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2018/0375 (NLE)

Proposal for a

COUNCIL IMPLEMENTING DECISION

authorising Croatia to introduce a special measure derogating from point (a) of Article 26(1) and Article 168 of Council 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 tax¹ ('the VAT Directive'), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogating 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 22 December 2016, Croatia requested to derogate from Articles 26(1)(a) and 168 of the VAT Directive and to restrict the right of deduction of VAT regarding the purchase and lease of aircrafts, vessels and personal cars including the purchase of accessories for such goods as well as services supplied in relation thereto. After a number of discussions with the Commission Croatia modified its request and a new request was submitted and registered with the Commission on 17 September 2018. In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 21 September 2018 of the request made by Croatia. By letter dated 24 September 2018, the Commission notified Croatia that it had all the information it considered necessary for the appraisal of the request.

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

Article 168 of the VAT Directive provides that a taxable person is entitled to deduct VAT charged on purchases made for the purpose of taxed transactions. Article 26(1)(a) of the same Directive requires the use of goods forming part of the assets of a business for private purposes to be a supply of services for consideration if the VAT on the goods was eligible for deduction. This system allows for the recovery of initially deducted VAT in relation to the private use.

Currently taxable persons in Croatia cannot deduct input VAT relating to personal cars unless the personal cars are used for drivers training, vehicles testing, repair service, economic activity of transporting passengers and goods, transport of deceased, rent and purchase for the purpose of resale. Taxpayers in Croatia continuously require the abolishment of this restriction on the right of VAT deduction on the purchase and lease of personal cars and on the expenses related thereto. Croatia intends to modify its legislation and allow the deduction of input VAT relating to passenger cars not wholly used for business purposes.

At the same time Croatia submits that it is complicated to determine the extent to which cars are used for private and for professional purposes. Croatia therefore considers that it would be appropriate to apply the fixed percentage for the VAT deduction. According to Croatia the application of the fixed percentage limit for the VAT deduction will not result in additional administrative burden and costs neither for businesses nor for tax authorities while the VAT deduction will be possible. The introduction of the VAT deduction will reduce the interest of taxpayers to procure goods and services related to passenger cars from persons performing a non-registered activity.

Croatia therefore requests, based on Article 395 of the VAT Directive, to introduce a measure derogating from Articles 26(1)(a) and 168 of the VAT Directive limiting the right of deduction on passenger cars to a set percentage.

¹ OJ L 347, 11.12.2006, p. 1.

Croatia conducted an analysis of the use of cars for business purposes which revealed that the business use should be estimated at approximately 40-60%. That is why Croatia submits that the 50% is the appropriate percentage limit.

The restriction to the right of deduction should apply to the VAT paid on the purchase and lease of personal cars including the purchase of all goods as well as services supplied in relation thereto. Passenger cars covered are considered to be motor vehicles intended for transport of persons with a maximum of eight seats in addition to the driver's seat.

The personal cars used for drivers training, vehicles testing, repair service, economic activity of transporting passengers and goods, transport of deceased, rent and purchase for the purpose of resale are not covered by the percentage limit.

The derogation should apply from 1 January 2019 and should be limited in time to 31 December 2021, so that it can be assessed whether the 50% restriction is a correct reflection of the overall apportionment between business and private use. Any extension request should be accompanied by a report which includes a review of the percentage applied and should be sent to the Commission with that request by 31 March 2021.

- **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 deduct², 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 simplify tax collection and to prevent certain forms of tax evasion or avoidance. In particular, taxpayers will be able to deduct 50% of VAT on passenger cars that they use for private and business purposes whereby they would not be additionally burdened by keeping records. The tax authorities would have a simplified VAT collection procedure.

² 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**

Proposed instrument: Council Implementing Decision.

Under Article 395 of Council Directive 2006/112/EC, derogation from the common VAT rules is only possible upon authorisation of the Council acting unanimously on a proposal from the Commission. A Council Implementing Decision is the most suitable instrument since it can be addressed to an individual Member State.

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

- **Stakeholder consultations**

This proposal is based on a request made by Croatia and concerns only this Member State.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The proposal responds to the request made by Croatia who would like to amend its legislation and allow for VAT deduction on the business use of passenger cars. Since it is complicated to determine the extent to which cars are used for private and for professional purposes, Croatia requested to apply the fixed percentage limit of 50%. The special measure is designed to simplify the procedure for charging tax and to counter VAT evasion and has, therefore, a potential positive impact for both businesses and administrations.

Croatia will allow the deduction of VAT which was not deductible until now. The measure will therefore have an impact on the Croatian state budget. The VAT revenues will be reduced by approximately 400 million per year based on data from 2015, i.e. 0.9% of total VAT revenue³.

4. BUDGETARY IMPLICATIONS

The proposal will have no negative impact on the Union's own resources accruing from VAT.

5. OTHER ELEMENTS

The proposal includes a sunset clause; an automatic time limit which is set at 31 December 2021.

