European Communities — Joint Information Service

Newsletter on the Common Agricultural Policy

No. 5 April 1968

Proposal for a third Council directive on the application of TVA to transactions involving agricultural products

This issue was produced in conjunction with the Directorate-General for Competition and the Directorate-General for Agriculture of the European Communities.

Published by the Division for Agricultural Information in collaboration with the Directorate-General for Agriculture of the European Communities Commission — 129, rue Stévin, Brussels 4

Proposal for a Council directive on TVA in agriculture

Introduction

The Commission of the European Communities has submitted to the Council a proposal for a directive laying down joint arrangements for the application of tax on value added (TVA) to transactions involving agricultural produce.

This third TVA directive forms part of the wider programme for the harmonization of the Member States' legislation on turnover taxes. In its first directive,[1] the Council decided to replace national turnover-tax systems by a common system of tax on value added by 1 January 1970 at the latest. At the same time, in a second directive,[2] the Council agreed on the structure of this common system and on the procedure for applying it. The problem of applying TVA to agriculture was not settled by these first two directives, but the Council did at that time take decisions in this direction which were of considerable significance for agriculture in the Community. First, it agreed that agriculture should be included in the scope of the common TVA system and, second, it instructed the Commission to submit, as soon as possible, proposals for directives on common procedures for applying TVA to transactions in agricultural produce (see Article 15 of the Second Directive).

.../...

[1] First Council Directive, dated 11 April 1967, on the harmonization of the legislation of Member States concerning turnover taxes (67/227/CEE). Official gazette No. 71, 14 April 1967.

[2] Second Council Directive, dated 11 April 1967, on the harmonization of the legislation of Member States concerning turnover taxes. Structure and procedure for applying the common system of tax on value added (67/228/CEE). Ibid.

The development of the common agricultural policy has shown that there is an urgent need for Community rules in this matter.

1 July 1968, the date on which the common market in agriculture becomes a reality, is rapidly approaching. This means that the Community must eliminate any obstacles to the free movement of farm products within the Community caused by differences between the timetable for the common agricultural policy and those adopted for other common policies.

There are many obstacles of this kind. The common transport policy is still in its infancy; at present neither the transport systems nor the freight rates applied in the member countries are uniform. This is a considerable barrier to the free movement of farm produce. One has only to think, as one example, of the vast distance to be covered by citrus fruit grown in Sicily before it reaches the German and Dutch markets. Differences in the member countries' laws on veterinary inspections and sanitary regulations - these form part of the larger problem of the alignment of legislation - represent another obstacle - particularly to the free movement of meat.

However, obstacles caused by the existence of tax frontiers are perhaps more important than any of the others and are probably the most obvious. They arise not only from the application in the six countries of different taxes to the same product - which does affect the free movement of goods within the Community - but, even more important, from the existence of entirely different systems of taxation in the Member States. The prices fixed by the Council for the common market organizations are common to all the member countries, but they lose much of their value and significance when applied if the procedures for levying existing taxes, the transactions subject to tax, and the products taxed are not specified and defined in such a way that the advantages of tax neutrality are felt at all points on the production chain from farmer to consumer.

.../...

The Commission's latest proposal, then, is designed to introduce special Community arrangements for the application of TVA to farmers in the six countries, to get the Member States to agree to the adoption of a reduced rate of tax for most farm products and to do away as far as possible with formalities and controls in intra-Community trade in farm products. Approaching the problem in this way, the Commission proposes the simultaneous implementation of fiscal and agricultural policies with a view to attaining the objectives of the Treaty of Rome.

Before going on to examine the reasons which led the Commission to draft this proposed directive incorporating the measures and the rules which we will discuss later, let us analyse the different turnover-tax arrangements applied to farm products in the Member States at present and discuss the principles and the structure of the common TVA system.

