COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE COUNCIL
PRESENTED IN ACCORDANCE WITH ARTICLE 2
OF THE COUNCIL DECISION 89/488/EEC
OF 28 JULY 1989

(Application of a measure derogating from
Article 17(2) of the sixth Directive 77/388/EEC
on the harmonization of the laws of the Member States
relating to turnover taxes)

Proposal for a
COUNCIL DECISION
authorizing the French Republic to extend the
application of a measure derogating from Article 17(2)
of the sixth Directive 77/388/EEC on the harmonization
of the laws of the Member States
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(presented by the Commission)

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I. INTRODUCTION

By Council Decision 89/488/EEC of 28 July 1989,[1] the French Republic was authorized on the basis of Article 27 of the sixth VAT Directive, still in force, to derogate from Article 17(2) of the sixth VAT Directive.

The derogation consists in excluding altogether from the right to deduct VAT previously charged expenditure in respect of goods and services in cases where private use of those goods and services accounts for more than 90% of their total use.

The Council Decision authorizes application of that derogation until 31 December 1992. Article 2 stipulates that the Commission is to present to the Council, prior to the date of expiry of the derogation, a report on its application, accompanied, if appropriate, by a proposal for a Council Decision authorizing its extension.

The purpose of the present report is to give an account of the application of the derogation and to examine the application for an extension submitted by the French Republic by letter registered by the Secretariat-General of the Commission on 22 October 1992.

II. APPLICATION OF THE DEROGATION

1. Background

On 3 February 1989 the French Council of State, in the "Alitalia" case, gave a condemnatory ruling in respect of Article 230-1 of Annex II to the French General Tax Code, which excluded from the right to deduct VAT previously charged expenditure on goods and services not used exclusively for the purposes of the taxable person's business.

By that ruling, and in accordance with Community law, exclusive use ceased to be one of the conditions governing the right to deduct VAT in France. From now on, where goods and services are used partly for non-business purposes, tax is deducted in full but, instead, private use of goods or services is taxed on the basis of Article 6(2) of the sixth Directive.

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1 OJ No L 239, 16.8.1989.

In the interests of simplification, the French Republic has requested authorization from the Council to continue on a temporary basis to exclude from the right to deduct VAT previously charged on expenditure on goods and services in cases where private use of those goods and services accounts for more than 90% of their total use. Such a provision is designed to avoid having to tax self-services, something which would raise difficulties since the taxable amount would be based on an assessment of the value of self-supplies resulting from the private use of the goods.

2. Entry into force in France

Articles 1, 3 and 5 of Decree No 89-885 of 14 December 1989, published in the Official Journal of the French Republic of 15 December 1989 (p. 15578), transpose the Council Decision into national law. The Decree entered into force in Paris on 17 December 1989 and in the provinces, in principle, on 18 December 1989. It gave rise inter alia to new Article 230-1 of the General Tax Code and was the subject of an Administrative Instruction of 21 February 1990, published in the Official Tax Gazette (ref. 3 D-3-90) and registered in the administrative documentation under reference 3-D-1512 (updated on 1 May 1990).

3. Quantitative assessment of private use (threshold of 90%)

The quantitative assessment is based on the following:

- nature of the goods or services;
- function of the goods or services;
- possible use of the goods or services in the business under consideration;
- apportionment of the periods of use of the goods or services under consideration in terms of the calendar year or as a fraction of the calendar year in cases where possible total use can, in any event, be only seasonal (e.g. pleasure boats).

4. Practical application of the derogation in France

The derogation in question is applied in the following circumstances:

- Purchases by a business of goods and services that are to be made immediately available to, or used in connection with the main activity of the business by, the head of the business, the managers, the staff or a third party: in this case, exclusion from the right to deduct tax is automatic.

Examples

. Purchase or leasing of a video camera for the use of the manager, with the camera being used exceptionally for in-house vocational training purposes;

. Pleasure vessel used essentially for private purposes but rented out for one week of each year.

- Purchase of goods and services that are normally used for the purposes of the business but which, after being used for one year, are found to have been used for private purposes to the extent of more than 90% of their total use: In this case, after the first year of use, the business will have to make an adjustment in respect of the VAT initially deducted. The adjustment will consist in payment of all the tax deducted.

