

European Commission: Green Paper on the future of VAT**Response by the Wellcome Trust**

May 2011

General comments

1. The Wellcome Trust is a global charitable foundation dedicated to achieving extraordinary improvements in human and animal health. We support the brightest minds in biomedical research and the medical humanities. Our breadth of support includes public engagement, education and the application of research to improve health. We are independent of both political and commercial interests.
2. The Green Paper makes little reference to charities. The Wellcome Trust (“the Trust”) is pleased to be able to contribute to the discussion by highlighting the issues it and other charities encounter with the existing VAT system.
3. The importance of charities in providing social benefit has become even more prominent in the current economic climate, with member states increasingly seeking to partner with charities to address societal needs. It is therefore imperative that the VAT system does not inhibit this partnership – rather, it should facilitate charitable activity. The current public interest exemptions (e.g. for educational, welfare and cultural activities – the “social exemptions”) only go part way to the solution. They fall far short of relieving charities of the VAT paid on goods and services which they procure in order to support their work. We would therefore look for the exemptions to be supplemented by measures to relieve charities of their irrecoverable VAT.
4. The Trust, like all charities, was established to provide a public benefit – in our case, research that generates new knowledge and improvements in health. The Trust’s policy is to provide its services (or funding) for no consideration so that the whole public can benefit, not just those who can afford to pay. We would argue that the majority of charities would like to achieve this fundamental objective, yet the current VAT system penalises the charities that can achieve the socially desirable goal of providing free services (or funding) by burdening them with irrecoverable VAT.
5. Copenhagen Economics has produced a useful economic review of the VAT impact on public bodies. We suggest that the report should be developed further to consider the impact on the beneficiaries those public bodies seek to serve i.e. the real consumer. The report proposes three possible solutions, which could address particular problems with the system in particular circumstances. We would welcome further debate on how the solutions proposed by Copenhagen Economics’ could be accommodated within VAT legislation and a wider debate on alternative solutions such as reduced rates on all supplies to charities.

Response to Green Paper questions

6. We have responded to the questions relevant to the Trust’s activities and those of charities more generally.

Question 3 - Do you think that the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality, and if not, why not?

7. The VAT rules for public authorities can act as a disincentive for outsourcing some types of services if this creates hidden irrecoverable VAT (i.e. the supply of exempt services) which cannot be recovered by the public authority under the UK rebate schemes. As a result it is cheaper for the public authority to resource these services in house. This could be resolved by extending the rebate scheme to charities so that charities need not pass on a VAT cost on these exempt services – whether this be to the public authority or directly to the beneficiary of the service. However, a national rebate scheme is outside the VAT system and therefore beyond the authority of the Commission. An alternative solution would be a reduced or zero rate applied to purchases by a charity - see paragraph 15 below.

Question 4 – What other problems have you encountered in relation to the scope of VAT?

8. Charities could be regarded as having the most complex administrative obligations of all taxpayers. The Trust has a combination of non-business (i.e. outside the scope of VAT), exempt and taxable activities requiring a complicated calculation of deductible input tax.
9. In addition the distinction between business and non-business is not always clear; for example, when does scientific research move from non-business to business, or when does a grant to a university to undertake research become consideration for a supply? Ultimately it is left for the courts to decide the distinctions but case law applies to the specific circumstances of the case and therefore often merely provides a guide rather than a definitive direction. In the meantime, charities are forced to spend money on expensive external VAT advisers to make sure that research and grants do not give rise to VAT claims.

Question 5 – What should be done to overcome these problems?

10. Legislation should be amended to reflect the case law decisions rather than leave the scope of the ruling to be interpreted by member states.
11. A full taxation solution (as suggested by Copenhagen Economics) might simplify some charities' administrative burdens. However, it would have an adverse impact on charities with low irrecoverable VAT on exempt activities or on activities outside the scope of VAT (if there were to be a deemed consideration where services are provided free of charge). Allowing charities the option to use the full taxation model might be preferable, however this would not resolve the non-business/business complications and it would create additional administrative headaches. We would counsel the Commission against this course of action without considering the impact on the activity of charities.

Question 6 – Which of the current VAT exemptions should no longer be kept? Please explain why you consider them problematic. Are there any exemptions which should be kept and, if so why?

12. We are concerned that the Green Paper considers the removal of exemptions without apparently quantifying the impact on the social services charities provide. Exemptions are of particular benefit to charities (and to the users of their services) and the broadening of the tax base to the full taxation model would be counterproductive if this were to impede charities' contribution to the social advancement of member states. We ask the Commission to consider the value of the social exemptions. The paper states that one third of consumption is subject to exemptions or reduced rates. This is measured by output but we would argue that it is an understatement of the true value as it will not take into account services that are part-funded by donation or subsidies nor the fact that commercial organisations' outputs include a profit which will be absent from the output figures of most charities.
13. An exemption within the Directive that has not been widely used but which is of potential interest to charities is Article 132 (1)(f) of the Principal VAT Directive – shared services. This has not been used in the UK because (a) there is uncertainty about its application and (b) it

relates to a restricted set of circumstances. Rather than abolish this exemption we ask the Commission to clarify and extend the scope to facilitate collaboration between organisations engaged in non-business activities and those engaged in exempt charitable activities.

