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## **Review of existing VAT legislation on public bodies and tax exemptions in the public interest**

**ECCVAT response: April 2014**

### **Introduction**

1. The European Charities' Committee on Value-Added Tax (ECCVAT) is a group of charities and foundations that has come together to research the impact of VAT and other taxes on the work of NGOs and to make representations to the EU institutions and governments on behalf of the sector. ECCVAT has been working to improve the VAT system for charities since 1992. ECCVAT sits as an Observer on the Commission's VAT Expert Group and was invited to attend and speak at the Fiscalis Conference in Mestre in May 2013 on the implications of this review for charities.
2. ECCVAT welcomes the opportunity to respond to this consultation. ECCVAT also appreciates the Commission's willingness to engage with the charity and voluntary sector and welcomed Ingmar Beuth's (DGTAXUD) participation in a seminar for charities about the consultation exercise which was held in London on 4 February 2014.
3. Reference is made throughout this submission to "charities". This term is taken to include all public benefit organisations, including public benefit foundations as well as charitable organisations providing services that are either outside the scope of VAT or exempt.

### **General remarks**

4. ECCVAT has been concerned for a long time about the impact of the VAT system on the work of charities and therefore welcomes the publication of the consultation paper "*Review of Existing VAT Legislation on Public Bodies and Tax Exemptions in the Public Interest*".
5. In particular, ECCVAT welcomes the acknowledgment that charities suffer from distortions and lack of neutrality arising from the existing VAT system. ECCVAT urges the Commission to take into account the impact of VAT on private sector charities when they work alongside public sector bodies. ECCVAT supports the overall intention of reducing unnecessary bureaucracy and simplifying the VAT system: that is long overdue and would have a positive impact in terms of administrative costs for charities.
6. ECCVAT also welcomes the references to the particular concerns and interests of charities as analysed in the Copenhagen Economics reports and the acknowledgement that certain reform options would have a negative impact on the sector. This represents a significant improvement as compared to the 2011 Green Paper on the Future of VAT.

7. ECCVAT continues to stress that the current VAT system has a detrimental effect on the work of charities in Europe. The economic crisis, recent increases in VAT rates in certain Member States and funding difficulties have all put the sector under significant financial strain. Additional VAT costs would be very damaging, would compromise charities' ability to deliver their services and would have a significant negative impact on the beneficiaries of charities. ECCVAT hopes that the Commission will continue to take into account the unique position of charities in the follow-up to this consultation and carefully considers every potential impact of future reform measures on the sector.
8. This is all the more important because we observe growing pressure on charities in a number of Member States to play a greater role in providing social welfare services and on foundations to help support such work. The current system massively disadvantages charities because it favours the provision of services by public bodies that are entitled to a refund of VAT; in contrast, charities cannot recover VAT costs where the service is VAT-exempted or financed by grants.
9. ECCVAT is relatively pleased with the range of reform options that the Commission is considering. In particular, ECCVAT welcomes the inclusion of the option to tax. However, as already discussed with the Commission, ECCVAT feels that the paper misses the links between the various options presented. Our response outlines these links, especially between the option to tax and refund schemes. It also assesses the impact of each option on charities. ECCVAT recognises that these solutions will not necessarily suit every single stakeholder – let alone every type of charity – but urges the Commission to consider the interests of civil society as part of an open and sustained consultation process.
10. In our view, it is crucial that, in making its final recommendations, the Commission should take into account the fact that the differing needs of four different types of charity have to be considered:
  - a. Pure fundraising charities, which provide services for no charge (eg sea-rescue charities)
  - b. Grant-making trusts and foundations
  - c. Charities providing the following types of service under contract (often on behalf of the state):
    - i. Exempt
    - ii. Non-business
    - iii. Taxable
    - iv. A mixture of two or all three
  - d. Hybrid charities (ie those that fundraise and supply non-business services and/or grant-making as well as providing services under contract).
11. ECCVAT understands that the ultimate objective of the consultation is the simplification and greater harmonisation of the EU taxation system. Once more, however, we should like to remind the Commission to keep in mind when pursuing this objective, the diversity of the charity sector and its special role for society.

#### **Q1: General evaluation of the current rules**

12. For many years, ECCVAT has been demonstrating to EU politicians and officials that the current VAT regime treats charities in a particularly unfair way. It is still not widely known

that, according to estimates by ECCVAT, charities in the EU lose about €5,824 million a year in irrecoverable VAT.