Turnover tax on agriculture products

Four Community countries (Belgium, Luxembourg, Italy and the Netherlands) still apply cumulative multistage or "cascade" turnover-tax systems pending legislation to introduce the common TVA system - which must come into force by 1 January 1970 at the latest.

Under present legislation in these countries, agricultural holdings are not generally liable for turnover tax on sales. The farmer, however, must pay tax when he buys the means of production. Generally speaking, only capital goods such as agricultural machinery are taxed at the normal rate; all other supplies are either subject to a reduced rate of tax or completely exempt. Means of production of agricultural origin in particular (fodder, breeding stock, etc.) are generally taxed at a very low rate and are not taxed at all if sold to another farmer.

As the turnover-tax systems in force in these four countries are cumulative, it is very difficult to calculate what tax has been charged on the individual means of production at previous stages. This means that is very hard to assess

.../...

the exact extent of the tax burden borne by agriculture as a whole in each country or by the various agricultural products in the different member countries.

The taxation of farm products and foodstuffs manufactured from them at successive marketing and processing stages varies quite considerably from one country to the next; as a general rule, however, no member country charges the full rate of tax. This means that in the Netherlands and Luxembourg, for example, the increase in the price of basic foodstuffs en route from producer to consumer is very slight indeed, while in other member countries there is a considerable increase in the price of most of these products because of taxation.

Both France and Germany now apply a system of tax on value added, and special arrangements for farmers in the two countries vary considerably.

In France farmers may opt for inclusion in the TVA system. If they do, a simplified system is applied which is less stringent as regards book-keeping requirements and tax obligations. For the time being farmers not subject to TVA are entitled to:

(a) a refund of the tax paid on purchases of certain types of agricultural equipment: the State pays farmers 6.25% of the invoiced price;

(b) a flat rate of compensation calculated on the basis of total sales of farm products: the State compensates farmers at a flat rate for the total tax charged on their purchases, paying them a sum corresponding to 2% of sales of crop products and, normally, 3% of sales of livestock products.

After 1 October 1968, farmers not subject to TVA will have to choose between the refund and the flat-rate compensation.

.../...

Similarly, in Germany farmers can choose between the standard TVA system and a flat-rate deduction arrangement. Under this last arrangement, farmers invoice the tax on their sales at a reduced rate of 5% (or 3% for sales of timber products). Under the TVA system, tax paid by an individual on his purchases is deductible from the tax payable on sales; assuming that the tax paid by farmers on purchase of supplies corresponds to 5% (or 3%) of their total sales, nothing has to be paid to the revenue authorities.

The infinite variety of ways in which turnover tax is charged in the member countries presents a considerable obstacle to the common agricultural policy.

In the first place, different rates of tax and differences in real incidence on farm products according to the method used (cumulative taxes, non-cumulative taxes on value added) mean that compensatory measures have to be implemented in intra-Community trade; this is why tax frontiers are becoming permanent at a time when customs frontiers are disappearing.

In the second place, differences in the real incidence of turnover taxes on agricultural products in each Member State stand in the way of the complete attainment of the aims of the common agricultural policy, which is designed to create uniform conditions of competition for the sale of farm products within the Community and to allow prices to play an effective role as regulators of quantity and type of regional production. Turnover tax must have the same incidence in all Member States if the Council decisions on common prices and the ratios between these common prices are to retain their full weight.

A general review of all the problems resulting from the existence of differing national turnover-tax systems proved to the Community institutions that the only way to ensure the continued development of the common agricultural policy was to adopt Community-wide arrangements for the application of turnover tax to transactions involving farm products.

.../...

This can now be done under the Community's tax policy as part of the introduction of a common TVA system if the Member States adopt special arrangements for applying this system to agriculture. With this third directive, therefore, Community policies would be using the same instruments to achieve the same ends.

