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Directorate-General for Internal Policies
Directorate A - Economic and Scientific Policy
Policy Department A.: Economic and Scientific Policy and Quality of Life Unit

VAT

Current Issues of Interest

**Workshop held in Brussels on
Wednesday 23 January 2008**

Summary

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ECON Workshop on
VAT
Current Issues of Interest

Workshop Summary

Wednesday 23 January 2008, 15.00-18.30, ASP 5G2

The two sessions of the workshop covered VAT Fraud (p. 2) and VAT Rates (p. 9). The workshop was chaired by Ms Pervenche Berès (PES, ECON Chairwoman) and Ieke van den Burg (PES), the latter replacing Ms Berès for the last hour. High level experts from national finance ministries, Commission, academia, research centres, the OECD, the UK House of Lords and the private sector attended the meeting. Other MEPs that attended the workshop were (in alphabetical order) Zsolt László Becsey (EPP), Sebastian Valentin Bodu (EPP), Sharon Bowles (ALDE), Elisa Ferreira (PES), Wolf Klinz (ALDE), Astrid Lulling (EPP) and Ole Schmidt (ALDE).

The programme of the event including a list of experts can be found in the compilation document of the workshop. For the entire documentation of the workshop as well as an exhaustive list of background materials, please refer to the VAT Key Issue pages of the Library at:

http://www.library.ep.ec/earc/CPdossiers/econ/key_issues/VAT_KI.htm

The following is a brief summary of the proceedings, containing the main messages conveyed by the experts. Please note that this compilation has been prepared by the Parliament services. It serves purely informational purposes, it is selective in nature and has not been endorsed by the experts.

1. Session I - VAT Fraud (15.00-17.00)

The first session was divided into two sub-sessions in the light of a high number of speakers. In the first sub-session, **the analysis of the present situation** was undertaken by researchers and high-level representatives from the German and Portuguese tax administrations. The topics discussed were:

- Fraud mechanisms (e.g. missing trader, carousel schemes),
- Quantification of levels of losses in Member States,
- Determinants of fraud in different environments.

The sub-session thus focused on the description of the problem, leaving the solutions and remedies to the next sub-session on "**remedies - more effective administrative cooperation and/or changes to the system**" which dealt with:

Administrative cooperation - striking the right balance between the fight against fraud and the burden on businesses,

- Changes to the system: reverse charge, taxation of intra-community supplies, and other possible changes.

The sub-session aimed to present best practices proposed as well as different remedies to VAT fraud, including their advantages and drawbacks.

In the beginning, Stephen Smith (Professor of Economics, University College London) and Rüdiger Parsche (Deputy Head of Public Finance Department, Ifo Institut München) delivered a research perspective to VAT Fraud. Both experts also delivered briefing papers for the workshop, which present their complete argument on VAT Fraud.¹

Stephen Smith started by describing some benefits (effective way of raising revenue, cumulative payment mechanism that makes VAT less vulnerable to certain forms of fraud and evasion) and drawbacks (susceptible to fraud due to zero-rating of exports and invoice repayment based on pure documentary evidence) of the EU VAT system. In the UK, the VAT "gap"² amounts to some 14,5% of VAT revenues, roughly a quarter of which happens due to organized crime. The Missing Trader Intra Community (MTIC) Fraud, also known as Carousel Fraud, is the best known example, and one that raises many concerns especially in the UK.

As for policy options, Stephen Smith presented a number of proposed solutions from general reverse charging, selective reverse charging, reverse withholding to third party guarantees, among others. His main conclusion was, however, that presently export zero-rating was possibly the core of the problem and alternatives should be effectively explored. The most important problem is the incentive bias of traders towards exports, as these are zero rated in comparison to non-zero rated domestic sales.

¹ See e.g. Library Key Issue for the compilation document containing the papers http://www.library.ep.ec/earc/CPdossiers/econ/key_issues/VAT_KI.htm

The need to "achieve symmetry" in the VAT treatment of domestic and intra-EU trade is pressing. Some innovative approaches such as CVAT (Compensating VAT) are being effectively used outside Europe.³ Exporter rating, uniform rating and VIVAT (Viable Integrated VAT) are also alternatives, all with pros and cons, but essentially something should be done about export zero rating.

