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ECFIN Country Focus

ECONOMIC ANALYSIS FROM EUROPEAN COMMISSION'S DIRECTORATE-GENERAL FOR ECONOMIC AND FINANCIAL AFFAIRS

HIGHLIGHTS IN THIS ISSUE:

- *The average performance of Belgium in terms of VAT revenue efficiency is partly explained by the widespread application of reduced VAT rates.*
- *Limiting the use of reduced VAT rates could improve the VAT revenue efficiency and contribute to shift the tax burden away from labour.*

The Belgian VAT rate structure in need of reform

By Athena Kalyva, Savina Princen*, Henk Van Noten***

Summary

The tax wedge on labour in Belgium is the highest in the EU and well above the EU average (56 % for the average wage-worker without children; 1st out of 28). VAT receipts in Belgium were substantially below the EU average in 2012, both as a percentage of GDP (7.2 %; 19th out of 28) and more clearly so as a percentage of total tax revenue (15.8 %; 26th out of 28). Since VAT is easier to administer and relatively less harmful to growth compared with other forms of taxation, increasing revenues from VAT could be important in alleviating the tax burden on labour, which is particularly high for low-income earners in Belgium. Shifting the tax burden away from labour could contribute to social fairness. While the policy debate in Belgium tends to focus on increasing the standard VAT rate, there are strong arguments in favour of simplifying the system by evaluating the existing VAT exemptions and reduced rates in light of the desired policy goals.

This note focusses mainly on the VAT rate structure in Belgium and identifies channels for potential efficiency and revenue gains. We compare the Belgian VAT rate structure with that of other Member States, in particular neighbouring countries where cross-border shopping effects could potentially arise. We find that the extensive application of reduced rates and the use of exemptions considerably impact the revenue efficiency of the VAT system and carry a large budgetary cost (roughly 2.3% of GDP). We also take a close look at the rationale used to justify the various reduced rates for specific categories of goods and services and find that reduced VAT rates may not be the best tool to achieve desired policy goals. We also find that there are strong arguments for having a simple and uniform VAT system, with a limited use of reduced rates. Finally, we suggest a number of ways to improve the efficiency of the VAT rate structure in Belgium, which could help finance a shift in the tax burden away from labour.

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Economic and Financial Affairs

1. Revenue efficiency of the Belgian VAT system

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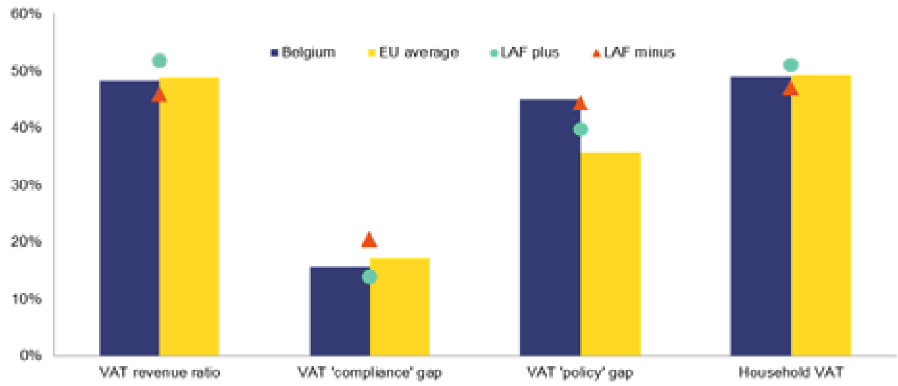
The overall efficiency of the Belgian VAT system, including a compliance component and a policy component, is at the EU average.

The revenue efficiency of a VAT system can be evaluated by comparing actual revenues with theoretical revenues that could be raised if VAT was applied at the standard rate to all final consumption. VAT efficiency consists of a compliance component and a policy component, which are evaluated using different indicators. The overall efficiency of a VAT system is assessed using the VAT revenue ratio; compliance efficiency is measured using the VAT compliance gap; and policy efficiency is evaluated using the VAT policy gap and the household VAT indicator (see note to Graph 1).

