



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.5.2007
COM(2007) 238 final

Proposal for a

COUNCIL DECISION

**authorising the Italian Republic to apply measures derogating from Articles 26(1)(a)
and 168 of Directive 2006/112/EC on the common system of value added tax**

(Only the Italian version is authentic)

(presented by the Commission)

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

Pursuant to Article 395(1) of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures derogating from the Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

By letter registered with the Secretariat-General of the Commission, Italy requested an authorisation to introduce measures derogating from Articles 26(1)(a) and 168 of Directive 2006/112/EC. In accordance with Article 395(2) of Directive 2006/112/EC the Commission informed the other Member States of the request by Italy on 28th February 2007. The Commission notified Italy on 21 November 2006 that it had received all the information that it considered necessary for appraisal of the request.

- **General context**

Article 168 of Directive 2006/112/EC provides that a taxable person is entitled to deduct the VAT charged on purchases made for the purpose of taxable 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 a consideration if the VAT on the goods was eligible for deduction. This system allows for the recovery of VAT on the initial purchase of assets which are used both in the business and privately, but in order to ensure that final consumption is taxed, the private use is then treated as a supply of services, with the associated VAT being unrecoverable by non taxable persons.

In the case of motor vehicles this system is difficult to apply for a number of reasons but principally because it is difficult to identify the split between private and business use. Where records are kept, they add an additional burden to both the business and the administration in maintaining and checking them. The number of vehicles concerned means that even small scale individual evasion has the capacity to grow into significant sums.

As an alternative to the system set out in the Directive, the Italian tax authorities have requested that they are allowed simply to restrict a set percentage of the initial deduction and in turn relieve the business from accounting for tax on the private use. This has the benefit of simplifying the system for all concerned and ensuring that a percentage of the tax, which might have otherwise been evaded, is collected.

The percentage restriction requested is 60%. This is based on Italy's own research and, under the terms of the proposal, would be reviewed after two years along with the working of the derogation.

The new system will apply to all businesses in which the vehicles are not used exclusively for business. The simplification benefit of a single flat rate would be lost if businesses were able to opt out of the system. However, certain vehicles would be

excluded from the restriction on the right to deduct and would therefore be treated under the normal rules. As a first step, any vehicle with more than 9 seats (including the driver's) and over a certain weight, would be excluded. This restricts the field of application to, in the main, cars, vans, pick ups, motorbikes and mopeds. In addition even if they fall within the scope of application and regardless of whether there is any private use, the following are excluded from the restriction: vehicles belonging to businesses whose trading activity was buying and selling vehicles; vehicles bought for lease or hire; taxis, vehicles used for instruction by driving schools and vehicles used by sales representatives.

- **Existing provisions in the area of the proposal**

Other derogations exist, or have existed, which limit the right to deduct VAT relating to vehicles. Currently the UK has a derogation allowing for a restriction to 50% of the right of a taxable hirer or lessee to deduct input tax on charges for the hire or lease of passenger cars for use by a business where the car is also used for private purposes. Authority is also provided for the UK to not treat the private use of such cars as supplies for consideration.

Article 176 of Directive 2006/112/EC 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 in relation to motor vehicles.

- **Consistency with other policies and objectives of the Union**

Not applicable.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Not relevant.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The proposal is designed to counter VAT evasion and to simplify the procedure for charging tax and has, therefore, a potential positive impact.

The solution has been identified by Italy as a suitable measure and is comparable to other past and present derogations. The requested measure is likewise similar in approach to the Commission's proposal found in COM(2004) 728, which contains rules on which forms of expenditure may be subject to a restriction on the right to deduct.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

Authorisation for Italy to apply a measure derogating from Article 168 of Directive 2006/112/EC so as to restrict the right of a taxable person to deduct VAT on expenditure related to motorised road vehicles when the vehicle is not used exclusively for business purposes. Where the right to deduct has been limited, a derogation from Article 26(1)(a) will relieve the taxable person from accounting for tax on the private use of the vehicle. The measure is restricted to vehicles under a certain seating capacity and under a certain weight, and provision is made for a limited number of specified exceptions from the rule.

The restriction is set at a flat rate of 60% and the rate and necessity for the derogating measure are to be reviewed and reported on by Italy after 2 years experience of operating the derogation. The Decision will expire on the earlier of the date specified in the Decision or the date on which Community rules come into force governing restrictions on the right to deduct in this area.

- **Legal basis**

Article 395(1) of Council Directive 2006/112/EC of 28 November 2006 on the Common system of value added tax.

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reason(s):

This Decision concerns an authorisation granted to a Member State on 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.

