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Proposal for a

COUNCIL IMPLEMENTING DECISION

**authorising Estonia to apply a measure derogating from Article 26(1), point (a), and
Articles 168 and 168a 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'¹), the Council, acting unanimously on a proposal from the Commission, may authorize 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 12 February 2021, Estonia requested an authorisation to apply a measure derogating from the overall principles governing the right of deduction of input VAT in relation to expenditure connected with passenger cars not wholly used for business purposes.

In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 19 March 2021 of the request made by Estonia. By letter dated 23 March 2021, the Commission notified Estonia that it had all the information it considered necessary for appraisal of the request.

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

Articles 168 and 168a of the VAT Directive provide that a taxable person is entitled to deduct the 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.

In the case of passenger cars, this system is difficult to apply, in particular 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.

Pursuant to Article 395 of the VAT Directive, Member States may apply measures derogating from the provisions of the VAT Directive to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance if they have been authorised by the Council.

Estonia has been authorised on the basis of Council Implementing Decision 2014/797/EU² to restrict to 50 % the right to deduct VAT on the purchase, leasing, intra-Community acquisition, and importation of certain passenger cars as well as expenditure related thereto when those cars are not wholly used for business purposes. The validity of Council Implementing Decision 2014/797/EU was extended by Council Implementing Decision 2017/1854/EU³ until 31 December 2020.

¹ OJ 347, 11.12.2006, p.1.

² Council Implementing Decision (EU) 2014/797 of 7 November 2014 authorising the Republic of Estonia to apply a measure derogating from point (a) of Article 26(1) and Articles 168 and 168a of Directive 2006/112/EC on the common system of value added tax (OJ L 330, 15.11.2014, p. 48).

³ Council Implementing Decision (EU) 2017/1854 of 10 October 2017 amending Implementing Decision 2014/797/EU authorising the Republic of Estonia to apply a measure derogating from point (a) of Articles 26(1) and Article 168 and 168a of Directive 2006/112/EU on the common system of value added tax (OJ L 265, 14.10.2017, p. 17).

Given that the validity of Council Implementing Decision (EU) 2014/797 had expired before Estonia submitted, in February 2021, the latest request to further extend its temporal scope, this request will be treated as an original request to apply a measure derogating from the overall principles governing the right to deduct input VAT in relation to expenditure connected with passenger cars not wholly used for business purposes.

Estonia has requested to be allowed to restrict the right of deduction to a set percentage and in turn to relieve the business from accounting for tax on the private use. This has the benefit of simplifying the system for all concerned and prevents, at the same time, tax evasion or avoidance because of incorrect record keeping.

Estonia informed the Commission that the grounds for granting the measure are largely the same as set out in the requests that led to the Council Implementing Decisions 2014/797/EU and 2017/1854/EU.

Estonia presented data suggesting that from the moment of the implementation of the derogation under Council Implementing Decisions 2014/797/EU, the vast majority of company cars continued to be used for private purposes, confirming that the derogation is justified.

The measure should apply to all passenger cars with a maximum of eight seats in addition to the driver's seat, not exceeding 3 500 kilograms, and which are not used exclusively for business purposes. However, passenger cars which are used for certain specific activities would be treated under the normal rules: cars purchased for resale, hire or lease, cars used for transportation of passengers (such as taxis), and cars used for driving lessons.

The restriction to the right of deduction should apply to VAT paid on the purchase, leasing, intra-Community acquisition, and importation of specified passenger cars as well as expenditure related thereto.

According to Estonia, the deduction limit should be set at 50 %, because the situation has remained unchanged compared to when the special measure was firstly introduced in 2014. Although the private use of company cars in Estonia is estimated to be at around 60 %, based on indirect evidence and assumptions available to the Estonian tax authorities, a 50 % input VAT deduction limit is considered the most appropriate, in order to exclude the possibility of overestimating the proportion of private use of passenger cars.