The overall revenue efficiency of Belgium's VAT system is similar to the weighted EU average. The VAT revenue ratio is estimated at 48.2% in 2012 for Belgium, compared to 48.8% for the EU (Graph 1).

Graph 1. Overall and specific VAT efficiency indicators



Source: CASE (2013)
Note: The VAT revenue ratio consists of actual VAT revenue divided by the product of the standard VAT rate and net final consumption expenditure, i.e. final consumption expenditure minus VAT receipts. A low value of the ratio suggests that exemptions, reduced rates or tax evasion have a significant impact on VAT revenue. The VAT 'compliance' gap measures the difference between the collected and the theoretical VAT revenues, taking into account reduced rates and VAT exemptions. The VAT 'policy gap' is the ratio of the VAT total theoretical liability (VTTL) to an ideal tax liability without reduced rates or exemptions. The average theoretical household VAT rate, as defined in CPB/CASE (2013), captures the impact of the existence of VAT exemptions and reduced rates, and is calculated as VTTL on household consumption divided by household consumption .'LAF plus' and 'LAF minus' are the two performance thresholds indicating a good and a poor performance respectively. 'LAF plus' captures the top one-third performers. The values below (above) 'LAF minus' capture the worst one third (see Wöhlbier et al. 2014).

The VAT policy gap in Belgium is well above the EU average, pointing to widespread use of reduced VAT rates and/or VAT exemptions.

The VAT 'compliance' gap measures the lack of compliance with the tax rules and the deficiency of the administration to collect revenue. For Belgium, CASE (2013) estimated the gap at 15.7%, below the EU average of 17.2%. This would typically indicate that Belgium does not face greater VAT evasion than other Member States. This note does not discuss compliance issues, which may be the subject of further research. As regards the policy component of VAT efficiency, the Belgian household VAT indicator was exactly at the EU average in 2011 (49%). However, the VAT 'policy' gap for Belgium over the period 2000-11 is estimated at 45%, well above the EU average of 35.8%, indicating widespread application of reduced VAT rates and/or VAT exemptions.

2. VAT structure in Belgium compared to other Member States

EU Member States are obliged to apply the common European VAT system, which was set up in 1967. This system has experienced several major reforms, altering the possible use of VAT exemptions and reduced rates over time. This has resulted in different VAT rate structures across Member States, which has also given rise to distortions of competition both among Member States and domestically.

In order to avoid that policy recommendations encourage cross-border shopping, it is

Belgium is one of very few countries in the EU applying a five-rate structure.

important to consider the VAT structure in other Member States, especially in neighbouring countries. Belgium is one of very few countries in the EU applying a five-rate structure, including a standard VAT rate of 21%, two reduced rates (6% and 12%), as well as a parking rate (12%)[1] and a zero rate. Eight Member States apply four or more rates, including France and Luxembourg. Eleven Member States have a three-rate structure and the remaining eight apply at most two rates, including Germany and the Netherlands (European Commission, 2014a).

The standard VAT rate is close to the average standard rate in the EU.

The standard rate in Belgium (21%) is only slightly below the average standard rate in the EU (21.5% in 2014) and applies to all goods and services, which are not exempted from VAT and are not subject to reduced rates. Currently, the standard rate applied ranges from 15% in Luxembourg, the legal minimum set by the VAT Directive (2006/112/EC), to 27% in Hungary. Applying a standard rate of 19-21 % is the practice in all neighbouring countries, except Luxembourg, which announced an increase in its standard rate from 15% to 17% in 2015.