  Where the circumstances referred to above are discovered during the adjustment period provided for in Article 20(2) of the sixth Directive, tax is paid in respect of the years of the adjustment period that have elapsed. It will, therefore, be equal to the amount of the previous deduction less one fifth (movable property) or one tenth (immovable property) for each year that has elapsed.

5. Special case of local authorities (non-taxable institutional persons within the meaning of Article 4(5) of the sixth Directive)

   In this case, the use of goods and services for the purposes of an activity falling outside the scope of VAT is regarded by France as corresponding to private use.

   Example

   . Computer used simultaneousy by a municipality for the purposes of taxable transactions and for the purposes of non-taxable services supplied by it in connection with civil status and social assistance.

     In addition, the French administration has informed its departments that, in any event, in the interests of simplification, there is no reason to call into question the situation of local authorities which, in cases where a capital good is used for both non-taxable and taxable transactions, consider that use in respect of the former accounts for more than 90% of their total use even where this is not actually the case.

6. Position of the French administration on the application of the derogation

The French administration takes the view that the derogation has simplified administration of the tax, both for itself and for the businesses concerned. Moreover, as far as it is aware, no dispute regarding application of the derogation has arisen between itself and the businesses concerned. Until recently, the derogation had, in any event, been applied only in a very few, marginal cases not caught by the statistics.

III. APPLICATION FOR AN EXTENSION OF THE AUTHORIZATION

In this connection, the French Republic points out that the derogation in question might be applied more often in future in view of the fact that, since 1991, a number of liberal professions (lawyers, solicitors, translators, interpreters, sports people, authors and artists) have carried out transactions that are taxed and no longer exempt.

Now, such professionals, given the liberal nature of their activities, commonly use goods forming part of their business for their own private purposes (e.g. mixed-use apartment, computer, or even photographic or hi-fi equipment in the case of a performing artist). If the derogation did not apply, such private use would require supervision by the tax authorities of such equipment throughout its useful life and, in any case, taxation of the self-supplies resulting from such private use. Calculation of the taxable amount for such supplies would not be straightforward and it would be no easy matter convincing the person liable to pay tax that the taxable amount had been calculated correctly since, in such circumstances, Article 11(A)(1)(c) of the sixth Directive stipulates that the taxable amount is the full cost to the taxable person of the self-supplies corresponding to the private use of the business asset (e.g. in the case of a car, purchase, fuel, repairs, maintenance, etc.).

IV. OPINION OF THE COMMISSION DEPARTMENTS

1. Case for extending the derogation

Since the derogation in question is designed to avoid "consumption without taxation", the Commission departments take the view that it is justified.

However, they are also aware of the fact that, from a financial viewpoint (in terms of a cash-flow benefit), taxation of the use for private purposes of goods or services is more favourable for the person liable to pay tax than is automatic exclusion of the right to deduct VAT previously charged. However, in cases where private use accounts for more than 90% of total use, the cash-flow benefit is not justified since the business makes virtually no use of the goods or services in question.

2. Period covered by the derogation

The Commission departments take the view that a definite expiry date should be set for the derogation so that an assessment can be made notably in the light of the progress in Community work on the proposal for a twelfth VAT Directive and in the light of the actual application of the derogation. Bearing in mind the observations set out below, the derogation could, therefore, be extended on a temporary basis until adoption of the twelfth VAT Directive if that takes place by 31 December 1996. If the twelfth VAT Directive were not adopted by that date, the derogation would, in any event, expire on 31 December 1996.

3. Application of the derogation in France

1.1 Application of the derogation to local authorities calls for the following observations and questions from the Commission:

> France has been authorized to exclude "expenditure in respect of goods and services in cases where private use of those goods and services accounts for more than 90% of their total use" from the right to deduct value added tax previously charged.
>
> The Commission departments consider that partial use of goods by a local authority for activities falling outside the scope of VAT pursuant to Article 4(5) of the sixth Directive could not be regarded as giving rise to private use within the meaning of Article 6(2) of the sixth Directive. Nor do such cases involve use for purposes other than those of the local authority since the very purpose of local authorities is to carry out transactions as public authorities.
>
> A local authority should, in fact, be regarded as using the goods in question partly for the purposes of a "non-taxable transaction".