Question 9 – What do you consider to be the main problems with the right of deduction?

14. The right of deduction depends on economic activity. This prevents charities that are providing a social service from deduction unless a charge is made. The end of the supply chain is the recipient of the charity's works yet the VAT system is unable to recognise this fact. In effect the VAT system is taxing the charity for providing services which in many cases are the government's responsibility.

Question 10 – What changes would you like to see to improve the neutrality and fairness of the rules on deduction of input VAT?

15. If charities were able to receive services and goods at a reduced or zero rate they would be better placed to advance their social objectives. This would not distort the neutrality of the tax system as any onward supply for consideration would re-enter the VAT economic chain and be subject to VAT in the normal way. This approach would, however, benefit charities that are not in business, and therefore not in competition, by reducing or eliminating irrecoverable VAT on purchases. The advantages of this model are:

- a) The extent of relief can be set by each member state within the parameters set by VAT legislation.
- b) Each member state can decide what qualifies as a charity: indeed since the Persche case member states have already started or completed this process.
- c) Relief will be tax forgone rather than expenditure – an important consideration for governments.
- d) This model would address the problem that reverse charging creates for non-business charities importing services or goods.

Question 11 – What are the main problems with the current VAT rules for international services, in terms of competition and tax neutrality or other factors?

16. The place of supply rules and reverse charge mechanisms on services are difficult to administer, particularly when dealing with countries that are outside the EU. A supplier of intra-EU services will agree with the Trust the correct VAT treatment before rendering an invoice, whereas suppliers from outside the EU have no reason to do this. Consequently, while dealing with thousands of invoices a week, the Trust's accounting staff have to spot invoices for services that require manual intervention to trigger a reverse charge accounting; the VAT on those invoices, because we are mainly non-business, becomes irrecoverable VAT. This requirement to apply reverse charge to non-EU services – a UK legislative requirement from 1 January 2010 – has increased the Trust's VAT burden by £2 million per annum.

17. In all cases it is fair to say that the Trust's decisions to commission services from one jurisdiction as opposed to another are not decided by whether VAT will be charged – it is dictated by where the expertise resides. VAT or the absence thereof does not have an impact on competition.

Question 12 – What should be done to overcome these problems? Do you think that more coordination is needed at international level?

18. For most organisations the reverse charge mechanism does not create a tax burden as the charge becomes deductible input VAT and the method evens the playing field for competition. For an individual not in business the reverse charge mechanism does not apply. Therefore the only taxpayers on which this has an adverse effect are partially non-business charities and exempt businesses. Two possible remedies for charities are:
- a) The Commission recognises that charities, like individuals, have a dual purpose – and can act in a non-business (private capacity for individuals) separate from its business activity. If this concept were adopted, charities would only need to reverse charge on inputs consumed in their business capacity.
 - b) Alternatively, if governments wished to relieve charities of this added burden, the reduced or zero rate model suggested at paragraph 15 above would provide the solution without jeopardising the objective of fair competition.

Question 13 – Which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?

19. Regulations provide certainty whereas directives provide a measure of flexibility. The distinction is most relevant in cross-border transactions where consistency is essential for the single market.

Question 16 – More broadly, what should be done to improve the legislative process, its transparency and the role of the stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?

20. We believe the interests of the charity sector are often overlooked when new legislation is considered. Stakeholders should be consulted during drafting and implementation.

Question 19 – Do you think that the current rates structure creates major obstacles for the smooth functioning of the single market (distortion of competition), unequal treatment of comparable products, notably online services by comparison with products or services providing similar content or leads to major compliance costs for businesses? If yes, in what situations?

21. The most notable unequal treatment of similar products the Trust encounters is the VAT treatment of paper books versus e-books. As the custodian of one of the largest collections of history of medicine books in the world we are acutely aware that VAT legislation has not moved with the times. Many of our new acquisitions are in downloadable format and our readers and researchers also require electronic access to the works. There is no logical reason why the original objectives which determined the treatment of paper books (i.e. zero-rated) should not apply to their modern equivalent.

Question 20 – Would you prefer to have no reduced rates (or a very short list), which might enable member states to apply a lower standard VAT rate? Or would you support a compulsory and uniformly applied reduced VAT rate list in the EU notably in order to address specific policy objectives as laid out in particular in “Europe 2020”?

22. Reduced rates, including zero rates, are very valuable to the Trust and many other charities in the United Kingdom. The removal of these would seriously jeopardise projects we support, many of which are in partnership with our Government, because there would be no source of funds for the 20 per cent increase in costs.

Question 33 – Which issues, other than those already mentioned, should be addressed in considering the future of the EU VAT system? What solution would you recommend?

23. The system needs to recognise and encourage the contribution charities and foundations make to society. Charities, and in particular grant-making endowed foundations, are not catered for in the current VAT legislation even though they are providing social services that governments would have to provide if the charities did not exist. Charities are an invaluable partner for governments and the argument that charities providing free services are outside the scope of the VAT system is not a valid reason for inaction. The Commission is not just responsible for creating an even playing field for businesses but also has social responsibilities for its citizens. Its tax system should empower member states to maximise the skills and resources of the charity sector and not penalise their efforts by creating a tax burden.