

Context

The Commission invited all interested parties to submit responses to a number of questions relating to existing legislation on VAT reduced rates.

The Commission asked:

Are there any concrete situations that you are aware of whereby the application of a reduced rate on certain goods and services by one or more Member States is effectively resulting in material distortion of competition within the Single Market? Please explain and, if possible, give an indication of the economic impact of the distortive effects.

Transport & Environment answered:

It is clear that the VAT treatment of the passenger transport sector as a whole, and most specifically aviation, distorts competition in a way that causes an obstacle to the proper functioning of the internal market and conflicts with other EU policies, notably the EU's environmental goals. The current VAT exemption for aviation creates clear distortions particularly as regards international bus and high speed train services, frustrating efforts to secure modal shift from climate intensive aviation onto more environmentally friendly transport modes. The VAT exemption for such a large sector also forces general VAT rates up, further exacerbating economic distortions and shifts demand from other goods and services towards aviation. Removing the exemption for aviation clearly accords with the stated goals of the EU VAT strategy:

"removing unjustified exemptions, broadening the tax base, shifting taxes away from labour" –European Council, March 2012

"EU VAT system which should be simpler, more efficient and neutral, robust and fraud-proof ... demands a strong fiscal consolidation of national budgets" –ECOFIN, May 2012

Passenger transport excluded from consultation

Against this background we find it inexplicable and of great concern that the exemptions from VAT of international passenger transport are explicitly excluded from the scope of the consultation. The commission correctly notes that the issue of the reduced VAT rate for passenger transport services is very broad and encompasses questions of the place of taxation, the different exemptions and also distortions of competition. This is why every opportunity to consider the reduced VAT rates for passenger transport should be taken and analysed. This would ensure that the distortions in the passenger transport VAT market did not continue, simply because the problem seems too complex to tackle. Consideration of passenger transport during a review of reduced VAT rates is eminently appropriate.

VAT is a general consumption tax

VAT is supposed to be a general tax that applies to all goods and services across the economy, so that preferential treatment should not be given to one sector, without justifiable reasons. However, it is clear that aviation currently benefits from an unjustified exemption.

Including aviation under the standard rate of VAT would clearly broaden the tax base across the EU. It is also evident that lowering taxes on labour can do much more to create employment across the Member States than subsidising aviation which is far from a labour-intensive industry. In addition, aviation is a highly environmentally damaging economic activity. The latest scientific estimates put the climate forcing impact of global aviation at 4.9%¹ of total greenhouse gas emissions, while its contribution to GDP is 0.7%.² This makes aviation seven times more climate-intensive than average economic activities.

What does this mean in the current economic climate?

With the current economic situation, budgets are being slashed across Europe, and governments are imposing VAT rate increases across the economy (e.g. in Spain, France, Cyprus, Greece, Hungary, Ireland, Italy, Lithuania, Netherlands, Poland, Portugal, UK to name but a few –see Eurostat, “Taxation Trends in the European Union”, 2012). Meanwhile the VAT rate on international aviation continues to be zero. The Commission has recognised that the most efficient way to provide additional revenue for national budgets is to broaden the tax base rather than increase the rates in sectors already subject to VAT as pointed out by the Commission in the 2012 Annual Growth Survey:

“[R]ather than increasing tax rates (further), broadening tax bases should be high on the agenda to meet revenue-based consolidation needs. ...

Where tax compliance is already high and/or revenue raising needs cannot be met by enhancing tax compliance alone, increasing the efficiency of taxation through base broadening measures such as reviewing tax breaks and reduced VAT rates should be considered. ...

Limiting VAT exemptions and the application of reduced rates, in respect of the VAT directive (2006/112/EC), will be instrumental in broadening the tax base and increasing overall tax efficiency.”

We estimate that the VAT zero rating of airline tickets results in a revenue shortfall for Member States of about €10bn.³ The figure should be related to the fact that each €1bn of lowered labour taxes is estimated to create about 10,000 jobs. Eliminating the €10bn shortfall from aviation could be used to lower labour taxes and thus indirectly generate some 100,000 jobs.