Rüdiger Parsche presented an overview of the present situation, distinguishing countries with lower VAT gap rates (DK, FR, DE, LU, NL, UK) and countries with higher VAT gap rates (BE, GR, IT, PT, ES). The German case is interesting because after continuously rising VAT receipts until 2000, the revenues started to diminish (ie the VAT gap rose), without any substantial explanatory downturn in the economic activities. Reaching a peak in 2005, the gap decreased afterwards as a result of increased efforts by the German tax administrations to control fraud.⁴ It has to be noted, however, that carousel fraud is only one determinant of the VAT shortfall, next to bankruptcy, general tax evasion and non-compliance.

As for remedies, in his paper Rüdiger Parsche stresses the room for more effective administrative cooperation between Member States. The political will for this has been limited until now. As for reforms to the VAT system, Parsche discusses the reverse charge with B2B invoice limit of 5000 euros, the ifo model of withholding tax as a solution involving minor changes to the present system.

Finally, there are numerous proposals which concern the taxation of intra-community supplies (e.g. CVAT, VIVAT). The principle is an attractive alternative, but would necessitate a clearing house. The clearing house, however, entails some considerable problems as well. In terms of implementation, in order to have the slightest chance of working it would have to be a centralized clearing house at EU level, something very difficult to achieve in the present climate.

Gabriele Himsel (Head of VAT Unit, German Ministry of Finance) and **João Durão (Deputy Director-General for Tax Inspection, Portuguese Tax Administration)** provided two high level positions and experiences from Member State tax administrations.

Gabriele Himsel presented the German situation on VAT fraud. She reminded Members that VAT is a general consumption tax that is charged at every stage of the production chain. However, it needs to be neutralized within the production process so that effectively only the final consumer pays the tax. VAT refunds/deductions play an important role here. In the present system, the VAT input deduction is not dependent on whether the supplier has actually paid VAT.

Speaking about VAT fraud, she stated that VAT shortfalls can happen in three ways. Either, 1) revenue is not taxed (grey economy), or 2) VAT input deduction is applied in excess (e.g. falsified invoices) or lastly 3) there is a lawful deduction of VAT, but the corresponding VAT has not been paid by supplier (decisive moment for carousel fraud) – the estimated loss for Germany in this carousel fraud were 6,7 billion euros in 2005. She explained that some progress had been made in Germany in the last years in the fight against fiscal crime. The tax administrations realized at some point the extent of organized criminal activity in this area, and how organized these criminal groups were. This was new for Germany, at least in terms of organized crime. The best remedy available here was to improve legislation as much as possible and increase administrative efforts. This however did not help much, as the problem was the combination of a non-justified VAT input deduction with the non-payment of VAT.

The best solution to this problem would be in Mrs Himself's view a reverse charge mechanism, as this forces the two payments mentioned above to be simultaneous and linked. It can also be easily implemented within the present system and would guarantee a systematic prevention of fraud. As Germany alone features 5 million companies liable to tax, 2.6 million of which submit their declarations monthly, any other solution might only end up being too costly. The great advantage of the proposed solution would be that the current fraud mechanisms would be considerably impeded. There would, in Mrs Himself's opinion, be no substantial reason why Austria should not be allowed to experiment with the reverse charge.

João Durão presented the Portuguese experience in collecting and administering VAT, and offered his views on future steps at EU level. VAT is the most important tax in terms of receipts in Portugal, amounting to 24% of total revenues. In the fight against fiscal fraud it has to be kept in mind that the VAT revenue is very unevenly distributed among firms: 10% of all firms pay 90% of the revenue. VAT fraud also has multiple determinants implying that with a considerable amount of it we will just have to live "as nothing is as certain as death and taxes" (Franklin) and as long as there are taxes, there will be fraud. Mr Durão also said the carousel fraud is by no means the most important type of VAT fraud in Portugal and recalled that it is difficult to quantify VAT fraud involved in the intra-EC transactions.