- **Choice of instruments**

Proposed instruments: other.

Other means would not be adequate for the following reason(s).

Under Article 395 of Council Directive 2006/112/EC on the common system of value added tax, derogation from the common VAT Rules is only possible on the authority of the Council acting unanimously on a proposal from the Commission. A Council Decision is the only suitable instrument since it can be addressed to an individual Member State.

4) BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

5) ADDITIONAL INFORMATION

- **Review/revision/sunset clause**

The proposal includes a review clause.

The proposal includes a sunset clause.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community

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 Commission²,

Whereas:

- (1) In a letter dated 9th October 2006 and registered in the Commission's Secretariat-General on 11th October 2006 Italy sought authorisation to introduce measures derogating from the provisions of Directive 77/388/EEC (now Directive 2006/112/EC) which govern a taxable person's right to deduct VAT paid on purchases and those which require tax to be accounted for on business assets used for private purposes
- (2) In accordance with Article 395(2) of Directive 2006/112/EC, the Commission informed the other Member States of the request made by Italy in a letter dated 28th February 2007. In a letter dated 21st November 2006, the Commission notified Italy that it had all the information that it considered necessary for appraisal of the request
- (3) Article 168 of Directive 2006/112/EC establishes a taxable person's right to deduct VAT charged on supplies of goods and services received by him for use in his taxable transactions. Article 26(1)(a) of the same Directive contains a requirement to account for VAT when a business asset is put to private use
- (4) The private usage of vehicles is difficult to identify accurately and even where it is possible, the mechanism for doing so is often burdensome. Under the requested measures, the amount of VAT on expenditure eligible for deduction on vehicles which are not used entirely for business purposes should, with some exceptions, be set at a flat percentage rate. Based on currently available information, the Italian authorities believe that a rate of 40% is justifiable. At the same time, to avoid double taxation, the requirement for accounting for VAT on the private use of a vehicle should be

¹ OJ L 347 11.12.2006, p.1.

² OJ C , , p. .

suspended where it has been subject to this restriction. These measures can be justified by the need to simplify the procedure for charging VAT and to prevent evasion through incorrect record keeping

- (5) These derogating measures should be limited in time to allow for an evaluation of its effectiveness and of the appropriate percentage, since the proposed percentage is based on initial findings on business use.
- (6) On 29th October 2004 the Commission presented a proposal for a Council Directive amending Directive 77/388/EEC, now 2006/112/EC, as regards the right to deduct VAT³. The derogating measure should end at the entry into force of the proposed Directive if earlier than the date specified in the Decision,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Article 168 of Directive 2006/112/EC, Italy is hereby authorised to limit to 40% the right to deduct the VAT charged on expenditure on motorised road vehicles not wholly used for business purposes.

Article 2

By way of derogation from Article 26(1)(a) of Directive 2006/112/EC, Italy is also required not to treat as supplies of services for consideration, the use for private purposes of vehicles included in the assets of a taxable person's business, where that vehicle has been subject to a restriction of the right to deduct under this Decision.

Article 3

Expenditure relating to vehicles is excluded from the restriction on the right to deduct as authorised by this Decision where the vehicle falls into any of the following categories:

- (1) the vehicle forms part of the taxable person's stock-in-trade in the exercise of his activity;
- (2) the vehicle is used as a taxi;
- (3) the vehicle is used for instruction by a driving school;
- (4) the vehicle is used for hire or leasing;
- (5) the vehicle is used by sales representatives.

³ OJ C 24 29.1.2005, p.10. COM(2004) 728

Article 4

The related expenditure shall cover the purchase of a vehicle, including contracts of assembly and the like, manufacture, intra-Community acquisition, importation, leasing or hire, modification, repair or maintenance, and expenditure on supplies or services performed in relation to vehicles and the use thereof, including lubricants and fuel.

Article 5

Articles 1 and 2 shall apply to all motorised vehicles, other than agricultural or forestry tractors, which are normally used for carrying persons or goods by road, with a maximum authorised mass not exceeding 3,500 Kilograms and having not more than eight seats in addition to the driver's seat.

Article 6

An assessment covering the first two years of the application of this Decision, including a review of the percentage restriction applied, shall be submitted to the Commission after the second anniversary of this Decision, and in any case by 31 December 2009.

Article 7

This Decision shall expire on the date of entry into force of Community rules determining the expenditure relating to motorised road vehicles that is not to be eligible for a full deduction of value added tax, but on 31 December 2010 at the latest.

Article 8

This Decision is addressed to the Italian Republic.

Done at Brussels,

*For the Council
The President*