13. The VAT system treats charities differently depending on the types of service that they provide and whether or not they charge for their services. Those that do not charge are treated as the final consumer even when they are not: as a result, they are unable to recover VAT on the purchases (input VAT) made to support their activities. Most of the charities that do charge for their services also suffer from irrecoverable VAT because their services are classified as exempt under Article 132 (1) a-q of the Principal VAT Directive (2006/112/EC)
14. In a number of Member States, charities have taken or are willing to take over the delivery of public services outsourced by public bodies. The current system provides a disincentive to contracting out because charities face irrecoverable VAT or are required to account for output tax – unlike the public body which has initiated the contracting-out process. This point has been made in the UK in a report by Monitor, the Regulator for health services which recommended extending the refund scheme for the National Health Service to charities performing outsourced services. Where the public sector body can recover VAT under a refund scheme, this is only effective in washing through the VAT incurred by a charity in providing the contracted-out service where it is taxable – the VAT continues to ‘stick’ where the service is exempt (or is non-business). In Spain, charities are also reluctant to take part in contracting-out processes because the VAT system makes it more costly for them than for companies to take over the delivery of public services.
15. When social welfare exemptions depend on the supplier having charitable status, exemption can actually work to the disadvantage of charities in tendering for public sector contracts and in favour of suppliers obliged to charge VAT. This is because when assessing public tenders authorities compare the offers without VAT in accordance with Directive 2004/18/CE. Since companies can recover VAT, for them contracting-out public services is fiscally neutral, while charities face irrecoverable VAT as part of their costs.
16. The current rules as written have led to interpretation problems and disputes on what constitutes business or non-business activities, often because it is not clear whether what is being done is a non-economic activity provided in return for a grant or an activity within the scope of the tax (even if it is exempt) provided for consideration under a contract for services. More clarification would be welcome. In practice, it has become particularly hard for charities, for those public bodies commissioning their services and for the tax authorities in many Member States to distinguish between business and non-business activities in a consistent and fair way. Much clearer guidance is needed in most Member States in this area. In addition, guidance would also be welcome making clearer whether the commission is working through grant agreements or contracts with charities when it acts as an outsourcer in commissioning projects.

## **Q2: Distortion of competition clause**

17. The Copenhagen Economics report concludes that the current VAT system, in particular Article 13 PVD, leads to a distortion of competition between public and private bodies performing the same activity. However, as outlined below, we believe that it is not really for charities to comment on this situation. By definition, charities are not public sector bodies at present: therefore, they are not covered by the special rules governing state bodies in Article 13 and cannot benefit from the “outside the scope” treatment allowed to state bodies where such treatment does not lead to distortion of competition. However, we note (and agree

with) the Commission's concern that the huge difference in the way the rules are applied in practice in different Member States creates problems and distortions – and even if these rules are kept in place, there should be a concerted effort to reach agreement on a consistent interpretation.

### **Q3: Reform measures**

18. ECCVAT has carefully considered each option and our position is as follows:

#### ***Full taxation***

19. As noted in the consultation paper, the full taxation option would have negative consequences for charities as it would result in significant extra VAT costs for the sector. This solution is totally unacceptable for charities and would be so even if charities were able to charge for their services at a reduced rate. Charities could only support the full taxation model if it were introduced in a way that was fiscally neutral, i.e. by allowing them to charge at an appropriate super-reduced rate to produce the same fiscal result as exemption in each Member State (taking into account the rate and scope of each VAT system). This fiscally-neutral rate would need to be calculated for each Member State and included in any future proposal.
20. This option assumes that the significant revenue increase that it would generate would possibly lead to a reduction of the standard VAT rate. However, there is no way in which the Commission could ensure that Member States would actually implement such a reduction or do so in full: ultimately, it would be a matter of the political will and economic judgment of domestic governments. Furthermore, not all Member States have implemented reduced rates in their VAT legislation at the present time; and those Member States would likely be reluctant to introduce reduced rate schemes in the future, thereby increasing the risk of an economic downside of the full taxation solution for charities. This option would therefore be a risky gamble for the sector and we oppose its introduction.
21. Even if Member States committed to reducing their standard rates and charities were allowed to charge for their formerly-exempt services at a super-reduced rate to produce a broadly fiscally-neutral result, the full taxation option would not solve the problem for charities that did not charge for their services such as, for example, search and rescue organisations.
22. The consultation paper mentions the New Zealand model, which allows activities of public bodies to be treated as taxable even when they are not carried out against a consideration (ie if no fee is charged). In this model activities are considered "deemed supplies". In considering moving towards the full taxation model, the Commission should embrace this ambitious option as it would provide a level-playing-field for those charities that do not charge. However, it would not provide full compensation and the option would still have huge additional costs for foundations and grant-making charities that neither charge nor provide a service as such.
23. Despite significant reduction of distortion of competition, this option appears to have more costs than benefits to charities. In addition, ECCVAT understands that it would be politically sensitive and has little chance of success. In conclusion, ECCVAT will not support it.