Table 1. Goods and services subject to reduced rates in Belgium

Category	Average EU rate(1)	MS with reduced rates for the category	Neighbouring MS with reduced rates for the category(2)	Average neighbouring rate(3)
Parking rate of 12% applied in Belgium				
Coal, lignite, coke	21.5%	1	n.a.	n.a.
Tyres as agricultural input	21.5%	1	n.a.	n.a.
Reduced rate of 12% applied in Belgium				
Restaurants	14.3%	15	LU(3%), FR(10%)	14.0%
Social housing	12.7%	15	LU(3%, 15%), FR(5.5%)	16.8%
Reduced rate of 6% applied in Belgium				
Foodstuffs	11.3%	24	DE(7%), LU(3%), NL(6%), FR(5.5%)	11.7%
Pharmaceutical products	13.4%	24	LU(3%), NL(6%), FR(2.1%)	14.4%
Books	8.8%	26	DE(7%), LU(3%), NL(6%), FR(5.5%)	9.0%
Periodicals	8.6%	24	DE(7%), LU(3%), NL(6%), FR(2.1%)	8.4%
Admission to cultural services	10.3%	21	DE(7%), LU(3%), NL(6%), FR(5.5%)	7.2%
Admission to amusement	17.4%	14	LU(3%), NL(6%), FR(10%)	15.9%
Renovation of private dwellings	13.6%	14	LU(15%), NL(6%), FR(5.5%)	16.0%
Hotel accommodation	10.9%	24	DE(7%), LU(3%), NL(6%), FR(10%)	8.0%
Admission to sporting events	15.0%	14	DE(7%), LU(3%), NL(6%)	14.8%
Use of sporting facilities	14.5%	9	LU(3%), NL(6%)	12.7%
Social services	9.2%	19	DE(7%), LU(3%)	13.4%
Minor repair services	18.7%	7	NL(6%)	17.8%
Soft drinks	15.7%	13	LU(3%), NL(6%), FR(5.5%)	12.4%
Electricity	15.5%	15	LU(6%), FR(5.5%)	16.8%
Firewood	13.8%	15	DE(7%), LU(6%), FR(10%)	9.7%
Zero rate of 0% applied in Belgium				
Newspapers	7.4%	24	DE(7%), LU(3%), NL(6%), FR(2.1%)	8.4%

Source: European Commission (2014a).
Note: (1) the average EU rate refers to the weighted average and includes the simple arithmetic average at country level when more than one rate applies to one category of goods or services; (2) countries not mentioned apply the standard VAT rate to the specific category; when more than one rate applies to one category of goods or services, only the lowest rate is mentioned in the table; (3) the average neighbouring rate refers to the weighted average of the VAT rate applied in Germany, France, Luxembourg and the Netherlands and includes the simple arithmetic average at country level when more than one rate applies to one category of goods or services.

Belgium applies lower tax rates than the EU Member States on average for most categories of goods and services subject to reduced VAT rates.

Belgium applies a zero rate and a parking rate to a very limited number of goods and services.

Belgium applies lower tax rates than the EU Member States on average for most categories of goods and services subject to reduced VAT rates (6% and 12%), This is also true for neighbouring countries, as shown in Table 1. In addition, Belgium is one of eight Member States applying a zero rate to specific goods and services, which provides a right to deduction of VAT paid on inputs used by the company. Also a parking rate of 12 % is still applied to a limited number of goods and services, although this was intended to be a transitional arrangement for a smoother shift to the standard rate when internal market legislation came into force in 1993.

Box: Exemptions under the VAT Directive

The VAT Directive (2006/112/EC) requires EU Member States to exempt certain goods and services from VAT ('mandatory exemptions') (e.g., postal services), while the exemption for certain other goods and services is optional ('optional exemptions') (e.g. certain financial services). For the purposes of ensuring a correct and straightforward application of those exemptions and preventing any possible evasion, Member States may lay down conditions under which mandatory exemptions are applied.

Moreover, from an economic point of view, two main categories of exemptions (including both mandatory and optional exemptions) need to be distinguished. Exemptions with the right to deduct previously paid VAT are generally applied to enable supplies of goods and services, which are exported or supplied intra-Community or are connected with such supplies, to leave the country VAT free. They are thus needed to comply with the destination principle of taxation and facilitate the proper functioning of the single market. Exemptions without the right to deduct previously paid VAT do not allow the taxable person to recover input tax on purchases. Based on the VAT Directive these exemptions are mainly:

(1) Exemptions in the public interest: e.g. postal services, hospital services, medical services, etc.

