

## Response to the European Commission's Consultation on the review of VAT legislation on public bodies and tax exemptions in the public interest

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### Introduction

The contract catering sector in Europe **employs over 600,000 people** and delivers over 6 billion meals each year. This equates to 67 million consumers served every day, or **one in four meals eaten outside the home**. In addition, catering is often provided within the context of a social food service in schools, universities, retirement homes, hospitals and prisons. It is therefore essential to ensure that consumers are able to benefit from the expertise, innovation and efficiencies, which can be attained by outsourcing to specialized providers.

Today, the contract catering industry has an annual turnover of approximately €24 billion, but only around 33% of firms or collective organizations in the EU have a contract with a catering company. There is therefore significant potential for growth in this market, the total size of which was estimated to be close to €68 billion in 2010.

Specifically concerning catering services to public bodies, on average, 60% to 85% of these services were self-operated in the EU in 2012. In this context, the VAT regime in the public sector is one of the most significant barriers to outsourcing when public bodies are exempt. As widely recognized, the current VAT regime applicable to public bodies and the provisions on exemptions in the public interest affect the neutrality of the VAT system and create an incentive for public bodies to self-supply. In addition, very often, exempted bodies are in direct competition with private catering operators that remain subject to VAT. While some Member States have put in place additional measures to correct this, distortions of competition on both the input and output side persist in most European countries.

The European Commission has already identified the main shortcomings that follow from the current VAT rules applicable to the public sector. Through our response below, FoodServiceEurope underlines that all the shortcomings identified by the Commission are relevant to the contract catering sector and outlines how our industry sees the reform of the VAT regime going forward.

**Evaluation of the current rules regarding the VAT treatment of the public sector (Questions 1 & 2 of the public consultation)**

Overall, FoodServiceEurope agrees with the Commission's assessment of the challenges which arise due to the differential treatment of public bodies and the exemptions granted for services in the public interest. In this respect, we are particularly concerned with the lack of neutrality and would like to highlight the distortions of competition occurring in the contract catering sector as a result. In addition, other shortcomings that have been identified by the Commission, namely the complexity of the VAT rules as well as the lack of harmonisation, are also present in our sector and will be mentioned subsequently.

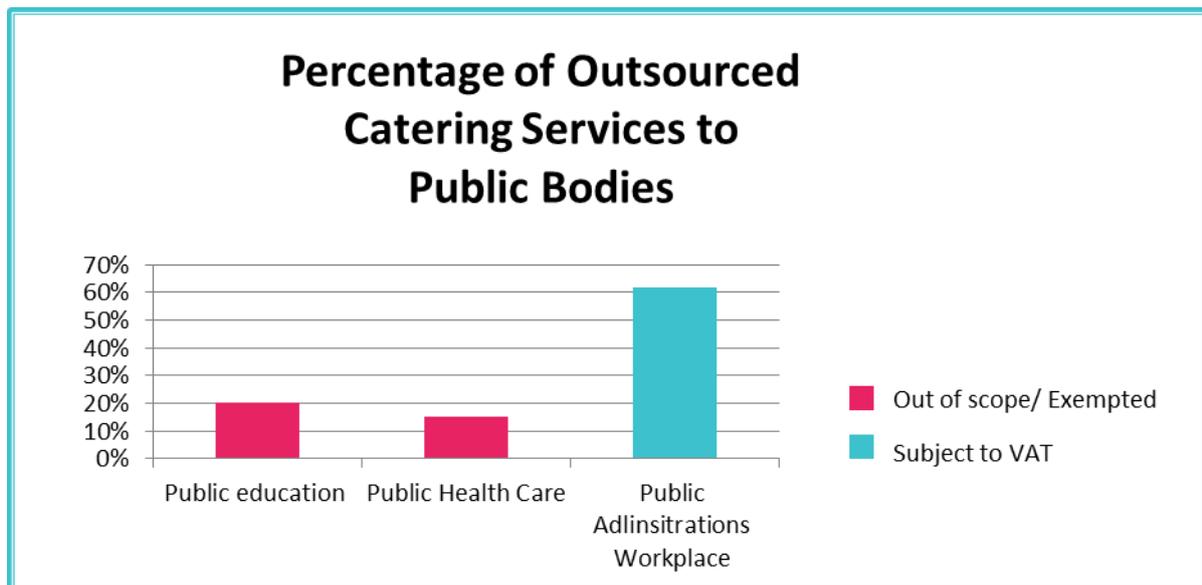
**INPUT-SIDE DISTORTIONS OF COMPETITION**

On the input side, the inability to deduct VAT paid for outsourced services creates an incentive to self-supply. This issue affects Member States to a different extent, due to the lack of harmonisation in the application of VAT rules. Some factors affecting the incentive to self-supply include:

- whether exemptions are applied based on the nature of the service or based on the nature of the provider (public vs. private)
- whether catering as an ancillary service is considered to be covered by the exemption
- whether the standard or a reduced rate is applied to private operators (the distortion being more significant where the standard rate applies).

