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Report

drawn up on behalf of the Committee on Economic and Monetary Affairs

on the proposal from the Commission to the Council (Doc. 1-1299/82 - COM(82) 870 final) for a Twelfth 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

Rapporteur: Mr B. BEUMER

PE 86.173/fin.

English Edition

By letter of 14 February 1983, the President of the Council requested the European Parliament to deliver an opinion on the proposal from the Commission 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.

On 7 March 1983, the President of the European Parliament referred this proposal to the Committee on Economic and Monetary Affairs.

At its meeting of 15/16 March 1983, the Committee on Economic and Monetary Affairs appointed Mr Schnitker rapporteur.

The committee considered the proposal and the draft report at its meetings of 20/21 April 1983 and 25/26 May 1983. At the last of these meetings, Mr Schnitker resigned as rapporteur and Mr B. Beumer was appointed in his place.

The committee considered the proposal and the draft report at its meetings of 19/20 September 1983 and 27/28 September 1983.

At the latter meeting it decided to recommend to Parliament that it approve the Commission's proposal with the following amendments.

The motion for a resolution as a whole was adopted unanimously.

The following took part in the vote : Mr J. MOREAU, chairman; Mr BEUMER, rapporteur and deputizing for Mr Vergeer; Mr ALBERS (deputizing for Mr Rogers), Mr BEAZLEY, Mr von BISMARCK, Miss FORSTER, Mr HERMAN, Mr PAPANTONIOU, Mr ROGALLA, Mr Van ROMPUY and Mr WEDEKIND (deputizing for Mr Schnitker).

The report was tabled on 29 September 1983.

C O N T E N T S

The Committee on Economic and Monetary Affairs hereby submits to the European Parliament the following amendments to the Commission's proposal and motion for a resolution together with explanatory statement :

Amendments tabled by the Committee on Economic and Monetary Affairs	Text proposed by the Commission of the European Communities
Proposal for a TWELFTH COUNCIL DIRECTIVE on the harmonization of the laws of Member States relating to turnover taxes - Common system of value added tax : expenditure not eligible for deduction of value added tax (Doc. 1-1299/82)	
Preamble and recitals unchanged	
	Article 1
Amendment No. 1 Article 1(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 (two words deleted) pleasure boats or private aircraft (two words deleted).	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.
(unchanged)	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.
To be deleted	'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.

Amendment No. 2

Article 1(2) (new)

2. The right to deduct value added tax in respect of expenditure on the purchase, manufacture, importation, leasing or hire, use, modification, repair or maintenance of passenger cars and motorcycles shall be subject to the following restrictions in all Member States :

(a) For a period of not more than two years after the entry into force of this Directive, not less than 25% and not more than 75% of VAT in respect of the abovementioned vehicles shall be deductible;

(b) For a period of not more than four years after the entry into force of this Directive, the right to deduct VAT in respect of such vehicles shall be fixed at 50% in all Member States.

In the case of value added tax in respect of expenditure on supplies (fuels, lubricants, spare parts, etc.) for, or services performed in relation to such vehicles and craft, the same rules on deductibility shall apply.

'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 (third sub-paragraph of Article 1(1) of the Commission's proposal).

Amendment No. 3

Article 1(3)

3. The exclusions of the right to deduct referred to in paragraphs 1 and 2 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 1(2)

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

Amendment No. 4

Article 2(1)

1. The right to deduct value added tax in respect of transport expenses incurred on business travel by a taxable person or by members of his staff shall be limited to specific percentages in accordance with the timetable stipulated in Article 1(2);

'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.

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.

(unchanged)

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.

(unchanged)

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.

Amendment No. 5

Article 4 (new)

4. However, a taxable person may request application of Article 17(2) of Directive 77/388/EEC in respect of expenditure under Articles 1, 2 and 3 above if he can furnish incontrovertible proof that such expenditure is exclusively for business purposes.

The Member States shall maintain or set up a system of control to verify ex post facto that such expenditure was indeed exclusively for business purposes.

They shall notify the arrangements made to this effect to the Commission, which shall supervise the efficiency and strict application of such arrangements.

