The Fiscal Council's opinion on title II, art. II, of the draft Emergency Ordinance amending and supplementing certain legislative acts (extending the application scope of the reduced VAT rate of 9% for retransmission services of television programs through electronic communications networks)

On the 9th of June 2015, the Ministry of Public Finance (MPF) remitted to the Fiscal Council (FC), the letter no. 40973 from the 8th of June 2015, requesting the Fiscal Council's endorsement on title II, art. II, of the draft Emergency Ordinance amending and supplementing certain legislative acts (extending the application scope of the reduced VAT rate of 9% for retransmission services of television programs through electronic communications networks) under art. 21 of the Fiscal Responsibility Law no. 69/2010 (FRL) republished.

According to the aforementioned article of the FRL*, "proposals for any legislation leading to a reduction of budgetary revenues must provide a financial statement according to article 15 of Law no. 500/2002, as amended and supplemented and meet at least one of the following conditions:*

a) to have the endorsement of the Ministry of Public Finance and of the Fiscal Council, confirming that the financial impact was taken into account in the budgetary revenue forecast and does not affect the annual budget targets and medium term targets;

b) to be accompanied by proposals for measures to compensate the financial impact, by increasing other budgetary revenues."

The case in question is covered by paragraph a) of the FRL article cited above, given the fact that there have not been announced/taken any relevant compensation measures to offset the negative impact on revenues.

Brief description of the legislative proposal and its budgetary impact. General considerations

The article of law on which the endorsement of the Fiscal Council is requested regards the amendment of the Fiscal Code to extend the application scope of the reduced VAT rate of 9% for „retransmission services of television programs through electronic communications networks". The provisions of the draft legislation would come into force starting July 1, 2015.

From the perspective of the first-round budgetary impact, the explanatory note attached to the draft project assesses a budgetary income loss of 167.6 million lei in 2015 (corresponding to a period of 5 months of execution in cash standards), 402.2 million lei in 2016, 420.4 million lei in 2017 and 473.6 million lei in 2018. The document presents as sources of compensation for the tax cuts impact on VAT revenues in 2015, the supplementary revenues collected by the

National Agency for Fiscal Administration (NAFA) relative to the intra-annual budget programming, assessed in the explanatory memorandum to 3.9 billion lei at the end of May. Regarding the medium-term impact, the document states that "at the elaboration of the annual budget laws the measure will be taken into account at the substantiation of revenues and expenditures, in order that the deficit targets assumed trough the Stability and Growth Pact will be respected".

The Fiscal Council has no objections/reservations about the first-round budgetary impact estimated by the MPF that it considers as a conservative estimate. If reliable data regarding the number of cable TV users are available (6.9 million, 92% penetration degree at the households level), being reported by ANCOM (the National Authority for Management and Regulation in Communications), there is uncertainty regarding the characteristics/price of the relevant service package from the average consumer perspective. The implicit average price of this representative service package related to the estimation of revenue losses from the Explanatory Note of the normative act is about 40 lei/month (including VAT of 24%), while the offers for the basic package of the main operators of cable television services are about 30 lei monthly – therefore, the estimation has also a substantial safety margin in terms of a representative service package including more options compared to the basic package.

The Explanatory Note provides as an argument for the proposed measure the fact that ”the application of the reduced VAT on these services will generate significant positive effects on the business environment by improving the cash-flows, thus reducing a number of difficulties faced by the economic agents in this perspective”. In the Fiscal Council's opinion, the argument validity appears to be ambiguous, considering that reducing a consumption tax in a branch in which practically there is no VAT evasion can generate additional cash-flows only to the extent that it is not transferred in the final price to the consumer while the potential of further expansion from a 92% penetration degree at the household levels appears insignificant. Obviously, the arguments that occur in the case of food products, where there is a significant percentage of economic agents that operate on the black market and a VAT reduction has the potential to improve the competitive position of the honest taxpayers, cannot be sustained in the case of the cable television services sector.

The financial sources for covering the revenue losses

The Explanatory Note of the normative act indicates as sources of coverage for the budgetary impact in the current year the additional revenues collected by NAFA compared to the budgetary programming in the first 5 months of 2015, evaluated at 3.9 billion lei and states that revenue and expenditure projections in the medium term will be elaborated such as the budgetary targets assumed under international treaties and FRL to be respected. However, it should be noted that these additional revenues have been already indicated as a source of compensation for the extension of the reduced VAT rate for food products starting with June

2015 (2.44 billion lei in 2015, respectively 5.2 billion lei from 2016) and in the meantime the measure regarding doubling the children allowance was also adopted (with an impact of 900 million lei in 2015, respectively 1.8 billion lei in 2016). Therefore, the discussion on the present measure cannot disregard the impact of the above measures already adopted.

The Fiscal Council admits that the dimension of the tax measure's impact is rather small for the current year - preserving the surplus revenue realized now, due both to an improvement in the collection, as well as to an economic growth much higher than initially forecasted, should not create problems in terms of achieving the deficit target for 2015, taking into account the other discretionary measures adopted, given their application only from the second half of the year. But the assessments get complicated when it comes to achieving the medium-term targets for several reasons:

1. In the year 2016, the impact of extending the reduced VAT rate on food is more than 5 billion lei, reflecting a full year application;
2. In the year 2016, the impact of doubling children benefits is 1.8 billion lei, also corresponding to a full year of application;
3. To the extent that the economic growth for the current year will be higher than expected, and this will be reflected, as it is natural, only in a small proportion in the potential GDP growth, this would entail an upward revision of the size of the cyclical component of the deficit, which would imply a headline deficit target for 2016 below the levels currently envisaged (1.2% of GDP in ESA 2010 standard under the Convergence Programme 2015-2018), in order to be consistent with respecting the MTO defined as structural deficit of 1% of GDP.

About a month ago, the Fiscal Council has endorsed with reservations the extension of the reduced VAT tax rate for food products, invocating the uncertainties about the size, persistence and the origins of additional budget revenues cited as an element of compensation for the budgetary impact of that measure. Even if the Fiscal Council would suspend these reserves (despite the fact that it believes that the reasons given in its previous opinion remain relevant) it cannot give a favorable opinion on the proposed measure extending the reduced VAT rate to services of television retransmission using electronic communications networks without a complete budgetary projection that would identify the concrete ways envisaged in order to ensure the compliance with the medium-term budgetary targets, especially since, in the meantime, the measure of doubling the children benefits must be also accommodated. According to the Fiscal Council, the discretionary measures already adopted, mentioned above, exhausted the additional fiscal space created on the medium-term under the assumption of maintaining the collection efficiency gains achieved so far (assuming that the budget expenditure are also maintained at the level approved in the medium-term budgetary framework).

Conclusions

Given the above mentioned arguments, and the previous opinions of the FC cited above, the Fiscal Council cannot endorse title II, article II of the draft Emergency Ordinance amending and supplementing certain acts (extending the scope of the reduced VAT rate of 9% for television retransmission services through electronic communications networks).

The above opinions and recommendations of the Fiscal Council were approved by the Chairman of the Fiscal Council, according to Article 56, paragraph (2), letter d) of Law no. 69/2010 republished, based on the vote of the Fiscal Council members in the meeting on June 12th, 2015.

June 12th, 2015.

Chairman of the Fiscal Council

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