Given the positive impact of the measure on the administrative burden of taxpayers and tax authorities alike, it is proposed to authorise the derogation measure. The authorisation should be valid for a limited period, i.e. until 31 December 2024, in order to allow for a review of the necessity and effectiveness of the derogating measure and the apportionment between business and non-business use it is based on. Any extension request should be accompanied by a report which includes a review of the percentage applied and should be sent to the Commission by 31 March 2024.

- **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 (Hungary⁴, Latvia⁵, Croatia⁶, Poland⁷, Italy⁸ and Romania⁹).

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 deduct¹⁰, 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 proposal falls under the exclusive competence of the European Union. The subsidiarity principle therefore 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. In particular, given the potential for businesses to under declare their liability and the burdensome check of mileage

⁴ Council Implementing Decision (EU) 2018/1493 of 2 October 2018 authorising Hungary to introduce a special measure derogating from point (a) of Article 26(1) and Articles 168 and 168a of Directive 2006/112/EC on the common system of value added tax, OJ L 252, 8.10.2018, p. 44–46.

⁵ Council Implementing Decision (EU) 2018/1921 of 4 December 2018 amending Implementing Decision 2015/2429/EU authorising Latvia to introduce a special measure derogating from point (a) of Article 26(1) and Articles 168 and 168a of Directive 2006/112/EC on the common system of value added tax, OJ L 311, 7.12.2018, p. 36–37.

⁶ Council Implementing Decision (EU) 2018/1994 of 11 December 2018 authorising Croatia to introduce a special measure derogating from point (a) of Article 26(1) and Article 168 of Directive 2006/112/EC on the common system of value added tax, OJ L 320, 17.12.2018, p. 35–37.

⁷ Council Implementing Decision (EU) 2019/1594 of 24 September 2019 amending Implementing Decision 2013/805/EU authorising the Republic of Poland to introduce measures derogating from point (a) of Article 26(1) and Article 168 of Directive 2006/112/EC on the common system of value added tax, OJ L 248, 27.9.2019, p. 71–72.

⁸ Council Implementing Decision (EU) 2019/2138 of 5 December 2019 amending Decision 2007/441/EC 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, OJ L 324, 13.12.2019, p. 7–8.

⁹ Council Implementing Decision (EU) 2020/1262 of 4 September 2020 amending Implementing Decision 2012/232/EU authorising Romania to apply measures derogating from Article 26(1)(a) and Article 168 of Directive 2006/112/EC on the common system of value added tax, OJ L 296, 10.09.2020, p. 6.

¹⁰ 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)

data for tax authorities, the 50 % restriction would simplify the VAT collection in a specific sector.

- **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 Estonia and concerns only this Member State.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The proposal is designed to simplify the procedure for charging tax by removing the need for taxable persons to keep records on the private use of specified passenger cars, and, at the same time, to prevent VAT evasion through incorrect record keeping. It has, therefore, a potential positive impact for both businesses and tax administrations. The solution has been identified by Estonia as a suitable measure and is comparable to other past and present derogations.

4. BUDGETARY IMPLICATIONS

The derogating measures 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.

5. OTHER ELEMENTS

The proposal is limited in time and includes a sunset clause set at 31 December 2024.

In case Estonia would consider another extension of the special measure beyond 2024, 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 2024.

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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), first subparagraph, thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) Articles 168 and 168a 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. Pursuant to Article 26(1), point (a), of that Directive, the use of business assets for private use of taxable persons or their staff or, more generally, for purposes other than those of their business is to be treated as a supply of services.
- (2) Council Implementing Decision 2014/797/EU² authorised Estonia to restrict to 50 % the right to deduct VAT on the purchase, leasing, intra-Community acquisition and importation of certain passenger cars and to relieve the taxable person from accounting for VAT on the non-business use of vehicles covered by the restriction until 31 December 2017.
- (3) Council Implementing Decision 2017/1854/EU³ extended the validity of Implementing Decision 2014/797/EU to 31 December 2020.
- (4) By letter registered with the Commission on 12 February 2021, Estonia submitted a request to the Commission to be authorised to apply a special measure derogating from Article 26(1), point (a), and Articles 168 and 168a of Directive 2006/112/EC in order to restrict the right of deduction concerning the purchase, leasing, intra-Community acquisition and importation of certain passenger cars used for non-business purposes.
- (5) In accordance with Article 395(2), second subparagraph, of Directive 2006/112/EU, the Commission informed the other Member States, by letter of 19 March 2021, of the

¹ OJ L 347, 11.12.2006, p.1.