Old Articles 4 to 9 become new

Articles 5 to 10 (unchanged)

A

MOTION FOR A RESOLUTION

closing the procedure for consultation of the European Parliament on the proposal from the Commission of the European Communities to the Council for a twelfth 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 European Parliament,

- having regard to the proposal from the Commission to the Council (COM(82) 870 final),
- having been consulted by the Council (Doc. 1-1299/82)[1],
- having regard to the report of the Committee on Economic and Monetary Affairs (Doc.1-777/83),
- having regard to the result of the vote on the Commission's proposal,

1. Takes note of Article 17(6) of the Sixth VAT Directive, which provides for the harmonization of the items of expenditure in respect of which VAT is not deductible;

2. Emphasises that the harminization at Community level of VAT regulations in this field is necessary in order to eliminate the distortions of competition resulting from the considerable differences in national legislation and to satisfy the requirements of a uniform basis of assessment and a non-discriminatory system of taxation;

3. Recognizes that, in the case of certain expenditure, it is difficult to establish what part of it relates to business activities and what part to private consumption;

4. Underlines that efforts must be made to establish rules governing the deductibility of VAT on such expenditure which accord most closely with the basic principles of VAT; this means that the system envisaged must ensure that VAT in respect of all expenditure incurred for normal business purposes is deductible while at the same time preventing expenditure for private consumption becoming eligible for the deduction of VAT;

[1] O.J. No. C 37, 10.2.83, p.8

5. Emphasises that, in view of the economic recession, no measures can be considered that would lead to an appreciable increase in the burden on industry; cannot therefore consent to the total exclusion from VAT deductibility of expenditure which largely bears a business character, since this would mean a considerable increase in costs for industry, more specifically the SMUs, and would adversely affect certain economic sectors;

6. Notes, however, that in view of the difficulty of distinguishing between the private and business components of certain expenditure, the Commission proposes totally to exclude such expenditure from the right to deduct VAT, a measure which would amount to dual and cumulative taxation and would thus be essentially a negation of the VAT system;

7. Points out that passenger cars used in industry are to a large extent intended for business activities, even though such vehicles are also used to a limited extent for private purposes; is aware of the difficulties involved in checking to what extent such vehicles are used for private and for business purposes respectively and therefore opts for a flat-rate scheme which meets as well as possible the objective set out in paragraph 4;

8. Is in favour of VAT in respect of expenditure on passenger cars and motor cycles being deductible at a flat-rate of 50% of the VAT paid; (see Amendment No. 2, Article 1(2), subparagraphs 1 and 2); considers however that, in view of the adjustments required in the various Member States in order to change over to such an arrangement, there is a need for a gradual transition; therefore proposes that, in an initial phase of harmonization, value added tax in respect of such expenditure should be deductible in all Member States at a rate of between 25% and 75%;

9. Is also of the opinion that transport expenses incurred on business travel are predominantly business expenditure and that it is therefore unacceptable that such items should be totally excluded from the right to deduction of VAT; is therefore in favour of a flat-rate scheme on the same lines as that for passenger cars and motor cycles, which would also be introduced in two phases;

10. Believes, however, that if it can be shown beyond all possible doubt that, contrary to what is presumed in Articles 1, 2 and 3 of this Directive, the expenditure in question is exclusively for business purposes, the taxable person should have the option of requesting the application of Article 17(2) of the Sixth VAT Directive; emphasizes on the other hand that this option must be linked to the introduction of a strict system of control, under the close supervision of the Commission, to verify ex post facto that such expenditure was indeed exclusively for business purposes.

11. Agrees that VAT should not be deductible in respect of the other expenditure listed by the Commission, which is not of a strictly business nature but is mainly a matter of consumption;

12. Emphasises that the interested parties, and more specifically governments and industry, should not view this proposal in isolation but should see it in the general context of tax harmonization;

13. Underlines that if the objectives of a non-discriminatory tax system and the elimination of distortions of competition are to be achieved, implementation of the right to deduct VAT in respect of the expenditure in question should not be circumvented by the introduction of new taxes, in addition to VAT, in respect of which there is absolutely no right of deduction; also urges the Member States to abolish the existing taxes on such expenditure, other than VAT, and, where necessary, to offset the loss of tax revenue by an increase in VAT rates;

14. Insists that, when this directive has been adopted, all other restrictions on the right to deduct VAT in the various Member States must be abolished, as provided for by Article 8 of the draft directive;

15. Instructs its President to forward to the Council and Commission, as Parliament's opinion, the Commission's proposal as voted by Parliament and the corresponding resolution.

B.

EXPLANATORY STATEMENT

1. Article 17(6) of the Sixth VAT Directive[1] states that '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 Community regulations are established, Member States may retain the legislation that was operative when the Sixth Directive came into force. The expenditure, which has to be examined to see whether or not it is eligible for deduction of input VAT, can be classified under the following headings:

(a) expenditure on food and drink;
(b) expenditure on lodging and accommodation;
(c) expenditure on entertainment;
(d) expenditure on gifts;
(e) expenditure on passenger cars.

