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2019/0239 (NLE)

Proposal for a

**COUNCIL IMPLEMENTING DECISION**

**amending Decision 2007/884/EC authorising the United Kingdom to continue to apply a measure derogating from Articles 26(1)(a), 168 and 169 of Directive 2006/112/EC on the common system of value added tax**

## EXPLANATORY MEMORANDUM

Pursuant to Article 395(1) of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive'<sup>1</sup>), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from the provisions of that Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance.

By letter registered with the Commission on 2 April 2019, the United Kingdom requested the authorisation to continue to apply a measure derogating from the overall principles governing the right of deduction of input VAT in relation to cars hired or leased where the car is not used entirely for business purposes. Together with the request for extension, the United Kingdom submitted a report including a review of the percentage restriction applied on the right to deduct VAT on the hire or lease of cars not entirely used for business purposes.

In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letters dated 29 April 2019 of the request made by the United Kingdom. By letter dated 2 May 2019, the Commission notified the United Kingdom that it had all the information necessary to consider the request.

### **1. CONTEXT OF THE PROPOSAL**

#### **• Reasons for and objectives of the proposal**

Articles 168 and 169 of the VAT Directive provide that a taxable person is entitled to deduct the VAT charged on purchases made for the purposes of his taxed transactions. At the same time, Article 26(1)(a) of the VAT Directive stipulates that the use of goods, forming part of the assets of a business, for private purposes is to be considered as a supply of services for consideration if the VAT on these goods was wholly or partly deductible. As a result, the system ensures that final consumption is taxed when the corresponding input VAT was initially deducted.

In relation to motor vehicles, it is sometimes difficult and burdensome for the taxable persons to identify and register the split between business and private use and for the tax administration to verify the effective division of use. This would be the case even if the United Kingdom would make use of the option provided for in Article 168a(2) of the VAT Directive to limit the deduction on expenditure related to company cars to the proportion of the taxable person's effective business use. In addition, because of the number of mixed use vehicles, tax evasion could become considerable.

In order to simplify VAT collection and to combat tax evasion, the United Kingdom has been authorised since 1995<sup>2</sup> and for the last time in 2016<sup>3</sup> to restrict, until 31 December 2019, to 50% the right of the hirer or lessee to deduct input tax on charges for hire or lease of a car

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<sup>1</sup> OJ L 347, 11.12.2006, p. 1.

<sup>2</sup> Council Decision 95/252/EC of 29 June 1995 authorizing the United Kingdom to apply a measure derogating from Articles 6 and 17 of the Sixth Council Directive (77/388/EEC) on the harmonization of the laws of the Member States relating to turnover taxes (OJ L 159, 11.7.1995, p. 19)

<sup>3</sup> Council Decision 2007/884/EC of 20 December 2007 authorising the United Kingdom to continue to apply a measure derogating from Articles 26(1)(a), 168 and 169 of Directive 2006/112/EC on the common system of value added tax (OJ L 346, 29.12.2007, p. 21) was extended by Council Implementing Decision 2011/37/EU of 18 January 2011 (OJ L 19, 22.1.2011, p. 11) up to 31 December 2013, by Council Implementing Decision 2013/681/EU of 15 November 2013 up to 31 December 2016 (OJ L 316, 27.11.2013, p. 41) and by Council Implementing Decision (EU) 2016/2265 of 6 December 2016 (OJ L 342, 16.12.2016, p. 28) up to 31 December 2019.

where the car is not used entirely for business purposes. In order to avoid double taxation the United Kingdom is also authorised not to treat the private use of a business car hired or leased by a taxable person as a supply of services for consideration.

This derogation removes the need for the hirer or the lessee to keep detailed private mileage records for each of these cars and to account for the VAT on the private use. The option provided for in Article 168a(2) of the VAT Directive does not foresee partial deduction at a flat rate and could be applicable only for input VAT on cars forming part of the business assets of the taxable person; therefore, a derogation is an appropriate measure to achieve the requested simplification.

In accordance with Article 3(2) of Council Decision 2007/884/EC<sup>4</sup>, as amended, the United Kingdom has presented a report covering the application of the Decision, which includes a review of the percentage restriction applied on the right to deduct VAT on the hire or lease of cars not entirely used for business purposes.

Derogations are normally granted for a limited time as to allow an assessment whether the special measure is appropriate and effective. The report provided by the United Kingdom suggests that the 50% apportionment between business and private use (or any other non-business use within the meaning of Article 26(1)(a) of Directive 2006/112/EC) currently still reflects the overall business and private use of leased and hired cars by taxable persons in the United Kingdom. An extension of the derogating measure is therefore appropriate.

The United Kingdom has requested to be authorised to continue the application of the derogation until the end of the implementation period foreseen in the withdrawal agreement. In this regard, on 29 March 2017 the United Kingdom submitted the notification of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on the European Union (TEU). In accordance with Article 50(3) TEU, the Treaties are to cease to apply to the withdrawing State from the date of entry into force of a withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. The period has been extended three times, last time by European Council Decision (EU) 2019/1810<sup>5</sup>, which extended it until 31 January 2020.

