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European Commission
Directorate-General for Taxation and
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VAT - Unit TAXUD/C1

SALAR response to the European Commission consultation on the review of existing VAT legislation on public bodies and tax exemptions in the public interest

The Swedish Association of Local Authorities and Regions (SALAR) represents the governmental, professional and employer-related interests of Sweden's 290 municipalities and 20 county councils, including the regions of Gotland, Halland, Skåne and Västra Götaland. All municipalities, county councils and regions in Sweden are our members. Membership is voluntary.

We speak for our members in dialogue with the Government, Riksdagen (Swedish Parliament), government agencies, the EU and other key organizations.

The Association strives to promote and strengthen local self-government and the development of regional and local democracy. The Association's operations are financed by the fees paid annually by members in relation to their population and tax capacity.

SALAR is a politically run organization and the President of SALAR is Anders Knape.

Local democracy is the foundation of all our work. Our ambition is to develop self-government in order to give our members greater freedom of action.

Local and regional self-government is an important element in the democratic system of Sweden and is written into the Swedish Constitution (the Instrument of Government). The right of municipalities and county councils to levy their own taxes among their citizens was established as long ago as in the local government ordinances of 1862.

Municipalities and county councils are responsible for supplying welfare services to their citizens. Revenues for municipalities and county councils consist mainly of income taxes (labor taxes). Their budgets represent over 75 % of the total public sector expenditure and they employ almost 25 % of the country's working population.



Summary

In Sweden the current VAT system works well for the public sector and we see no strong need for reformation. The current rules are generally satisfactory – except for the Swedish application of the distortion of competition clause.

SALAR is strongly against Option 1 (Full Taxation) and Option 3 (abolition of Article 13). We consider Option 2 (EU wide refund system) unrealistic and not efficient nor desirable but we encourage the use of national refund mechanisms in other member states.

We are open to Option 4 (sectorial reform) since we fully recognize that the Commission must ensure undue barriers across the EU. We consider that the current VAT treatment for services of general interest should be kept but we are open to Option 5 (option to tax). We are open to examine potential issues on a case by case basis.

We also stress the need for local government representatives in any impact assessment or pre-legislative consultation exercise.

General Comments

Commission's consultation on VAT legislation on public bodies introduces models for future development that would have major consequences for local and regional authorities in Sweden.

To broaden the EU VAT base in order to shift from labor taxes to indirect taxation is not within EU's competence. The design, or redesign, of tax systems lies within the competence of the Member States.

The right of Swedish municipalities and county councils to levy their own taxes among their citizens was established in the local government ordinances of 1862. The proposed full taxation model is in conflict with local self-government.

The full taxation model would increase costs for citizens, the civil society and non-profit organizations without solving any issues of neutrality.

If the full taxation model is supposed to eliminate distortion of competition between public bodies and private companies – there has to be an actual competition between public and private entities to eliminate. If there is no competition because it is the public bodies that procure services from private companies a full taxation model would benefit in-house activities.



The Swedish VAT regulation has taken into account the neutrality aspects between public and private actors. All services are (with minor exemptions) equally subject to VAT regardless of whether it is sold by a public or by a private actor. The municipalities and the county councils have a refund system which allows them to recover input VAT of basically all bought goods and services. For health care, social services and education there is a special refund of 6 % (alternative rule 5% and 18%) of the purchase price to compensate for hidden VAT of privately produced non VAT services.

The refund scheme makes the choice to operate in-house or by contract neutral. This system guarantees neutrality between the public and private sector although the VAT forms a cost for the local sector in general since the system is self financed (reduced general Government grant).

SALAR views on Survey questions

Q1: General evaluation of the current rules

In Sweden the current VAT system works well for the public sector.

The current rules are generally satisfactory – except for the Swedish application of the distortion of competition clause.

Most of the services provided by municipalities and county councils are publicly funded welfare services and therefore non-economic.

Municipality's and county council's revenue of goods or services for remuneration constitutes economic activities whether conducted for profit or not.

Article 13 is only applied when a public body is exercising public authority. These activities (e.g. issuing building permits) do not compete with services provided by private companies. In a full taxation model output VAT on these political decided fees would only increase costs for citizens. Taxation will not solve any neutrality problems or improve the functioning of the internal market.

If supplies are included as part of exercising public authority it's not an economic activity if not a significant distortions of competition. Disposal and destruction of waste and pollution, and wastewater treatment is, within the Swedish VAT Act, considered as economic activity if provided for remuneration. Since 2010 even on-street parking is due to VAT as a result of a ruling from The Supreme Administrative Court.

Articles 132-134 in the VAT directive are very important as they exempt social care, healthcare and education from VAT. In Sweden these services, carried out in the



public interest, are publicly funded and therefore out of the scope of the VAT Directive. Even so - there is of great importance that welfare services in the public interest will still be exempt. If not - the tax liability will be determined by the form of financing and also depending on the proportion between public and private funding.

