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Proposal for a

COUNCIL IMPLEMENTING DECISION

amending Implementing Decision 2009/1008/EU authorising the Republic of Latvia to extend the application of a measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax

EXPLANATORY MEMORANDUM

Pursuant to Article 395(1) of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive'[1]), the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to apply special measures for derogation from the provisions of that Directive, in order to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance.

By letter sent on 29 April 2024 and registered with the Commission on 2 May 2024, the Republic of Latvia (hereinafter Latvia) requested the authorisation to continue to apply a measure derogating from Article 193 of the VAT Directive, which determines the person liable for the payment of VAT. With the same letter, Latvia sent a report on the application of that measure.

By letter sent on 4 July 2024 the Commission requested additional information, to which Latvia replied by letter registered with the Commission on 12 August 2024.

In accordance with Article 395(2) of the VAT Directive, the Commission informed the other Member States by letters dated 3 September 2024, and Italy on 4 September 2024 of the request made by Latvia. By letter dated 5 September 2024, the Commission notified Latvia that it had all the information necessary to consider the request.

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

As a general rule, Article 193 of the VAT Directive stipulates that the taxable person supplying goods or services is normally liable to pay VAT.

Pursuant to Article 395 of the VAT Directive, Member States may apply measures derogating from the provisions of the VAT Directive to simplify the procedure for collecting VAT or to prevent certain forms of tax evasion or avoidance if they have been authorised by the Council.

On 29 April 2024, Latvia requested to continue to apply the reverse charge mechanism to timber transactions that entails to make the person to whom these goods or services are supplied liable for the payment of VAT.

The derogating measure for Latvia had been initially granted by Council Decision 2006/42/EC[2] until 31 December 2009 and by Council Implementing Decision 2009/1008/EU[3] until 31 December 2012. The authorisation to apply the derogation has subsequently been extended by Council Implementing Decision 2013/55/EU[4] until 31 December 2015, by Council Implementing Decision (EU) 2015/2396[5] until

1 OJ L 347, 11.12.2006, p. 1.
2 OJ L 25, 28.1.2006, p. 31.
3 OJ L 347, 24.12.2009, p.30.
4 OJ L 22, 25.1.2013, p.16.
5 OJ L 332, 18.12.2015, p.142.

31 December 2018, by Council Implementing Decision (EU) 2018/2006[6] until 31 December 2021, and by Council Implementing Decision (EU) 2022/81[7] until 31 December 2024.

According to Latvia, the timber market, which is one of the most important sectors of its economy, is particularly sensitive to VAT fraud, because it is dominated by a great number of small local operators and individual suppliers, and because it is very difficult to trace the movements of materials and related transactions. The businesses active in the sector may be not due to fulfil recording obligations and this may lead to undeclared transactions of timber. Thus, there is a significant risk that some operators could evade payment of VAT. The nature of the market and of businesses involved has generated VAT fraud, which the Latvian tax authorities have found difficult to control. In order to combat this abuse, they have introduced the reverse charge mechanism to timber transactions, which has proven to be very effective and has decreased VAT fraud in this sector significantly.

Moreover, this special measure does not have a negative impact on the total amount of VAT revenues collected at the final stage of consumption and thus, does not affect the Union's VAT own resources in a negative way, according to Latvia.

Derogations are in general granted for a limited period of time as to allow an assessment whether the special measure is appropriate and effective and in order to grant Member States time to introduce other conventional measures at national level to monitor the movement of materials, the payment of VAT, and the compliance of taxable persons which should tackle the respective problem until the expiry of the derogating measure, thus making an extension of the derogation redundant. A derogation allowing making use of the reverse charge mechanism is only granted exceptionally for specific fraudulent areas and constitutes a means of last resort.

Latvia requested the extension of the measure until 31 December 2027. Latvia is committed to apply different measures to tackle VAT fraud in the sector. It is planned to impose an obligation of non-cash payments, and a specific tracking tool that will help to control transactions and production processes more efficiently, finally, by 2026 the national authorities plan to introduce e-invoicing requirement for B2B transactions for companies registered in the Republic of Latvia. Taking into consideration the unchanged legal and factual situation, it is therefore proposed to extend the derogating measure, allowing Latvia to continue to apply this derogating measure until 31 December 2026. Until the expiry of this derogation, Latvia should be able to implement other conventional measures at national level to monitor the movement of materials, the payment of VAT, and the compliance of taxable persons which would underpin the fight and prevent the VAT fraud in the sector of timber.

- **Consistency with existing policy provisions in the policy area**

Similar derogations in relation to Article 193 of the VAT Directive have been granted to other Member States, Portugal[8], Romania[9] and Lithuania[10].

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6 OJ L 322, 18.12.2018, p. 20–21.

7 OJ L 13, 20.1.2022, p. 49–50.

8 Council Implementing Decision (EU) 2019/1592 of 24 September 2019 authorising Portugal to introduce a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax, OJ L 248, 27.9.2019, p. 67–68.

The proposed measure is, therefore, consistent with the existing provisions of the VAT Directive.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

• Legal basis

Article 395 of the VAT Directive.

• Subsidiarity (for non-exclusive competence)

Considering the provision of the VAT Directive on which the proposal is based, the subsidiarity principle does not apply.

• Proportionality

The Decision concerns an authorisation granted to a Member State upon 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 the instrument

Proposed instrument: Council Implementing Decision.

