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REPORT

of the Committee on Economic and Monetary Affairs and Industrial Policy

on completion of the internal market : approximation of indirect taxation in the Community up to 1993 and thereafter

Rapporteur : Ben PATTERSON

PE 146.286/fin.
Or. EN

A Series: Reports – B Series: Motions for Resolutions, Oral Questions – C Series: Documents received from other Institutions (e.g. Consultations)

*	= Consultation procedure requiring a single reading	**II	= Cooperation procedure (second reading) which requires the votes of a majority of the current Members of Parliament for rejection or amendment
**I	= Cooperation procedure (first reading)	***	= Parliamentary assent which requires the votes of a majority of the current Members of Parliament

CONTENTS

By letter of 28 June 1990 the Committee on Economic and Monetary Affairs and Industrial Policy requested authorization to draw up a report on completion of the internal market: approximation of indirect taxation in the Community up to 1993 and thereafter.

At the sitting of 8 October 1990 the President of the European Parliament announced that the committee had been authorized to report on this subject.

At its meeting of 16 October 1990 the committee appointed Mr Patterson rapporteur.

At its meetings of 5-7 November 1990, 5-7 February 1991, 18-20 March 1991, 24-25 April 1991, 14 May 1991 and 29-31 May 1991 the Committee considered the draft report.

At the last meeting, 29-31 May 1991, it adopted the motion for a resolution unopposed with two abstentions.

The following took part in the vote: Beumer (Chairman), Desmond (Vice-Chairman), Patterson (rapporteur), Beazley P., Bofill Abeilhe, Cassidy, Colom I Naval, Cooney (for Bernard-Reymond) Cox, De Piccoli, Di Rupo (for Caudron), Frierich, Herman, Hoppenstedt, Megret, Merz, Metten, Nielsen (for De Donnea), Porto (for Punset I Casals), Read, Riskær Petersen, Rogalla, Roumeliotis, Sboarina, Seal, Siso Cruellas, Tongue, von Wogau

The report was tabled on 30 May 1991.

The deadline for tabling amendments will appear on the draft agenda for the part-session at which the report is to be considered.

A.

DRAFT MOTION FOR A RESOLUTION

on completion of the internal market: approximation of indirect taxation in the Community up to 1993 and thereafter

The European Parliament,

- having regard to the Communication from the Commission of 26 August 1987 (COM(87) 0320 final),
- having regard to Articles 8a and 17 of the Single European Act,
- taking into account the evidence presented to its Committee on Economic and Monetary Affairs and Industrial Policy on 18-20 April, 21 June and 12 July 1988 (PE 123.347),
- having regard to the initial report of its Committee on Economic and Monetary Affairs and Industrial Policy (A2-0315/88),
- noting the Communication from the Commission of 14 June 1989 (COM(89) 0260 final),
- recalling its resolution of 25 October 1989,
- in the light of the Communication from the Commission of 3 November 1989 (COM(89) 0551 final) and its most recent proposals in the field of indirect taxation (COM(90) 0182 final), COM(90) 0183 final and COM(90) 0430-0434 inclusive),
- recalling the report from its Committee on Economic and Monetary Affairs and Industrial Policy on the transitional arrangements for Value Added Tax (PE 143.204/fin.) and its resolution of 20 November 1990,
- having regard to the report of the Committee on Economic and Monetary Affairs and Industrial Policy (A3-0156/91),

1. re-affirms that fiscal frontiers within the Community must be abolished, both to achieve the gains outlined in the Cecchini Report, and to create an area "without internal frontiers" in accordance with the Single European Act;

2. observes that, in the case of Value Added Tax, this cannot be fully achieved until the system of charging tax on imports and remitting tax on exports in trade between Member States is ended;

3. in consequence, has accepted the transitional arrangements for a common system of Value Added Tax on the understanding that both Commission and Council are committed to the full abolition of fiscal frontiers at the earliest possible date;

4. notes that a system based on charging Value Added Tax in, and at the rate of, the country of origin will result in transfers of revenue to Member States with net surpluses on internal Community trade; and therefore asks Commission and Council either to agree to the payment of all VAT revenues into the Community Budget, or to give immediate priority to devising a workable and acceptable VAT clearing system;

5. draws attention to the fact that some 95% of trade between Member States takes place between VAT-registered bodies, where differences in tax rates, even after the complete abolition of fiscal frontiers, cannot greatly distort competition;

6. also draws attention to the evidence showing that differences in VAT rates play only a limited part, overall, in determining price differences between Member States;

7. observes that significant distortions of competition might have arisen in the case of sales to bodies exempt from Value Added Tax, but that this danger will now be removed;

8. concludes that any distortions of competition as a result of differences in VAT rates will arise largely on sales to individual final consumers, particularly where these take place across certain frontiers (e.g. Denmark/Germany) and in the case of high-value, low volume goods;

9. believes, however, that the temptation to counter such possibilities by retaining VAT controls on cross-border purchases by individuals should be resisted; and demands that travellers' VAT-paid allowance within the Community should become infinite on 1 January 1993, as reaffirmed by the Commission in its Communication of 14 June 1989;

10. observes that the removal of limitations on cross-border purchases will to some extent bring the VAT systems of Member States into competition with each other, and create pressures for the convergence of rates;

11. observes, also, that this convergence might be achieved either through the operation of market forces; or through some prior approximation or harmonization of rates; believes, however, that convergence of VAT rates is preferable through some prior approximation or harmonization;

12. calls on the Commission to investigate the effect that the removal of limitations on cross-border purchases by individuals, without prior approximation of rates, would have on trading patterns in border areas;

13. meanwhile, is aware that the operation of market forces on their own is liable to produce convergence on the lowest tax levels and create the danger of a continuing competitive downward pressure on rates;

14. concludes that at least a minimum standard rate of VAT will have to be agreed;

15. notes, however, that the fixing of single, target rates of tax in the case of either VAT or excise duties, or of an upper limit (i.e. a band) in the case of VAT, will create additional constraints on the fiscal policies of Member States, which will have implications going beyond the field of indirect taxation;

16. also notes that the determination of tax rates at Community level raises important institutional questions, in particular the voting system to be used in Council and the participation of the European Parliament;

17. supports an obligatory reduced rate VAT on certain basic goods, the purchase of which accounts for a high proportion of the expenditure of lower-income families;

18. observes that differing VAT rates on most of these goods - for example, fuel for household heating and cooking, and basic foodstuffs - are unlikely to give rise to cross-frontier shopping;

19. believes, therefore, that a zero rate of VAT should be a valid reduced rate on such goods;

20. calls on the Commission to publish as extensive a list as possible of goods and services which might be taxed, pursuant to the principle of subsidiarity, at the reduced rate of VAT;