The common TVA system

Perhaps it would be as well to review the structure of the common TVA system defined in the first and second directives (see also Annex). The Community's TVA is a general tax on consumption; in other words, it is a tax levied on the utilization of goods and services by the final consumer but paid to the revenue authorities piecemeal by the various producers, traders and those providing services at various points along the production and distribution chain. At each stage, the tax is invoiced by the seller to the buyer, but the seller only pays to the authorities the difference between the tax levied on the sale (or on the services rendered) and the tax which he paid his suppliers when he bought the goods (or when he paid for the services). Thus the tax is not borne wholly by a seller since he can pass it on to a purchaser.

When goods are delivered or services are rendered to persons liable to TVA, the tax is charged on the invoice in addition to the net price. In an enterprise's accounts therefore the tax appears as a temporary item; for book-keeping purposes incoming and outgoing goods and services may be recorded at their net price.

TVA is of course a genuine tax burden for the final consumer, being passed on to him by suppliers as one element in the price of goods and services offered to him.

An essential feature of the common system is that tax paid at previous stages is deducted. It is important to note that a separate deduction is not made for each individual

.../...

delivery or service rendered but that all tax paid for a given period is offset against the total tax due for the same period. All tax shown in invoices for goods, raw materials, services, investments and general expenses is deductible.

If correctly applied, the tax-on-tax deduction arrangement ensures that the real incidence of TVA on the final price of goods and services is proportional to the rate of tax applied, with no cumulative effect. This is the main advantage of the TVA system.

The Community's institutions see the adoption of a common TVA system, fully harmonized in its details, as a process to be completed in several stages, culminating in the elimination of tax frontiers. The first stage involves the adoption by all the Member States of the structure and joint procedures for applying the system laid down in the second directive by 1 January 1970. Rates of tax and exemptions do not have to be harmonized during this first stage, and the six countries retain considerable freedom to introduce special arrangements and make exceptions in the case of certain services to which the rules of the second directive do not apply and with regard to the transitional measures needed to incorporate the common TVA system into domestic legislation.

Until such time as tax frontiers are eliminated, the Member States will have the option of applying the common TVA system up to the wholesale stage only and to introduce, if need be, an additional national tax for the retail stage or the stage immediately preceding it. They must, however, notify the Commission in advance so that consultation can take place.

In the absence of Community regulations in the matter, the Member States may - providing they consult the Commission first - introduce such special arrangements for small businesses and farmers as may be best suited to national conditions.

.../...

The facility of having special national regulations will lapse once specific joint regulations are introduced for the entire Community.

The third directive

With a view to obtaining a system that will be neutral in its effects on competition and for other reasons inherent in the requirements of the common agricultural policy, the proposed directive is aimed at:

(a) making it easier for agriculture to integrate into the economy as a whole by putting it on the same competitive footing as regards indirect taxation as other sectors of the economy, so as to avoid any discrimination between Community producers;

(b) facilitating the free movement of farm products within the Community;

(c) avoiding differences in the impact of the tax at the stages where agricultural prices in the Member States are normally formed.

The common TVA system provides the necessary framework for attaining these objectives. The special nature of agricultural policy and of the farming economy, however, meant that special technical solutions, which depart from the normal Community system, had to be found.

Since the common TVA system will have to be introduced in all Member States by 1 January 1970, implementation of the provisions of the third directive will be delayed until that date. Member States applying a TVA system prior to 1 January 1970 must, however, align their arrangements as much as possible on the third directive so as to avoid any difficulties arising from disparities between progress made towards establishing a single market in agriculture and the application of the common TVA system.

.../...

The special structural and economic features of agriculture in the Community have shown that the vast majority of small farmers cannot be expected to comply with the administrative formalities involved in the application of the normal TVA system. The third directive therefore makes provision for the introduction of a flat-rate deduction arrangement. The Community's flat-rate deduction system is quite different from the flat-rate arrangements in France and Germany. Under the Community's system, when a farmer sells agricultural products covered by the system, the purchaser, if he is liable to TVA, refunds to him in the price which he pays the tax already paid by the farmer on his purchases at a flat rate which will be fixed for each Member State by the Council before 1 July 1969.