## ***Refund system***

24. Refund systems are currently in place for public bodies in eight Member States: Austria, Denmark, Finland, France, the Netherlands, Portugal, Sweden and the United Kingdom. As noted in the consultation paper, these systems are very different from each other and are sometimes quite restrictive. In this regard, ECCVAT welcomes the Commission's confirmation that refund systems can apply both to exempt business activities and to non-business activities as well as to private sector bodies such as charities, subject to compliance with state aid rules.
25. ECCVAT welcomes the suggestion that tailored refund schemes should be reconsidered, having previously argued for those schemes to be extended to all providers of public good, including charities, and to exempt supplies as well as non-economic activities. Although we recognise that this can already be done outside the VAT system through matching grants, we believe that it would be simpler and more effective if it were to be done inside the VAT system by introducing zero-rates, as suggested in the Copenhagen Economics report. This would bring many organisations that are currently outside it into the VAT system but it will not compensate charities that are not making supplies for consideration (financed through donations). A zero-rate solution must therefore take this issue into account. This could be done by using so-called "deemed supplies". These organisations are, to a large extent, driven by volunteers. An introduction of zero-rates will, other things being equal, impose many new obligations on these organisations and their volunteers with regard to invoicing requirements and accounting. A refund solution within the VAT system must take this issue into account and therefore be combined with specific lighter administrative rules for charities.
26. ECCVAT favours the first variant of the option under which all of the current exempt or non-taxable services would qualify for a refund of their input VAT expenditure. We believe that the second variant (ie. making refund schemes only available for health, education, public administration and cultural services) is practically unworkable as it could prove difficult to define precisely which services would qualify. In addition, it would not significantly lower additional costs.
27. The downside of this option is that it may be problematic and more difficult to implement refund schemes in federal States, such as Germany or Austria. This is due to the multi-level fiscal structure of these States.
28. Despite implementation difficulties in federal States, this option would have the advantage of solving the irrecoverable VAT problem of most charities. ECCVAT recognises that the Commission has no competence to propose the establishment of an EU-wide refund scheme outside the VAT system but it would very much welcome a renewed recommendation and encouragement from the Commission to Member States on the use of extended refund schemes where the fiscal/budgetary system governing public expenditure makes it practicable to implement.
29. ECCVAT points out that the consultation paper does not make the link between refund schemes and the option to tax as charities.

## ***Deletion of Article 13 while keeping the tax exemption in the public interest***

30. ECCVAT notes the conclusions of the Copenhagen Economics report and of the consultation paper that Article 13 is a source of distortions of competition. At the same time, it is

important to acknowledge that public bodies still play a very important role in delivering public services in certain Member States where there is less outsourcing. However, the problem is serious enough to warrant further consideration; and ECCVAT would like to see it examined before any decision to delete it is taken. As noted above, there is also a strong case for greater harmonisation and consistency in the way these rules are applied in practice. Subject to that, we consider whether or not the issue needs to be addressed is a question for the Member States themselves, not for the charity sector.

31. As noted already, a significant issue is the inconsistency of treatment of public sector activities across the 28 Member States because of different definitions and interpretations of what is meant by “public sector activities” as such. If Article 13 is to stay, ECCVAT would like the Commission to press strongly for greater consistency and harmonisation of the definitions.

#### ***Additional ideas and proposals***

32. ECCVAT’s main objective remains the reduction of the irrecoverable input VAT costs that many charities face. Over the years, we have proposed different solutions to achieve this and would like to outline them once more for the Commission’s consideration.
33. In effect, charities are being treated as the final consumer even when they are not. ECCVAT is aware that the suggestion to extend reduce rates goes against the Commission’s analysis in the Communication on the Future of VAT and the recommendation that Member States limit the use of such reduced rates. ECCVAT would like to remind the Commission that in the case of public bodies and charities, the VAT system should be viewed not purely as a revenue raiser but also as a way of supporting charities that provide services in the public interest: in short, supporting the social aspects of the EU. Granting preferential reduced VAT rates and exemptions is one way of achieving that goal.
34. Therefore ECCVAT suggests that the Commission should reconsider the idea of introducing within the VAT scheme the discretion for Member States to introduce a reduced rate of output tax on supplies made to charities incurred strictly in the course or furtherance of their charitable purposes. The advantage of this approach would be that it would also take into account the situation of foundations that do not charge for the goods or services they provide. Ideally, the reduced rate already allowed on outputs of charities that are not exempt should also be allowed to apply to the input tax incurred by charities on expenditure in support of their charitable objectives. This was originally proposed by the European Commission during the early 1990s and was opposed only by three Member States. Although this would not solve the total irrecoverable VAT bill incurred by charities, it would dramatically ease the problem without requiring radical reform of the VAT system.