21. noting the Commission proposal that 'books, newspapers and periodicals' should be taxed at the reduced rate of VAT, believes that such a rate should apply only if such publications are in printed form;

22. affirms that the rates of VAT to be introduced should be those adopted in the Parliament's opinion in the report by Mr METTEN (PE 148.345) on the proposal for a Directive on the approximation of VAT rates (COM(87) 0321 final);

23. calls for the speedy adoption by Council of the Directive on the VAT treatment of second-hand goods and works of art;

24. calls on the Commisison to investigate what impact there would be, notably on SMUs, if undertakings established in several Member States were regarded as a single enterprise for VAT purposes, and to take any action necessary to remove obstacles to cross-frontier co-operation in this context;

25. calls on the Commission, in its negotiations with the EFTA countries on the European Economic Space, to propose that exemption from duty should be ended throughout the European Economic Space;

26. calls on the Commission to propose an adequate rate of tax from the point of view of the environment on the use of non-renewable sources of energy which are not covered by the present proposals;

27. calls on the Commission to ensure that account is taken in all measures to harmonize VAT and excise duties of the ecological impact of such measures;

28. welcomes, at last, the Commission's proposals for the movement within the Community of goods subject to excise duties;

29. in contrast, is sceptical as to whether early agreement is possible on either the structures or the rates of duty on tobacco products and alcoholic beverages;

30. draws attention, in this context, to the considerable effects which harmonization of these excise duties would have within Member States on revenues, price levels, patterns of consumption, employment and financial and budgetary policy;

31. believes, however, that continuing disparities in the rates of excise duties after 31 December 1992 <u>are</u> compatible with the abolition of tax checks at internal Community frontiers;

32. in particular, believes that significant tax avoidance can be prevented through limiting the bulk movement of excisable goods to within the duty-suspension system, and by controlling the resale in high-tax Member States of excisable goods bought duty-paid in low-tax countries;

33. consequently calls for personal tax-paid allowances for excisable goods to become infinite on 1 January 1993, as in the case of VAT;

34. is of the opinion that a continuation of "duty-free" sales on intra-Community journeys by air or sea is compatible with the abolition of frontier checks on travellers;

35. draws attention to the danger of a "two-speed Europe" which would arise if certain Member States were to opt out of the fiscal aspects of 1992; and believes that the temptation to solve the problems of particular Member States through derogations and/or exemptions should be resisted;

36. instructs its President to forward this report to the Council and Commission and to the parliaments of the Member States.

B.

EXPLANATORY STATEMENT

1. HISTORICAL INTRODUCTION

Article 99 of the original EEC Treaty required the Commission to "consider how the legislation of the various Member States concerning turnover taxes, excise duties and other forms of indirect taxation ... can be harmonized in the interests of the Common Market." Under this provision, the 1st and 2nd VAT Directives of 1967 introduced a common system of Value Added Tax. Agreement on the Community's "own resources" led to the 6th VAT Directive of 1977, the object of which was to harmonize the VAT base so that "application of the Community rate to taxable transactions leads to comparable results in all Member States".

Meanwhile, attempts were also made to act in the field of excise duties. A start was made on harmonizing the structure of tobacco taxes in 1972, but the process soon stalled at its second phase. There was a similar lack of progress in the fields of alcoholic beverages and hydrocarbon oils.

In 1987, however, Article 17 of the Single European Act replaced Article 99. Under this "the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and functioning of the Internal Market within the time-limit laid down in Article 8a." (i.e. by 31 December 1992).

In June 1985, the Commission published its Internal Market White Paper[1], Part III of which outlined the case for "the removal of fiscal barriers". The annexed timetable for the completion of the Internal Market listed 27 proposals in the tax field. Half of these were already on the table[2]. Among the new proposals forecast was a "standstill" on indirect tax rates, which was published the following year[3], but was subsequently replaced by the Convergence Directive (see below).

The Milan summit of June 1985 invited the Council of Economic and Finance Ministers (ECOFIN) to examine what action was needed in the tax area. ECOFIN passed this task on to "a high-level group of fiscal experts", who reported in

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[1] COM(85) 0310 of June 1985.

[2] VAT Directives: the 7th (works of art and second-hand goods), which was subsequently replaced, in 1988, by COM(88) 0846 final; 12th (non-eligible expenditure) COM(82) 0870; 13th (tax refunds); 14th (deferred payments on importing, COM(82) 0402, which was later withdrawn; 16th (VAT-paid imports by final consumers) COM(84) 0318 and COM(86) 0163; 17th. (temporary importation) COM(84) 0412; and the 18th and 19th, COM(84) 0649 (amended proposal COM(87) 0272) and COM(84) 0648 (amended proposal COM(87) 0315), which consisted of various "tiding up" amendments to the 6th. Excise proposals: alcoholic beverages COM(72) 0225, COM(82) 0153, COM(85) 0150, COM(85) 0151; wine tax COM(72) 0225; cigarettes COM(80) 0069; mineral oils COM(73) 1234.

[3] COM(85) 0606 and COM(87) 0017.

June of 1986. The group's main conclusion was that no firm conclusion was possible until detailed proposals were available.

The 1987 tax package

Accordingly, in August 1987, the Commission published eight tax documents:

The Global Communication	**COM(87) 0320 final**
VAT Rates Directive	**COM(87) 0321 final**
Fiscal Frontiers Directive	**COM(87) 0322 final**
Clearing Mechanism Working Document	**COM(87) 0323 final**
Convergence Directive	**COM(87) 0324 final**
Cigarettes Directive	**COM(87) 0325 final**
Manufactured Tobacco Directive	**COM(87) 0326 final**
Mineral Oils Directive	**COM(87) 0327 final**
Alcoholic Beverages Directive	**COM(87) 0328 final**

These were referred for study to the Community's Economic Policy Committee, which published a report in April 1988[4].

During late 1987 and early 1988, the European Parliament's Economic Committee held a series of meetings to exchange views with delegations from the national parliaments. Public hearings took place on the 18-20 April; on 21 June; and on 12 July. The Committee also received substantial written evidence[5]. As a result of this work, the Committee found itself in a position to adopt a number of opinions on the Commission texts during at its meeting of 1 and 2 December 1988: Global (rapp. MR G.B.PATTERSON, A2-0315/88); VAT Rates (rapp. MR A.METTEN A2-0308/88); Fiscal Frontiers (rapp. MR K.DE GUCHT, A2-0320/88); Clearing Mechanism (rapp. MR K.DE GUCHT, A2-0314/88).

The Economic and Social Committee had meanwhile also adopted its opinions at its plenary sitting of 6-7 July 1988[6].