The current rules are generally satisfactory. VAT was introduced in Sweden in 1969. The VAT tax base was broadened in 1991, as part of a fundamental change of the whole of the Swedish tax system, and at that time neutrality issues between the public and private sector was solved. A system with a general right to deduct input VAT for municipalities and county councils was incorporated within the ordinary VAT system. In connection with Sweden becoming a Member State in the EU in 1995 a refund system was introduced. The system was introduced in order to avoid distortion of competition and the purpose of the system has been fulfilled.

The problems that do exist are not generally related to the VAT rules as such. Problems are more often related to the Tax Authority's enforcement and the Courts interpretation. One of our current problem is the Swedish application on the distortion of competition clause (see answer point 2).

There is no distortion of competition between the public and private sector on the output side. If, and when, public bodies provide goods or services in competition with private companies the VAT treatment on the output side is equal. Public bodies are not in general competing against private companies on the same market. The municipal competence defined in the Local Government Act and in special legislation indicates the activities a municipality may undertake. These regulations limit the municipal operations.

Municipalities and county councils provide welfare services in the public interest and they can either provide in-house services or they can procure the same services from private companies. Healthcare and social services are always provided by the municipality or the county council towards the consumer/caretaker. Any distortion on the input side has been taken care of within the refund system. The refund system enables compensation for hidden VAT to private companies when purchasing exempt welfare services. Municipalities and county councils get a 6 % special refund when they buy social and health care services from the private sector. There is no incentive for in-house activities in the public sector since the refund system makes contracting out "VAT-neutral". The refund system is therefore of benefit for the private sector.

Education can be provided by public or independent schools. Education is free of charge and publicly funded regardless of the provider. The public schools have a right to refund VAT and independent schools are compensated by public funds for hidden VAT.



Dental care is the only service where public bodies (the county councils) compete in the same market as private companies. Distortion of competition on the input side, caused by the refund system, has however been taken care of. No competition problems on the output side can arise.

Q2: Distortion of competition clause

The current application of the distortion of competition clause counteracts the purpose of the provision.

There is no legal mechanism in the Swedish VAT Act.

Art. 13 - the first subparagraph - only applies when public bodies exercise public authority. Therefore - there is no significant distortion of competition to be eliminated by the competition clause in the second subparagraph. Nevertheless - Sweden is probably the first Member State to have applied the distortion of competition clause on administrative fees for the exercise of public authority. In 2010 The Supreme Administrative Court decided that the competition of distortion clause is applicable on administrative fees for organizing traffic (on-street parking fees).

The distortion of competition clause was implemented in 2008 in the Swedish VAT Act. Unfortunately our national legislation has no legal mechanism which has caused problems and the current application of the competition clause counteracts the purpose of the provision.

The Swedish Tax Authority believes that the distortion of competition clause should be applied retroactively. The Tax Authority has decided that municipalities have to pay VAT for the period prior they, as the collectors of VAT, can turn it over to consumers ("on-street-parkers"). The application and interpretation is obviously not compatible with the legal function of VAT as a turnover tax on consumption. This "application issue" will, if leave to appeal is granted, be subject to review by The Supreme Administrative Court.

The purpose of the distortion of competition clause is to ensure a uniform VAT treatment of public and private entities. If public bodies, as VAT collectors, have to bear the burden of VAT they will have no incentive to raise any competition issues and will not participate to eliminate distortion of competition. Therefore- the current application of the distortion of competition clause counteracts the purpose of the provision.

To ensure a predictable and legally certain application, and to meet the purpose of the distortion clause, we have pointed out the need for a legal mechanism to The Ministry of Finance and asked the following questions.



Who decides when distortion of competition exists?

How to proceed in order to determine if distortion of competition exists?

From what point can an established distortion of competition situation be subject to VAT?

Unfortunately - no action has yet been taken by The Ministry of Finance.

Due to the Swedish “application problems” we consider that a special procedural rule is necessary to ensure that public bodies do not have to bear the burden of VAT. The Swedish application does not provide equal treatment between public and private entities and is not consistent with the purpose of the provision.

A legal mechanism is necessary even with regard to private entities right to rely on direct effect (ECJ, Case - 430/04).

Q3: Reform measure

We believe that the VAT treatment of public bodies and public services functioning well in Sweden. We do not see a need for any major reform in this aspect.

We are strongly **against Option 1** (Full Taxation) **and Option 3** (abolition of Article 13). We consider **Option 2** (EU wide refund system) **unrealistic and not efficient nor desirable** but we encourage the use of national refund mechanisms in other member states.

We are **open to Option 4** (sectorial reform) since we fully recognize that the Commission must ensure undue barriers across the EU. We consider that **the current VAT treatment for services of general interest should be kept** but we are **open to Option 5** (option to tax).