(2) Some other exemptions: e.g. financial services, the supply of immovable property, services by employers' or employees' organisations, or by political and religious organisations, etc. Some of those exemptions are granted on condition that the supplier is a non-profit institution and/or on condition that no distortion of competition will occur as a result of the exemption (article 13 VAT Directive).

Finally, the VAT Directive provides some mandatory exemptions linked to the EU Customs Code and to international organisations (i.e. exemptions for travellers and non-commercial consignments, diplomats etc.).

Belgium applies certain mandatory exemptions in the public interest without restrictions and makes use of optional exemptions provided for in the VAT Directive.

Moreover, Belgium applies certain mandatory exemptions in the public interest without restrictions and makes use of optional exemptions provided for in the VAT Directive (see Box). For instance, Belgium, by not specifying any condition foreseen by the VAT Directive, extends the mandatory exemption for hospital and medical care, intended for public providers or private providers operating under comparable social conditions, to all private providers.[2] Belgium also applies optional exemptions and special derogations[3] from the VAT Directive, e.g. the exemption of the supply of diamonds and related services. However, this specific exemption generally concerns business to business supplies and does not in principle lead to large revenue losses.

The widespread application of reduced VAT rates leads to substantial revenue losses.

The widespread application of reduced VAT rates and the use of optional VAT exemptions have led to substantial revenue losses. Overall, the revenue forgone from VAT tax expenditures is far from negligible: for 2012, the revenue forgone per category of reduced rate is estimated at 0.05% of GDP for the zero rate, 2.17% of GDP for the 6% reduced rate (not yet including the reduced rate on electricity) and 0.10% of GDP for the 12% rate (Belgian Chamber of Representatives, 2013). Not taking into account behavioural effects, phasing out all reduced VAT rates would potentially represent a revenue gain of roughly 2.3% of GDP. If used to reduce social security contributions, this could result in a reduction of the implicit tax rate on labour by around 4 pp. (from 42.8% in 2012 to around 39%), without taking into account behavioural effects and macro-feedback loops.[4] The use of reduced VAT rates also affects the coherence and the efficiency of the overall taxation system. Therefore, Belgium has regularly been recommended to review its VAT system. For instance, under the 2014 European Semester, Belgium was recommended to '*improve the balance and fairness of the overall tax system and prepare a comprehensive tax reform that will allow shifting taxes away from labour towards more growth friendly bases, simplifying the tax system, closing loopholes, increasing VAT efficiency, broadening tax bases, reducing tax expenditures and phasing out environmentally harmful subsidies*.' (Council of the EU, 2014).

In recent budgetary years, Belgium extended the use of reduced rates and abolished some minor exemptions.

In recent budgetary years, Belgium extended the use of reduced rates. In July 2011, the use of the 6% reduced rate was made permanent for the renovation of private dwellings, as well as for the repair of bicycles, shoes and clothing.[5] Moreover, in 2010, the reduced 12% rate was extended to restaurant services, resulting in a budgetary cost of approximately 0.08% of GDP (Belgian Chamber of Representatives, 2013). In April 2014, the VAT rate on household electricity consumption was decreased from 21% to 6% at a budgetary cost of 0.13% of GDP. On the other hand, some minor exemptions were abolished in recent years, e.g. for the services of notaries and bailiffs (2012) and lawyers (2014). In its 2015 Draft Budgetary Plan, Belgium announced that it would tighten the conditions to avail of the reduced rate for the renovation of private dwellings.

3. Assessment of arguments used to justify reduced rates

No strong theoretical or empirical evidence is found that supports the use of reduced VAT rates to encourage the consumption of certain goods and services or to achieve social equity.