The events of 1989 and 1990

It had originally been intended that Parliament's tax reports would be debated and voted on at the December 1988 plenary. However, following the news that the responsible Commissioner, Lord Cockfield, was to be replaced at the end of the year, the debate was postponed until January 1989.

A full debate did, indeed, take place on 17 January (OJ 2-373). It immediately became clear, however, that the incoming Commissioner, Christiane Scrivener, was contemplating substantial revisions to the proposals. Since Parliament has only one reading on legislation in the tax field, and since there was no guarantee of re-consultation on any revised proposals, Parliament decided to keep its powder dry, and took no final vote. The Commission's new thinking was eventually outlined in its Communication of 14 June 1989[7], which advocated a more flexible approach in the fields of both VAT and excise duties.

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4 Report to the Council and Commission from the European Communities Economic Policy Committee of 6 April 1988 (II/066/2/88).

5 Some of this has been published (PE 123.347).

6 ECO/104 to 112.

7 COM(89) 0260 final.

Meanwhile, little progress had been made in Council. In July, however, the incoming French Presidency realized that unless decisions on the system for handling VAT and excise duties on intra-Community trade could be reached by the end of 1990, there would be no chance of ending tax collection at frontiers by 1993. ECOFIN rapidly reached the conclusion that agreement on the Commission's VAT proposals could not be reached in time. Following an examination of the VAT dossier by a high-level working party, an alternative was devised. This was endorsed by the European Council at in December 1989.

The position of the Council formed the basis of two revised Commission proposals, published on 19 June 1990:

"Transitional Arrangements" Directive	**COM(90) 0182 final**
"Administrative Cooperation" Regulation	**COM(90) 0183 final**

Parliament's Economic Committee adopted opinions on these proposals on the basis of Reports by MR G.FUCHS (A3-0271/90 of 7 November 1990) and MR K.DE GUCHT (A3-0279/90 of 6 November 1990), which were voted through by Parliament at its November 1990 plenary sitting. The proposals were also adopted by Council before the end of the year.

Excise duties

Meanwhile, the Commission had also produced revised proposals in the field of excise duties. At the end of 1989, amended versions of the existing proposals on excise-duty rates were published, together with a Communication on the Commission's new approach:

New Commission Approach	**COM(89) 0551 final**
Tobacco products (rates of duties)	**COM(89) 0525 final**
Mineral oils (rates of duties)	**COM(89) 0526 final**
Alcohol (rates of duties)	**COM(89) 0527 final**

Finally, in late 1990 and early 1991 came the long-awaited proposals on the movement of excisable goods, and new proposals on the structure of excises.

Communication on regime and structures	**COM(90) 0430 final**
General arrangements (bonded warehouses)	**COM(90) 0431 final**
Alcohol (structures of duties)	**COM(90) 0432 final**
Tobacco (structures of duties)	**COM(90) 0433 final**
Mineral Oils (structures of duties)	**COM(90) 0434 final**
Mineral Oils (rates of duties)	**COM(91) 0043**

2. FISCAL FRONTIERS

In the Global Communication, the Commission pointed out that "fiscal checks feature prominently among the functions carried out at the Community's internal frontiers". The costs of carrying out such functions were later quantified in the Cecchini Report of 1988[8]. Were customs formalities at internal frontiers to be abolished, the immediate gain would be a 0.4% increase in Community GDP, a 1% fall in consumer prices and 200,000 extra

[8] "The European Challenge 1992. The benefits of a Single Market" by Paolo Cecchini and "European Economy" no.35 of March 1988 (ISBN 0379-0991).

jobs. In addition, the elimination of fiscal frontiers would contribute to the long-term dynamic effects of creating the Single Market.

As the report of the Economic Policy Committee noted, however, change also involved penalties. "In evaluating the Commission's approach it is important to compare the administrative costs arising ... from present frontier controls with the costs which would result from the implementation of the Commission's proposals." In particular, the proposal to change the levying of VAT on intra-Community trade from a "destination" to an "origin" basis, involving as it did the creation of VAT clearing system, was heavily criticized by national administrations. Hence the eventual adoption instead of the "transitional" arrangements, which retain the destination principle, but move the tax point from frontiers to the place of delivery.

Similarly, in the case of excise duties, the original Commission proposals for the complete harmonization of rates raised a storm of protest. Here, the feared costs were not so much administrative as economic: a loss of tax revenue in high-tax countries, a rise in inflation and unemployment in low-tax countries. Even the more modest proposals of 1990 for minimum rates are being similarly criticized (see section 4).

The abolition of tax controls at frontiers, however, is not the same thing as the abolition of fiscal frontiers. Though, under the transitional VAT regime, tax controls at frontiers will end, goods moving from (say) France to the United Kingdom will still be "de-taxed" (i.e. zero rated) in France and "re-taxed" when arriving at their UK destination. For the "fiscal frontier" to disappear, they would have to be treated like goods moving from Scotland to England. It is for this reason that, from the 2nd. VAT Directive onwards, "de-taxing/re-taxing" has been considered only a temporary arrangement.

Moving to the alternative "origin" system, however, raises the issue of revenue allocation. VAT is a general consumption tax, and in all cases is paid by the final consumer, since input tax is rebated at earlier stages. Under the "destination" principle, the whole of the tax paid also accrues to that consumer's national Exchequer. Under the "origin" system, however, some of the revenue will accrue to Exchequers in other Member States.

If the trade of all Member States in VAT-rated goods were in perfect balance, this would not matter. In practice, a move to the origin system would probably result in substantial transfers of revenue. The Commission's own calculations showed a substantial gain for Germany and the Benelux countries at the expense of the rest[9]. A number of solutions are possible:

i) Do nothing, and accept the transfers of revenue.
ii) Follow the England-Scotland model: trade imbalances do not matter, since all VAT goes to the UK Exchequer. Similarly, all VAT could accrue to the Community Budget.
iii) Re-allocate revenues between Member States on the basis of estimated trade flows.
iv) Re-allocate revenues on the basis of actual VAT returns, administered by a central Clearing System.

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[9] See COM(87) 0323 final.

The first two solutions have hitherto proved politically unacceptable; and in the Council discussions held before adoption of the "transitional" Directive, it was felt that no statistical basis existed of sufficient accuracy to support either of the revenue re-allocation solutions.

The transitional arrangements, however, themselves include harmonized data-exchange systems for control purposes, which will increasingly be electronic in nature. Once these have been installed, and experience has been gained in their operation, a workable VAT revenue clearing system might become feasible. As the FUCHS Report noted, "the transitional period must acquire a momentum of its own, paving the way for the establishment of the definitive arrangements".

