COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.11.2005
COM(2005) 581 final

Proposal for a

COUNCIL DECISION

authorising the Republic of Lithuania to apply a measure derogating from Article 11(A)(1) and Article 28e of the Sixth Council Directive (77/388/EEC) on the harmonisation of the laws of the Member States relating to turnover taxes

(presented by the Commission)

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

Pursuant to Article 27(1) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from that Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

By letter registered with the Secretariat-General of the Commission, the Republic of Lithuania requested an authorisation to introduce measures derogating from Article 11(A)(1) of Directive 77/388/EEC, subsequently confirming to the Commission that the application also included a request for a derogation from Article 28e of the same Directive. In accordance with Article 27(2) of Directive 77/388/EEC the Commission informed the other Member States of the request by Lithuania on 7th June 2005. The Commission notified Lithuania on 14 June 2005 that it had received all the information that it considered necessary for appraisal of the request

- **General context**

Article 11(A)(1) of Directive 77/388/EEC establishes the taxable amount of a supply of goods or services to be "everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser….". This provision is normally sufficient in cases where the supply is solely a commercial transaction and where there is no connection between the supplier and purchaser which would affect the value of the supply. However, where the parties to the transaction are connected there is evidence that some supplies incur less tax through the manipulation of their value. Where the connected recipient does not have a full right to deduction, an undervaluation by reference to the normal market value reduces their exposure to irrecoverable input tax. In cases where the supplier only has a limited right to deduct, an overvaluation of a supply to a fully taxable recipient will have no effect, other than cash flow, on the recipient but by altering the ratio of the value of taxable and exempt supplies it may improve the supplier's recovery position.

In order to prevent tax losses arising through such variations in value, Lithuania has requested the ability to amend the taxable amount in those cases described where the taxable amount varies significantly from the open market value and where the supply is between connected persons. Connected persons for the purposes of applying the re-valuation are objectively defined and set out in Lithuanian VAT law.

The proposal allows the Lithuanian tax authorities to apply the open market value (as defined in Article 11(A)(1)) to the supply for the purposes of calculating VAT, rather than the consideration that was actually paid.

The rules for the valuation of intra-Community acquisitions are found in Article 28e of Directive 77/388/EEC which extends the Article 11(A) rules to intra-Community acquisitions. In order to ensure that both domestic supplies and intra-Community

acquisitions are treated equally and that the counter measure cannot be easily avoided through the exploitation of connected persons in other Member States, Lithuania wishes to include intra–Community acquisitions within the scope of the special measure.

The proposal allows for the authorisation of the special measure until 31 December 2009. It is time limited to allow a review of the measure in the light of experience and an assessment of any continuing need. However, on 16th March 2005 the Commission presented document COM(2005)89 to the Council. This is a proposal for a Directive modifying Directive 77/388/EEC as regards certain measures to simplify the procedure for charging VAT and to assist in countering tax evasion and avoidance, and repealing certain Decisions granting derogations. The so-called "Article 27 rationalisation proposal" includes, amongst other things, legislation which covers the same ground as the requested measure. The proposed derogation will therefore cease to have effect as from the entry into force of measures in this area contained in the Directive resulting from the rationalisation proposal.

- **Existing provisions in the area of the proposal**

Similar derogations in relation to Article 11(A)(1) and Article 28e of Directive 77/388/EEC have been granted to other Member States.

- **Consistency with other policies and objectives of the Union**

Not applicable.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Not relevant

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The proposal is designed to counter potential VAT avoidance and evasion and has, therefore, a potential positive impact, not least from its compliance effect.

The path followed is one which other Member States have taken and was identified by Lithuania as suitable measure to counter tax losses. The requested measure is also in line with the Commission's proposal found in COM(2005)89 to rationalise the number of Article 27 derogations.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

Authorisation for Lithuania to apply a measure derogating from Articles 11(A)(1) and

28e of the Sixth Council Directive 77/388/EEC so as to allow the recalculation of the taxable value of supplies of goods and services as well as of intra-Community acquisitions in certain cases where the value differs significantly from the open market value; the parties are connected and where one party to the transaction has a restricted right to deduct. The revaluation may be to the open market value of the supply as defined in Article 11(A)(1)(d) of the Sixth Directive.

- **Legal basis**

Article 27(1) of the Sixth Council Directive 77/388/EEC of 17 May 1977 (as amended) on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment.