Numerous illustrations of the bias towards self-supply that follows from the current VAT rules can be found in the contract catering industry. For example, in **France, where VAT applies, the public sector outsourcing rates are significantly higher:**

*Figure 1: Percentage of catering services outsourced by public bodies in France and VAT regime by segment*



Source: Gira 2013 in % of turnover

In the workplace sector, where contract catering is subject to VAT, catering is largely outsourced: 62% of public bodies outsource. **By comparison, where an exemption applies, outsourcing rates are much lower, generally at or below 20%.**

This type of distortion of competition results from the fact that the exempted body, which provides services in-house, only incurs input VAT on part of the meal price: VAT is only paid on the food products needed, which in France is largely at the reduced VAT rate of 5.5%. By contrast, if the service is outsourced, the private operator would be forced to charge 7% VAT rate (increased to 10% as of 1 January 2014) on the entire cost of the meal, which would include, for example, employee expenses. Thus, the non-deductible VAT charged by private food service providers is higher than the input VAT incurred by a self-supplying public body. As a result, public bodies have an incentive to base their decisions on VAT concerns rather than on economic considerations.

A difference in the VAT paid when outsourcing and when self-supplying was also identified in **Portugal**. Similar to the case in France, exempted public bodies providing catering in-house, only have to pay 6/13% VAT for the raw materials purchased, which represent about 40% of the total cost of the food service. By comparison, if the service is outsourced, the non-deductible input VAT incurred would be the standard rate of 23%, charged on the full cost of the meal.

Another example of input-side distortions of competition can be observed in the **German** health care sector. In addition to hospitals paying VAT only on the cost of the raw materials purchased, they are also able to benefit from a lower VAT rate. If catering is insourced, hospitals would pay 7% VAT on the cost of food, 19% on drinks and 0 on labour costs. By contrast, if the service is outsourced, the hospital would have to pay 19% VAT on the total price.

*Figure 2: Example of price differential created by VAT exemption in Germany*

	<i>Insourced services</i>	<i>Outsourced services</i>
<i>Employee costs</i>	EUR <b>20.00</b>	EUR <b>20.00</b>
<i>VAT on employee costs</i>	EUR <b>0.00</b>	EUR <b>3.80</b> (19%)
<i>Cost of raw materials</i>	EUR <b>20.00</b>	EUR <b>20.00</b>
<i>VAT on cost of raw materials</i>	EUR <b>1.40</b> (7%)	EUR <b>3.80</b> (19%)
<i>Other costs</i>	EUR <b>5.00</b>	EUR <b>5.00</b>
<i>VAT on other costs</i>	EUR <b>1.00</b> (19%)	EUR <b>1.00</b> (19%)
<b>Total</b>	<b>EUR 47.40</b>	<b>EUR 53.60</b>

FoodServiceEurope has identified similar problems in **Luxembourg, Spain, and Romania** – all countries where there is differential VAT treatment for public and private providers in the catering sector, as seen in the table below:

Figure 3: Difference in VAT treatment of self-supply and outsourced services in selected Member States

Country	In educational institutions to students		In health care establishments to patients		Social sector (retiring homes and others)	
	In-house	Outsourced	In-house	Outsourced	In-house	Outsourced
<b>France</b>	Generally exempt. Some are subject to reduced rate (5.5/10%)	5.5/10% rate	Exempt	10% rate	Generally exempt. Some are subject to reduced rate (5.5%)	5.5% rate for the majority
<b>Italy</b>	Exempt	4% rate	Exempt	10% rate	Exempt	10% rate
<b>Luxembourg</b>	Exempt	3% rate	Exempt	3% rate	Exempt	3% rate
<b>Portugal</b>	Exempt	23% rate	Exempt	23% rate	Exempt	23% rate
<b>Romania</b>	Exempt	24% rate	Exempt	24% rate	Exempt	24% rate
<b>Spain</b>	Exempt	10% rate	Exempt	10% rate	Exempt	Generally 10%, but can be exempt

