COMMISSION OF THE EUROPEAN COMMUNITIES

COM(82) 870 final
Brussels, 25 January 1983

Proposal for a

TWELFTH COUNCIL DIRECTIVE

on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: expenditure not eligible for deduction of value added tax

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EXPLANATORY MEMORANDUM

I. GENERAL

1. Article 17(6) of the 6th VAT directive provides as follows : "Before a period of four years at the latest has elapsed from the date of entry into force of this directive, the Council, acting unanimously on a proposal from the Commission, shall decide what expenditure shall not be eligible for a deduction of value added tax. Value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment.

Until the above rules come into force, Member States may retain all the exclusions provided for under their national laws when this directive comes into force."

2. The existing exclusions from the right to deduct input tax are extremely varied. In most Member States, the sometimes significant exclusions from and limitations on, this right apply primarily to expenditure on entertainment and hospitality and to the purchase and use of motor vehicles.

3. This wide variety of national rules is attributable to a number of factors, including, in particular, the following :

Some countries withhold or limit the right to deduct input tax so as to avoid or greatly simplify those cases where a distinction has to be made between expenditure which relates to the private needs of a taxable person or of other persons and expenditure which is linked to a taxable person's economic activities. This facilitates the task of the tax authorities and is intended to reduce or obviate tax fraud.

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Other countries, in accordance with Art. 17(2) and (3), allow taxable persons to deduct in full in respect of all the expenditure in question or of the most important categories of such expenditure, with only non-business expenditure being excluded.

Thus, the individual Member States made use in quite different ways of the possibility afforded by Art. 11(4) of the second VAT directive (repealed by the sixth VAT directive), which stipulated : "Certain goods and services may be excluded from the deduction system, in particular those capable of being exclusively or partially used for the private needs of the taxable person or of his staff." Member States, in moving over to the system provided for in the 6th directive, have to a considerable extent simply retained in their legislation the exclusions for which they had already opted when the common VAT system was set up.

4. The present situation is not consistent with the requirements of a uniform basis of assessment and a non-discriminatory system of taxation.

Taxable persons in a Member State in which tax is fully deductible for all expenditure except non-business expenditure are afforded more favourable tax treatment than taxable persons in a Member State in which certain categories of expenditure are excluded from the right to deduct input tax. This difference in treatment may lead to some distortion of competition in international trade in goods and services insofar as it is reflected in the prices of the goods and services.

The fact that only certain Member States refuse to allow deductions has economic drawbacks in those States for the industries that are particularly affected by this prohibition (notably the motor vehicle industry and the hotel and catering industry). The budgetary benefit to the State whose receipts are initially increased by the ban on deduction may thus eventually decline or even be completely eroded.

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If the present situation were left unchanged, the equitable collection of VAT-based own resources might be jeopardized, without there being any possibility of financial compensation (except for the purchase of motor vehicles and oil products).

5. In addition, since certain categories of expenditure, even where incurred in connection with the normal operation of a business, often serve private needs too and since apportionment of such expenditure between business and private use cannot be accurately verified, that exercise of the right to deduct input tax presents the risk of abuse or tax evasion, giving rise to distortion of competition.

Account must be taken in this regard of the practical effect of the new legal situation brought about by the adoption of the 8th directive. The right to claim the refund of VAT invoiced in one Member State to a taxable person established in another Community State is now recognized, but here again there are risks of abuse or tax evasion in allowing a taxable person to obtain, simply be presenting invoices, a refund of the tax charged on the cost of using a private car, travel expenses, and hotel or restaurant bills.

The principal limitations on the right to deduct input tax in certain or in all Member States are under the following headings :

1. - Expenditure on food and drink
2. - Expenditure on lodging and accommodation
3. - Expenditure on entertainment
4. - Gifts
5. - Expenditure on passenger cars

All the Member States except one impose limitations on the right to deduct in respect of categories 1 and 4. Where deductibility exists it is inevitably for expenditure either away from the office base or else for contacts outside the business.