As to possible changes, to the VAT system, Mr Durão held the generalized reverse charge to be inadequate as it mostly adds to complexity and increases compliance costs. With VAT paid in the retail phase, fraud would not diminish. He favoured the use of stronger administrative cooperation, through existing frameworks (such as VIES) by reducing timeframes to exchange information on Community level, and on the national level by enhancing early detection, enhancing cooperation among police authorities and accelerating the trials of investigated cases.

The international perspective was covered by **David Holmes (Head of Unit, Consumption Taxes, OECD)** who delivered some "external" views on the EU practices and proposed some best practices. Holmes referred to the Joint Council of Europe and OECD Model Tax Convention as an insight in improving exchange of information at the EU level and urged all EU Member States to join this convention. He reminded that a recent statement by the EU Court of Auditors had been very critical about how the exchange of information is being done in the EU. In this context, Holmes said that especially the timing of the exchange was very critical. It is not easy to implement this kind of cooperation as usually, Member States do not care about tax receipts of other Member States.

David Holmes brought forward a critical difference between EU and non-EU VAT practices. EU countries tend to have high standard rates and reduced rates in a narrow base regime, whereas non-EU countries tend to have often broad bases with low standard rates. He stated that high standard rates coupled with a narrow base are one significant determinant of fraud, and by reducing the rates and broadening the base one could achieve less fraud. Moreover, the simultaneous existence of standard and reduced rates adds to compliance costs, and on top of that, tend to favour the wealthier. Furthermore, he showed statistics on C-efficiencies (a performance indicator that compares the VAT revenues to the standard rate) in VAT collections across OECD Members proving that EU countries in general do not fare all too well (while countries with low rates like New Zealand, Switzerland and Japan were relatively more efficient). Finally, Holmes said that not many countries calculate VAT gaps today, and more work need to be done in determining the causes of VAT gaps in order to develop effective responses. For the future, he predicted that whatever solutions will be found the key would lie in the improved use of technology.

Jean-Claude Bouchard (Chairman of VAT Europe and Intl. VAT Association) provided a very determined private sector and practitioners view to VAT fraud. Mr Bouchard started by identifying a number of sources of VAT fraud, including incomplete legal harmonization, excessive legislative choice of the tax payer and the VAT borders as well as non-communication and absence of transfers between Member States tax administrations. Tax administrations are largely responsible for the present inertia. For example, in markets such as second hand cars, insurance services or distance sales fraud is not too difficult at the moment. Member States are presently passive accomplices of VAT fraud in other Member States.

In terms of carousel fraud, Mr Bouchard observed that 80% of intra-community trade is done by 10% of the companies, which means that it is relatively easy to conceive a risk-management system that concentrates on areas with high risk of tax fraud and evasion, whilst not bothering too much about companies that are known to be compliant (see the "VAT passport" idea below). Today, with the zero-rate for intra-EC transactions, the door is open to fraudsters. There needs to be more cooperation and appropriate legislative measures to identify the fraudsters in the invoicing chain. This could be done e.g. through an intra-community VAT passport or through a more systematic model of EU intra-community invoicing which makes better use of Intrastat⁵ returns.

Ultimately, however, there is a clear need to get rid of the zero-rating system that invites fraud. A definitive system with an intra-community tax of 15% would be useful together with an Intrastat declaration between Member States as well as a reverse charge applied on the difference. Is an origin or destination VAT desirable? VAT is a tax on consumption, and therefore belongs to where consumption takes place. Centralized VAT wouldn't work. A new flexible system is needed.

Mr Bouchard reminded that in the USA in the 1930s at the time of the prohibition, state tax administrations were stopped at the border and enforcement did not work. As a consequence the FBI was created. He sees the need for something similar in the EU; more interconnection, more effective cross-border enforcement with transnational powers in order to really fight the criminal activity. Trust is essential. Only with trust between Member States can this system be created. Today this trust doesn't exist.

