common VAT System of 28 November 2006 defines possibilities of using reduced rate for a certain range of commodities.

Results 2: Analysis of changes in tax rates

During the whole period the predominant system in EU countries is a system with two or three VAT rates excluding Denmark (flat rate of 25%) and Luxembourg (four rates). In seven EU countries, there is an exception of so-called super reduced VAT rate (less than 5%), which was extended by 31 December 2010 by the 2007/75/ES Directive last time. Changes in rates were made by 13 EU countries, it means 1/3 of all member states and these changes are illustrated in the Tab. I (see supplement). The overall view on changes in standard and reduced rates is given in the Fig. 2 (in supplement). View of changes in accordance with the methodology chosen is given in the Tab. II. For the theoretical background, see supplement.

The second fact analyzed, which can be under a significant influence of the economic crisis is about EU member states using or respectively not using a possibility of the new application of reduced VAT rate to some services: (i) services originally registered in Attachment IV according to the article 106 of the 2006/112/EC Directive (services with a high share of labour), and (ii) restaurant and catering services.

7 These exceptions, which are included in the chapter 5 (articles 123–130) of the 2006/112/EC Council Directive are extended by the 2007/75/EC Council Directive by 31 December 2010.

8 More details in COPENHAGEN ECONOMICS, 2007.

9 Ditto.

10 These facts are also one of the reasons why article 106 of the 2006/112/EC Council Directive existed. This Directive enables member states to apply reduced rates to services with a high part of labour. This article lost its validity on 31 December 2009.

11 More details in BOGETIĆ, HASSAN, 1993, or KEEN, LOCKWOOD, 2007.

12 References to the Directive 67/227/EEC and Directive 77/388/EEC shall be construed as references to this Directive 2006/112/EC in accordance with the correlation table in Annex XII.

I: *Development of VAT rates in EU Member States*¹³

EU Member State	on 1/1/2008	on 1/7/2008	on 1/1/2009	on 1/7/2009	on 1/1/2010	on 1/7/2010
Belgium	6; 12; 21	6; 12; 21	6; 12; 21	6; 12; 21	6; 12; 21	6; 12; 21
Bulgaria	7; 20	7; 20	7; 20	7; 20	7; 20	7; 20
Czech Republic	9; 19	9; 19	9; 19	9; 19	10; 20	10; 20
Denmark	25	25	25	25	25	25
Germany	7; 19	7; 19	7; 19	7; 19	7; 19	7; 19
Estonia	5; 18	5; 18	9; 18	9; 20	9; 20	9; 20
Greece	4,5; 9; 19	4,5; 9; 19	4,5; 9; 19	4,5; 9; 19	4,5; 9; 19	5,5; 11; 23
Spain	4; 7; 16	4; 7; 16	4; 7; 16	4; 7; 16	4; 7; 16	4; 8; 18
France	2,1; 5,5; 19,6	2,1; 5,5; 19,6	2,1; 5,5; 19,6	2,1; 5,5; 19,6	2,1; 5,5; 19,6	2,1; 5,5; 19,6
Ireland	4,8; 13,5; 21	4,8; 13,5; 21	4,8; 13,5; 21,5	4,8; 13,5; 21,5	4,8; 13,5; 21	4,8; 13,5; 21
Italy	4; 10; 20	4; 10; 20	4; 10; 20	4; 10; 20	4; 10; 20	4; 10; 20
Cyprus	5; 8; 15	5; 8; 15	5; 8; 15	5; 8; 15	5; 8; 15	5; 8; 15
Latvia	5; 18	5; 18	10; 21	10; 21	10; 21	10; 21
Lithuania	5; 9; 18	5; 9; 18	5; 9; 19	5; 9; 19	5; 9; 21	5; 9; 21
Luxembourg	3; 6; 12; 15	3; 6; 12; 15	3; 6; 12; 15	3; 6; 12; 15	3; 6; 12; 15	3; 6; 12; 15
Hungary	5; 20	5; 20	5; 20	5; 18; 25	5; 18; 25	5; 18; 25
Malta	5; 18	5; 18	5; 18	5; 18	5; 18	5; 18
Netherlands	6; 19	6; 19	6; 19	6; 19	6; 19	6; 19
Austria	10; 12; 20	10; 12; 20	10; 12; 20	10; 12; 20	10; 12; 20	10; 12; 20
Poland	3; 7; 22	3; 7; 22	3; 7; 22	3; 7; 22	3; 7; 22	3; 7; 22
Portugal	5; 12; 21	5; 12; 20	5; 12; 20	5; 12; 20	5; 12; 20	6; 13; 21
Romania	9; 19	9; 19	5; 9; 19	5; 9; 19	5; 9; 19	5; 9; 24
Slovenia	8,5; 20	8,5; 20	8,5; 20	8,5; 20	8,5; 20	8,5; 20
Slovakia	10; 19	10; 19	10; 19	10; 19	10; 19	6; 10; 19
Finland	8; 17; 22	8; 17; 22	8; 17; 22	8; 17; 22	8; 12; 22	9; 13; 23
Sweden	6; 12; 25	6; 12; 25	6; 12; 25	6; 12; 25	6; 12; 25	6; 12; 25
United Kingdom	5; 17,5	5; 17,5	5; 15	5; 15	5; 17,5	5; 17,5