The purchaser then pays to the revenue authorities the difference between the tax which he paid the farmer (at the flat rate) and the common reduced rate fixed for agricultural products; the purchaser liable to tax may of course deduct from the tax payable by him the amounts previously paid to the farmer and to the authorities.

Available macroeconomic data will serve as a basis for calculating the flat rate, which will be determined in such a way as to cover all the deductible TVA paid on purchases made by all the farmers who come under the flat-rate deduction arrangement.

This system is nothing more than a practical way of applying the tax; it should not entail financial advantages or disadvantages for the farmers coming under it. For this reason, farmers who are in a position to apply the normal system and farmers' associations will be excluded from the simplified system.

Any agricultural producer who feels that the application of the flat-rate deduction system is working to his disadvantage may opt for the application of the normal system.

For the purposes of this directive an "agricultural producer" means any person engaged in productive activities of the kind listed in Annex B to the directive in an agricultural, forestry or fishery establishment. These include agriculture

.../...

proper, animal husbandry, fresh-water fishing, fish farming, clam cultivation, etc. The annex is based on the International Standard Industrial Classification of All Economic Activities, published by the UN Statistical Office (Statistical Papers, Series M, No. 4, Rev. 1, New York 1958).

The layman may regard this flat-rate deduction arrangement for farmers as a piece of technical juggling typical of the TVA system. The proposal for a reduced Community rate of tax to be applied to most agricultural products is, however, a new departure the importance of which cannot be overlooked. It constitutes the first step towards the application of a common rate of TVA throughout the Community: its introduction ahead of time was made necessary by the implementation of arrangements for the common market in agriculture.

The common agricultural policy is based on single prices fixed by the Council and the relationship between these single prices. It is essential, therefore, that TVA should have the same incidence in all the Member States so that the impact of the Council's decisions should not be impaired. The application of different rates of tax could have a direct effect on price levels and an indirect effect on types of production and the operation of the European Agricultural Guidance and Guarantee Fund.

For instance, farm prices would go up in member countries applying a relatively high rate of tax to farm products, and this might lead to a drop in consumption. Increased quantities of products would then be offered to the intervention agencies, and the EAGGF would have to step in to finance expenditure on support buying or export refunds in the countries concerned, the cost being borne by the other Member States who had charged lower rates of tax which did not produce the same effects.

.../...

Annex A to the proposed directive lists the agricultural products to which either the reduced common rate of tax or the flat-rate deduction system will apply (that is to say, where these products are sold by a farmer coming under the flat-rate system). The list contains, in principle, all "ex-farm" products, including certain processed products. It also lists a number of means of production such as seeds and seedlings, fertilizers, insecticides and pesticides. The common reduced rate for means of production is intended to reduce and equalize the burden of tax paid at previous stages. Finally, the list contains certain groups of agricultural products regarded as substitutes for others on the list.

Since, however, there will be no common rates of tax during the first phase of harmonization, and since the aims of social and budget policy still differ, all Member States cannot be asked to limit the application of this common reduced rate to deliveries to final consumers of the goods appearing in Annex A. The Member States will therefore be free to increase or reduce the rate of tax paid at the final stage. The effect of the discretionary powers thus granted the Member States could run counter to the aims of the directive. It was for this reason that the Commission suggested a procedure designed to align the measures taken by the Member States and to achieve a certain degree of harmonization so that the aims of the common agricultural policy can be complied with as far as possible.

Since the single market in agriculture will be complete by 1 January 1970, intra-Community trade in farm products must also be relieved as far as possible from tax formalities and frontier controls. The common rate of tax proposed in this directive is an essential step on the road to this goal. Until taxes on imports and tax refunds on exports are abolished, that is to say until such time as tax frontiers are eliminated, the intention is to cease, as a transitional measure, to levy tax when goods cross frontiers between the Member States, the tax being collected from the first buyer after importation. Although this means that intra-Community

.../...

trade in agricultural products will continue to be subject to tax adjustment, this will be done by means of a procedure entailing the minimum amount of frontier formalities and controls. Adjustment will then, incidentally, no longer be required because of different rates but will merely serve to maintain the principle of taxation in the consumer country.