The use of reduced VAT rates may not be the best instrument for achieving social equity or for encouraging the consumption of certain goods and services. The use of reduced VAT rates is allegedly justified by the wish to make the consumption of certain goods and services more affordable, either based on their intrinsic merit (this is e.g. the justification for a reduced VAT on cultural goods) or because they are seen as essential goods that should not be highly taxed (e.g. medicines or food) in view of achieving distributional or other social policy goals. However, empirical evidence shows that abolishing reduced rates hardly has any equity consequences (Boeters et al., 2006 and Jacobs, 2013). Moreover, using reduced VAT rates comes at a cost, because reduced rates do not allow for specific targeting of low-income households. Since reduced rates are granted on all purchases of a given good or service, both low- and high-income households benefit from them. This leads to a considerable revenue loss from wealthier households since, in absolute terms, they spend considerable amounts on for instance food, medicines and cultural goods (Copenhagen Economics, 2007). Moreover, applying reduced VAT rates to energy products constitutes environmentally harmful subsidies and goes against environmental goals. For these reasons, other policy tools that can be targeted at specific groups, like means-tested benefit schemes, may better achieve social equity, while incurring a lower budgetary cost and triggering fewer economic distortions. As highlighted by the ECOFIN Council, more efficient alternatives should always be considered before extending the use of reduced VAT rates (Council of the EU, 2012).

The evaluation of other economic reasons for using reduced rates (see Table 2) suggests that the use of reduced VAT rates rests on rather weak theoretical or empirical evidence. Copenhagen Economics (2007) finds some theoretical arguments that may justify the use of reduced VAT rates to serve some employment-related objectives, in particular for services that fit the combination of (i) employing low-skilled labour, (ii) substituting do-it yourself work or being complementary to such work and (iii) having a high risk of tax evasion. However, there is no empirical evidence so far to support these theoretical arguments. Moreover, it should be kept in mind that employment targets could be achieved more efficiently by reducing the tax wedge for low income earners, which is particularly high in Belgium (42.8% versus 34.7% in the EU on average in 2012).

If demand is inelastic and the risk of evasion low, applying a reduced VAT rate is particularly costly.

Whenever a reduced rate is used to support demand, the extent to which households would respond to a price increase should be examined. If the expected consumption response is low (inelastic demand) and the risk of evasion small, applying a reduced VAT rate is particularly costly. Moving from the reduced rate to the standard would not decrease demand considerably and substantial revenue would be gained. It should be recalled, however, that the substitution of other goods and services, the tax rates applied to them and the ability of businesses to pass on the tax rate increase to the final consumer will also matter for the total change in revenue.

A simple and uniform VAT system also reduces distortions and lowers collection and compliance costs.

Also from an efficiency point of view, there are strong arguments in favour of a simple and uniform VAT system. First, a uniform and broad-based VAT structure fosters economic efficiency by reducing distortions of consumer choices. In addition, differences in VAT rates between similar products give rise to administrative and legal conflicts about the definition and the proper classification of specific goods. Moreover, a simple VAT structure, in most cases,[6] reduces the opportunities for political lobbying for the application (or re-introduction) of reduced rates to specific goods and services, which can result in extra costs for businesses and the tax administration, which have to classify the goods according to different VAT rates. Finally, collection and compliance costs are minimised under a simple and uniform VAT system, as costs rise sharply when the number of VAT rates increases (European Commission, 2010). In Belgium, the time taken for taxpayers to comply with VAT requirements exceeds the EU average (BE: 65 hours, EU: 42 hours to prepare VAT returns) (PWC, 2011).

Table 2. Economic reasons to apply reduced rates to specific categories of goods and services - based on economic literature

