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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 26.11.2007
COM(2007) 752 final

Proposal for a

COUNCIL DECISION

**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**

(Only the English 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 (VAT), 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 Secretariat-General of the Commission on 5 February 2007, the United Kingdom requested authorisation to continue to apply a derogating measure as first granted by Council Decision 95/252/EC of 29 June 1995 and then by Council Decision 98/198/EC of 9 March 1998 (as amended). In accordance with Article 395(2) of Directive 2006/112/EC, the Commission informed the other Member States by letter dated 15 October 2007 of the request made by the United Kingdom. By letter dated 17 October, the Commission notified the United Kingdom that it had all the information necessary to consider the request.

- **General context**

The above-mentioned Council Decisions authorised the United Kingdom to apply a restriction of the right to deduct to 50% of the input VAT incurred on the hire or lease of passenger cars used by taxable persons for both business and private use and, at the same time, not to consider the private use by taxable persons of such leased or hired cars as supplies 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 derogation is therefore essentially to be considered as a simplification measure. The derogation has been renewed several times and is due to expire on 31 December 2007.

As a rule, derogations are granted for a limited time so as to allow an assessment whether the special measure is appropriate and effective. In this respect, the Commission understands, on the basis of the information available, 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. Therefore, the legal and factual circumstances which justified the original derogation are still relevant.

However, on 29 October 2004, the Commission presented a proposal for a Council Directive that includes a harmonisation of the categories of expenses for which Member States may apply exclusions to the right to deduct (the so-called VAT simplification proposal (COM(2004)728 final)). As expenses in relation to motor cars are included in this proposal, any extension in the period of validity should not go beyond adoption and entry into force of the proposed Directive. The derogation should in any case be limited to 31 December 2010 in case the proposed Directive has not come into force by that date, in order to be able to assess whether the 50% restriction is

still a reasonable and acceptable reflection of the overall apportionment between business and private use.

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

Council Decision 98/198/EC of 9 March 1998 authorising the United Kingdom to extend the application of a measure derogating from Articles 6 and 17 of the Sixth Council Directive (77/388/EEC) on the harmonisation of the laws of the Member States relating to turnover taxes (OJ L 76, 13.3.1998, p. 31). Decision amended by Council Decision 99/79/EC of 18 January 1999 (OJ L 27, 2.2.1999, p. 22), Council Decision 2000/747/EC of 27 November 2000 (OJ L 302, 1.12.2000, p. 63), Council Decision 2003/909/EC of 22 December 2003 (OJ L 342, 30.12.2003, p. 49) and Council Decision 2004/855/EC of 7 December 2004 (OJ L 369, 16.12.2004, p. 61).

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 the 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 Decision proposal aims at extending in time a simplification measure which removes the need for the taxable person to keep records of and to account for VAT on private mileage travelled in cars operated by a business and has therefore a potential positive economic impact.

However, because of the narrow scope of the derogation and the limited application in time, the impact will in any case be limited. Moreover, the measure is similar in approach to the Commission's proposal found in COM(2004) 728 final, 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 the United Kingdom to continue to apply a derogating measure from Directive 2006/112/EC as regards the restriction of the right of deduction to 50% of the input VAT incurred on the hire or lease of motor cars not exclusively used for business purposes. Where the right to deduct has been limited, the taxable person is relieved from accounting for VAT on the private use of the vehicle. The Decision will expire on the earlier of the date specified in the Decision or on the date on which Community rules come into force governing restrictions on the right to deduct in this area.

- **Legal basis**

Article 395 of the VAT Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

- **Subsidiarity principle**

In accordance with Article 395 of the VAT Directive, the proposed measure, which authorises a Member State to derogate from provisions of the same Directive, must be adopted by the Council on a proposal from the Commission. Therefore, the proposed measure can only be adopted at the Community level.

- **Proportionality principle**

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

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

Given the very 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 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. A Council Decision is the most suitable instrument since it can be addressed to individual Member States.

4) BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

5) ADDITIONAL INFORMATION

- **Review/revision/sunset 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 (VAT), and in particular Article 395(1) thereof,

Having regard to the proposal from the Commission²,

Whereas:

- (1) By Council Decision 95/252/EC³ and subsequently by Council Decision 98/198/EC⁴, the Council authorised the United Kingdom to restrict to 50% the right of the hirer or lessee to deduct input VAT on charges for the hire or lease of a passenger car where the car is not used entirely for business purposes. The United Kingdom was also allowed not to treat as supplies of services for consideration the private use of a car hired or leased by a taxable person for his business purposes. This simplification measure removed the need for the hirer or the lessee to keep records of private mileage travelled in business cars and to account for tax on the actual private mileage of each car.
- (2) By letter registered with the Secretariat-General of the Commission on 5 February 2007, the United Kingdom requested an extension of the period of validity of that derogation, which expires on 31 December 2007.
- (3) In accordance with Article 395(2) of Directive 2006/112/EC, the Commission informed the other Member States by letter dated 15 October 2007 of the request made by the United Kingdom. By letter dated 17 October 2007, the Commission notified the United Kingdom that it had all the information necessary to consider the request.
- (4) The legal and factual circumstances which justified granting the authorisation to apply a derogation have not changed and are still relevant.

¹ OJ L 347, 11.12.2006, p. 1. Directive amended by Directive 2006/138/EC (OJ L 384, 29.12.2006, p. 92).

² OJ C, , p.

³ OJ L 159, 11.7.1995, p. 19.

⁴ OJ L 76, 13.3.1998, p. 31. Directive as last amended by Directive 2004/855/EC (OJ L 369, 16.12.2004, p. 61).

- (5) On 29 October 2004, the Commission presented a proposal for a Council Directive amending Directive 77/388/EEC, now Directive 2006/112/EC, that includes the harmonisation of the categories of expenses for which exclusions of the right to deduct may apply⁵. Under this proposal, exclusions to the right to deduct may be applied to motorised road vehicles. It is therefore appropriate to extend the period of the authorisation until that Directive comes into force. However, the authorisation will in any case expire on 31 December 2010 at the latest if that Directive has not come into force by that date, to enable an assessment of the necessity of this Decision in the light of the percentage of the overall apportionment between business and private use.
- (6) The extension in time of the derogation will not have an adverse effect on the European Communities' own resources accruing from VAT.

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Articles 168 and 169 of Council Directive 2006/112/EC, the United Kingdom is hereby authorised to restrict to 50% the right of the hirer or lessee of a car to deduct the VAT on the cost of the hiring or leasing of that car where it is not used entirely for business purposes.

Article 2

By way of derogation from Article 26(1)(a) of Council Directive 2006/112/EC, the United Kingdom is hereby authorised not to treat as supplies of services for consideration the private use of a business car hired or leased by a taxable person.

Article 3

This authorisation shall expire on the date of entry into force of Community rules determining what expenditure relating to motorised road vehicles is not to be eligible for full deduction of VAT, but on 31 December 2010 at the latest.

Article 4

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

Done at Brussels,

*For the Council
The President*

⁵ COM(2004) 728 final