2. It is difficult to establish whether this kind of expenditure is incurred in the normal conduct of business or simply to satisfy private needs. If such expenditure is eligible for deduction, there is a risk that VAT will also be deducted in respect of expenditure incurred for private purposes and that frauds will thus be committed.

Faced with the risk of fraud, the Member States have imposed a variety of restrictions on deductibility, together with various control systems. The Commission now proposes to harmonize the different national laws restricting deductibility of VAT. This is very necessary since the disparities in national legislation result in distortions of competition between Member States, seeing that Member States which apply fairly liberal rules on the deductibility of VAT are putting their industry at an advantage vis-à-vis industry in other Member States which do not permit the deduction of VAT in respect of certain kinds of expenditure. Moreover, the Eighth VAT Directive, which governs the refund of VAT to taxable persons from other Member States, makes it possible to avoid the strict legislation of one Member State by obtaining the refund in another.

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[1] OJ No. L 145, 13.6.1977

3. Harmonization of the existing laws in the various Member States is thus necessary from the point of view of competition. But, how does the Commission propose to harmonize the rules on deductibility. All the expenditure listed, namely expenditure on passenger cars, pleasure boats, private aircraft or motor cycles, transport expenses incurred on business travel, expenditure on accommodation, food and drink, expenditure on entertainment and expenditure on amusements and luxuries, is excluded from the right to deduct. The exceptions to these rules are extremely limited; for example, where the vehicles are the means through which the taxable person pursues his economic activity, as is the case with taxis, driving schools, car hire, etc. In the case of VAT on food and drink, the right to deduct is restricted to economic sectors whose activities consist in providing the goods or services which may be the object of the exclusion, particularly the hotel and catering trade and suppliers and manufacturers of food. Similarly, expenditure incurred in transporting staff to their place of work and in providing accommodation for security or caretaking staff is also eligible for deduction.

4. These harmonization rules do in fact virtually rule out the possibility of tax frauds, which means that there would no longer be distortions of competition resulting from the existence of divergent national laws on exclusion from the right to deduct. The questions that arise are whether such strict regulations are necessary, whether they accord in essence with the VAT system and what the negative repercussions are of the application of such strict rules.

One of the basic principles of VAT is that the system of successive payments of tax at the various stages of production and distribution, whereby each taxable person is entitled to the full and immediate deduction of VAT already paid, makes it possible to avoid any cumulative effect and thus makes taxation independent of the length of the economic cycle. The present proposal to restrict the right to deduct will introduce a cumulative element which is not compatible with the VAT system. For, if the expenditure mentioned is incurred in the course of business activities it would be subject to VAT twice, thus imposing an additional burden on industry. Moreover, the measure would mainly affect small and medium-sized businesses, since this expenditure represents a much higher percentage of the total costs of the latter than it does for large undertakings. In addition, the proposal threatens to do serious economic damage to sectors supplying the goods and services concerned, such as the car industry.

5. Your rapporteur cannot therefore support all the elements in the proposal for a twelfth VAT directive, which affects on the one hand all undertakings in that they no longer have the right to deduct VAT in respect of the expenditure concerned and, on the other, the sectors supplying the goods and services in question. In the present economic crisis, with steadily increasing unemployment, when measures designed to promote economic recovery should be given absolute priority, it is incomprehensible that, the Commission should suggest imposing additional burdens on industry, which will severely affect the small and medium-sized businesses that play such an important role in creating new jobs. It is indeed somewhat surprising that the Commission totally fails to mention this point in its explanatory memorandum on the proposal for a directive. The Commission is no doubt interested in seeing the VAT revenue of the Member States increase with a view to an increase in the Community's own resources. Although the Committee on Economic and Monetary Affairs supports the Commission's efforts to raise the level of own resources, it cannot approve this proposal, which imposes an excessively severe burden on the economy.

6. As stated at the beginning, harmonization is undoubtedly necessary. However, the way in which the Commission proposes to harmonize the laws cannot be endorsed. It is in the very nature of the VAT system that all expenditure incurred in connection with business activities must be eligible for deduction. Although in the case of expenditure covered by this draft directive it is difficult to draw a clear line between the private and business components, this ought not to mean that the expenditure concerned should be totally excluded from the right to deduct. Having regard to the ideal situation, in which input VAT in respect of expenditure for business purposes would be deductible whereas expenditure incurred for private consumption would not be able to enjoy this facility, a number of amendments to the draft directive have been proposed here. These amendments relate to the expenditure covered by the draft directive, though where the business component is usually considerable. In such cases, the expenditure cannot be totally excluded from the right to deduct merely on the grounds that it is difficult to draw a line between the business and the private components of the expenditure. This applies particularly to expenditure on passenger cars and motor cycles, transport expenses incurred on business travel and the cost of accommodation.

