The EU VAT reform: are national budgets to be balanced at the expense of the contributors to the social security system?

The financial repercussions of abolishing tax-free status and reduced rates of tax on the benefits provided by the German statutory social insurance institutions in the context of the European Union's proposed VAT reform

Position paper
of the German statutory social insurances

AOK-Bundesverband, BKK Dachverband, Deutsche Gesetzliche Unfallversicherung, Deutsche Rentenversicherung Bund, IKK e.V., Knappschaft, Sozialversicherung für Landwirtschaft, Forsten und Gartenbau, Verband der Ersatzkassen e.V., GKV-Spitzenverband

Submitted on 27 May 2013

Preliminary remarks

The European Union co-ordinates the VAT systems of the Member States in order to assure the functioning of the Single Market. Over the years, the European Commission has launched various initiatives aimed at reforming this VAT system: these include the Green Paper on the future of VAT, COM(2010) 695 final, issued in December 2010. As part of its actions the Commission is reviewing areas where reduced rates of VAT or exemptions to VAT apply, including in the public or social sector.

The umbrella associations of the German social insurance institutions welcome in principle the objective of simplifying existing VAT legislation and the procedures for its administration. VAT exemptions and reduced rates currently apply however in the interests of those insured by and contributing to the state social insurance systems. The planned reform should not lead to the abolition of the special rates paid by these individuals or of the special status enjoyed by the public bodies responsible for these systems.

The blanket inclusion of public bodies to liability for VAT would lead to a substantially higher financial burden for both the insured individuals and the social security systems in general. This would be the case in particular if the VAT exemption and reduced VAT rates were abolished for benefits which the statutory social insurance bodies purchase from public and private service providers (for example from doctors, clinics and assessors) in fulfillment of their statutory functions, or which they pay for or provide themselves in the form of benefits in kind. For Germany, the social insurance bodies estimate this additional expenditure at €34 billion for 2014, corresponding to an increase in the total social insurance contribution rate of over three percentages points.

The additional expense would have to be met by an increase in contributions and/or by higher subsidies from the German government in certain areas. It cannot be ruled out that benefits would have to be cut in order to fund the changes. The resulting consequences for the economy run contrary to the EU's objective of enhancing its competitiveness within a globalised world.

Abolition of tax-exempt status and reduced tax rates would substantially constrain the freedom of the Member States to structure their social security systems, and thus constitutes interference in an area that is their remit under the Community Treaties.

The umbrella organizations of the German social insurance institutions therefore call for the tax relief granted within the sphere of the social insurance systems to be retained.

Impacts – social insurance overall

The scenario presented below refers to the abolition of VAT exemptions and reduced rates of VAT only for benefits financed by the German statutory social insurance institutions in fulfillment of their statutory functions. Following an analysis carried out by the umbrella associations of the German social insurance institutions, the anticipated financial impacts of this abolition are set out below.

Should exemption from VAT and reduced VAT rates for benefits be abolished, additional costs of over €34 billion could be expected for the year **2014** for the statutory health, long-term care, retirement, accident and unemployment insurances together. To cover this, the **total social insurance contribution rate** would need to rise by **over 3 percentage points**. (*The effects on the separate branches of the social insurance system are described in more detail below*.)

With regard to the statutory social insurance overall, the following additional points need to be considered:

- The additional expenditure would not be associated with any form of improvement in the benefits delivered to the insured individuals.
- In certain situations, the German federal, regional and local governments would pay the VAT to themselves: for example, where benefits delivered by the statutory accident insurance institutions are financed from the public purse.
- The additional costs within the statutory insurance scheme would have to be compensated for by increases in the contribution rate and/or perhaps by increased subsidies paid by the German government.
- The increases in contributions in certain branches of the social insurance system e.g. health insurance, will have additional impact on other branches. This would be the case where the statutory retirement insurance scheme pays a part of its retired members' health insurance premiums.
- The substantial increase in the overall social insurance contribution rate could have a considerable impact upon the competitiveness of the German economy (rising ancillary wage costs, falling purchasing power).
- The increase in ancillary wage costs could bring additional financial pressure, on for example the health economy, by way of increased remuneration for doctors, hospitals, and other service providers.

Health and long-term care insurance

For the **statutory health insurance**, the estimated additional cost is put at **€26.56 billion in the year 2014**. In the absence of any other intervention, this would require an **increase in the contribution rate of 2.35 percentage points**. The cost was estimated based upon summarised data for 2011. For the purpose of this estimate, the individual benefits were assigned to the following categories under the current VAT legislation:

- Categories of benefits not subject to VAT
- Categories of benefits subject to the reduced VAT rate
- Categories of benefits already subject to the normal VAT rate

The summarised data did not allow however all benefits delivered by the statutory health insurance to be assigned precisely to the individual categories defined; this would require a more detailed study. The estimate therefore constitutes a scenario which assumes that all benefits that are currently VAT-free would in future be subject to full VAT, and all benefits currently subject to the reduced rate of VAT would in future be subject to the standard VAT rate. The greatest additional cost is observed in the areas of treatment by doctors and treatment within hospitals, which in 2011 accounted for 56.6% of the total expenditure for benefits. At present, all treatment by doctors and treatment in hospitals is VAT-exempt. Abolition of VAT-free status in 2014 for these two categories of benefits would result in the statutory health insurance institutions facing additional costs of approximately €19.92 billion.