Having chaired an extensive Scrutiny Committee on Missing Trader Fraud in 2006/2007 at the UK House of Lords, **The Baroness Cohen of Pimlico** was invited to present and share the main findings of that work with the Committee. Having heard a high number of experts in both oral and written hearings, the Scrutiny Committee was well informed to give its assessment on the situation. Baroness Cohen introduced three criteria by which to measure any remedies: 1) right tax in right place, 2) minimal fraud and non compliance and 3) no unreasonable burden. As concerns administrative changes, her conclusion was that it was difficult to improve this within the present system without incurring a considerable burden on legitimate businesses and administrations (extended verification, pre-registration checks etc.). Possible remedies could lie in the internet and in managing data flows but whatever the administrative change, it is probably going to be too costly.

As a result, prevention would be better than the cure. In thinking about changes to the system, it must be made sure that individual countries cannot export the problem or simply move it to other products (e.g. as the present UK derogation in a targeted reverse charge for mobile phones and microchips). Changes to zero rating could be difficult for various reasons (political considerations, existing derogations etc.) but the best solution may nevertheless be to move to an origin system where VAT is charged at the rate of the exporting country, and a clearing house would facilitate the passing of revenue among the states. A clearing house is technologically feasible today. Baroness Cohen of Pimlico recalled, however, the risk involved in the fact that such a system would imply Member States trusting what other Member States do and say. Alternatively, it could be combined with a flat rate system: origin system + flat rate + clearing house.

This change would be simple for firms but the challenge would lie in Member States cooperation. The only thing that is certain is that action is required now and a more courageous change would be desirable in order to solve the problem. A long term scheme can be started by implementing bits and pieces of the long term plan. In the short term, small steps could be taken. The answer lies somewhere in technology. The European Commissions One-Stop-Shop is a very useful initiative in this regard. In line with Mr Bouchard's statement, Baroness Cohen of Pimlico stated that priority should be given to get the fraudsters out of the system.

Alexander Wiedow (Director, Indirect Taxation and Tax Administration, DG TAXUD) was the last speaker in the session. In his intervention, he assessed the three present propositions by the Commission, i.e. the reverse charge, the taxation of intra community supplies as remedies in changing the system, and finished with some ideas for improving the current system. All propositions have benefits and drawbacks which need to be carefully assessed. There should be no rush, as elements of especially the first two options are far-reaching with too much at stake in terms of risk (and revenue).

Option 1) The reverse charge

The Commission has been looking at the 5000 Euro invoice threshold, analyzing scenarios both below and above. Implementing a reverse charge of this kind would eliminate fraud. But it would introduce new risks and add to complications for the taxable person as they would have to apply both the traditional and the reverse charge system. The value threshold is also a complication. It means more reporting obligations for the tax payers, as they have to replace the fractioned payment with providing just the information, as this obligation would not be eliminated. The Commission therefore cannot make a final judgement on the pros and cons as there is presently only theoretical evidence, and no empirical evidence. A pilot scheme could be a good idea, but there is also one caveat to the whole discussion: if reverse charge was to be applied, it should replace the VAT system currently in its whole. That is why the value added of a pilot project is questionable.

Option 2) Taxation of intra-community supplies

The taxation of intra-community supplies would reduce the attraction of MTIC fraud, but it could at the same time add scope for other fraud mechanisms, and there would be a clear cash-flow impact on the business community as there needs to be massive pre-financing to implement the system.

A system of taxation of intra-community supplies also requires a decision as to taxation at departure vs. taxation at destination. Both solutions have different implications:

1) Taxation at departure necessitates clearing of tax revenues. At that point the question becomes political: can tax revenues in one Member State be made dependent on transfers coming from other Member States? This clearly is a political question, and a challenge for the Council. In a clearing house, the problem is not how to transport the information (i.e. technology), but the reliability of the information. Would Member States do enough to collect the money to be transferred to the other Member State? Currently this is not realistic. As a maximum, a bilateral clearing system between two Member States could work.