7. Although company cars and motor cycles are usually also used for private purposes, this is no reason to exclude the expenditure in question from the right to deduct. However, it is extremely difficult to separate the private and business components of the expenditure and to carry out checks. The only feasible solution is therefore to establish flat-rates for the business and private components. In fixing the flat-rates it must be assumed firstly that company cars and motor cycles are primarily used for private purposes in the evenings and at weekends. Secondly, it must be borne in mind that establishing a uniform percentage of expenditure eligible for the deduction of VAT will require considerable adjustments in many Member States, namely in those where expenditure incurred in connection with the use of passenger cars for business purposes is not eligible for deduction. Thus, granting the right to deduct VAT in respect of a fixed percentage of such expenditure will entail a loss of tax revenue for such Member States. For these reasons, the introduction of a flat-rate of 50% for the expenditure eligible for the deduction of VAT would appear appropriate. In view of the adjustments required to introduce such a flat-rate in various Member States, a gradual transition would be necessary: in an initial phase, that is for two years after the entry into force of this directive, all Member States would be required to allow the deduction of VAT in respect of no less than 25% and no more than 75% of such expenditure. Only in a second phase, starting four years after the entry into force of the directive, would the standard rate of 50% be established throughout the Community.

8. With regard to transport expenses incurred for business travel, the same arrangements are proposed, partly to prevent discrimination and to ensure fair competition. In the event of other rules, the taxable person would be inclined to choose his means of transport - passenger car, train or plane - in the eight of which was the most advantageous from the point of view of VAT deductibility.

9. It is, however, possible that expenditure under Articles 1, 2 and 3 of the Directive may be solely and exclusively for business purposes. In such cases, even an arrangement based on a flat rate of 50% as proposed for cars and motorcycles is incompatible with the purpose of the VAT system. A taxable person who incurs such expenses solely for his business purposes must therefore be given the option of applying for the full deduction of VAT on the expenditure concerned, in accordance with Article 17(2) of the Sixth VAT Directive.

however, to prevent this facility being abused, the Member States must set up watertight control systems to verify ex post facto that such expenditure was indeed exclusively for business purposes. The setting up of such systems must be left to the Member States. However, the Commission must be notified by the Member States of the way in which the controls are organized so that it can assess the effectiveness of the control systems and monitor their strict application.

10. The remaining expenditure listed by the Commission as not being strictly of a business nature and thus excluded from the right to deduct VAT basically consists of: expenditure on entertainment
amusements and luxuries. Although such expenditure is partly of a business nature, the consumption element is not inconsiderable. It is difficult, if not impossible, to establish the extent to which such expenditure is justified in the pursuit of business activity. Article 17(6) of the Sixth VAT Directive clearly provides 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 entertainments'. Your rapporteur supports the exclusion of such expenditure from the right to deduct VAT.

11. In a number of Member States the expenditure under discussion is currently subject to other taxes, in addition to VAT, which are not deductible. Such taxes vitiate the VAT system, the objectives of which are non-discriminatory taxation and the abolition of distortions of competition caused by taxation. Efforts must therefore be made to abolish such taxes, which could be replaced by an increase in VAT rates to maintain the tax revenue of the Member States concerned. Furthermore, the entry into force of legislation making VAT deductible in respect of a number of items of expenditure which are not at present eligible for deduction in some Member States must not induce the latter to introduce other taxes, in addition to VAT, whereby they would partly be able to avoid granting the right to deduct.

12. Finally, it should be pointed out that the adoption of this directive implies that the right to deduct VAT in respect of all other expenditure must be recognized pursuant to Article 17(2) of the Sixth VAT Directive. Expenditure in respect of which VAT is currently not deductible in certain Member States, for example VAT on advertising expenditure, will also become fully deductible when this directive is adopted. This is ensured through Article 8 of the proposal for a directive which states that the second sub-paragraph of Article 17(6) of the Sixth VAT Directive shall cease to have effect as from the date of implementation of this directive. The second sub-paragraph of Article 17(6) provides that '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'. Implementation of the Twelfth VAT Directive thus means the abolition of all national legislation that does not comply with the provisions of the Directive.