Within the **statutory long-term care insurance** system, **potential additional costs of approximately €3 billion may be assumed for 2014**, which corresponds to an increase of **approximately 0.27 percentage points** in the contribution rate. The items exempt from VAT cannot be clearly classified in all cases. Nevertheless, it may be assumed that the additional expenditure is in the order of magnitude stated.

These figure are calculated on the same basis as that used for health insurance. On the benefits side, a steeper rise in expenditure for benefits (approximately 4.5% p.a. on average) may be assumed, based upon the data from previous years and the topical issue of further development of long-term care provisions.

Retirement pension insurance

The **German retirement insurance scheme** is responsible for part of the health insurance contributions of the retired persons it insures. An increase in the contribution rate as calculated above of 2.35 percentage points for the statutory health insurance as a result of taxation of benefits in the out-patient and in-patient care sector corresponds approximately to an additional €2.35 billion which would have to be paid by the retirement insurance scheme for the contributions concerned.

Within its rehabilitation function, the German retirement insurance scheme pays around €5.6 billion for rehabilitation benefits for its insured persons. Abolition of VAT exemption/reduced VAT rates, where relevant, would impact upon benefits accounting for approximately €3 billion per annum. For these benefits, the retirement insurance scheme would have to pay an additional €0.57 billion.

According to preliminary estimates, the retirement insurance scheme would thus face **additional expenditure of around €3 billion for health insurance contributions and rehabilitation benefits alone**. This additional expenditure would have to be compensated for by an **increase of 0.31 percentage points** in the contribution rate for the statutory retirement insurance premium.

Accident insurance

Within trade and industry, the agricultural sector and the public sector, the **German social accident insurance** delivers comprehensive benefits in kind and services, in addition to cash payments, following occupational accidents and diseases. These benefits include curative treatment, medical rehabilitation and care, and benefits for participation in working life and life in the community. Over €3 billion was spent in 2011 for these benefits in kind and services.

To date, these benefits have not been subject to VAT. Had they been subject to VAT, this would have given rise to additional costs of around €0.58 billion in 2011. Based on average cost increases over the last five years, an estimated **€0.67 billion** would have to be paid in VAT.

These additional costs would be keenly felt by those paying the contributions, i.e. businesses in trade and industry and the agricultural sector and the German federal, regional and local administrations. In trade and industry alone, the average contribution rate in 2011 would have been 1.4% instead of 1.3%. The total contributions paid to the statutory accident insurance would have been 4% higher in trade and industry, 7% higher in the agricultural sector, and 9% higher in the public sector. To some extent, this VAT would be paid out of the public purse.

Certain cash benefits would give rise to additional cost increases. A VAT reform of this kind would result in increases in contributions in all branches of the social security system. The German Social Accident Insurance pays injury benefit and temporary allowances where appropriate, to which these social insurance premiums are added.

Unemployment insurance

Within the budget of the **German Federal Agency for Employment**, the costs of benefits under labour market policy would be particularly affected by abolition of the special VAT regimes. Under Section 4 of the German VAT Law, the bodies responsible for such measures are currently generally fully exempt from VAT. Abolishing the reduced VAT rate and VAT exemption would have an indirect impact upon the Agency's budget. Assuming that the bodies delivering benefits would be subject to VAT at 19% and that they would pass on the VAT in full to the Agency, the latter would face additional expenditure of around €725 million per annum.

In addition, the Agency would be impacted by the increased expenditures faced by other branches of social security and resulting in increased contribution rates for health insurance, long-term care insurance and retirement insurance equivalent to 2.93 percentage points in total. The Agency would therefore have to fund expenditure of around **€450 million** per annum from its budget for the social security contributions levied upon **unemployment benefits**.

Further, the increased contribution rates for the statutory social insurance would result in increased expenditure for the employer's component of the social insurance contributions for the Agency's own employees, and for supplementary benefits. Expenditure of around a further **€46 million** would have to be found in the **budget**.

Altogether, the resulting **additional expenditure** for the Agency would be in the order of **€1,221 million** per annum (equating to **around 0.14 percentage points on the contribution rate)**. In the face of these impending additional costs, the German Federal

Agency for Employment demands retention of the reduced VAT rate and of VAT exemption in line with the current status quo**.**