3. IS APPROXIMATION OF TAX RATES NECESSARY?

The abolition of fiscal frontiers within the Community will have the effect of bringing the tax systems of the Member States into competition with each other. Such competition might be expected to bring about a convergence of tax rates; but two schools of thought exist as to how this should take place:

a) The "market" solution. The position of some Member States (notably the UK) is that no legislative measures are required to align tax rates. Once the fiscal frontiers had ceased to exist, market forces would exert the necessary pressure for alignment. Member States, however, would retain full sovereignty over the system; and would be able to calculate for themselves, for example, any trade-off between loss of revenue from tax cuts and loss of revenue through consumer shopping in lower-tax countries. The steady fall in the French "luxury" rate of VAT from 33.3% in 1987 to 28% (1988), then 25% (1989/90) and now 22% can be seen as an example of market forces already in action.

b) Fiscal approximation/harmonization. The position of the Commission, as stated in the Global Communication, is that "the abolition of fiscal frontiers necessitates approximation of VAT and the main excise duties if unacceptable levels of distortion of competition, diversion of trade, and tax fraud are to be avoided". Based on US experience with Sales Tax (see Section 6), the Commission proposal is for a maximum spread of 6% between Member States (both for VAT alone and for excise plus VAT).

A number of factors are germane to the argument:

i) The competitive effect of tax differences

Evidence presented to the European Parliament's Economic Committee by the European consumers organization, BEUC[10], indicated that, for many products, VAT played a very small part in determining price differences across internal frontiers. The price of a film, for example, was roughly the same on the two sides of the Channel, although the tax rate was 15% on the UK side and 33.3% (at that time) in France. But in Belgium, it was 7.5% cheaper than in the UK, although the tax rate was 25%.

A more systematic study by the Commission[11] was also presented to the

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10 "BEUC's response" (BEUC 85/88) of 15 April 1988.

11 "The role of VAT in explaining price differentials across the Member States".

Committee. Differences in indirect taxes (VAT and excise), it found, "account for only a quarter or thereabout of the price dispersion". "The part of price differentials explained by VAT differentials is rather modest (between 4% and 8%). Therefore it can be concluded that differences in VAT rates are not the main cause, and not even a major one, of price differentials."

The implication of these findings is that the abolition of fiscal frontiers, without prior approximation rates, would not, after all, lead to major distortions of competition. However, three 'caveats' must be entered:

a) The importance of tax differences varies with product. The same BEUC survey, for example, found a closer relationship between tax and price in the case of compact cameras than in the case of films: in the UK tax 15%, price 105; in Belgium tax 25%, price 127; in France tax 33.3%, price 131.

b) To the extent that current price differences are caused by various restraints on competition, and by market segmentation, the 1992 process as a whole might be expected to increase the pressure for price convergence. This would increase the significance of tax differences.

c) Tax forms a major element in the price of excisable goods.

The whole issue, however, is further complicated by another factor: it is not possible to consider indirect taxation in isolation from tax systems as a whole. The relative weighting of indirect taxes and direct taxes on individuals, taxes on companies and social security charges varies markedly between Member States, with effects upon relative competitivity.

Under the current system of remitting VAT inputs on exports, for example, the Danish tax system gives that country's exports a certain competitive advantage. A proportion of social expenditure, which in other Member States is financed out of direct contributions by employers and/or employees, is financed in Denmark out of the uniform 22% VAT. But this tax is remitted on exports, a possibility which does not exist for competitors. Is a competitive advantage achieved by having a low VAT rate; or by having a high VAT rate?

It is not even the tax system alone that must be considered. The Boiteux Report prepared for the French Government in 1988[12] refers to analyses which discount completely variations in tax rates. In conditions of free competition "the differences in costs due to certain factors like fiscal charges will be offset by compensating adjustments in other cost factors like the return on capital or on labour".

ii) The effect of VAT registration

At present some 96% of internal Community trade takes place between bodies registered for VAT. Under the destination principle, goods are exported free of tax; and taxed on import at the rate of the importing country. Under the origin system, goods would be exported at the rate of the exporting country; but this would be deducted as input tax by the importer, who would charge

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12 "Fiscalite et marche uniques europeen" by M.Boiteux and M.Achard (Ministere de l'ecoonomie, des finances et de las privatisation, 1988).

customers at the rate of the importing country. In neither case can differences in VAT rates have a major effect on competition.

Similarly, excises are currently levied at the rate of the importing country, on arrival. Under the Commission proposals tax will be levied at the rate of the importing country as soon as the goods are released for consumption. Again, differences in tax rates can have no effect on competition.

Competition problems (apart from those, of course, which result from fraud) could therefore only arise in relation to the 5% or so of goods which cross frontiers as a result of trading to the VAT-exempt sector (e.g. financial services, hospitals); or tax-paid goods carried by final consumers.

The Boiteux Report considered the VAT-exempt sector, despite its limited role in trade, of critical importance. French hospitals or banks wishing to purchase high-value items like computers might have had a major incentive to buy in Luxembourg (12% VAT) or Germany (14% VAT) rather than to purchase from a domestic supplier (18.6% VAT). This problem, however, has already been solved by bringing such bodies into the VAT system.

Most recently, a study commissioned by the French Senate for their Committee on Finance[13] concluded that since "firms subject to VAT ... which recover the tax on their purchases, take into consideration only the prices net of tax", "the strict harmonization of VAT rates is not necessary".

<u>iii) Cross-border shopping</u>

As Mrs Robinson points out in her Report for the ESC[14] the "opportunity cost" of cross-border shopping depends upon geography and product characteristics. As a rule-of-thumb, the higher the value in relation to transportability, and the greater the tax difference in relation to distance to be travelled, the more likely "tax shopping" will be.

'Bona fide' travellers, it might be thought, account for so few cross-border movements of goods as not to affect competition at all. In that case, one might well ask why Member State governments have resisted so resolutely any substantial rise in the duty-paid allowances for travellers (not to be confused with the duty-free allowance)? Two Member States (Denmark and Ireland) have even tried to limit the allowances currently in force.

In the case of cross-border shopping proper, a map of the Community, indicating tax rates, demonstrates clearly which are likely to be the most sensitive <u>geographical factors</u>. In the case of goods and services taxed at the standard rate of VAT, the most sensitive border is that between the North and South of Ireland (10 percentage points difference), followed by Denmark/Germany (8 points), and Belgium/Luxembourg (7 points).

However, because certain categories of goods taxed at a standard rate in some countries are taxed at a "luxury" rate or at a "reduced" rate in others, there are much greater rate differences on some borders for certain goods. On the

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[13] "The Economic Consequences of Fiscal Harmonization in Europe" (Summary published by the European Parliament, "National Parliaments" series No.10, 1990).

[14] ECO/104 of 18 May 1988.

