

Can we hope for new reduced rates of VAT?

1/18/22



Senior Manager, Tax Reporting, Accounting
and Strategy, PwC Latvia
Juris Boiko

Four years of work have been crowned with amendments passed to the VAT directive¹ concerning a reduced rate of VAT on 5 April 2022. The new provisions will give the governments of the EU member states greater flexibility in applying the rates and will ensure transnational equality. The reduced rates clearly point to EU shared priorities, such as protection of public health, fight against climate change, and support for the European Green Deal, while preparing to phase out the current preferential regime for environmentally damaging supplies.

The standard rate and reduced rates

The member states will continue applying the standard VAT rate of at least 15% and will be allowed to apply two reduced rates of 5% or higher. In adopting the reduced rates, the member states have to follow Annex III to the VAT directive, which lists categories of goods and services eligible for a reduced rate. The amendments have revised this list, which is almost thirty years old.

In addition to the two reduced rates, each member state may apply one more rate that is lower than 5% and a VAT exemption with input tax deduction rights. These specially reduced rates may only be charged on supplies of goods and services mentioned in seven items on the list. The specially reduced rates may be applied on supplies of food, water, medicines, pharmaceuticals, health and hygiene products, books and periodicals, as well as passenger transport. The list of items qualifying for a specially reduced rate now includes solar panels. Introducing such a reduced rate is consistent with the EU's environmental commitments to decarbonisation and the European Green Deal, as well as giving the member states an opportunity to promote the use of renewable energy.

The VAT directive's amendments retain a number of derogations for specially reduced rates, which had been granted to certain member states because of their special geographical or social situation. Other member states may now use such derogations on the same conditions under the principle of equality. A period of transition for the final 7-item list of goods and services eligible for a specially reduced rate is set to end no later than 1 January 2032.

Similarly, various derogations allow certain member states to apply a reduced rate of 12% or higher on goods and services that are not listed in Annex III. Any member state may now apply this reduced rate, which is close to the standard rate, on the same conditions under the principle of equal treatment.

The following significant changes are worthy of note:

- To make the member states' health systems more resilient, the scope for applying a reduced rate on medical devices has been widened.
- A reduced rate can still be applied on admission fees for theatre, circus, concert, museum, zoo, cinema, sports and similar events, but this may now be applied also on access to live streaming of those services.

- Given the significance of digitalisation, to address the poor coverage of internet access services and promote their development, a reduced rate may be applied on internet access services (this does not apply to content) supplied as part of the digitalisation policy defined by each member state.
- Chemical pesticides and chemical fertilisers have been taken off the list of goods used in agricultural production that were eligible for a reduced rate (the member states applying a reduced rate on these goods are allowed a period of transition until 1 January 2032).
- In order to give the member states an opportunity to support the upgrading to environmentally friendly heating systems, a reduced rate may be applied on supplies of electricity, district heating, district cooling, and certain biogas, as well as the supply and installation of certain very efficient low-emission heating systems, and until 1 January 2030 for natural gas and wood used as fuel.
- The list of goods and services eligible for a reduced rate now includes again:
 - Live equidae and supplies of related services
 - Live plants and other floricultural products (bulbs, roots, cut flowers etc)
 - Children's clothing, footwear, car seats
 - Bicycles, including electric ones (including hire and repair)
 - Certain works of art, collectibles, and antiques
 - Certain legal services
 - Tools and other equipment normally intended for use in rescue or first aid services, if supplied to public bodies or certain non-profit organisations
 - Supplies of services involving the use of floating beacons, lighthouses or other navigational aids and life-saving services, including the organisation and maintenance of rescue boat service

The directive also contains amendments aimed at making it ready to respond to crises. For this purpose, the member states that are allowed to apply a VAT exemption on goods imported for disaster victims are allowed to apply, on the same conditions, an exemption with the right to deduct VAT on intra-Community acquisitions and domestic supplies of those goods, as well as on related services.

The reduced rates a member state adopts should reflect its priorities and efforts to meet targets of overall significance. The question is whether Latvia will change the way it applies the reduced rate.

¹By Council Directive (EU) 2022/542 of 5 April 2022 amending Directives 2006/112/EC and (EU) 2020/285 as regards rates of value added tax