In the case of passenger cars, there is a rather clear distinction between the four or five Member States who permit deductions in respect of the purchase of motor vehicles on the one hand and those who permit no such deductions at all. There is a similar division between Member States over allowing deductions for running costs.

In the view of the Commission the above analysis shows that there is no single consistent pattern in the practices of the Member States in refusing deduction of VAT. Nevertheless, where restrictions are imposed on the right to deduct, there is an implicit recognition that expenditure which has the characteristic of final consumption should bear VAT. The Commission, therefore, considers that in order to harmonise the differing practices in the Member States, to overcome the potential distortions of competition in the differing practices and to eliminate the risk of fraud, deduction should be prohibited in the most typical cases where final consumption forms part of the direct operational costs of the undertaking.

It is in the light of these considerations that the Commission presents to the Council the proposal for a 12th directive on the harmonization of the laws relating to turnover taxes.

II. COMMENTARY ON THE ARTICLES

Concerning Article 1

Article 1 concerns the exclusion of the right to deduct the tax on expenditure relating to passenger cars.

This exclusion is justified by the fact that this type of vehicle necessitates expenditure which, even if it is incurred in connection with an undertaking, is not necessarily linked directly and exclusively to the activities of that undertaking.

However, this exclusion is accompanied by a number of riders designed to maintain the right to deduct input tax where vehicles constitute stock in trade or are the subject of the economic activity of certain taxable persons (taxis, driving schools, car hire firms).

Concerning Article 2

The exclusion provided for in Article 2 concerns transport costs incurred on business travel. The justification for this provision is identical to that given in respect of Article 1.

Paragraph 2 of Art. 2 stipulates that the exclusion of travel expenses does not extend to transportation costs borne by an undertaking which relate to the movement of staff between different places of work - to work sites, for example - or to the collection of staff from their homes.

Concerning Article 3

The purpose of this provision is to exclude from the right to deduct a category of expenditure which is primarily consumption expenditure, even if it is incurred in connection with the operation of an undertaking. This is in accordance with the general approach that expenditure on accommodation, food or drink should not escape taxation altogether solely because it is borne by an undertaking.

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It is made clear that this exclusion does not concern those economic sectors whose activities consist in providing the goods or services which are the object of the exclusion (the hotel, restaurant and suppliers and manufacturers of food).

Nor does the exclusion cover works canteens, even where these can operate only with the help of subsidies, provided these subsidies are included in the taxable amount in accordance with Art. 11(A)(1)(a) of the 6th directive.

In the event of subsidies not being included in the taxable amount, the provisions of Art. 19(1) of the 6th directive (application of the pro rata deduction) must be applied.

Exclusion from the right to deduct does not apply to expenditure incurred by an undertaking in providing accommodation free of charge for security staff.

Concerning Articles 4 and 5

These exclusions, which concern expenditure on entertainment, amusements and luxuries, stem from the same arguments as those outlined above. Furthermore, the principle of such an exclusion is already laid down in Art. 17(6) of the 6th directive.

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PROPOSAL FOR A TWELFTH COUNCIL DIRECTIVE

on the harmonization of the laws of the Member States relating to turnover taxes - common system of value added tax : expenditure not eligible for deduction of value added tax

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax : uniform basis of assessment[1], and in particular Article 17(6) thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas Article 17(6) of Sixth Directive 77/388/EEC stipulates that the Council shall decide what expenditure shall not be eligible for a deduction of value added tax;

Whereas some items of expenditure, even where incurred in connection with the normal operation of a business, nevertheless have the characteristics of final consumption and apportionment of such expenditure between business and private use cannot be accurately verified;

Whereas the nature of such expenditure presents the risk of abuse or tax evasion, not only on the part of resident taxable persons, but also on the part of non-resident taxable persons who are entitled to the refund of tax in a Member State other than that in which they are resident;

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(1) O.J. N° L 145, 13.6.1977, p.1.