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reason(s):

This Decision concerns an authorisation granted to a Member State on 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.

- **Choice of instruments**

Proposed instruments: other.

Other means would not be adequate for the following reason(s):

Under Article 27 of the Sixth Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes, derogation from the common VAT rules is only possible on the authority of the Council acting unanimously on a proposal from the Commission. A Council Decision is the only suitable instrument since it can be addressed to an individual member state.

4) BUDGETARY IMPLICATION

The proposal has no implication for the Community budget.

5) ADDITIONAL INFORMATION

- **Review/revision/sunset clause**

The proposal includes a sunset clause.

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(Only the Lithuanian version is authentic)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to the Sixth Council Directive (77/388/EEC) of 17 May 1977 on the harmonisation of the laws of the Member States relation to turnover taxes – Common System of Valued Added Tax; uniform basis of assessment[1], and in particular Article 27 thereof,

Having regard to the proposal from the Commission[2],

Whereas:

(1) Under Article 27(1) of Directive 77/388/EEC, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from that Directive in order to simplify the procedure for charging the tax or to prevent certain types of tax evasion or avoidance.

(2) In letters dated 3 August 2004 and 16 December 2004 the Republic of Lithuania sought authorisation to introduce a measure derogating from the provisions of Directive 77/388/EEC governing the taxable amount for VAT purposes.

(3) In accordance with Article 27(2) of Directive 77/388/EEC, the Commission informed the other Member States of the request made by the Republic of Lithuania in a letter dated 7 June 2005. In a letter dated 14 June 2005, the Commission notified the Republic of Lithuania that it had all the information it considered necessary for appraisal of the request.

(4) Article 11(A)(1)(a) of Directive 77/388/EEC establishes the taxable amount of a supply for value added tax (VAT) purposes to be everything which constitutes the consideration paid for the supply. Article 28e(1) of the same Directive governs the taxable amount of intra–Community acquisitions, by reference to Article 11(A).

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[1] OJ L 145, 13.6.1977, p1 as last amended by Directive 2004/66/EC (OJ L 168, 1.5.2004, p.35)

[2] OJ C , , p. .

(5) The measure requiring a derogation is intended to counter tax losses arising from the manipulation of the taxable amount of supplies of goods, services and intra-Community acquisitions subject to VAT where one of the parties does not have a full right of deduction.

(6) The measure should be targeted so that it applies only in cases of VAT avoidance or evasion and only when a number of conditions have been met. The measure is therefore proportionate to the aim pursued.

(7) Similar derogations have been granted to other Member States in order to counter tax avoidance or evasion and have been found to be effective.

(8) Derogations pursuant to Article 27 of Directive 77/388/EEC which counter VAT avoidance linked to the taxable amount of supplies between related parties are included in the Commission proposal of 16 March 2005 for a Directive rationalising some of the derogations pursuant to that Article[3]. It is therefore necessary to limit the application period of this derogation until this Directive comes into effect.

(9) This derogation will safeguard the amount of VAT due at the final consumption stage and has no negative impact on the European Communities' own resources from VAT,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Article 11(A)(1)(a) and Article 28e of Directive 77/388/EEC, the Republic of Lithuania is hereby authorised to provide that the taxable amount of a supply of goods or services or of an intra-Community acquisition of goods shall be the same as the open market value, as defined in Article 11(A)(1)(d) of the said Directive, in either of the following circumstances:

(a) where the consideration is significantly lower than the open market value and the recipient of the supply, or in the case of an intra-Community acquisition, the acquirer, does not have a full right of deduction under Article 17 of Directive 77/388/EEC.

(b) where the consideration is significantly higher than the open market value and the supplier does not have a full right of deduction under Article 17 of Directive 77/388/EEC.

This measure may only be used in order to prevent tax avoidance or evasion and when the consideration on which the taxable amount would otherwise be based has been influenced by family, management, ownership, financial or legal ties as defined in national legislation. For these purposes, legal ties shall include the formal relationship between employer and employee.

[3] OJ C 125, 24.5.2005, p12. COM(2005)89

Article 2

The authorisation granted under Article 1 shall expire on the date of entry into force of a Directive rationalising the derogations pursuant to Article 27 of Directive 77/388/EEC which counter avoidance or evasion of value added tax through the valuation of supplies between connected persons, or on the 31 December 2009 whichever is the earlier.

Article 3

This Decision is addressed to the Republic of Lithuania.

Done at Brussels,

For the Council
The President