Economic reasons and alternatives (based mainly on Copenhagen Economics, 2007 and Mirrlees Review, 2011)	Categories for which reduced rates are applied in Belgium
Services substitutable with own work or complementary to work Lower VAT rates could be used to encourage the consumption of services which are easily substituted by do-it-yourself work (e.g. repair services, cleaning) or which are complementary to work (e.g. childcare services) (Mirrlees Review, 2011). Those services tend to be under-consumed, as taxation drives a wedge between the costs of supplying them oneself and buying them on the market. As simulations indicate productivity gains in countries with high labour tax wedges (Copenhagen Economics, 2007), reducing the tax burden on specific labour market groups may increase efficiency. Equivalently, complements to leisure (entertainment, holiday accommodation, theatre tickets) should not be subject to reduced VAT rates.	• Restaurant services (12%) • Renovation and repair of private dwellings (6%) • Repairing of bicycles, shoes and clothing (6%) • Admission to cultural events, amusement parks, sports events (6%) • Hotel and camping accommodation (6%).
Services employing low-skilled labour Reduced VAT rates could potentially boost demand for services employing low-skilled workers, (e.g. hotels and restaurants). Analysis (e.g. in tourism sector, see OECD, 2013), however, shows that their economic effects tend to be temporary and to hold only in countries with rigid and non-flexible labour markets for low skill workers where wages do not easily adjust. Reducing the tax wedge for low income groups and adjusting the labour market would be more targeted and effective than applying a reduced VAT rate.	• Hotel accommodation (6%) • Restaurant services (12%) • Renovation and repair of private dwellings (6%)
Services with a high risk of tax evasion Reduced VAT rates are sometimes applied to services which tend to be provided by undeclared workers in order to lower the potential gain from tax evasion. As services performed by small businesses or self-employed tend to be less subject to external scrutiny, the risk of evasion is typically higher. Whenever compliance is a major issue and enforcement and scrutiny is insufficiently developed, reduced VAT rates might limit evasion (Copenhagen Economics, 2007). However, an alternative solution could be to strengthen compliance by performing targeted controls based on risk analysis and market segmentation.	• Renovation and repair of private dwellings (6%) • Restaurant services (12%).
Merit goods and services Lower VAT rates are also used to encourage the supply of and demand for merit goods and services, as consumers often do not recognise the full (long-term) benefit of consuming merit goods and services (e.g. transfer of knowledge). Since high-income people tend to consume merit goods anyway, using reduced VAT rates tends to be very costly. Reduced VAT-rates for printed material (books, newspapers) additionally introduce a distortion on the basis of the form of the media since, under EU law, standard VAT rates apply to competing e-services. This is especially questionable from a growth perspective.	• Admission to cultural events (6%) • Periodicals and books (6%) • Newspaper (printed and electronic format) (0%)
Limit distortions of competition related to publically provided services Reduced VAT rates are occasionally applied to reduce the tax burden on public services provided by private suppliers. Since, under the EU VAT system, these services are VAT exempted when carried out by a public body, reduced VAT rates are applied to private agents in order to counteract the distortions of competition. Such reduced rates, however, increase the complexity of the system and create additional distortions (e.g. definition of the status of services, higher risk of distorted competition).	• Admission to sporting and cultural events (6%) • Supply of sporting facilities (6%) • Supply of social services (6%)
Limit distortions of savings and investment choices Reduced VAT rates on new buildings (e.g. social housing in the EU) could support owner-occupied housing as a basic need. However, owner-occupied housing is also a rather favourably taxed investment good (low recurrent property taxes and non-existing taxation of imputed rents), leading to distortions of savings and investment choices and hampering growth. Applying the standard VAT rate to new buildings is a way to capture the consumption value of housing services and counterbalance the low tax burden on owner-occupied housing as investment good. However, this might create distortions between the sale of old and new dwellings.	• Social housing (6%/12%)

A reform of the Belgian VAT rate structure could contribute to improving the VAT revenue efficiency.

4. Issues to be considered in VAT reform

In light of the high tax burden on labour, this note shows that Belgium faces also a VAT efficiency problem, which is partly due to the use of reduced VAT rates. Assessing the rationale used to justify the application of reduced rates to specific categories of goods and services, it is shown that a reform of the VAT rate structure could contribute to an improvement in the efficiency of the system and to a rise in VAT revenues, which would create room to shift the tax burden away from labour and contribute to more social equity. However, it should be kept in mind that changes in VAT rates will also have an impact on inflation and therefore on the evolution of wages through the generalised practice of automatic indexation of wages to inflation. In order to offset the negative impact on competitiveness, accompanying wage cost measures might be needed, such as reforms in the wage-setting system or a reduction of the tax burden on labour, both of which have been recommended by the ECOFIN Council to Belgium in the context of the 2014 European Semester.