Whereas Article 17(6) of Sixth Directive 77/388/EEC stipulates that value added tax shall in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment;

Whereas the establishment of common rules on the expenditure referred to in Article 17(6) of the aforementioned Directive is not intended to affect the general arrangements governing the right to deduct that result from First Council Directive 67/227/EEC[1] and from the Sixth Council Directive 77/388/EEC or the other cases of non-deductibility that result from the Sixth Directive, and in particular from Article 17(7), 24(5), 25(5) and 26(4) thereof;

Whereas it is necessary to achieve greater uniformity of the basis of assessment for the collection of own resources as provided for in Council Decision 70/243/ECSC, EEC, Euratom of 21 April 1970 on the replacement of financial contributions from Member States by the Communities' own resources[2];

Whereas the harmonization of national provisions relating to exclusion of the right to deduct contributes at the same time to the harmonization of the arrangements for the refund of value added tax to taxable persons not established in the territory of the country as provided for in Eighth Council Directive 79/1072/EEC[3],

HAS ADOPTED THIS DIRECTIVE :

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(1) OJ N° 71, 14.4.1967, p. 1301

(2) OJ N° L 94, 28.4.1970, p. 19

(3) OJ N° L 331, 27.12.1979, p. 11

Article 1

1. Value added tax shall not be deductible in respect of expenditure on the purchase, manufacture, importation, leasing or hire, use, modification, repair or maintenance of passenger cars, pleasure boats, private aircraft or motor cycles.

   Nor shall value added tax be deductible in respect of expenditure on supplies (fuels, lubricants, spare parts etc.) for, or services performed in relation to, such vehicles and craft.

   "Passenger car" means any road vehicle (including any trailer) other than one which, by its design and equipment, is intended solely for the transport of goods or is intended for industrial or agricultural use or has a seating capacity of more than nine persons including the driver.

2. The exclusions of the right to deduct referred to in paragraph 1 shall not apply to vehicles or craft which are:

   (a) used for carriage for hire or reward;

   (b) used for driving training or instruction;

   (c) hired out;

   (d) part of the stock in trade of a business.

Article 2

1. Value added tax shall not be deductible in respect of transport expenses incurred on business travel by a taxable person or by members of his staff; "business travel" means a journey undertaken by a taxable person or by a member of his staff for business reasons away from the place of establishment or away from the place at which the traveller's functions are exercised.

2. The exclusion of the right to deduct referred to in paragraph 1 shall not apply to transport expenses relating to the movement of an undertaking's staff between particular places of work or to those relating to transport of staff to and from their homes.

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Article 3

1. Value added tax shall not be deductible in respect of expenditure on accommodation, food and drink.

2. The exclusion of the right to deduct referred to in paragraph 1 shall not apply :

   (a) to expenditure incurred by a taxable person in respect of the supply of accommodation, meals, food or drink for consideration;

   (b) to expenditure on accommodation provided free of charge for security or caretaking staff on works, sites or business premises.

Article 4

Value added tax shall not be deductible in respect of expenditure on entertainment, including expenditure on hospitality extended to business contacts or, more generally, persons outside the business or in respect of expenditure relating to buildings, parts of buildings or their fittings intended primarily for such entertainment.

Article 5

Value added tax shall not be deductible in respect of expenditure on amusements and luxuries .

"Expenditure on luxuries" means expenditure which, by its nature and amount, does not consitute normal operating expenditure, or which relates to items which are not normally installed as fittings in buildings.

Article 6

The words "Article 17(6)" in Article 13 B.(c) of Sixth Directive 77/388/EEC are hereby replaced by the following : "the provisions of Twelfth Directive .:/.../EEC".

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Article 7

Member States shall bring into force the provisions necessary to comply with this Directive not later than 1 January 19...

This directive shall apply only with respect to value added tax charged on the purchase of goods or services invoiced, and on imports effected, from that date.

Member States shall communicate to the Commission the texts of the main provisions of national law which they adopt in the field covered by this Directive. The Commission shall inform the other Member States thereof.

Article 8

The second subparagraph of Article 17(6) of Sixth Directive 77/388/EEC shall cease to have effect in each Member State as from the date of implementation of this Directive.

Article 9

This Directive is addressed to the Member States.