In case Croatia would consider another extension of the derogating measure beyond 2021, a report including a review of the percentage limit should be submitted to the Commission together with the extension request no later than 31 March 2021.

³ Study and Reports on the VAT Gap in the EU-28 Member States: 2018 Final Report; Table 3.11., p.32.

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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 tax¹, and in particular Article 395(1) thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Article 168 of Directive 2006/112/EC establishes a taxable person's right to deduct value added tax (VAT) charged on supplies of goods and services received by that person for the use of that person's taxed transactions. Point (a) of Article 26(1) of that Directive contains a requirement to account for VAT when a business asset is put to use for private purposes of the taxable person or his staff or, more generally, for purposes other than those of his business.
- (2) By letter registered with the Commission on 22 December 2016, Croatia requested authorisation to derogate from the provisions of Directive 2006/112/EC governing the right to deduct input tax in relation to the purchase and leasing of aircrafts, vessels and personal cars including the purchase of accessories for such goods as well as services supplied in relation thereto. After a number of discussions with the Commission Croatia submitted a modified request limited to passenger cars which was registered with the Commission on 17 September 2018.
- (3) The Commission transmitted the request of Croatia to other Member States by letter dated 21 September 2018. By letter dated 24 September 2018, the Commission notified Croatia that it had all the information it considered necessary for the appraisal of the request.
- (4) Taxable persons in Croatia cannot deduct VAT related to passenger cars used partially for business purposes. Croatia intends to modify its legislation and allow the deduction of input VAT relating to passenger cars.
- (5) Croatia claims that the extent to which cars are used for private and for professional purposes is often difficult to identify accurately and even where it is possible, this is often burdensome. Croatia therefore considers that it would be appropriate to apply the fixed percentage for the VAT deduction. Based on estimations Croatia submits that the 50% limit is appropriate.

¹ OJ L 347, 11.12.2006 , p. 1.

- (6) According to Croatia the application of the fixed percentage limit for the VAT deduction will not result in additional administrative burden and costs neither for businesses nor for tax authorities while the VAT deduction will be possible. The introduction of the VAT deduction will reduce the interest of taxpayers to procure goods and services related to passenger cars from persons performing a non-registered activity.
- (7) Croatia therefore requested, based on Article 395 of the VAT Directive, to introduce a special measure derogating from point (a) of Article 26(1) and Article 168 of Directive 2006/112/EC limiting the right of deduction on passenger cars to a set percentage.
- (8) The restriction to the right of deduction should apply to VAT paid on the purchase and lease of personal cars including the purchase of all goods and services supplied in relation thereto. Passenger cars covered are considered to be motor vehicles intended for transport of persons with a maximum of eight seats in addition to the driver's seat.
- (9) The special measure is designed to simplify the procedure for charging tax and to counter VAT evasion while allowing the VAT deduction on passenger cars used partially for business purposes. Given a potential positive impact for both businesses and administrations, it is appropriate to grant the special measure.
- (10) The special measure should apply from 1 January 2019 and should be limited in time to 31 December 2021, so that it can be assessed whether the 50% restriction is a correct reflection of the overall apportionment between business and private use.
- (11) In the event that Croatia considers an extension of the authorisation beyond 2021 to be necessary, it should submit a request for an extension to the Commission by 31 March 2021 accompanied by a report which should include a review of the percentage applied.
- (12) The special measure will only have a negligible effect on the overall amount of tax revenue collected at the stage of final consumption and will have no adverse impact on the Union's own resources accruing from VAT,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Article 168 of Directive 2006/112/EC, Croatia is authorised to limit to 50% the right to deduct the value added tax (VAT) on expenditure related to passenger cars not wholly used for business purposes.

Article 2

By way of derogation from point (a) of Article 26(1) of Directive 2006/112/EC, Croatia shall not treat as supplies of services for consideration the use for non-business purposes of a passenger car included in the assets of a taxable person's business, where that car has been subject to a limitation authorised under Article 1 of this Decision.

Article 3

The expenditure referred to in Article 1 shall cover the purchase and leasing of passenger cars including the purchase of all goods and services supplied in relation thereto.

Article 4

The Decision should only apply to motor vehicles intended for transport of persons with a maximum of eight seats in addition to the driver's seat.

Article 5

Articles 1 and 2 shall not apply to:

- (a) vehicles used for drivers training, vehicles testing, repair service, economic activity of transporting passengers and goods, transport of deceased, rent;
- (b) vehicles purchased for the purpose of resale.

Article 6

This Decision shall apply from 1 January 2019 until 31 December 2021.

Any request for the extension of the authorisation provided for in this Decision shall be submitted to the Commission by 31 March 2021 and shall be accompanied by a report which includes a review of the percentage set out in Article 1.

Article 7

This Decision is addressed to the Republic of Croatia.

Done at Brussels,

*For the Council
The President*