² Council Implementing Decision 2014/797/EU of 7 November 2014 authorising the Republic of Estonia to apply a measure derogating from point (a) of Article 26(1) and Articles 168 and 168a of Directive 2006/112/EC on the common system of value added tax (OJ L 330, 15.11.2014, p. 48).

³ Council Implementing Decision (EU) 2017/1854 of 10 October 2017 amending Implementing Decision 2014/797/EU authorising the Republic of Estonia to apply a measure derogating from point (a) of Articles 26(1) and Article 168 and 168a of Directive 2006/112/EU on the common system of value added tax (OJ L 265, 14.10.2017, p. 17).

request made by Estonia. By letter of 23 March 2021, the Commission notified Estonia that it had all the information it considered necessary for appraisal of the request.

- (6) The non-business use of passenger cars is often very difficult to identify accurately and even where it is possible, the mechanism for doing so is often burdensome. Under the requested authorisation, the amount of VAT on expenditure eligible for deduction in respect of passenger cars 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 Estonian authorities believe that a rate of 50 % is justifiable. At the same time, in order to avoid double taxation, the requirement of accounting for VAT on the non-business use of passenger cars should be suspended where those cars have been subject to a limitation. This simplification measure removes the need to keep records on private use of business cars and, at the same time, prevents tax evasion through incorrect record keeping.
- (7) The limitation of the right of deduction under the requested authorisation should apply to VAT paid on the purchase, leasing, intra-Community acquisition and importation of specific categories of passenger cars and on expenditure related thereto, including the purchase of fuel.
- (8) The requested authorisation should only apply to passenger cars with a maximum authorised weight not exceeding 3 500 kilograms and having not more than eight seats in addition to the driver's seat, since any non-business use of passenger cars exceeding 3 500 kilograms or having more than eight seats in addition to the driver's seat is negligible due to the nature of those passenger cars or the type of business they are used for. A detailed list of specific passenger cars excluded from that authorisation should also be provided, based on their particular use.
- (9) The authorisation should be limited in time until 31 December 2024, in order to allow for a review of the necessity and effectiveness of the derogating measure and the apportionment rate between business and non-business use it is based on.
- (10) Where Estonia considers that an extension of the authorisation beyond 2024 is necessary, it should submit, by 31 March 2024, to the Commission a request for an extension accompanied by a report which includes a review of the percentage applied.
- (11) The derogation 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 Articles 168 and 168a of Directive 2006/112/EC, Estonia is authorised to limit to 50 % the right to deduct the value added tax on expenditure on passenger cars not wholly used for business purposes where that expenditure covers the purchase, leasing, intra-Community acquisition or importation of passenger cars not wholly used for business purposes, as well as on expenditure related to the maintenance and repair of such cars and to the purchase of fuel for them.

Article 2

By way of derogation from Article 26(1), point (a), of Directive 2006/112/EC, Estonia 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

1. This Decision shall only apply to passenger cars with a maximum authorised weight not exceeding 3 500 kilograms and having not more than eight seats in addition to the driver's seat.
2. This Decision shall not apply to the following categories of passenger cars:
 - (a) cars purchased for resale, hire or lease;
 - (b) cars used for transportation of passengers for a fee, including taxi services;
 - (c) cars used for the provision of driving lessons.

Article 4

This Decision shall expire on 31 December 2024. Any request for the extension of the authorisation provided for in this Decision shall be submitted to the Commission by 31 March 2024 and shall be accompanied by a report which includes a review of the percentage set out in Article 1.

Article 5

This Decision is addressed to the Republic of Estonia.

Done at Brussels,

*For the Council
The President*