The Commission departments would note that, from a strictly legal viewpoint, the sixth Directive provides for an option to tax only in respect of "the application of goods by a taxable person for the purposes of a non-taxable transaction", that is to say, in the case in point, where self-supplies of goods take place. Where goods are used for the purposes of a non-taxable transaction, the sixth Directive does not introduce on either an optional or a compulsory basis any arrangement "parallel" to that provided for in Article 5(7)(b) with a view to bringing a self-supply of services within the scope of VAT.

In such cases, however, there is no denying that local authorities must be treated in the same way as fully taxable persons and that, where they use goods or services partly for the purposes of a non-taxable transaction, such use should be taxed if VAT previously charged on those goods and services was deductible. For this to happen, the Member States should agree to treat such use as use for purposes other than those of the business within the meaning of Article 6(2) of the sixth Directive. Such treatment could be the subject of a decision by the VAT Committee.

Accordingly, the Commission departments propose that the legal arrangements for the derogation granted to France should be adjusted in such a way as to duly establish that it applies to the type of use in question here. France would then be authorized to "exclude expenditure in respect of goods and services in cases where use of those goods and services for the purposes of a non-taxable transaction accounts for more than 90% of their total use from the right to deduct value added tax previously charged".

1.2 More generally, the Commission departments would note that France makes extensive use of the derogation in that it applies it as soon as use for non-business purposes accounts for more than 90% of total use. Now, Article 1 of the Council Decision introducing the derogation is concerned solely with those cases where private use accounts for more than 90% of total use. As a result, uses other than those for the private purposes of the taxable person or his staff are not expressly concerned by the derogation. Among other things, private use by a third party is not covered.

In this respect, the Commission departments, which would like to observe the neutrality of VAT and take the view that any consumption without taxation should be avoided, propose that the legal arrangements for the derogation be improved by restoring a parallel with Article 6(2) of the sixth Directive, which, in the absence of any derogation, should be applied in its entirety. Accordingly, the derogation could apply in all cases where goods are, in any event, used for purposes <u>other than those of the business</u>.

Proposal for a

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EXPLANATORY MEMORANDUM

1. By letter registered by the Secretariat-General of the Commission on 22 October 1992, the Government of the French Republic submitted a request for an extension of the derogation previously granted to it for a limited period by Council Decision 89/488/EEC of 28 July 1989,[1] which was based on Article 27 of the sixth VAT Directive[2] with a view to avoiding tax evasion and avoidance.

   This derogation from Article 17(2) of the sixth VAT Directive[2] consists in excluding altogether from the right to deduct VAT previously charged expenditure in respect of goods and services in cases where private use of those goods and services accounts for more than 90% of their total use.

2. The Council Decision authorizes application of that derogation until 31 December 1992. Article 2 stipulates that the Commission is to present to the Council, prior to the date of expiry of the derogation, a report on the application of the derogation, accompanied, if appropriate, by a proposal for a Council Decision authorizing its extension.

3. In support of its request, the Government of the French Republic points out that the derogation in question will probably have to be applied more often in future in view of the fact that, since 1991, a number of liberal professions (lawyers, solicitors, translators, interpreters, sports people, authors and artists) have been carrying out, on the basis of the eighteenth VAT Directive,[3] operations that are taxed and no longer exempt, with such individuals, on account of the liberal nature of their profession, using goods forming part of the assets of their business for their own private use. If the derogation did not exist, such private use would necessitate surveillance by the tax authorities of such goods throughout their useful life and, in any case, the taxation of self-supplies resulting from such private use. Calculation of the taxable amount for such supplies would not be straightforward and it would be no easy matter convincing the person liable to pay the tax that the taxable amount had been calculated correctly.

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1 OJ No L 239, 16.8.1989.
2 OJ No L 145, 13.6.1977.
3 OJ No L 226, 3.8.1989.

Under such circumstances, it is advisable to withhold any entitlement to tax deduction rather than to tax self-supplies, notably with a view to preventing tax evasion and avoidance, which have hitherto been so easy to perpetrate.