Danish/German border, for example, the tax difference is 15 percentage points for those goods taxed at 7% in Germany (e.g. food, books and works of art). On the Belgian/Luxembourg border the difference is 13 percentage points for goods taxed at 25% in Belgium. In the case of cars the differences are exacerbated in many cases by additional taxes.

iv) Tax categories

In the area of product characteristics, there are some goods and services which are unlikely to cross frontiers for tax reasons, if at all. Many of these, under the Commission's proposals, would come into the "reduced" rate VAT band: energy products for heating and lighting, supplies of water, internal passenger transport and newspapers (which tend to be language- or locality-specific). In these cases, wide variations in rates could exist without causing distortion.

Theoretically, goods and services might be classified under three headings:

i) Those which are "tax sensitive" - i.e. in the case of which tax differences might cause distortions of competition - and which should be taxed at the standard rate (e.g. consumer electronics);

ii) Goods which are tax sensitive, and which should be taxed at the reduced rate (e.g. pharmaceutical products ?); and

iii) Those which are not tax sensitive, and could be taxed at whatever rate Member States chose (e.g. immovable property, water and sewage services).

In practice, a number of problems arise: for example,
- Which products or services should be specifically included in the reduced rate category? Charitable and "cultural" activities, for example, might be put in the reduced rate category. Alternatively, Member States might be left free to fix the tax rate, on the grounds that these are not tax sensitive as between Member States.
- Where a "product" is specifically included in the reduced rate category, how is it to be defined: for example, "food"? In some Member States (e.g. the UK) some food products are taxed at a reduced rate (bread); others at the standard rate (biscuits). Should the Community give definitions?
- How can it be ensured that competing products are included in the same tax category, so that distortions of competition are avoided? For example, newspapers, periodicals and books might be thought to be competing products; yet Ireland taxes them at different rates. It can also be maintained that "publications" can take either a physical (e.g. books) or electronic (e.g. tape) form, and that it is illogical to place them in different VAT categories.

v) Maxima, Minima, Bands and Points

Between proponents of "market" solutions and those like Boiteux, who believe that abolishing frontiers is unacceptable without almost identical rates, there seems to be a great gulf set. As the British Institute of Fiscal Studies indicated in its analysis of the Commission's 1987 proposals[15], however, the various positions are not as far apart as they might seem.

The result of a "fiscal free-for-all", the Institute noted, would be a downward pressure on rates, which would continue "if low-tax Member States try to maintain the tax differential in their favour by reducing their own indirect tax rates still further". This scenario would be wonderful for consumers; less so for Finance Ministers. The IFS concluded that Member States would find it "strongly in their interests" to reach a prior agreement.

The only agreement really necessary, however, would be on minimum rates. In the case of the Commission's proposal for a rate band, the downward pressure would tend to force rates to the lower limit anyway, making the upper limit irrelevant. In effect, this choice of minimum would amount to exactly the same thing as the Boiteux preference for a narrowly defined "target" rate.

The IFS also saw no political justification for preventing any Member State from setting rates as high as they wished. "The revenue losses and the loss of retail business that might result from doing so would be borne entirely by the Member State concerned, and would not impose costs on the rest of the Community that would justify Community action".

4. EXCISE DUTIES

The danger of competition being distorted as a result of differences in VAT rates can, therefore, be exaggerated. Moreover, the spread of rates - as Lord Cockfield used to point out - is in the form of a normal distribution curve, with most countries' rates bunched at the centre. By contrast, the differences in rates of excise duties are very large indeed: in some cases of the order of several 100%. Unlike VAT-rates, they are distributed in a 'U'-curve, with most countries' rates either at the low or the high extreme.

For this reason, the scope for distortion of competition in the case of excisable goods is theoretically considerable. Put in the form of an example: how does one prevent someone driving a lorry to Italy; stocking up in a supermarket - where the goods are, of course, tax paid - with wine (only 19% VAT), spirits (excise 0.69 ECU a bottle plus VAT) and cigarettes (45.19 ECU a thousand VAT incl.); driving to Denmark; and selling the goods free of Danish tax on wine (1.6 ECU per litre plus 22% VAT), spirits (10.5 ECU per bottle plus VAT) and cigarettes (141.71 ECU per thousand, VAT incl.)? Either:

a) frontier controls will have to continue; or

b) excise duties will have to be aligned to the extent necessary to make the journey unprofitable; or

c) other methods of control will have to be used.

Of these, solution (a) would clearly be the least satisfactory. Just as one cannot be "a little bit pregnant", frontier controls either exist, or they do not. All luggage would have to be subject to control, whether the targets were taxable goods in general or just those subject to excise duties.

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15 "Fiscal harmonization: an analysis of the European Commission's proposals" (IFS Report 28, Feb.1988).

The 1987 proposals

Solution (b) was the one originally chosen by the Commission. A complete harmonization of excise duties would have reduced the possible tax spread across frontiers to 6% (the VAT charged on top of excise).

The Commission's Global Communication had declared that, since the objective was "not...an ideal fiscal system for the Community, but a blueprint for the abolition of fiscal frontiers", nothing would be proposed that was not "strictly necessary for that purpose". Accordingly, the approach to excise duty rates was mathematical. For spirits, the proposed rate was the arithmetic average of tax on alcohol content. For wine, beer and intermediate products it took the average, weighted by GDP, on volume. For tobacco products it took the arithmetic average of the specific and 'ad valorem' elements separately; for petrol and LPG the arithmetic average; for fuel oil the weighted average.

Even this apparent mathematical rigour was open to criticism, however. Taking the strict average was justified by the Commission as "the most equitable since it gives equal weight to each Member State, irrespective of size". Yet why it was "equitable" to give small, high-tax countries like Denmark and Ireland equal weight with larger economies was not immediately apparent. The weighted average, by contrast, had the advantage of being revenue-neutral for the Community as a whole - though not, of course, for individual countries.

The Commission presumably hoped that a strictly mathematical approach would avoid the long-running disputes about the structure of excise duties: for example, the extent to which all forms of alcoholic beverages are in competition with each other (and should therefore be taxed on their alcoholic content alone); or the balance between the specific and 'ad valorem' elements of cigarette duty. As Parliament's committee hearings abundantly demonstrated, however, any such hopes were soon dashed.

The main reason for the general rejection of the 1987 proposals, however, was the factor already noted by Lord Cockfield. In the case of VAT, most national rates are close to the average. In the case of excise duties, however, they are not; so the average is acceptable to nobody.

The "flexible approach"

The Commission's new proposals for excise duties are designed to circumvent this political stone-wall by introducing an "element of flexibility". Instead of single, harmonized rates, the proposals would set two rates:

a) minimum rates, which would apply after 1992; and

b) target rates, at a level similar to the original proposals, on which there would be long-term convergence.