Mr Wiedow reminded that an origin system which merely adds the taxation at departure is not the same as the origin system (definitive system) of 1992. It is only a solution to replacing zero-rating, where the zero is replaced by a positive rate. This solution, unlike the old "definitive system", does not entail the pressure on rate harmonization as everything would remain segmented as it is today. But it would necessitate a clearing house.

2) If taxed at destination, there would be no need for clearing, but this would have to go together with a One Stop Scheme. This is a more realistic option.

Option 3) Improving the current system (see also COM(2007)758 of 26 Nov 2007)

More immediately, the current system could be improved through the following administrative reform elements:

- Improve data on intra EC supplies,
- More information and more uniform reporting,
- Member States should consider the EU dimension of their activities much more clearly through protection of revenue of other Member States, facilitated data exchange and better risk management,
- Reliance on VAT status of taxpayers needs to be strengthened,
- Enhance possibilities to collect VAT through mutual assistance for recovery and rules on joint and several liability,
- Cooperation with legitimate businesses in labelling of business, and thinking about advantages for cooperative businesses. It is easier to identify a cooperative business than a fraudulent one, and therefore the honest businesses could be rewarded.

In the area of VAT fraud, there has generally been a lot of mistrust among Member States, but for the first time there is currently some readiness among Member States to embark on some cooperation.

Discussion with Members of the European Parliament Bowles, Klinz, Berès, Becsey and, van den Burg:

Mrs Bowles referred to the feasibility of an origin VAT system with a 15% flat rate and a clearance system, along the lines of existing, well performing examples. Mrs van den Burg raised the question whether it would be technically possible to control electronically the VAT collection and clearance. Mr Klinz supported the Baroness Cohen of Pimlico's intervention and asked why the institutions and Member States were reluctant to test one or two cases. Mrs Berès underlined the fact that a generalisation of the reverse charge mechanism would in fact imply the end of VAT. She also asked which would be the right incentives to foster administrative cooperation.

In response to these interventions, the experts made the following comments: Prof. Smith did not see any particular problem in starting a reverse-charge experiment with one or two countries. He also expressed the opinion that clearance, if any, should be centralised. Mr. Parsche also pleaded in favour of a centralised clearance system. In his view, taxation of intra-EC supplies would worsen the situation. The only solution that is adapted to the concrete problem is the reverse-charge mechanism. Mrs Himsel did not believe in the feasibility of a clearance system, and discarded it as a "purely academic debate".

She restated her view that only a reverse charge mechanism could solve the underlying problem. Mr Durão expressed doubts on the clearance system and, in line with Baroness Cohen of Pimlico's intervention, said that such a system would have to rely on the truthfulness and quality of the declarations from Member States. Mr Holmes coincided with Mr Becsey's perception that there was a correlation between tax rates and tax collecting efficiency. Mr Bouchard stated that the VAT "belongs" to the state of consumption. He was sceptical about a centralised system and pleaded for a "coordination-within-flexibility" approach that addresses issues pertaining to cross-border transactions only. Too much rigidity would lead to the system's collapse. In his view, the reverse-charge experiment is tantamount to "jumping through the window without a parachute". Commenting on Mr Klinz's remarks, Baroness Cohen of Pimlico pleaded in favour of an origin system with clearance and underlined that the response to the feasibility problems lies "somewhere in technology".

Mr Wiedow agreed that there was an urgent need for action. He did however not see the need of launching a pilot project without getting the assurance that such experiment will not cause major problems to other Member States, On top of that, he warned that this experiment would cost money. As regards the incentives for cooperation, Mr Wiedow said that the main problem is mistrust amongst Member States. He underlined, however, that for the first time Member States are ready to discuss ideas on cooperation, exchange of information, risk analysis. On the clearance system, Mr Wiedow said again that the problem was not how to transmit the information but rather a problem of confidence.

