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Proposal for a

COUNCIL IMPLEMENTING DECISION

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

EXPLANATORY MEMORANDUM

Pursuant to Article 395(1) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[1] ('the VAT Directive'), 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 19 April 2022, Italy requested an extension of the derogation from Article 26(1) point (a) and Article 168 of the VAT Directive that it currently applies. The Commission asked for further information on 2 May 2022 and Italy provided the requested clarifications on 1 June 2022.

Italy asks for an authorisation to continue to derogate from Article 168 of the VAT Directive by limiting to 40% the right to deduct input VAT charged on expenditure related to motorised road vehicles not wholly used for business purposes. In addition, Italy requests an authorisation to continue to derogate from Article 26(1) point (a) of the same directive by exempting from VAT the use for private purposes of vehicles included in the assets of a taxable person's business, where such vehicles are subject to a restriction of the right to deduct.

In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letter dated 23 June 2022 on the request made by Italy. By letter dated 24 June 2022, the Commission notified Italy 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

The deduction right may be difficult to exercise when goods can be used privately or for business purposes without distinction. In these cases, the ratio business use to non-business use may be complex to establish and the conduct of inspections to confirm such ratio may create significant difficulties and red tape for both tax authorities and taxable persons. It could even lead to time-consuming and costly disputes. In practice, it is sometimes even impossible to verify the actual use of vehicles which may result in (attempted) VAT fraud (such as unreliable record keeping), and consequently a decrease in VAT revenue.

Italy is dominated by small companies (94.7% of the Italian enterprises are micro-enterprises) and most of the company cars in circulation are owned by these kind of enterprises. The fact that such vehicles are used in the exercise of the ordinary business activity does not preclude their private use. In such situation, that is when these vehicles are to a certain extent used for private purposes, VAT shall be borne for the private use. In the Italian circumstances where almost all the economic fabric is composed of micro-entreprises, the workload to assess and verify the allocation of use in the private sphere or in the business sphere would require disproportionately large outlays, including those resulting from the need to maintain detailed documentation.

For those reasons, Italy has been authorised to derogate from Article 168 of the VAT Directive by limiting to 40% the right to deduct VAT on the purchase of a vehicle, including contracts of assembly and the like, manufacture, intra-Community acquisition, importation,

[1] OJ L 347, 11.12.2006, p. 1.

leasing or hire, modification, repair or maintenance, and expenditure on supplies or services performed in relation to vehicles and their use, including lubricants and fuel, provided that the vehicle in question is not used exclusively for business purposes. The special measures cover all motor vehicles but agricultural or forestry tractors, normally used for carrying persons or goods by road and having a total maximum weight lower than 3.5 tonnes and fewer than nine seats, including the driver's seat.

Likewise, Italy is authorised to derogate from Article 26(1) point (a) of the VAT Directive by exempting from VAT the use for private purposes of vehicles forming part of the assets of a taxable person's business where those vehicles are covered by the above special measures.

The authorisation for the derogating measures mentioned above was first granted by the Council by means of Decision 2007/441/EC of 18 June 2007[2] until 31 December 2010. Subsequently, the derogating measures were prolonged four times following Italy's request: Council Implementing Decision 2010/748/EU of 29 November 2010[3] extended them for the period 1 January 2011 until 31 December 2013; Council Implementing Decision 2013/679/EU of 15 November 2013[4] for the period 1 January 2014 until 31 December 2016; Council Implementing Decision (EU) 2016/1982 of 8 November 2016[5] for the period 1 January 2017 until 31 December 2019; and last, Council Implementing Decision (EU) 2019/2138 of 5 December 2019 for the period 1 January 2020 until 31 December 2022[6].

The present request from Italy to prolong the special measures until 31 December 2025 is based on the same grounds as those presented in the previous requests. The request and the information provided by Italy on 1 June 2022 include an explanation of the percentage limitation applied on the right of deduction.

Given the positive impact of the special measure on the administrative burden of taxpayers and tax authorities alike, it is proposed, subject to certain conditions, to authorise the requested extension. Any further extension request should be accompanied by a duly substantiated and justified report reviewing the necessity and effectiveness of the special measures and a review of the percentage applied for the period starting 1 January 2023 until the submission of the request and should be sent to the Commission by 31 March 2025.

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

Similar special measures, although at the rate of 50%, in relation to the right of deduction have been granted to other Member States[7].