These proposals on rates are accompanied by a new attempt to harmonize the structure of excise duties. Two key questions arise:

First, are these proposals sufficiently flexible to avoid rejection on the same grounds as those of 1987? Even in the case of the minimum rates, sensitive political issues are raised: the introduction of a wine tax in wine-producing countries; and the specific/'ad valorem' ratio for cigarettes.

Secondly, are they sufficiently inflexible to permit the removal of fiscal frontiers? In the words of the Economic and Social Committee's opinion[16], "are we....not entitled to ask whether there is any real point in tinkering with present arrangements and encroaching on the autonomy of individual Member States when the results will in any case be of dubious or limited value?" It can certainly be argued that the introduction of the minimum rates - even if this can be effected by the end of 1992 - will reduce only very marginally the danger of "parallel trading" from low-tax to high-tax countries.

An "administrative" solution?

Fortunately, the Commission's proposals for the general movement of excisable goods (COM(90)431) hold out some possibilities for ending frontier controls without the harmonization of excise duty rates (see **report by MR.PATTERSON A3-137/91**). The proposal for "linked bonded warehouses" will mean that virtually all commercial movements of goods will take place within a tax-suspension regime. Fiscal frontiers will no longer exist; but neither will there be incentives to "parallel trading".

This leaves goods moving outside the tax-suspension regime (i.e. duty-paid). The key problem is to separate goods carried by final consumers (travellers and individual shoppers) from potentially commercial movements. Though most commercial movements are likely to take place between authorized bonded warehouses, the possibility does exist that certain traders will wish to move tax-paid goods to another Member State for resale. In this case the proposal includes mechanisms for either a return to bond, or for the payment of duty in the country of consumption and the rebating of duty originally paid.

The main danger is fraud: i.e. the commercial movement of goods, disguised as a movement by a final consumer. It will be crucial, therefore, to ensure that such a movement gives rise to an offence. This might either be the act of resale itself (i.e. contravention of licencing laws in the case of selling alcoholic beverages in the UK); or contravention of rules governing the movement of excisable goods. The regime might be as follows:

i) Final consumers would be free to take excise-paid goods across internal frontiers without further tax or control.

ii) It would be an offence, however, to offer such goods for re-sale: in these circumstances, the carrier would automatically have lost the status of "final consumer".

iii) The possibility would also exist of maintaining or introducing tax stamps or "banderoles" to control resale. The Commission proposals leave this up to the Member States themselves. Stamps, however, are expensive to administer; and might segment the market - though it could be argued in the case of cigarettes that the market has already been segmented by the language rules governing health warnings.

Hydrocarbon oils and transport

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[16] OJ C 225/48 of 10 September 1990.

Such an administrative system should enable internal frontier checks to be abolished, without any harmonization of excise duties, as far as alcoholic beverages and tobacco products are concerned. In the case of hydrocarbon oils, however, there are additional reasons for aligning the rates of duty.

Principal among these is the need to make progress in creating a common transport policy. It is sobering to recall that the original EEC Treaty singled out transport, together with agriculture, as one of the two key industries where a special Community regime was required. Yet - and in spite of Parliament having successfully taken the Council to the Court for its lack of action - only marginal progress has so far been achieved.

Taxation is one of the main reasons for this failure. Abolition of the complex quota system for road-haulage, for example, has been continuously postponed because the industry in countries with relatively high rates of duty on diesel (e.g.Germany: 381.39 ECU per 1000 litres) has feared "unfair" competition from those with lower rates (e.g. the Netherlands: 156.6 ECU per 1000 litres). To this has been added the problem of registration taxes, with various countries (e.g. Belgium and Germany) trying, from time to time, to impose special "road use" taxes on vehicles registered in other Member States.

If the Single Market is to be a reality in the field of road transport, therefore, some harmonization of excise duties on hydrocarbon oils (and possibly of goods vehicle registration taxation too) seems unavoidable. In addition to the existing proposals, the Commission's legislative programme for 1991 contains a **further proposal on hydrocarbon tax rates**.

Considerations of competition policy are perhaps of less significance in the case of petrol than in the case of diesel. By contrast, environmental issues affect all fuel oils, and all vehicles. The Commission's 1991 programme also contains a new proposal in this field.

5. POLITICAL, ECONOMIC AND SOCIAL EFFECTS OF FISCAL APPROXIMATION

In assessing the possible impact of the Commission proposals, and of alternatives, several economic and social factors need to be considered: the effects on revenues, prices, employment, patterns of consumption, health, etc. The most fundamental issue, however, is likely to be political: the consequences for the fiscal sovereignty of Member States.

The most complete political, as well as technical, solution to the problem of fiscal frontiers would be to make both VAT and excises true "Community taxes": i.e. the revenues would accrue to the common Community Budget. This would have the added advantage that the resources available to the Community would make possible substantial compensating finance through the structural funds to areas adversely affected by "1992". Such a radical solution, however, has been rejected in favour of one which retains 12 separate tax authorities. "In terms of the integration process these proposals are retrograde steps," comments Mrs Robinson, "but have been adopted for political expediency".

Any Community decisions in this area, however, would place some limit on the ability of national governments to change indirect tax rates. As a result, the scope for increasing tax revenue would increasingly be confined to direct taxation or social security contributions. The Boiteux Report warned that "the tax system of each country is the often complex product of national characteristics, in which economic, social and political factors play a part".

Yet the approximation of indirect tax rates would be bound to produce some convergence of systems; in particular, the proportion of indirect taxes in relation to taxation as a whole and to GDP. There is a wide diversity:

	VAT		Excise duties		
	% of GDP	% of revenue	% of GDP	% of revenue	
Belgium	7.2	25.8	2.1	11.7	
Denmark	9.8	27.8	6.7	20.3	
Germany	5.9	29.3	2.4	16.0	
Greece	10.0	40.7	4.8	27.0	
Spain	5.6	25.4	2.0	19.5	
France	8.7	41.8	2.9	19.8	
Ireland	8.1	24.4	6.9	24.1	
Italy	5.3	22.9	2.6	16.2	
Luxembourg	5.9	21.8	4.0	16.6	
Netherlands	7.9	30.5	2.7	13.8	
Portugal	6.6	31.8			
U.K.	6.1	23.0	4.4	21.1	(OECD 1987)

To the extent that tax approximation took place, there would also be a more precise political problem: once fixed, how could the rates be changed?

Institutionally, the answers are contained in the Single European Act: decisions of this kind must be taken by Council, acting by unanimity. In practice, this could well mean that the indirect taxes of every Member State would be effectively frozen.