On 11 January 2019, by Decision (EU) 2019/274<sup>6</sup>, the Council authorised the signature of the withdrawal agreement agreed at negotiators' level on 14 November 2018. The Union confirmed that it stands ready to proceed swiftly with its signature and conclusion in the event that the United Kingdom Parliament approves the withdrawal agreement. Part Four of the withdrawal agreement<sup>7</sup> provides for a transition period starting on the date of entry into force of the agreement, during which Union law is to continue to apply to and in the United Kingdom as laid down therein.

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<sup>4</sup> Council Decision 2007/884/EC of 20 December 2007 authorising the United Kingdom to continue to apply a measure derogating from Articles 26(1)(a), 168 and 169 of Directive 2006/112/EC on the common system of value added tax (OJ L 346, 29.12.2007, p. 21).

<sup>5</sup> European Council Decision (EU) 2019/1810 taken in agreement with the United Kingdom of 29 October 2019 extending the period under Article 50 (3) of the Treaty on the European Union (OJ L 278I, 30.10.2019, p. 1).

<sup>6</sup> Council Decision (EU) 2019/274 of 11 January 2019 on the signing, on behalf of the European Union and of the European Atomic Energy Community, of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ L 47 I, 19.2.2019, p.1).

<sup>7</sup> Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ C 144 I, 25.4.2019, p. 1).

In any event, this Decision applies only as long as Union law applies to and in the United Kingdom.

Therefore, given the uncertainty related to the date of entry into force of the withdrawal agreement, it is considered that the most appropriate way forward is to include a sunset clause, set at 31 December 2022. The United Kingdom is requested to present a new report no later than 1 April 2022, if a new extension request would be envisaged beyond 31 December 2022.

Nevertheless, in case of withdrawal of the United Kingdom from the European Union without agreement or in case of the ratification of the withdrawal agreement, the derogation should cease to apply on whichever date happens first: either 31 December 2022, or the date of withdrawal from the Union without an agreement, or the date of the end of the transition period foreseen in the withdrawal agreement in case of the ratification of the withdrawal agreement.

- **Consistency with existing policy provisions in the policy area**

Similar derogations in relation to the right of deduction have been granted to other Member States.

Article 176 of the VAT Directive stipulates that the Council shall determine the expenditure on which the VAT is not deductible. Until such time, it authorises Member States to maintain exclusions which were in place on 1 January 1979. There are therefore a number of “stand still” provisions restricting the right to deduct VAT in relation to passenger cars.

Notwithstanding previous initiatives to establish rules on which categories of expenditure may be subject to a restriction on the right to deduct<sup>8</sup>, such derogation is appropriate in the awaiting of a harmonisation of these rules at EU level.

## **2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY**

- **Legal basis**

Article 395 of the VAT Directive.

- **Subsidiarity (for non-exclusive competence)**

Considering the provision of the VAT Directive on which the proposal is based, the subsidiarity principle does not apply.

- **Proportionality**

The Decision concerns an authorisation granted to a Member State upon its own request and does not constitute any obligation.

Given the limited scope of the derogation, the special measure is proportionate to the aim pursued, i.e. to prevent certain forms of tax evasion or avoidance and to simplify the VAT collection in a specific sector.

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<sup>8</sup> COM (2004) 728 final - Proposal for a Council Directive amending Directive 77/388/EEC with a view to simplifying value added tax obligations (OJ C 24, 29.1.2005, p.10) withdrawn on 21 May 2014 (OJ C 153, 21. 05. 2014, p. 3).

- **Choice of the instrument**

Under Article 395 of the VAT Directive, derogation from the common VAT rules is only possible with the authorisation of the Council acting unanimously on a proposal from the Commission. Moreover, a Council Decision is the most suitable instrument since it can be addressed to individual Member States.

### **3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS**

- **Stakeholder consultations**

No stakeholder consultation has been conducted. This proposal is based on a request made by the United Kingdom and concerns only this Member State.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The Decision aims at extending in time a simplification measure which is designed to counter VAT evasion and to simplify the procedure for charging tax. The 50% input tax restriction is a proxy for the actual amount of tax due on the use of relevant cars for private motoring. It removes the need for the hirer/lessee to keep records of the private mileage travelled in business cars and to account for tax on the actual private use of each car.

Moreover, because of the narrow scope and the limited application in time, the impact will in any case be limited.

### **4. BUDGETARY IMPLICATIONS**

The proposal will have no negative implication for the EU budget.

### **5. OTHER ELEMENTS**

The proposal includes a sunset clause; an automatic time limit which is set at 31 December 2022. If the United Kingdom withdraws from the European Union before that date without an agreement, this Decision will cease to apply automatically on the date of withdrawal, as an effect of the application of Article 50 TEU. If the withdrawal agreement enters into force, the Decision will cease to apply on the date of the end of the transition period foreseen in that agreement, in case it is set at a date prior to 31 December 2022.