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[2] OJ L 165, 27.6.2007, p. 33.
[3] OJ L 318, 4.12.2010, p. 45.
[4] OJ L 316, 27.11.2013, p. 37.
[5] OJ L 305, 12.11.2016, p. 30.
[6] OJ L 324, 13.12.2019, p. 7.
[7] For example: Council Implementing Decision (EU) 2021/1997 of 15 November 2021 amending Implementing Decision (EU) 2018/1994 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 408, 17.11.2021, p. 1–2); 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, 10.9.2020, p. 6–7); 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); Council Implementing Decision (EU) 2017/1854 of 10 October 2017 amending Implementing Decision 2014/797/EU authorising the Republic of Estonia to

Article 176 of the VAT Directive stipulates that the Council shall determine the expenditure on which the VAT is not deductible. Until it does, Member States can maintain exclusions that were in place under national laws on 1 January 1979. On this basis, there is a number of 'stand still' provisions restricting the right to deduct VAT in relation to corporate motor vehicles[8].

Previous initiatives to establish rules on which categories of expenditure may be subject to a restriction on the right to deduct have failed[9]. Until those rules are harmonised at EU level, special measures such as the present ones are considered appropriate.

The proposed measures are therefore consistent with the provisions of the VAT Directive.

• Consistency with other Union policies

This measure is consistent with the Commission Communication of 15 July 2020, Action Plan for Fair and Simple Taxation in Support of Economic Recovery[10], which highlights the need to support companies which face more administrative complexity and where compliance costs are proportionately much higher, that is notably the small and medium-sized enterprises. It is also compatible with the Commission's 2017 work programme[11], which highlights the need to simplify VAT for smaller businesses.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

• Legal basis

Article 395 of the VAT Directive.

• Subsidiarity (for non-exclusive competence)

The granting of the extension of the special measures cannot be achieved by Italy. The intervention of the Commission is necessary to present a proposal to the Council, who may authorise Italy to extend the special measures.

• 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, given the potential for businesses to under declare their liability and the burdensome check of mileage data for tax authorities, the 40% restriction would simplify the VAT collection procedure and would prevent tax evasion inter alia through incorrect record keeping.

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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 265, 14.10.2017, p. 17–18).

8 See the list compiled by Madeleine Merkx (2018) VAT deduction and member state sovereignty: (still) a good idea?, World Journal of VAT/GST Law, 7:2, 53-75, DOI: 10.1080/20488432.2018.1550163.

9 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).

10 Communication from the Commission to the European Parliament and the Council An Action Plan for Fair and Simple Taxation in Support of Economic Recovery (COM(2020)312 final).

11 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Commission Work Programme 2017. (COM(2016) 710 final).

- **Choice of the instrument**

The instrument proposed is a Council Implementing Decision.

Recourse to a Council decision responds to the requirement of Article 395 of the VAT Directive under which a derogation from the common VAT rules is only possible upon authorisation by the Council, which is acting unanimously on a proposal from the Commission.

In the case at hand, the aim is to address Italy only. The recourse to a Decision is therefore warranted as such an instrument can be addressed to an individual Member State and be binding only towards this Member State.

The choice of an Implementing act is warranted as it activates the option opened under Article 395 of the VAT Directive.

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

- **Stakeholder consultations**

No stakeholder consultation has been conducted. The present proposal is based on a request made by Italy and concerns only this particular Member State.

- **Collection and use of expertise**

There was no recourse to external expertise.

- **Impact assessment**

The proposal aims to simplify the procedure for collecting VAT and to prevent VAT evasion. It has, therefore, a potential positive impact for both businesses and administrations. The derogating measures have been identified by Italy as the most appropriate solution. The measures are comparable to other past and present derogations granted to other Member States.

- **Regulatory fitness and simplification**

The special measures contribute to simplifying compliance obligations and reducing administrative burdens on taxable persons, especially in the SMEs sector, and for the tax administration. It significantly reduces the difficulties associated with verifying the correctness of input VAT deductions, which often lead to costly and time-consuming administrative and court disputes.

The proposal does not have any information and communication technology (ICT) consequences.

- **Fundamental rights**

The proposal does not have any consequences for the protection of fundamental rights.