Does aviation receive other subsidies?

Yes. In addition to the subsidy provided by the reduced rate VAT on aviation, the sector is granted additional implicit subsidies by not being subject to a fuel tax and lacks rules surrounding State Aid grants to airlines and airports. As the IMF has stated:

“The case for a generalised increase in aviation taxes is strong. Air travel is in principle just as proper an object of indirect taxation as any other commodity.”⁴

How does this fit into the EU’s wider environmental goals?

The EU has set a goal of reducing greenhouse gas emissions from transport by 70% in 2050 and 20% in 2030, compared with 2008 levels. The Commission has recognised that aviation is by far the most climate-intensive form of transport and so, in order to reduce emissions, the sector was included in the Emissions Trading System (ETS). Apart from the fact that the

¹ Aviation and Global Climate Change in the 21st Century, Lee et al, 2009

² The importance of the aviation industry for the global economy, Stephen Perkins, International Transport Forum, September 2010

³ Europe’s global market share is almost 30%, of a 2010 market of \$565bn or €430bn <http://www.iata.org/pressroom/pr/Pages/2010-12-14-01.aspx>. Europe’s aviation market is therefore worth about €120bn, of which approx. €100bn for passenger transport. Well over half of passenger transport revenues, or about €50bn+, is leisure and would hence normally be subject to VAT (after business deduction of input VAT). Assuming an average 20% VAT rate we arrive at an estimated €10bn subsidy as a result of the current zero rating.

⁴ IMF WP/06/124S

future of aviation's inclusion in the ETS currently hangs in the balance, it in no way justifies perpetuation of an implicit subsidy in the form of a VAT exemption.

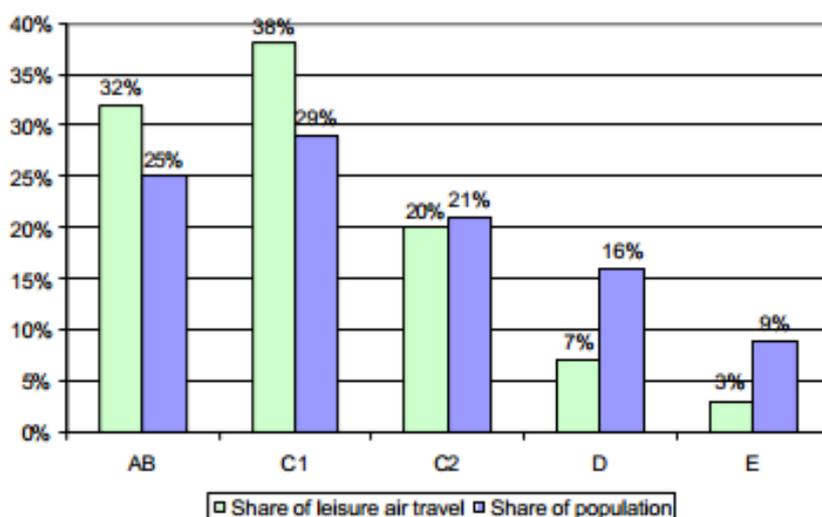
The derogations for international air and sea travel contained in the 1977 Sixth VAT Directive were meant to be temporary; however, they are still in place. As the Commission's Working Paper has acknowledged, these exemptions have now acquired a life of their own. There is no case for delaying dealing with these exemptions any longer.

Isn't VAT a regressive tax?

The benefit of the VAT exemption is directly proportional to the cost of the ticket so individuals who fly frequently or long distances can save hundreds of euros. In this sense the benefit is also proportional to capacity to pay; those who can afford to travel more frequently, or over long distances or in business class or first class, or take a cruise holiday, will benefit more than the average citizen. These exemptions are clearly inequitable and regressive.

Cruises by ship and about 80% of air travel is for leisure purposes and the great majority of flights, even those of low-cost airlines are undertaken by well-off people:

Figure 2 Leisure air trips abroad by socio-economic status (adult population)



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Absence of VAT on these tickets means the tax shortfall has to be made up elsewhere and this will inevitably fall on those with less means.