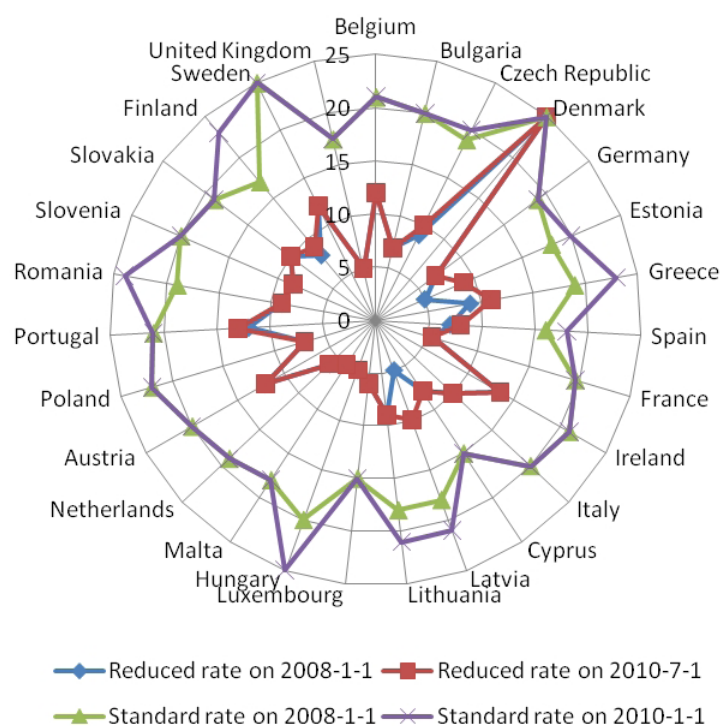
The history of the effort to support higher employment by reduced tax rate with services, which are labour – intensive, goes back to 1999, when the 1999/85/EC Directive was approved and which changed the 77/388/EEC Directive in terms of the possibility of the experimental application of reduced VAT rate to services with a high share of labour. These services were defined in the Attachment of the 77/388/EEC Directive, which was marked with IV and completely adopted by the 2006/112/EC Directive with effect from 1 January 2007 (more details in TÝČ, 2006, or STEINER, WOODS, 2000). It included: (i) minor repairs of bicycles, shoes and leather goods, garment and furnishing goods (including repairing and refashioning), (ii) renovation and repair of private flats and blocks of flats excluding materials which make a substantial part of the value of the service provided, (iii) windows cleaning and house cleaning, (iv) homecare services (e.g. chore and child care, senior care, sick and disabled persons care), (v) barbershop and hairdresser.

Member states could have chosen two of five services, to which they applied reduced rate¹⁴. On 5 May 2009, 2009/47/EC Directive was adopted and among other things it cancelled article 106 of the 2006/112/EC Directive. With effect from 1 January 2010 services stipulated in the Attachment IV were transferred into Attachment III, which means, that member states can apply reduced tax rate to all these services originally stipulated in Attachment IV. Attachment III was extended with delivery of books on any medium and restaurant and catering services.

However, not all member states used all possibilities granted by amendment of 2006/112/EC Directive with regard to national fiscal interests. All possibilities which amended 2006/112/EC Directive granted with effect from 1 January 2010 were fully used by one EU country – Slovenia, another two states – Finland and Malta used possibilities of the Directive in four cases. Latvia is the only state, which extracted one service from reduced rate and transferred it to the basic rate. However, it came to the

¹³ Source: Own comparison according to VAT Rates Applied in the Member States of the European Union (2008, 2009, 2010).