Source: Internal research in 2013

These input-side distortions create a barrier to outsourcing and thus reduce efficiency and innovation. Other things being equal, a specialized company would have the necessary resources and expertise to provide a service more efficiently and at a lower cost. **However, when differential VAT treatment tips the scales in the opposite direction, the benefits of outsourcing in terms of efficiency are lost.**

### OUTPUT-SIDE DISTORTIONS OF COMPETITION

FoodServiceEurope considers that in spite of the current legal provisions and the existing case law, **distortions of competition on the output side persist in some Member States.** Concrete examples of output-side distortions of competition between public and private providers in the catering sector to education establishments can well illustrate this and are provided below:

Figure 4: Examples of output-side distortions of competition in the Education segment

<p><b>France</b></p> 	<p>CROUS (Centres régionaux des œuvres universitaires et scolaires) are exempted from VAT and provide catering services for all university-level education establishments. In addition, CROUS have recently started to take over the provision of food services to higher education establishments that are not affiliated to the University and that were previously outsourced to private operators.</p>
<p><b>Spain</b></p> 	<p>Recently adopted legal provisions now clearly state that public and equivalent bodies that provide childcare services are exempted from VAT. The exemption expressly covers the provision of food services. As a consequence a Foundation that operates school canteens, for example, will be exempted from VAT even when it takes part in a tender procedure in direct competition with private operators.</p>
<p><b>Slovenia</b></p> 	<p>The Law on School Food adopted in 2010 establishes the possibility for schools to delegate the provision of food services to their students to another school or kindergarten. These services are also considered to be exempt from VAT by the tax authorities. By contrast, food services provided to schools by private contract catering operators remain subject to VAT.</p>

As evidenced by the examples above, output-side distortions of competition in the contract catering sector persist in some Member States and lead to an unfair competitive environment. FoodServiceEurope therefore strongly believes that any reform of the VAT system proposed by the European Commission should aim to effectively deal with all distortions of competition, whether on the input or on the output side.

### COMPLEXITY

In addition to creating distortions of competition, the current VAT treatment of public bodies and the existing exemptions in the public interest increase the complexity of the VAT system and make it more difficult to apply correctly. Not only do different rules apply on the basis of the character of the supplier, but it is often the case that **different rules are applied to different consumers in the same establishment. For example, in some Member States food services to patients and students are VAT exempted, while those provided to visitors and/or staff are not.** This has notably been confirmed as a correct interpretation by the European Court of Justice in Joined Cases C-394/04 and C-395/04 *Ygeia* [2005] ECR I-10373, §35. Furthermore, in the education sector, some Member States apply special rules based on the age of the student, thereby rendering the correct application of VAT even more complicated.

## LACK OF HARMONISATION

As can be seen in the table below, the VAT regime applicable to catering services in the various segments will vary widely between Member States, in contradiction with the harmonization aim of the EU VAT Directive.

Figure 5: Differences in the application of exemptions across Member States

Country	To public officials/employees		Health Care Establishments			Educational Institutions			Social Services			Defence sector and detention facilities	
	By public bodies themselves	By contract caterers	By public hospitals	By approved private hospitals	By contract caterers	By public bodies	By approved private bodies	By contract caterers	By public bodies	By approved private bodies	By contract caterers	By public bodies	By approved private bodies
Czech republic	Taxable	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt/Taxable	Taxable	Taxable
Finland	Taxable	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt, if listed in Social Services Provider Register	Exempt	Taxable, excluding conscripts and military personnel
France	Taxable	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable/Exempt		
Germany			Exempt	Exempt									
Italy			Exempt		Taxable	Exempt		Taxable	Exempt	Exempt	Taxable		
Latvia						Exempt	Exempt		Exempt	Exempt			
Luxembourg	Exempt	Taxable	Exempt		Taxable	Exempt		Taxable	Exempt		Taxable	Exempt	
Netherlands	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable	Taxable		
Portugal	Exempt	Taxable	Exempt		Taxable	Exempt	Exempt	Taxable, but can be exempt if in partnership with public entities	Exempt		Taxable	Exempt	
Romania			Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable		
Slovakia	Taxable	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt/taxable	Taxable	Taxable
Slovenia						Exempt		Taxable					
Spain			Exempt	Taxable	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt	Taxable	Exempt	Exempt
UK	Taxable	Taxable	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Exempt	Taxable	Taxable

For simplicity, both out-of-scope (under Art 13) and exempted services (under Art 132-134) are marked as **exempt**. In healthcare and education services the exemption will in some countries not apply to visitors and /or staff.