We are open to examine potential issues on a case by case basis in cooperation with the Commission.

In the GREEN PAPER On the future of VAT (COM (2010) 695 final) the Commission set out that “taxation systems will have to be adapted”. The Commission indicates that a shift from labor taxes to indirect taxes is necessary when it comes to financing the welfare state in the future. The Commission's proposal, the full taxation model (**Option 1**), is designed to provide a transition from direct taxes to indirect taxes.

We would like to emphasize that a shift from labor taxes to a full taxation model have major effects on local and regional self-government. The right of municipalities and



county councils to levy their own taxes among their citizens is a fundamental part of local self-government.

Municipalities and county councils levy 90 percent of all labor taxes in Sweden. The change of tax system, proposed by the Commission, will affect the Swedish tax system as a whole. The design, or redesign, of tax systems in Member States is not within the Commission's competence. ***We therefore strongly object to the proposed full taxation model (Option 1).***

We would, in addition to the above, like to comment on other issues and problems with the proposed full taxation model.

Welfare services funded by taxes are non-economic activities and therefore out of the scope of VAT. Tax funded services may be considered as non-economic regardless of the status of the provider (ECJ Case C-246/08). Even in a full taxation model this will still be the case and not even an option to tax model could be applied on non-economic activities.

Welfare services provided for remuneration would, in a full taxation model, be taxed if not exempt. But when are these services considered to be provided for remuneration? At what level of private financing would welfare services in the public interest be provided for remuneration? Welfare services will most likely always, to a certain extent, be publicly funded and therefore there is reason to keep the current exemptions. The way of financing will otherwise determine tax liability and effects of VAT has to be considered when selecting or altering ways of funding. Services in the public interest should be exempt since the exemptions are complementing the society's contribution to these activities.

An elimination of exemptions has consequences for citizens, non-profit organizations, public bodies, private entities etc. that need to be carefully assessed. We stress the need for local government representatives in any impact assessment or pre-legislative consultation exercise. The assessment made by the Copenhagen Economics can not be the basis for further actions.

We oppose a Europe-wide refund scheme (Option 2) for different reasons. The most important reason is that refund systems are not within EU competence. "Refund" can not be achieved by means other than a general right of deduction of input VAT in the VAT Directive.

A general right of deduction may however not be possible to introduce for non-economic activities since non-economic activities are out of scope of the VAT Directive.

Furthermore - we oppose a Europe-wide refund scheme since refund systems has to be designed for real and existing conditions in every Member State. Additions or



amendments to the refund system rules can not be negotiated at EU level. It is not efficient - nor desirable.

We do not support a Europe-wide refund scheme, but member states could be encouraged by EU to introduce refund mechanisms. The Swedish refund system is fulfilling its purpose to create neutrality in choosing to perform activities in-house or to procure from private providers. The system also leads to increased procurement as well as VAT revenues.

We are strongly against a deletion of Article 13 (Option 3) since it would only increase costs for citizens without any impact on neutrality between public bodies and private companies.

Article 13 only applies to public bodies and when these bodies exercising public authority. Under The Swedish VAT Act, the term public body is limited to the state, municipality and county council. Companies, regardless of ownership, do not fall within the term public body. The exercise of public authority refer to decisions or actions that are ultimately an expression of society's powers and which come into being and has effects for or against the individual by virtue of public law rules.

A deletion of Article 13 will only lead to higher costs for citizens due to output VAT – if or when administrative fees are considered as remuneration. A deletion may also cause new problems such as if and when exercising public authority is considered to be “economic”.

A deletion will have no impact on neutrality between public and private entities and will not create better conditions for the internal market.

We consider that ***the current VAT treatment for services of general interest should be kept***. There might be a need for modernization but any changes has to be carefully analyzed and in collaboration with local and regional authorities.

We are open to a sectorial reform (Option 4). We are open to examine potential issues since we fully recognize that the Commission must ensure that there is no distortion of competition and undue barriers across the EU. Nevertheless – the sectors pointed out by Copenhagen Economics that affect municipalities are already subject to VAT in Sweden. Waste management, sewage and parking areas (both off- and on-street parking) are subject to VAT.

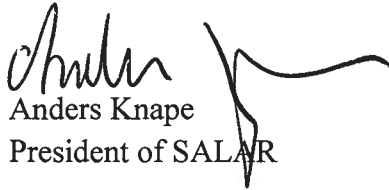
We consider that ***the current VAT treatment for services of general interest should be kept but we are open to discuss an option to tax (Option 5)***. We advocate that the Commission allows the Member States to decide what should be taxed and what should be exempt provided that the functioning of the internal market is not affected. Since the option to tax might complicate the VAT system this needs to be further examined.



We stress the need for local government representatives in any impact assessment or pre-legislative consultation exercise as well as in future stakeholder dialogue meetings.

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