¹⁴ 2006/774/EC Decision of the Council enabled some member states (including the Czech Republic) to apply reduced rates on these three services.



2: Total view of changes in standard and reduced rates

II: View of changes according to used methodology

Time period	α	β	γ	$\alpha + \beta$
1/1/2008 - 30/06/2008	0	1	26	1
1/7/2008 - 31/12/2008	4	1	22	5
1/1/2009 - 30/6/2009	2	0	25	2
1/7/2009 - 31/12/2009	2	3	22	5
1/1/2010 - 30/6/2010	5	0	22	5

Source: Own calculations according to data from Taxation and Custom Union

SUPPLEMENT

Theoretical background for Tab. II

It is possible to examine a motion of rates schematically according to relation (1):

$$\Sigma_T = \alpha_i \beta_j \gamma_k, \quad (1)$$

where Σ_T are total changes during the period observed, α is number of states which increased tax rate, β is number of states, which decreased tax rate and γ is number of states, which preserved tax rate during a relevant period; there is an obvious relation (2)

$$(i + j + k) = 27. \quad (2)$$

paradoxical situation, and as a result of the increase in basic rates in five EU states, there is an increase in tax burden on the service selected instead of the possible reduction of the rate of the service selected (as a result of possible transfer from basic VAT to reduced VAT). Also only 10 EU states use a possibility to apply VAT reduced rate to restaurant and catering services.

DISCUSSION

Other possible aspects of VAT rates

In the context of the economic crisis, when fiscal interventions of national governments are absorbed by individual economics more perceptive, the current legislative in the area of VAT rates and a relative flexibility in its applying enable to find new opportunities for improving of VAT system performance in EU. One of such opportunities is a convergence of VAT rates, which could be helpful in the process of simpler performance of the EU internal market. Another possibility is a reduction of administrative burden which currently accompanies a process of VAT administration on the level of payers as well as on the level of tax administrator.

On the other side it is necessary to deal with potential negative impacts or threats which can appear during (or while solving) the economic crisis. First of all there is a question if in the case of changes in VAT during the economic crisis it does not come or will not come only to increasing of these rates in accordance with predominance of effort to fill revenue part of public budgets. It is also related with the question, if during the economic crisis member states will not be prefer only their own fiscal interest to the EU interests. The last risk is a possible existence of no links between changes, which are performed without deeper connections with a longer time period.

An interesting circumstance of VAT changes can be also its influence on the price level. This is investigated with households according to the changes in final prices (including VAT) of commodities of the market basket¹⁵. Although the inflation change is a result of many factors (when some of them have opposite effect), it is obvious that an increase in VAT rates – *ceteris paribus* – lead to increasing of the price level.

SUMMARY

Relative autonomy in policy of VAT rates

The area of VAT shows a relative autonomy of member states in the sphere of rates and it illustrates different reasons and causes of legislative changes of such an important tax in EU. This can result partly from national interests and partly from an obligation to follow the Community Law, although these interests do not have to be always in accord.

Looking for national policy instruments, which can be used to face or moderate consequences of the economic crisis, these tax policy instruments cannot stay aside.

Although the reason of all changes does not have to be necessarily an economic policy reflection of the economic crisis, it is obvious, that particularly the Baltic States, the Czech Republic and Hungary have chosen the way of rates increasing. In these countries changes of VAT rates were officially stated as a result of the economic and mainly budget crisis. Economic conditions were a reason to justify one year change of basic VAT rate in Great Britain, which was grounded in rate decreasing. VAT rate was also changed in Finland, Ireland and Portugal.

During the period monitored, 13 EU countries had changed VAT rate, only three states had used possibilities, which were granted by the amended 2006/112/EC Directive and they extended number of services, to which they apply reduced VAT rate.

The economic crisis substantially "has stirred" stagnant waters of VAT rates changes. However these changes did not have a positive side aspect of reduction of VAT rates range in the European Union, but they result from fiscal interests of individual EU Member States. However, in any case, a better rates harmonization contributes to the running of the single internal market.

Acknowledgement

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15 E.g. in the Czech Republic, in accordance with international classification COICOP, the market basket observed is classified into 14 sections, 58 groups and 157 classes and there are total 730 items. In 2009, 16.06% of the basket belonged to exemption from taxation, 25.96% to reduced rate and 57.98% to basic tax rate. For more details, see ŠÍROKÝ, KOVÁŘOVÁ, 2010.

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