## Reform measures (Questions 3-5)

### FULL TAXATION

FoodServiceEurope believes the full taxation model would provide a very good solution for both output and input side distortions of competition and would resolve the difficulties experienced by the contract catering sector in the EU. As demonstrated by Copenhagen Economics in their study conducted for the European Commission, this solution would also bring the highest economic gains. However, we are aware that, from a political perspective, it will be difficult to agree upon and therefore, we have focused on highlighting the advantages and disadvantages of the other possibilities under consideration.

## REFUND SYSTEM

Refund systems are already in place in 8 Member States and are used with great success in some (e.g.: UK and the Netherlands).

In the **UK**, a mechanism known as “contracted out regime”, which is established outside the VAT legislation, allows public bodies, such as Government Departments and the NHS to recover from the Treasury the input VAT they pay on contracted out services. In addition, provisions in the VAT legislation (e.g. section 33 VAT Act 1994) allow other public bodies, such as local authorities, to **recover input VAT**. These measures are complemented by a special “**catering staff wages concession**”, which allows private operators to provide catering services to exempted bodies without charging VAT on the costs incurred in staff wages. **The combination of these measures effectively deals with the disincentive to outsource inherent in the VAT regime.**

In the **Netherlands**, a similar combination of legislative measures is used to correct the distortions that result from public sector exemptions. A “**VAT Compensation Fund**” has been set up in order to enable local public authorities to recover the input VAT where they would usually not be able to do so. Additionally, a **special regime for catering services provides an opportunity to charge for employee costs without VAT**. The result is that public bodies are not left with an irrecoverable input VAT and therefore **VAT does not act as a barrier to outsourcing.**

As we can see from the examples above, **refund systems, particularly when combined with provisions on staff wages for private caterers, can significantly mitigate input-side distortions.** However, FoodServiceEurope would like to draw attention to the fact that a refund system would have to be very well-designed and would **need to apply equally to all exempt providers (whether public or private)** in order to bring the greatest possible gain. Some Member States, which have a refund system in place, have chosen to apply it only to public bodies, which are out of scope of VAT as established in Article 13 of the VAT Directive. At the same time, public and private bodies benefitting from an exemption under Article 132 remain unable to recover input VAT and continue to provide supporting services in-house. This is notably the case in **Finland**, where public bodies are able to recover input VAT while private operators in the education or social service sector must pay VAT on their input materials. Similarly, as described by Copenhagen Economics, both public and private hospitals in **Denmark** are VAT-exempt, but only public hospitals can take advantage of the refund system. When combined with the prohibitively high level of VAT that would have to be paid on outsourced services (25%), this leads many private hospitals to produce support services in-house.

Therefore, FoodServiceEurope would like to highlight the **importance of designing a potential refund system in such a way that it does not perpetuate the discrimination between public and**

private service providers. Additionally, as it would only remedy input-side distortions, it should ideally be combined with a solution that deals with output-side distortions of competition.

### DELETION OF ARTICLE 13

FoodServiceEurope considers the deletion of Article 13 to be a **good option** for alleviating the distortions of competition between public and private bodies, as it would put public bodies within the scope of VAT. However, the important distortions that arise from the exemptions in Articles 132-134 will persist. Therefore, we believe that this **should always be accompanied by targeted amendments to the current exemptions in the public interest as mentioned further below, in a dedicated paragraph.**

### SECTORIAL REFORM

With regard to the option to follow a sectorial reform, FoodServiceEurope agrees that it has the potential to reduce distortions of competition in specific sectors significantly and that it has the advantage of not requiring a general change of the VAT system in the EU. This approach, however, risks being incomplete and becoming outdated quickly. On the other hand, an amendment to Annex 1 and the exemptions in Article 132 may be an instrument to bring the needed clarity on the scope of the VAT rules in the public sector.

Should this be the approach followed by the Commission, FoodServiceEurope underlines the relevance of the contract catering sector and the current distortions of competition that arise between public and private entities as illustrated above. Under this approach, FoodServiceEurope calls on the Commission to address in its proposal the concerns in our sector through an amendment to both Annex 1 and the exemptions under Article 132.

**Annex 1** currently includes a mention to the “*running of staff shops, cooperatives and industrial canteens and similar institutions*” (the French version more explicitly referring to “*cantines d’entreprises*”, similarly to other language versions such as in German, Spanish, Portuguese and Italian). This reference is unclear and seems today to be outdated. In fact, the concept “*industrial canteens*” seems to refer to services provided to (public) companies, which today would hardly ever be considered an activity in which public bodies would engage as “*public authorities*” and would by definition already be excluded from the scope of Article 13.