In a VAT reform the following elements deserve to be considered:

- Increasing the efficiency of the VAT system by reducing the number of rates. For instance, moving to a system of two rates, by abolishing the zero rate, the parking rate, and one of the reduced rates, would considerably simplify the VAT rate structure. Moreover, moving the goods and services subject to the zero rate to the reduced rate or to the standard rate would go in the direction of having a neutral VAT system, which does not favour one sector, activity or technology over others. Abolishing the parking rate would fulfil the initial intention of the law, by making this a transitional arrangement.
- Moving some goods and services from the reduced rate to the standard rate. Obvious candidates for this would be energy products and soft drinks. Given that no convincing rationale can be found to justify reduced rates and given the rather inelastic demand for these goods, substantial increases in revenue could be expected when moving these categories to the standard rate.
- Assessing whether the use of reduced rates for the remaining goods and services effectively supports the demand for these categories. Even if some arguments can be found to justify reduced rates for some specific categories, there is a need to evaluate whether the policy objectives of using reduced rates are met.
- Increasing the reduced rate rather than the standard rate to generate extra revenue. For revenue-raising purposes, countries with a two-rate structure often apply a reduced rate varying between 10 and 12%. Further analysis of the revenue effects would, however, be needed to determine the possible scope for setting the reduced rate to 10-12%.

Belgium could broaden the VAT base by limiting the extent of mandatory exemptions and the use of VAT optional exemptions and derogations.

Furthermore, Belgium could broaden its VAT base by limiting the extent of mandatory exemptions and the use of VAT optional exemptions and derogations. Options could include:

- Introducing certain conditions foreseen by the VAT Directive to limit mandatory exemptions for hospital and medical care undertaken by profit-making private suppliers in order to ensure that these exemptions are provided under conditions comparable with those applicable to public bodies.
- Abolishing the use of certain optional exemptions and bringing into the VAT system the supply of building land, the supply of old buildings and renting services.
- Abolishing the derogation for the supply of real pearls, natural gemstones and related services to persons who are traders exclusively in those goods.

A VAT reform should also include efficient control systems to ensure compliance.

To conclude, it is important to bear in mind that VAT compliance tends to fall as rates are increased, at least in Member States with weaker tax enforcement (CASE, 2013). To ensure satisfactory compliance, it is therefore important that a reform of the VAT system also includes efficient control systems. This implies more targeted tax inspections based on risk analysis and market segmentation, which reduce the administrative cost.

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[1] Under Belgian tax law, no distinction is made between the parking rate and the reduced rate of 12 % (KB/AR No 20, 20/07/1970, Table B). However, they are different in nature. The use of a parking rate was a derogation negotiated when Directive 92/77/EEC on the approximation of VAT rates was adopted in the context of the Treaty on European Union in 1992, which - as a first step to the completion of the internal market - required the removal of border controls. Member States, which on 1 January 1991 were applying a reduced rate to the supply of goods or services other than those specified in Annex III of the VAT Directive, were allowed to apply a reduced rate no lower than 12%. This measure was meant as a transitional arrangement for a smoother shift to the standard rate. A similar derogation was granted to Austria.

[2] Belgium recently announced in its Draft Budgetary Plan for 2015 that it would abolish the exemption for esthetical surgery.

[3] These special derogations are granted to the Member States by a Council decision according to article 395 of the VAT Directive 2006/112/EC. These derogations are usually intended to allow Member States to introduce special VAT rules under certain conditions (to support simplification of the VAT system, to prevent certain type of VAT fraud etc.).

[4] 2.3% of GDP amounts to roughly one tenth of revenue from taxes on employed labour (22.4% of GDP in 2012, European Commission, 2014b).

[5] The reduced VAT rate of 6% for the renovation of private dwellings, as well as for the repair of bicycles, shoes and clothing was introduced in 2000 as temporary measure, part of the EU pilot programme, and made permanent from 2011 onwards.

[6] As experience shows in Denmark, Estonia and Hungary.