In case the United Kingdom would consider another extension of the derogating measure beyond 2022, a new evaluation report should be submitted to the Commission together with the extension request no later than 1 April 2022.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax<sup>1</sup>, and in particular the first subparagraph of Article 395(1) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Articles 168 and 169 of Directive 2006/112/EC establish a right for taxable persons to deduct value added tax (VAT) charged on supplies to them of goods and services that are used for the purposes of their taxed transactions or for certain other purposes. Article 26(1)(a) of that Directive treats the use of business assets for the private use of taxable persons or their staff or, more generally, for purposes other than those of their business as a supply of services for consideration.
- (2) Council Decision 2007/884/EC<sup>2</sup> authorises the United Kingdom to restrict to 50% the right of the hirer or lessee of a car to deduct VAT under Article 168 or 169 of Directive 2006/112/EC on the cost of hiring or leasing of a car where the car is not used entirely for business purposes. It also authorises the United Kingdom not to treat as supplies of services for consideration the private use of a business car hired or leased by a taxable person. Those simplification measures remove the need for the hirer or lessee of a business car to keep records of private mileage travelled in that car or to account for VAT on the actual private mileage travelled in that car. Decision 2007/884/EC is due to expire on 31 December 2019.
- (3) By letter registered with the Commission on 2 April 2019, the United Kingdom requested authorisation to continue to apply the derogating measures authorised by Decision 2007/884/EC (“the derogating measures”).
- (4) By letter dated 29 April 2019, the Commission informed the other Member States pursuant to Article 395(2) of Directive 2006/112/EC of the request that had been made by the United Kingdom. By letter dated 2 May 2019, the Commission notified the United Kingdom that it had all the information necessary to consider the request.
- (5) On 29 March 2017, the United Kingdom submitted the notification of its intention to withdraw from the Union pursuant to Article 50 of the Treaty on the European Union

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<sup>1</sup> OJ L 347, 11.12.2006, p. 1.

<sup>2</sup> Council Decision 2007/884/EC of 20 December 2007 authorising the United Kingdom to continue to apply a measure derogating from Articles 26(1)(a), 168 and 169 of Directive 2006/112/EC on the common system of value added tax (OJ L 346, 29.12.2007, p. 21).

(TEU). In accordance with Article 50(3) TEU, the Treaties are to cease to apply to the withdrawing State from the date of entry into force of a withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. The period has been extended three times, last time by European Council Decision (EU) 2019/1810<sup>3</sup>, which extended it until 31 January 2020.

- (6) On 11 January 2019, by Decision (EU) 2019/274<sup>4</sup>, the Council authorised the signature of the withdrawal agreement agreed at negotiators' level on 14 November 2018. The Union confirmed that it stands ready to proceed swiftly with its signature and conclusion in the event that the United Kingdom Parliament approves the withdrawal agreement. Part Four of the withdrawal agreement<sup>5</sup> provides for a transition period starting on the date of entry into force of the agreement, during which Union law is to continue to apply to and in the United Kingdom as laid down therein.
- (7) In any event, this Decision applies only as long as Union law applies to and in the United Kingdom.
- (8) Alongside its request, the United Kingdom submitted a report to the Commission in accordance with Article 3(2) of Decision 2007/884/EC including a review of the percentage restriction applied on the right to deduct VAT. The information provided by the United Kingdom shows that a percentage restriction of 50% still remains a fair reflection of actual circumstances on the ground as regards the ratio of business to non-business use of the vehicles affected by the derogating measures. Extension of the derogating measures should, however, be limited to the time needed to evaluate the effectiveness of the derogating measures and the appropriateness of the percentage. The United Kingdom should therefore be authorised to continue to apply the derogating measures for a further limited period to 31 December 2022.
- (9) A deadline should be set for requesting authorisation for any further extension of the derogating measures beyond 2022. The United Kingdom should also be required to submit a report alongside any such extension request, including a review of the percentage restriction applied on the right to deduct VAT.
- (10) The derogating measures will have no adverse impact on the Union's own resources accruing from VAT,

HAS ADOPTED THIS DECISION:

#### *Article 1*

Article 3 of Decision 2007/884/EC is replaced by the following:

#### *'Article 3*

This Decision shall expire on 31 December 2022.

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<sup>3</sup> European Council Decision (EU) 2019/1810 taken in agreement with the United Kingdom of 29 October 2019 extending the period under Article 50(3) TEU (OJ L 278I, 30.10.2019, p.1).

<sup>4</sup> Council Decision (EU) 2019/274 of 11 January 2019 on the signing, on behalf of the European Union and of the European Atomic Energy Community, of the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ L 47 I, 19.2.2019, p. 1).

<sup>5</sup> Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (OJ C 144 I, 25.4.2019, p. 1).

Any request for authorisation to extend the derogating measures authorised by this Decision shall be submitted to the Commission by 1 April 2022. The request shall be accompanied by a report which includes a review of the percentage restriction applied on the right to deduct VAT on the cost of hiring or leasing cars not used entirely for business purposes.’.

*Article 2*

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels,

*For the Council  
The President*