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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee / Council
Subject:	Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC as regards rates of value added tax - Policy debate

I. Introduction

1. On 18 January 2018, the Commission submitted its proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards rates of value added tax[1].
2. The Proposal aims at creating a level playing field and granting Member States more flexibility in the application of reduced and zero rates of value added tax.
3. In the view of the Commission, these objectives would be achieved by replacing the list of goods and services to which reduced rates can be applied, included in Annex III to the VAT Directive, by a negative list to which reduced rates cannot be applied. In addition, Member States would be required to ensure that reduced rates are for the benefit of the final consumer and that the setting of these rates pursues an objective of general interest. Furthermore, Member States would need to ensure that the weighted average VAT rate (WAR) applied to those transactions for which VAT cannot be deducted, exceeds 12% at any time.

[1] COM(2018) 20 FINAL.

4. The European Parliament delivered its opinion on 3 October 2018.[2] The opinions of the European Economic and Social Committee and the Committee of Regions were adopted respectively on 23 May 2018[3] and 10 October 2018[4].
5. The examination of the proposal continued under the Austrian, Romanian and Finnish Croatian and German Presidencies addressing the main elements of the proposal such as: the condition of the final consumer benefit and pursuing an objective of general interest; the introduction of the weighted average rate (WAR) condition; the link to the proposal on VAT Definitive System; the use of a negative or a positive list; the use of CN/CPA codes; the number of VAT rates.

II. Main developments and the state of play

6. Against this background, the Portuguese Presidency has been working extensively on the proposal in order to address all issues raised by delegations and to create conditions to present a compromise text.
7. The approach proposed by the Presidency was discussed in five videoconference meetings of the Working Party on Tax Questions and at the informal videoconference of the members of the High Level Working Party on Tax Issues on 1 June 2021. The latest Presidency compromise text is set out in (doc. WK 6368/2021).
8. On this basis, the Presidency prepared a short progress report with two questions to guide the orientation debate which will be held in Council (Ecofin) at its meeting on 18 June 2021.
9. The Committee of Permanent Representatives is invited to take note of the questions prepared by the Presidency as contained in the Annex *(paragraph 12)* to this note and to forward them to the Council.

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[2] https://www.europarl.europa.eu/doceo/document/TA-8-2018-0371_EN.html
[3] OJ C 283, 10.8.2018, p. 35-38.
[4] OJ C 283, 21.12.2018, p. 43-51.

ANNEX

I. INTRODUCTION

1. On 18 January 2018, the Commission presented a proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards rates of value added tax[5].
2. The proposal aims at creating a level playing field and granting Member States more flexibility in the application of reduced and zero rates.
3. These objectives would be achieved by replacing the list of goods and services to which reduced rates can be applied, included in Annex III to the VAT Directive, by a negative list to which reduced rates cannot be applied. In addition, Member States would be required to ensure that reduced rates are for the benefit of the final consumer and that the setting of these rates pursue an objective of general interest. Furthermore, Member States would need to ensure that the weighted average VAT rate (WAR) applied to those transactions for which VAT cannot be deducted, exceeds 12% at any time.

II. STATE OF PLAY

4. During the negotiations on this dossier at Working Party on Tax Questions (WPTQ) level under the Croatian and German Presidencies, it became apparent that delegations would prefer to work on the option of a positive list, and that it required further discussion on the design principles of such list.
5. Additionally, during all the discussions held on this proposal, Member States have always stressed they wanted to hold the derogations they currently have.
6. Apart from that, delegations held different views on most substantial issues.

[5] COM(2018) 20 FINAL.

7. Against this background, in view of creating the conditions to present a compromise proposal, the Portuguese Presidency has been working extensively on the proposal and has held five meetings of the WPTQ. The Presidency has adopted a step-by-step approach, focusing on the following issues:
   - Identifying the principles that should guide the drafting of a positive list: benefit of final consumer and pursue objectives of general interest, health protection, consistency with the EU Green Deal, taking into account the digital transformation of the economy, neutrality principle;
   - Modernising the current Annex III based on such features;
   - Resolve other fundamental issues raised by the proposal, such as the scope of zero rates and rates lower than the minimum of 5%, the derogations, the need to include a revenue safeguard, and the use of CN/CPA codes.
8. The last compromise text was submitted to the Working Group on 27 May 2021 (doc. WK 6368/2021 INIT, of 12 May 2021).
9. The Presidency is of the view that this compromise text addressed most of the concerns raised by the delegations as it aimed at striking the right balance between a number of diverging concerns.
10. All delegations have been supportive of the work done. However, at that WPTQ meeting and at the HLWP held on the 1st June 2021, some delegations still kept reservations on certain aspects of the compromise.

III. MAIN OUTSTANDING ISSUES

11. At this stage the Presidency believes that in order to move forward with the proposal, political guidance is required on the three following outstanding issues:

    a) Establishing a sunset clause to the following categories included in the Annex III of the VAT Directive closely related with the EU Green Deal objectives and the conclusions on climate change adopted by the European Council in its meeting on 10 and 11 December 2020: natural gas and firewood; chemical pesticides and chemical fertilisers.

Presidency proposed solution: to phase out the possibility to apply reduced rates to these categories by the 1st January 2035.

b) Including in the VAT Directive a standstill clause (Article 105a) for derogations which Member States currently apply regarding the application of reduced, parking, zero or super reduced rates and exemptions with or without deductibility of the tax.

Presidency proposed solution: Member States can continue to apply their derogations, except existing derogations on fossil fuels, chemical pesticides and chemical fertilisers, which, to be consistent with the objectives of the Green Deal, should be subject to the same sunset clause that is proposed to related categories of Annex III, having to be phased out by 1 January 2035.

Furthermore, in order to ensure equal treatment, and to comply with Article 27 of TFUE, derogations under the standstill clause would become available to all Member States, provided that interested Member States notify the VAT Committee until 1 January 2023.

c) Ensuring a level playing field in the VAT Directive in what concerns the application of VAT rates, by allowing all Member States the right to apply a zero rate or a super reduced rate to a limited set of supplies of goods and services.

Presidency proposed solution: Allow the application of these rates exclusively to certain supplies of goods and services that address basic needs and clear public policies (covering the categories related to food and water, medicines and health products, transport of persons, some cultural items and solar panels).

IV. WAY FORWARD

12. Against the above background and in order to get political guidance on the way to move forward with the VAT rates proposal, the Presidency would like to invite the Council to address the following questions:

1) *Do Member States agree that both the categories included in Annex III and the application of derogations should be coherent with the EU Green Deal objectives? If this is the case, could the 1st January 2035 be accepted as the date to phase out the application of reduced rates to fossil fuels, chemical pesticides, chemical fertilizers and firewood, so that all Member States are given sufficient time to adapt their VAT rates system?*

2) *Can Member States accept a standstill clause by which, with the exception of those not in line with the Green Deal, current derogations would continue to be applied but would become available to all Member States to ensure fair and equal treatment and a level playing field?*