2. Session II - VAT Rates (17.00-18.30)

Having been the last speaker on the session on fraud, **Alexander Wiedow** was the first speaker on the session on VAT rates. This session discussed the rationale behind reduced and differentiated VAT rates in the single market and the current regime of derogations, taking into account, amongst others, the Commission communication of 5 July 2007 (COM(2007) 380). Topics of discussion were:

- Reduced VAT rates on labour-intensive services, on locally supplied goods and services and on basic good and services,
- Distortionary impacts resulting from differentiated VAT rates and from the lack of consistency of the existing set of derogations and exemptions,
- Competition effects of differentiated rates on the industry - SMEs vs. big industry.

Alexander Wiedow started by asking whether tax competition is acceptable in the field of VAT. Also, should reduced VAT rates be optional or compulsory in order to avoid distortions? Finally, what is politically achievable under the rule of unanimity? The above Commission Communication presents some ideas and elements for discussion as regards these questions in order to launch a broad debate. As a fact, it can be stated that the present situation is too complicated and simplification is needed. More autonomy is possible for Member States, but the proper functioning of the Internal Market has to be secured. The response to the Communication has been limited, and the Council in December 2007 also provided no guidance. According to Mr Wiedow, the Council seems not ready to revise the Annex to the VAT Directive which lists the reduced rates.

Following this inertia, the Commission takes a pragmatic approach and chooses to address the most urgent matters first, namely the issue of rates in labour intensive services, restaurants, housing and locally supplied services. These are in themselves not easily definable areas, and there are many differences within Member States. Nevertheless, these areas have a priority. Furthermore, there are also other more difficult categories, e.g. a French and UK application to apply reduced rates "energy saving materials and environmentally friendly products". A second difficult category is electronic products (CDs, internet etc.). However, for both these categories it is somewhat more problematic to justify reduced rates.

Sigurd Naess-Schmidt (Senior Economist) from Copenhagen Economics was the main co-author of the study on the impact of reduced rates in Member States, the basis for the Commission communication COM 380(2007) of 5 July. He presented the main findings of that study⁶ focussing on the question how widespread reduced VAT rates are used and where they are applied. Also, what are their pros and cons, where do they create problems and in which industries can gains be reached? All Member States with the exception of Denmark and Slovakia use reduced rates. Super-reduced rates are in addition applied in France, Spain, Luxembourg, Italy, Greece and Poland. The lowest rates usually apply to food, books, medical products and passenger transport, while low rates are applied to electricity, heating, postal and telecom services. However, on average, 2/3 of EU household consumption is taxed at the standard rates.

Analyzing the pros and cons, Naess-Schmidt recalled that reduced rates are known to be administratively costly, they distort consumer choice and overall spending is rarely changed as spending just moves to other products. Potential gains include the following: firstly, increased productivity by shifting from amateur to professional work by reducing the incentive to do-it-yourself-work (lower VAT on services such as cleaning and repair etc). Secondly, jobs could be created for low-skill work. However, these effects are small as the number of relevant industries is very few with few people employed in them. Thirdly, the income distribution can be a legitimate argument. If low income households spend a considerably higher proportion of their income on products such as food than richer households, lower VAT rates can in exceptional cases serve distributional goals. However, here direct social policy measures are more likely to be more effective. Also, the expected effects are very heterogeneous across Europe and larger in countries where the income distribution is relatively more uneven (Portugal, Greece, Italy, UK).

Moreover, there is an interesting community dimension to the problem. Will reduced rates create distortion of competition across the EU, and related to that, will high tax countries suffer as a result of relocation of production? The answer is that one should avoid reduced rates in goods that are easily traded across borders. Characteristics of these goods include often that they are high value, branded and transportable. In terms of low VAT rates on CDs, books and computers Naess-Schmidt underlined the potential distortive character of rates disparities, with some MS applying reduced rates and others not. This distortion becomes even more important with the rise of e-commerce. Finally, there is a special case of lower rates on energy efficient products to help meet climate change objectives. However, low rates for these are problematic for several reasons: first, the Emission Trading System (ETS) already provides incentives to save electricity. Second, the net effect on energy consumption is not always clear as consumption may shift. Thirdly, these products are mostly high value and traded and therefore fulfil the above mentioned criteria. Also here, direct subsidies may be a better tool to achieve these energy objectives. In general, and in conclusion, one always has to balance the national effects with the Community effects of reduced rates.