Conclusions

The application of TVA to agriculture is regarded as one way of encouraging a more modern structure of agriculture in the Community. Seen in this light, the solutions put forward in the third directive to deal with the various technical problems are only temporary ones intended to make it possible for European farmers to adapt to the common TVA system gradually as they modernize their farming methods.

The common reduced rate and the arrangements for intra-Community trade in the goods listed in Annex A are proposals which have gone beyond the purely agricultural sphere to assume considerable political importance.

The first step has been taken; it is now up to the Commission to forge ahead and for the six Governments to give proof of their goodwill.

The best way of understanding tax on value added and the way it is applied is to take an example, illustrated by a diagram to which the letters A, B, C and D refer. Let us assume that the rate of TVA is 20%.

I. The producer (A) sells his product at 40 francs, 8 francs being invoiced on the sale for TVA. He may, however, deduct tax paid by him on purchases of capital goods, raw materials and services. Assuming that these cost him 30 francs, he will already have paid 6 francs in TVA; he will therefore pay the revenue authorities:

   8 francs - 6 francs = 2 francs.

II. The industrial processor (B) buys A's product at 40 francs, plus 8 francs TVA. He resells at 70 francs and should therefore pay 14 francs tax, but he can deduct the 8 francs already paid when he bought A's product and any tax paid on his purchases of capital goods (say, 3 francs on purchases costing 15 francs). B will therefore pay the authorities:

   14 francs - 11 francs (8 + 3) = 3 francs.

III. The wholesaler (C) pays 70 francs for B's product plus 14 francs TVA. He resells to the consumer at 150 francs plus 30 francs TVA. If he is unable to deduct anything for the purchase of goods essential to the sale, he will pay the authorities:

   30 francs - 14 francs = 16 francs.

IV. The consumer pays 150 francs for the product and another 30 francs in TVA. Since he is the last link in the chain he must bear the full weight of the tax. From this example we can see that TVA is:

.../...

(1) A tax on value added

The amount paid to the revenue authorities by each enterprise, representing the difference between TVA invoiced on sale and TVA paid on purchase, is proportional to the value added by the enterprise to the goods used in production and to the products bought and resold.

A: 40 francs - 30 francs = 10 francs (value added)

10 x 20% (rate of TVA) = 2 francs tax payable

B: 70 francs - (40 + 15) = 15 francs (value added)

15 x 20% (rate of TVA) = 3 francs tax payable

C: 150 francs - 70 francs = 80 francs (value added)

80 x 20% (rate of TVA) = 16 francs tax payable

(2) A consumer tax

The tax paid by the final consumer equals the total tax paid at all points in the production and distribution process.

The 30 francs TVA paid by the consumer is made up as follows:

TVA paid at stage prior to A	6
" " by A	2
" " at stage prior to B (in Case II)	3
" " by B	3
" " by C	16
Total:	30

(3) A neutral tax

For the same price for the same product, the amount of TVA paid to the authorities will be the same irrespective of the number of links in the production chain.

.../...