FoodServiceEurope therefore believes that, in the event Article 13 is not deleted, **Annex 1 should be amended to refer to any type of contract catering services.**

In addition, this option should be complemented by a provision to ensure that the **exemptions established in Articles 132-134 are amended to address the problems identified**, as detailed below.

### REVIEW OF ARTICLES 132-134

In order to address the distortions of competition that follow from the current rules, FoodServiceEurope believes it is **essential to ensure that the exemptions in Article 132 are dependent on the character of the supply and not on the character of the supplier** as this would help clarify the rules applicable and would level the playing field for public and private operators across the EU.

**In addition, and more importantly, FoodServiceEurope also believes the exemptions in Article 132 should be narrowly drafted and their scope precisely defined.** Most of the distortions of competition in the contract catering sector (as in other support services), arise from the fact that catering services are perceived by Member States as closely related activities to hospital and medical care as well as the provision of education. This however should not be the case, as catering services can and should be distinguished from these public services. This is particularly evident in the education sector, where (i) catering services to schools/universities are often provided in different premises from the education activities; (ii) the service is also provided by completely different staff; and (iii) not all students will necessarily eat in the school canteen, they can bring food from home or, in certain cases, go home/outside of school to have their meals.

To avoid the present confusion, FoodServiceEurope therefore believes that Article 132, notably paragraphs (b) and (i), should not cover the supply of services closely related to hospital care and the provision of education. The need to include under these provisions other activities that today do not fall under the definition given by the ECJ of medical care and education should be addressed by providing a wider definition of these terms instead of opening the door to include within the scope of the exemption activities that are clearly separate, such as the provision of food services.

#### **CLEARER STRUCTURE OF ARTICLE 13, E.G. DELETION OF ARTICLE 13(2)**

In principle, we are not against the deletion of Article 13(2), but do not consider that this would resolve the difficulties experienced by operators in the contract catering sector.

#### **OPTION TO TAX**

Providing operators or Member States with an option to tax could help in alleviating input-side distortions of competition, but would increase the complexity of the VAT regime and will decrease harmonisation. An option to tax for Member States would enable them to tax certain activities that are now exempted in the public interest, possibly at a very low rate so as to be budget-neutral. **If taken up by Member States, this could be a good option to encourage outsourcing.**

### **Conclusion**

Having considered all options, FoodServiceEurope is of the opinion that, if full taxation cannot be adopted, **a combination of the solutions discussed will be necessary in order to effectively deal with the problems identified, in particular both input- and output-side distortions of competition, as presented above.**

A summary of FoodServiceEurope's position on the reform of the VAT rules in the public sector is outlined in the page below.

## FOODSERVICEEUROPE'S POSITION ON THE REFORM OF THE VAT RULES IN THE PUBLIC SECTOR

### IN BRIEF:

- The contract **catering sector in Europe is significantly affected** by distortions of competition both on the input and the output side. The complexity and lack of harmonization of the current VAT regime are also clearly felt in our sector. **FoodServiceEurope therefore strongly believes that any solution chosen by the Commission should also address the concerns of our sector.**
- **Although the full taxation model would resolve the problems identified, FoodServiceEurope understands this is not a politically viable solution. We therefore support tackling the problems identified through selective amendments to the current provisions.**
- **The amendments to the current VAT regime should necessarily include a revision of both Articles 13 and 132-134, as follows:**
  - FoodServiceEurope supports the deletion of Article 13. Should this not be acceptable for Member States, FoodServiceEurope supports as a good alternative, which would contribute to greater legal certainty, the introduction of relevant changes to Annex 1. In this context, FoodServiceEurope calls on the Commission to replace the current outdated reference to “industrial canteens” by a clear mention to contract catering services as being outside the scope of Article 13.
  - The exemptions listed in Article 132 should be narrowly drafted and their scope precisely defined so as to exclude food (and other support) services from the scope of the exemptions. To this end, the exemptions (notably in paragraphs (b) and (i)), should not apply to “closely related activities”.
  - The exemptions in Article 132 should be drafted on the basis of the character of the supply (“in the public interest”) and not on the character of the supplier (public vs. private).
- **If the Commission opts for a refund system**, it is important to design it in such a way that it can be applied by both public and private bodies. As this solution would only remedy input-side distortions, it should be combined with a solution that deals with output-side distortions of competition as well.