Revenues, prices and employment

Estimating the fiscal and economic effects of tax approximation presents a number of methodological problems.

Simple, one-off effects are easy enough to calculate: the gain/loss in revenue or the increase/decrease in prices as a result of changes in a particular tax rate. Such figures, however, are of little long-term predictive value. Price changes will give rise to changes in the pattern of consumption; and, for these to be calculated, information is required on the price-elasticities of demand for the goods and services in question. The Institute of Fiscal Studies estimated, for example, that the Commission's 1987 wine proposals, assuming no change in the pattern of consumption, would have cost the UK Exchequer £3.9 billion. Allowing for increased consumption, however, the loss in revenue would have been only be £1.9 billion.

The Commission's Global Communication gave a "tentative global qualitative assessment" of the revenue effects of its 1987 proposals. There would have been little change for Belgium, Italy and the Netherlands. For France there would have been a small revenue loss. For Germany, Greece and the UK a small revenue increase. Luxembourg, Spain and Portugal would have experienced substantial increases; Denmark and Ireland substantial losses. So far, no figures have been published for the modified proposals.

The effects in terms of prices and - to some extent - employment are likely to be a mirror-image of revenue figures. Thus Danish and Irish consumers would have been the major beneficiaries of the 1987 proposals, as tax rates were cut. By contrast, there would have been significant increases in the cost of living in Luxembourg, Spain and Portugal.

Social effects; and the Zero VAT-rate issue

Changes in tax rates and prices are not, of course, socially neutral. The proposed cuts in tax on alcohol and tobacco in the UK, Ireland and Denmark have been strongly attacked as contrary to policies on public health. On the other hand, such tax cuts would clearly be "progressive", in the sense that they would reduce the cost of living of the poorer sections of society. By contrast, the steep rises in tobacco and alcohol prices in the Mediterranean countries would be "regressive", and would also have a significant effect on agricultural employment.

One issue which illustrates this problem is the Zero Rate of VAT. This exists in some form in seven Member States (Belgium, Denmark, Spain, Ireland, Italy, Portugal and the UK), but is only important in Ireland, the UK and Portugal.

The zero rate is often confused with VAT exemption. From the point of view of traders within the VAT system, a rate of zero must be treated in exactly the same way as a rate of 1% or 5% or 15%. VAT returns must be completed, and tax paid on inputs is recovered. In the case of exemption, by contrast, no VAT returns are needed, and no input tax is recovered.

The effect for final consumers is likewise different. In the case of exemption, the consumer does pay some tax: i.e. on the exempt trader's inputs, which are passed on. Indeed, where there is an exempt stage in the middle of a chain, this can lead to double taxation (tax on tax), as in the case of some financial services. In the case of zero rating, all tax paid at preceding stages in rebated. From the technical point of view, therefore, zero is a tax rate like any other. Its purpose is to ensure that the final price is entirely free of tax, either open or hidden.

Some critics of the zero rate have maintained that it is not a true tax rate, but a subsidy. This appears to be the view embodied in the 2nd. and 6th. VAT Directives, which state that VAT must be "high enough to permit in normal circumstances the deduction of tax paid at the preceding stage". Such a view, however, is illogical: it is impossible to receive a rebate of VAT which has not already been paid at an earlier stage.

What are the benefits of the zero rate of VAT?

From a number of points of view, in particular administrative convenience and fiscal neutrality, the best form of VAT would be a single rate on all transactions (as is almost the case in Denmark). However, such a system is clearly regressive, in the sense that it takes a higher proportion of income from the poor than from the rich.

In the case of income taxes, this defect is corrected by the device of higher rates on higher incomes and various allowances. Indeed, it has been argued that the potential regressivity of VAT can be offset by greater progressivity in direct taxation. This, however, has its own drawbacks: notably disincentive effects, and the creation of "poverty traps".

The regressivity of VAT can, alternatively, be reduced through the mechanism of reduced (including zero) rates on certain goods. In the UK, for example, the proportion of income spent on basic food by the less well-off is about double the national average. The zero-rating of this, together with gas and electricity for household use, has the effect of eliminating altogether the regressivity of the VAT system in the UK.

5. DEROGATIONS

The working assumption behind the Commission proposals is that all Member States will be participating. To what extent, though, should Member States be allowed derogations?

The Global Communication discussed this question at some length. Member States "facing difficulties", it stated, "may well wish to be granted derogations." The Commission itself had come to "the clear view" that it should not itself make any proposals, but should leave these to Member States. "Though the proliferation of derogations would present serious problems that could threaten the operation of the Internal Market ... the Commission would of course take a constructive part in the discussions ..."

The Communication added two important qualification, however:

a) Since derogations may cause distortions of competition, they were "not simply a matter concerning the Member States asking for the derogation, but concern also the other Member States".

b) "Derogations always carry a cost (and) may lead neighbouring Member States to insist on the maintenance of frontier controls directed specifically against the Member State concerned."

At the extreme, a particular Member State or Member States might be given a "global derogation" from the whole fiscal package. Were Denmark, the UK and Ireland excluded, for example, the problem of aligning indirect tax rates-particularly excise duties - would be a great deal easier for the other nine. This situation, however, would clearly mean a "two-speed Europe".

It now appears, in any case, that the Commission has revised its position on making specific proposals. The 1991 legislative programme now includes an imminent proposal on **temporary derogations to the 6th Directive** (no doubt covering the Zero Rate issue outlined above).

6. THE US EXAMPLE

The system of indirect taxation in the United States has been cited both in support of the Commission's tax proposals, and as evidence against them.

On the one hand, the 1987 White Paper argued that the "American experience is instructive". The maximum spread of Sales Tax rates in different States is 7.5% (Connecticut 7.5%, Alaska, Oregon, Montana, New Hampshire 0%). Across any one state line it is 6.5% (Washington 6.5%; Oregon 0%). These figures, as Lord Cockfield pointed out, were the basis for the Commission's proposed maximum spread of 6% for VAT[17].

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[17] Answer to PQ by Mr Marshall (OJ Annex 2-363, March 1988).

On the other hand, it is claimed that the US experience indicates the compatibility of open fiscal frontiers and differing tax rates. For example, Peter Lilley (then a British Treasury Minister) told the House of Commons that "experience in the United States has shown that individual states can retain fiscal powers without damaging the self-evident internal market that the United States as a whole possesses"[18].