However, the Commission report on the application of the derogation over the period 1990-92 showed that the legal arrangements for the derogation should be adapted so as to ensure that they cover local authorities and all possible types of use for purposes other than those of the business. The Commission proposal for a Decision also sets a definite date for the expiry of the derogation so that a new assessment of its application can be made in four years' time.

4. The Commission informed the other Member States by letter dated 20 November 1992 of the French request for an extension.

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THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,

Having regard to the sixth Council Directive 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] as last amended by the Council Directive of 16 December 1991 with a view to the abolition of fiscal frontiers,[2]

Having regard to the proposal from the Commission consequent upon its report on the application by the French Republic of Council Decision 89/488/EEC of 28 July 1989,

Whereas, under Article 27(1) of the sixth Directive, the Council, acting unanimously on a proposal from the Commission, may authorize any Member State to introduce special measures for derogation from that Directive, in order to simplify the procedure for charging tax or to prevent certain types of tax evasion or avoidance;

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1 OJ No L 145, 13.6.1977, p. 1.
2 OJ No L 376, 31.12.1991, p. 1.

Whereas, by letter registered by the Secretariat-General of the Commission on 22 October 1992, the French Republic requested authorization to extend application of the derogation previously granted to it for a limited period by Council Decision 89/488/EEC of 28 July 1989[3] on the basis of Article 27 of the sixth Directive;

Whereas the said measure consists in excluding altogether from the right to deduct VAT previously charged expenditure in respect of goods and services in cases where private use of such goods and services accounts for more than 90% of their total use, in order to refrain from taxing self-supplies the taxable amount of which is particularly difficult to establish under those circumstances;

Whereas, moreover, the said measure makes it possible to prevent certain types of tax evasion or avoidance and, in any event, combats certain forms of consumption without taxation while, at the same time, simplifying the VAT treatment of certain transactions;

Whereas the said measure constitutes a derogation from Article 17(2) of the sixth Directive, whereby a taxable person is entitled to deduct the tax charged on goods and services used by him in so far as those goods and services are used for the purposes of his taxable transactions;

Whereas the said measure also constitutes, as demonstrated in the Commission report on its application over the period 1990-92, a derogation from Article 6(2) of the sixth Directive, whereby the use of goods forming part of the assets of a business for the private use of the taxable person or of his staff or, more generally, for purposes other than those of his business where the value added tax on such goods is wholly or partly deductible must be treated as a supply of services for consideration;

Whereas the request for an extension of the said measure can be accepted subject to certain conditions and adjustments to its legal arrangements in accordance with the observations made by the Commission in respect of its application over the period 1990-92;

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3 OJ No L 239, 16.8.1989.

Whereas, without a new authorization from the Council based on a proposal from the Commission, the said measure cannot be extended beyond 31 December 1996, by which time the Commission is to present a report on its application to the Council;

Whereas the temporary extension of the said derogation will not a priori affect the amount of tax due at the final consumption stage, taking into account Article 11(A)(1)(b) of the sixth Directive, which defines the taxable amount for self-services caught by Article 6(2) of that Directive;

Whereas, moreover, it will not a priori have a negative effect on the European Communities' own resources accruing from value added tax;

Whereas the other Member States were informed on 20 November 1992 of the request for an extension of the said derogation submitted by the Government of the French Republic,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Articles 6(2) and 17(2) of the sixth Council Directive (77/388/EEC), as last amended by Directive 91/680/EEC, the French Republic is hereby authorized until 31 December 1996 to exclude expenditure in respect of goods and services in cases where use of such goods and services for the private use of the taxable person or of his staff or, more generally, for purposes other than those of his business account for more than 90% of their total use from the right to deduct value added tax

previously charged. Similarly, the French Republic is hereby authorized until 31 December 1996 to exclude expenditure in respect of goods and services in cases where use of those goods and services for the purposes of a non-taxable transaction accounts for more than 90% of their total use from the right to deduct value added tax previously charged.

Article 2

On the basis of a report on the application of the authorizations referred to in Article 1, accompanied, if appropriate, by a proposal for a Decision, the Council shall determine on the basis of that proposal before 31 December 1996 whether the said authorizations are to be extended.

Article 3

This Decision is addressed to the French Republic.

Done at Brussels,

For the Council

The President

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DOCUMENTS

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