The VAT exemption gives aviation and other forms of international passenger transport cash flow and investment advantages compared to other sectors of the economy where VAT is charged on outputs *and* inputs, as has been outlined in the Commission Staff Working Document accompanying the Green Paper on the future of VAT.

But wouldn't it be impossible to collect as flights are sold online?

Further there is no reason why with modern IT systems it would not be easily feasible to introduce VAT on all flights into the EU, from any location. In this context we would like to refer to the development of VAT for electronic trade. Council Directive 2002/38/EC, changed the EU rules for charging VAT on the supply over electronic networks of software and computer services generally, plus information and cultural, artistic, sporting, scientific, educational, entertainment or similar services. Following this Directive these services are taxed in the country where the customer resides rather than where the supplier is located. This had the effect of removing the competitive distortion created by EU suppliers being required to charge VAT while non-EU suppliers were not required to charge VAT. Businesses that were not established in the EU were simply required to register and account for VAT in respect of taxable activities in the EU. The relevant business simply registers in a Member State for all VAT requirements. There is, as far as we can see, no reason why when

⁵ Source: UK CAA, http://www.caa.co.uk/docs/5/ERG_Elasticity_Study.pdf

such a system is established for such diverse electronic goods and services, it could not be established for airlines as well. With modern accounting systems it would be simply ludicrous to claim that practical difficulties could stand in the way of collecting and distributing VAT from airline tickets.

This change for VAT on the supply of electronic services raised a number of questions that are also applicable to a consideration of placing VAT on international passenger transport tickets, due to the cross-border nature of the industry. The explanatory website for the Council Directive on the supply over electronic networks contains a list of FAQs which deal with these relevant questions:

“[Question:] Why did the EU not address competitiveness concerns by instituting a moratorium on taxation so as to give the e-commerce environment time to mature, while working toward a comprehensive international arrangement?”

[Answer:] A moratorium would only have been of benefit to those who wished to ensure that an equitable tax system is not developed. This would have put Europe out of step with the emerging international consensus on fair and predictable rules for taxing e-commerce and would have created a climate of uncertainty that would further hamper the development of e-commerce within the Community.”⁶

This is clearly a lesson learnt from imposing a moratorium on taxation of international passenger transport. The exemptions have left Europe out of step with the rest of the world, are a hindrance to the internal market and have developed a life of their own.

“[Question] Won't the Directive be difficult, if not impossible, to implement?”

[Answer] This view ... can only be seen as representing the position of a business sector that is fundamentally "anti-tax" and simply does not want to see VAT imposed on e-commerce in any shape or form. ...

Nobody is seriously suggesting that, simply because legal enforcement and regulatory issues on the Internet present new challenges, nothing should be done about these issues. Tax laws are ultimately just as enforceable as any other laws or regulations affecting e-commerce.”

All of this directly resonates again with international passenger transport. Why should this sector of the EU economy be exempted from basic taxes when no other sector is? The sector was exempted (especially the aviation industry) on the basis that it was a young industry that needed to be nurtured. If the internet is no longer a young industry in need of nurture and therefore subject to VAT, it cannot be claimed that the aviation or any other form of passenger transport is either. Imposing VAT on passenger transport will not present any practical difficulties which have not been encountered in other sectors of the economy.

What about local public transport?

The question as to whether VAT should be levied on public transport i.e. buses, trams, metro, some trains etc. is a separate question. In principle all modes should be treated equally; but that means first removing the air and sea exemptions. Having achieved that, there are good equity as well as environmental arguments for saying that VAT on local public transport should be low or zero in recognition that it is a basic necessity because poorer citizens drive cars less, public transport is environmentally efficient and reduces congestion.

⁶ See http://ec.europa.eu/taxation_customs/taxation/vat/traders/e-commerce/article_1610_en.htm

Conclusion

The reduced rates for passenger transport generally and aviation particularly should be abolished. The only justified reduced rate would be for local passenger transport where such a reduction is necessary to ensure equality of access to transport as a public service.

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