4. BUDGETARY IMPLICATIONS

The proposal will not have a negative impact on the EU budget. The proposal aims to authorise Italy to continue restricting the right to deduct for certain vehicles and related expenditure for the period 2023-2025.

5. OTHER ELEMENTS

- **Implementation plans and monitoring, evaluation and reporting arrangements**

The proposal includes a sunset clause set at 31 December 2025.

In case Italy considers a further extension of the derogating measures beyond 2025, it should submit to the Commission an extension request accompanied by a report including a review of the percentage restriction no later than 31 March 2025.

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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[1], and in particular the first subparagraph of Article 395(1) thereof,

Having regard to the proposal from the European Commission,

Whereas:

(1) Article 168 of Directive 2006/112/EC establishes a right for taxable persons to deduct value added tax ('VAT') charged on supplies of goods and services that they use for the purposes of their taxed transactions. Article 26(1), point (a), of that Directive treats the use of business assets by taxable persons or their staff for private use or, more generally, for purposes other than those of their business as a supply of services for consideration.

(2) Council Decision 2007/441/EC[2] authorises Italy to limit the right to deduct VAT under Article 168 of Directive 2006/112/EC to 40% in respect of the purchase of certain motorised road vehicles, including contracts of assembly and the like, manufacture, intra-Community acquisition, importation, leasing or hire, modification, repair or maintenance, and related expenditure, including lubricants and fuel, where the vehicle in question is not entirely used for business purposes. For vehicles to which that 40% limit applies, Italy requires that taxable persons do not treat the use for private purposes of vehicles included in the assets of a taxable person's business as a supply of services for consideration in accordance with Article 26(1), point (a), of Directive 2006/112/EC.

(3) Decision 2007/441/EC is due to expire on 31 December 2022.

(4) By letter registered with the Commission on 19 April 2022, Italy requested authorisation to continue to apply the special measures authorised by Decision 2007/441/EC ('the special measures') for a further period until 31 December 2025.

(5) By letter dated 2 May 2022, the Commission requested further information and Italy provided the requested information by letter dated 1 June 2022.

[1] OJ L 347, 11.12.2006, p. 1.

[2] Council Decision 2007/441/EC of 18 June 2007 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 165, 27.6.2007, p. 33).

(6) In response to the Commission request, Italy provided an explanation of the percentage limitation applied on the right of deduction. Italy maintains that a rate of 40 % is still justified. In its request, Italy also maintains that the suspension of the requirement to account for VAT on the private use of a motor vehicle, where the vehicle has been subject to that limitation, is still necessary to avoid double taxation. It further maintains that those special measures are justified by the need to simplify the procedure for collecting VAT and to prevent tax evasion resulting from incorrect record-keeping and false tax declarations.

(7) By letter dated 23 June 2022, the Commission notified the other Member States of the request that Italy had made, pursuant to Article 395(2), second subparagraph, of Directive 2006/112/EC. By letter dated 24 June 2022, the Commission notified Italy that it had all the information necessary to consider the request.

(8) The application of the special measures will only have a negligible effect on the overall amount of tax revenue of Italy collected at the stage of final consumption and will not adversely affect the Union's own resources accruing from VAT.

(9) It is therefore appropriate to extend the authorisation set out in Council Decision 2007/441/EC. The extension of the authorisation should be limited in time, to allow for an evaluation of its effectiveness and of the appropriateness of the percentage restriction applied to the right to deduct VAT.

(10) Italy should therefore be authorised to continue to apply the derogating measures until 31 December 2025.

(11) Italy could consider that the special measures are necessary beyond the date of expiry of Council Decision 2007/441/EC. In order to ensure a timely examination of any request to extend the authorisation provided in that Decision, it is necessary to lay down requirements for such a request.

(12) Council Decision 2007/441/EC should be therefore amended accordingly,

HAS ADOPTED THIS DECISION:

Article 1

Decision 2007/441/EC is amended as follows:

1) Article 6 is replaced by the following:

'*Article 6*

The Italian Republic may request extension of the authorisation provided for in this Decision by 31 March 2025. Such request shall be submitted to the Commission and accompanied by a report, which includes a review of the percentage restriction applied on the right to deduct VAT on the basis of this Decision.';

2) Article 7 is replaced by the following:

'*Article 7*

This Decision shall expire on 31 December 2025.'.

Article 2

This Decision is addressed to the Italian Republic.

Done at Brussels,

For the Council
The President