Tomasz Michalik, the Chairman of the VAT Working Group in the Polish Confederation of Private Employers Lewiatan, provided a New Member State and practitioners view and also commented on the Copenhagen Economics Study. He stated that the results of the Commission Communication and the Copenhagen Economics study are clear in that they prove the point, from an economic perspective, for one unified standard rate which is possibly supported by one unified reduced rate. However this is not politically feasible, and therefore the most important element is to think about the (distortive) competition effects of reduced rates and to minimise their negative effect on the Internal Market. It can be said in light of the evidence that the real distortive impact on competition does not come so much from the reduced rates as the scope of these is rather limited, but more from competition in the standard rates.

In locally supplied services (incl. food), there are practically no distortive effects. Consequently, these can be completely left to the discretion of the Member States. In goods and services where there is more pronounced cross-border trade, one should be more careful. The scale of competitive distortion of course always depends on the size of rate differences. However, when drawing up such a list of goods for reduced rates, it would be best if this list became as closed and exhaustive as possible. A clear definition of these goods and services is also important in order to minimise compliance costs incurred on business. The list should be also obligatory for all Member States in terms of its scope of goods and services (not the level of the rates). Proper transposition into national legislation is also important.

Finally, it is not always clear whether subsidies are better than lower VAT rates to achieve certain political objectives. Often, direct and targeted subsidies are more efficient than lower rates. However, their use is likely to raise a number of issues with regard to state aid and EC competition rules, and the final assessment is therefore in general not a priori clear. In general, when no competition distortions can be identified, Member States should be allowed to apply reduced rates within clearly defined rules. The benefits of doing so are also clearly set out in the Copenhagen Economics study.

The Committee chose to invite one representative of an industry association to exemplify a specific industry case.⁷ **Per Hultengård representing the European Newspaper Publisher Association (ENPA)** was thus the last speaker of the workshop. He presented the wide application of reduced rates on newspapers across the EU today. Are newspapers just a normal good among all goods and services? ENPA argues that newspapers have a unique and central role to play in providing information to citizen. Freedom of the press and literacy are important aspects supported by reduced rates. Newspapers qualify as locally supplied services, and they have hardly any impact on the Internal Market.

Discussion with Members of the European Parliament van den Burg, Ferreira, Lulling, and Bodu:

Mrs Ferreira asked the Commission whether it could agree to replace reduced tax rates by subsidies. Mrs Lulling pleaded in favour reduced VAT rates and, in general, for the Member States' freedom to apply reduced rates. Mr Bodu referred to the case of pharmaceutical products in Romania: the Government lowered the VAT on pharmaceutical products, but prices did not go down. Companies kept the prices at the same level. Mrs van den Burg raised two issues: which is the Commission's reaction to her legislative report on the extension of certain reduced VAT rates; and how efficient had the VAT reduced rates on labour intensive service been in reducing illegal employment.

Mr Bouchard indicated that in so far as local services do not interfere with the common market, there should be no EU competence to set the rates. The cross-border element should be the triggering factor for the EU competence. The principle of subsidiarity should be the decisive factor here. Mr Smith reiterated that it would be easier and less costly to have one rate per Member State. Mr Naess-Schmidt indicated that there was no conclusive evidence showing that reduced rates increase compliance. He also recalled that reducing VAT rates on food could put pressure on food-related sectors. Mr Wiedow commented on several issues raised by MEPs and experts: there are clear examples of cases where subsidies can efficiently replace a reduced rate; flexibility is appropriate but sometimes (e.g. broadcasting) it can lead to very important market distortions; moreover, too much flexibility creates additional compliance costs for companies and tax administrations. Mr Wiedow also recalled that the principle of subsidiarity does not apply where EU legislation is already in force. Finally, he said that reduced VAT rates are not a leading factor in reducing the rate of illegal employment in the market.

⁷ Due to time constraints at the workshop, only one industry representatives could be heard.