What is the truth of the matter? A number of points are relevant.

a) In the US, there are no systematic controls on the movement of goods across State borders - indeed this is guaranteed by the Constitution. Nor is there any question of taxes on goods leaving a State being remitted, as is the present case with VAT in the Community.

b) Sales Taxes are levied at both local and State level. Unlike VAT, these are charged at a single stage: to the final consumer. Raw materials and goods purchased for resale are therefore not taxed. However, since input taxation is not rebated, as in the case of VAT, there is some "pyramiding" (i.e. tax charged on tax), despite an exemption in some States for machinery.

c) User taxes are in theory charged on out-of-State purchases. These are collected by the seller, if he does business in the State of delivery. If this is not possible, the purchaser is required to remit the tax. However, the only effective controls on compliance exist in the case of goods requiring registration: e.g. cars and boats. Otherwise enforcement is "sporadic"[19]. The growth of mail order has also caused particular problems of tax collection. Congress has even considered requiring mail order firms to register in every State from which they solicit sales. (This, of course, is how VAT will be applied in the Community).

d) Alcohol and cigarette taxes are the only excises of any importance, and are levied on both a Federal and a State basis. Federal taxes have been increasing sharply in recent years, but are of course uniform in all States. State alcohol and cigarette taxes, by contrast, vary widely from State to State. The spread of rates is not as great as between the Member States of the European Community. On the other hand, the lowest rate of liquor tax is 25% that of the highest, the lowest cigarette tax only 7.5% of the highest.

e) Consequently, there is an appreciable amount both of competition between States on tax rates, and attempted tax evasion. Both can be observed in the North-Eastern States of Massachusetts, Connecticut, New Hampshire, New York, Rhode Island, Vermont and Maine, the size and geographical relationship of which are similar to those in the Community. In 1983, for example, New York raised its cigarette taxes; Massachusetts, Connecticut, Vermont and New Hampshire followed suit within 4 months.

Problems which might be instructive for the Community exist; in particular, on the border between Massachusetts and New Hampshire. New Hampshire, lacking a Sales Tax, is highly dependant on liquor and cigarette taxes, and is also

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[18] Hansard 11 May 1988 Col.413/4.

[19] "Examination of the differences in US and state/local taxation as they relate to interstate commerce" by Michael Kuhn and Glenn W. White (Intertax 1986 No.5).

within easy driving distance of Massachusetts' major population centres. It has regularly tried to maintain a price advantage over its neighbours.

In the case of cigarettes, the Massachusetts Department of Revenue has estimated that "for each 1 cent difference in the tax rate between Massachusetts and New Hampshire, Massachusetts loses 1.08 packs per capita annually. The 9 cent differential between the two states translates into a revenue loss of $15.1 million or 8% of Massachusetts' annual cigarette revenue"[20].

In the case of liquor taxes, the situation is complicated in that New Hampshire has a State monopoly on sales, which it exploits to raise revenue (c.f. the State tobacco monopolies in the Community). In the past there have been amazing scenes, as tax agents "travelled clandestinely across state borders to record the licence plate numbers of Massachusetts cars parked at New Hampshire liquor stores and make the drivers pay taxes on the alcohol they brought home"[21].

It is clear, therefore, that the United States has not avoided cross-border shopping problems. Despite the absence of border controls, attempts are made to enforce restrictions on the movement of excisable goods: for example, in the State of Maine, people who bring more than one case of beer, one gallon of wine and one gallon of liquor through toll booths in their cars face a fine of up to $500 or a prison sentence. The smuggling of tobacco from production centres like North Carolina (c.f. Greece) to high-tax markets, like New York, provides enforcement problems.

It remains true that a spread of tax rates co-exists with open frontiers. "Tax trading" is limited by other means.

7. SOME OTHER TAX ISSUES

In the field of indirect taxation, the Commission's proposals to eliminate fiscal frontiers have understandably attracted the most attention. Nevertheless, other issues of some importance also remain to be resolved, notably in the field of VAT.

Second-hand goods

No decision has yet been reached, for example, on the crucial proposal covering second-hand goods, works of art, antiques and collector's items[22]. Under the 6th VAT Directive this matter should already have been resolved before 31 December 1977!

Travellers' allowances

Even more serious is the failure of the Council to agree on the raising of travellers' allowances within the Community. In July 1989[23] the Commission

20 "Massachusetts Economic Indicators" (Mass.Dept.of Revenue Jan.1987).

21 See 'New York Times' 14 September 1986.

22 See Parliament's Report by MR. PATTERSON and MR. VON WOGAU (A3-0070/89).

23 COM(89) 0331 final and COM(90) 0076 final. Parliament gave its opinion in the CASSIDY report on 23 November 1989 (A3-0061/89).

proposed that the existing levels should be quadrupled in a phased programme between 1990 and the end of 1992. (Even this was inadequate, given that any limitations on tax-paid purchases by final consumers will be absurd within the completed Single Market.) Yet progress has been systematically blocked by a number of Member States, most recently by Belgium. In the past, both Ireland and Denmark have been found by the Court to be in breach of Community Law through introducing "length-of-stay" restrictions on existing allowances. Both countries are seeking possible derogations from the Commission's proposals, which in any case have already been watered down in Council discussions.

"Duty-free"

Quite separate from the issue of the duty-paid allowances, is that of "duty-free". Tax-free shops at ports and airports (and duty-free sales on board ships or planes) are able to operate because the goods they sell are regarded as having been previously "exported". The Commission's position is that the VAT and excise duty legislation will abolish the concept of "export" from intra-Community movements[24]. "Duty-free" will thus cease to exist.

The abolition of duty-free in this way, however, could have some quite far-reaching social and economic consequences. The income from tax-free shops, for example, comprises a large part of the revenue of airports and cross-Channel ferries, which would have to be made up by fare-increases. Since duty-free is widely considered one of the "perks" of package tours, Community countries might suffer a loss of trade.

After 1992, it will of course be unacceptable to control duty-free sales through customs checks. If they are to continue, therefore, a system of "vendor-control" will have to introduced.

Charities

Under Article 13 of the 6th. VAT Directive a number of medical, welfare, educational and cultural public services are exempt from Value Added Tax. In certain categories, Member States are empowered to extend the exemption to "bodies other than those governed by public law", on the condition that they "shall not systematically aim to make a profit", are "managed and administered on an essentially voluntary basis", and are "not likely to create distortions of competition".

In so far as these provisions cover charities, they give rise to a number of problems. Firstly, the Directive yields only a limited definition of "charity". Secondly, normal activities have to separated from "commercial" fund-raising. And thirdly, the Directive gives charities only exemption, which means that they are generally unable to recoup VAT paid on their purchases. In some countries (e.g. the UK) the derogation permitting a zero rate does enable some input tax to be rebated; but there are fears that this right will be lost. Since charitable activities rarely have cross-frontier implications, one solution would be to allow charities the right to taxation at the lower-including zero - rate, both on their own activities and on inputs.

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[24] See Answer to Written Question No.2289/90 by MR PATTERSON.