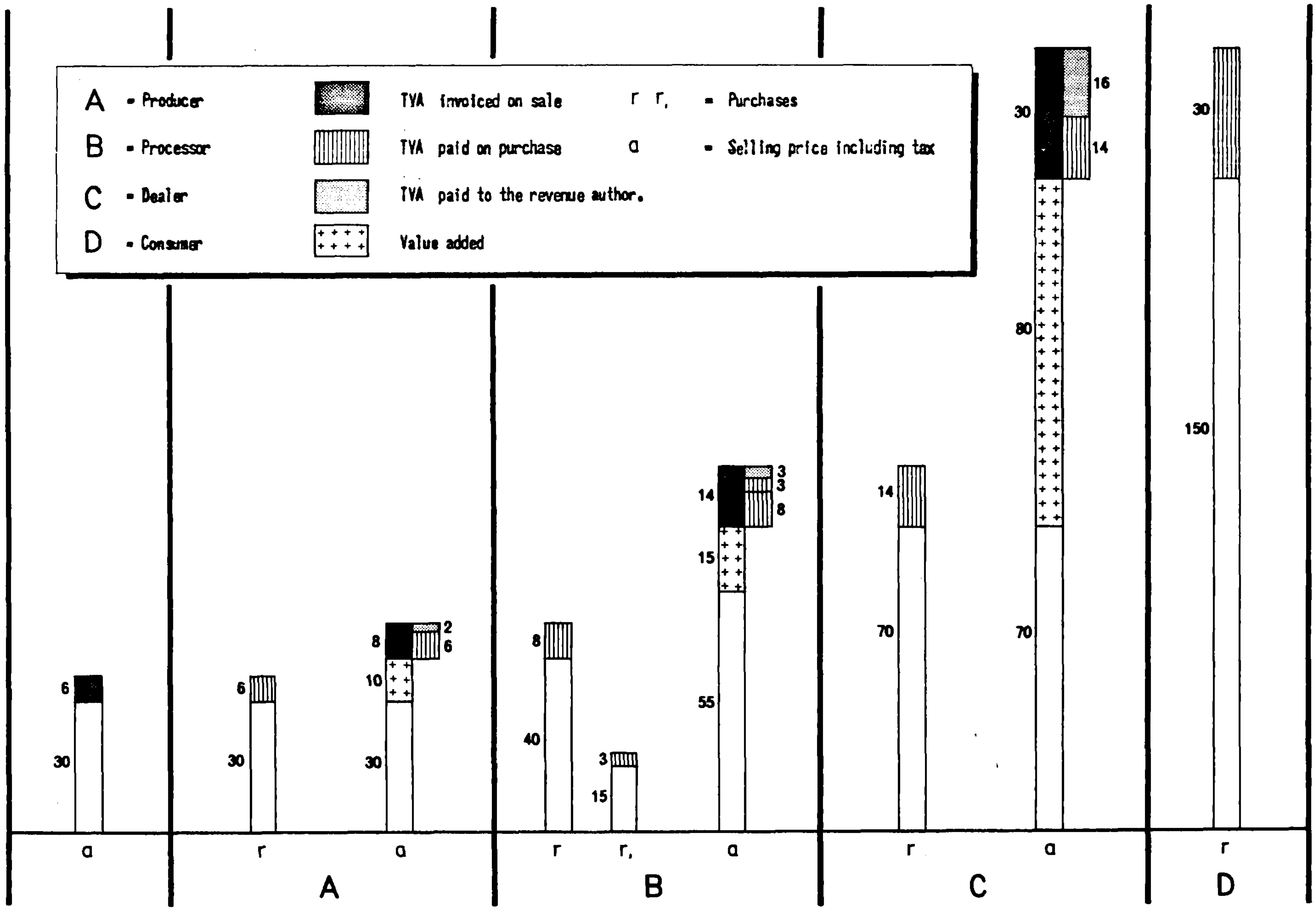
	Case 1		Case 2
	A	B	AB
Sales	40	70	70
	less 30	less 40 + 15 = 55	less 30 + 15 = 45
Value added	10	15	25
TVA (20%)	2	3	5

(4) A tax neutral in its effect on trade

Since TVA is a tax on consumption it is not levied on exports but on imports only. This means that home-produced and imported products receive identical treatment in the matter of turnover tax.

(5) An incentive to efficient book-keeping

An enterprise purchasing goods will always ask for an invoice so that it can deduct tax already paid when it sells. What is in the interest of each enterprise in the chain is also in the interests of the revenue authorities.



CEE - DG VI - 6802.33