#### **Q4: Sectoral reform**

35. ECCVAT points out that this option remains vague but understands that the Commission has not yet taken any decision as to which exemptions may be removed and will take into account the replies to this consultation. ECCVAT understands, after clarification from the Commission, that the idea behind sectoral reform is to delete exemptions when they lead to distortion of competition.
36. ECCVAT notes that the paper does not refer to social exemptions at all. ECCVAT extensively outlined the importance of retaining social exemptions for charities in its response to the

Green Paper in 2011. However, Member States have often implemented them in a narrow way.

37. Example 1: the UK has a very restrictive interpretation of the exemption for fundraising events. Since 1990 the Government has tightened the conditions under which such events can benefit from the exemption as their prime purpose must be to raise funds, while it used to be just one of the conditions before 1990. The First Tier Tribunal (FTT) is currently looking at the case following a judgment from the Upper Tribunal, which said that the current interpretation would only be justified if it prevents unfair competition with commercial events rather than, as implied, protecting the revenue.
38. Example 2: Germany has only limited regulations that secure the exemption of the whole chain when the service, which is exempt for the charity, is physically delivered by a freelance contracted by the charity. This is especially relevant for the education and training sector as well as cultural institutions.
39. Example 3: the UK definition of “social welfare” requires the recipient to be sick, disabled, elderly or in distress. This may not cover all categories of those in need of social welfare help (for example, children); and ECCVAT considers that it is an unduly narrow interpretation of article 132(g).
40. In conclusion, ECCVAT would welcome the Commission looking into the interpretation and implementation of social exemptions and providing better guidance to Member States.

#### **Q5: Option to tax**

41. ECCVAT welcomes the inclusion in the consultation paper of the possibility of introducing an option to tax. However, it is disappointing that the Commission has not linked this option to the functioning of refund schemes, as it would work as a complementary solution. Its role would be to allow wash-through of otherwise ‘sticking’ VAT where the provider of contracted-out services to a public sector body able to recover VAT under a refund scheme makes exempt supplies, e.g. of health care or social welfare. This technique would be particularly helpful where refund schemes are restricted to public bodies only.
42. Generally, we feel that this proposal is quite limited and would like the Commission to take a bolder approach. This option deserves further examination.

#### **Conclusions**

43. ECCVAT welcomes the fact that the generally adverse impact of the present single market VAT system on the charity sector is now widely recognised as a result of the analysis by Copenhagen Economics and that it is now accepted that it is important to address this as part of the reform of the VAT regime for the public sector. The core problem is the large and growing burden of irrecoverable VAT which limits the ability of charities to respond to the increasing social demands being placed on them, and also seriously distorts decision-making processes in commissioning and contracting out by the public sector in all Member States.
44. The range of possible solutions to the present problems deserves serious further study. However, all changes to the *status quo* need to be weighed with great care to avoid worsening the present position of charities rather than improving it; and the fiscal and

economic impact on the different types of charity described above needs to be carefully assessed before changes are made. We hope that the package to be submitted in due course by the Commission to the Council will recommend changes that bring measurable incremental improvements to the present position even if the more radical options are effectively ruled out for political reasons.

**Annex one:** The following organisations support this submission



**Isobro – Danish Fundraising Association (Denmark)”**

<http://www.isobro.dk/>



**European Foundation Centre (pan-European)**

<http://www.efc.be/Pages/default.aspx>



**Charity Tax Group (UK)**

<http://www.ctrg.org.uk/home>



**Irish Charity Tax Reform Group (Ireland)**

<http://www.ictr.ie/>



**DAFNE (pan-European) – Donors and Foundations Networks in Europe** – has a collective membership of over 6,000 foundations

<http://www.dafne-online.eu/Pages/default.aspx>



**Fundación ONCE (Spain)** – provides training and employment programmes for people with disabilities

<http://www.fundaciononce.es/EN/Pages/Portada.aspx>



**Swedish Red Cross (Sweden)**

<http://www.redcross.se/>



**EUFED – European Union Federation of Youth Hostels**

<http://www.eufed.org/EN/home.html>



**Spanish Association of Foundations (Spain)**

<http://www.fundaciones.org/es/home>



**European Fundraising Association (pan-European)**

<http://www.efa-net.eu/>



**euroCom (Germany)** – improves the organisational competence and effectiveness of NGOs

[http://www.eurocom.org/english-site/index\\_main.htm](http://www.eurocom.org/english-site/index_main.htm)



**Tercer Sector Social de Catalunya (Spain)** – works to improve the rights, equality and quality of life of Catalan people

<http://www.tercersector.cat/>



**Swedish Fundraising Council (Sweden)**

<http://www.frii.se/>