Under Article 395 of the VAT Directive, a derogation from the common VAT provisions is only possible upon authorisation of the Council acting unanimously on a proposal from the Commission. A Council Implementing Decision is the most suitable instrument since it can be addressed to an individual Member State.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

• Stakeholder consultations

This proposal is based on a request made by Latvia and concerns only this Member State.

• Impact assessment

The proposal for a Council Implementing Decision authorises Latvia to continue to apply the reverse charge mechanism to timber transactions. The situation, on which the initial derogation was based, continues to exist. Latvia claims that despite the fact that there has been a reduction in the number of cases of fraud involving VAT and VAT evasion on the timber market since the introduction of the reverse charge procedure, the risk is not eliminated.

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[9] Council Implementing Decision (EU) 2019/1593 of 24 September 2019 amending Implementing Decision 2013/676/EU authorising Romania to continue to apply a special measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 248, 27.9.2019, p. 69–70).

[10] Council Implementing Decision (EU) 2018/1920 of 4 December 2018 amending Implementing Decision 2010/99/EU authorising the Republic of Lithuania to extend the application of a measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 311, 7.12.2018, p. 34–35).

The measure has previously been authorised in the 2003 Act of Accession[11], in particular in Chapter 7, point 1(b) of Annex VIII thereto, and by Decision 2006/42/EC[12] under the then applicable Sixth Directive 77/388/EEC. However, over time, fraud in the timber sector has moved to include transactions that were not subject to the VAT reverse charge procedure. For instance, transactions relating to wood by-products. Accordingly, the scope of application of the VAT reverse charge procedure was further broadened, in order to reduce the number of opportunities for fraud. Furthermore, as of 1 January 2020, the recipient of timber must pay for the goods received, and the recipient of services for the services rendered, by means of non-cash payments. These modifications were made to standardise payment requirements in all cases where the reverse charge procedure is applied, in order to enhance the effectiveness of the measure aimed at combating VAT fraud.

Latvia submits that the extension of the derogating measure is necessary to fight fraud occurring in the timber sector.

The forestry sector is one of the cornerstones of Latvia's economy. In 2022, the declared net turnover of traders operating in the timber sector represented 7.4 % of the total net turnover declared in the annual accounts, i.e. EUR 6.3 billion. The export value of the forestry sector in 2023 was around EUR 2.3 billion, or 12.4% of the country's total exports, whilst the number of people employed in the sector in 2022 was 41 400, or 4.8% of the total number of employees in the national economy.

The timber market in Latvia is dominated by small and medium-sized traders and individual suppliers (represent over 90% of the total number of enterprises in the sector), buying or selling timber and providing or receiving related services.

The number of taxable persons in the timber sector was 11 713 at the beginning of 2024. According to Latvia, in 2023, another 13 063 natural person was trading in the timber sector with a total revenue of EUR 219 million.

The extension of this measure will not have a negative impact on the total amount of VAT revenue collected at the final stage of consumption and thus, does not affect the Union's VAT own resources in a negative way.

4. BUDGETARY IMPLICATIONS

The proposal has no implication on the EU budget.

5. OTHER ELEMENTS

The proposal is limited in time.

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[11] OJ L 236, 23.9.2003, p. 33.
[12] OJ L 25, 28.1.2006, p. 31.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[1], and in particular Article 395(1) thereof,

Having regard to the proposal from the European Commission,

Whereas:

(1) Council Decision 2006/42/EC[2] authorised Latvia to apply a special measure derogating from Article 21(1), point (a), of Council Directive 77/388/EEC[3], to designate the recipient as the person liable to pay value added tax (VAT) on the supply of timber or on the provision of related services until 31 December 2009. By Council Implementing Decision 2009/1008/EU[4] Latvia was, by way of derogation from Article 193 of Directive 2006/112/EC, authorised to continue to designate the recipient of timber or related services as the person liable to pay VAT in the case of timber transactions until 31 December 2012 ('the special measure'). Following the last amendment to Implementing Decision 2009/1008/EU, that authorisation is due to expire on 31 December 2024.

(2) By letter registered with the Commission on 2 May 2024, Latvia requested the authorisation to continue to apply the special measure. Along with that letter, Latvia submitted a report on the application of that special measure.

(3) In accordance with Article 395(2), second subparagraph, of Directive 2006/112/EC, the Commission informed the other Member States by letter dated 3 September 2024, and Italy on 4 September 2024 of the request made by Latvia. By letter dated 5

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1 OJ L 347, 11.12.2006, p. 1, ELI: http://data.europa.eu/eli/dir/2006/112/oj.

2 Council Decision 2006/42/EC of 24 January 2006 authorising Latvia to extend the application of a measure derogating from Article 21 of the Sixth Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes (OJ L 25, 28.1.2006, p. 31, ELI: http://data.europa.eu/eli/dec/2006/42(1)/oj).

3 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 (OJ L 145, 13.6.1977, p. 1, ELI: http://data.europa.eu/eli/dir/1977/388/oj).

4 Council Implementing Decision 2009/1008/EU of 7 December 2009 authorising the Republic of Latvia to extend the application of a measure derogating from Article 193 of Directive 2006/112/EC on the common system of value added tax (OJ L 347, 24.12.2009, p. 30, ELI: http://data.europa.eu/eli/dec_impl/2009/1008/oj).

September 2024, the Commission notified Latvia that it had all the information necessary to consider the request.

(4) According to Latvia, the timber market, which is one of the most important sectors of its economy, is particularly sensitive to VAT fraud, because it is dominated by a great number of small local operators and individual suppliers. The nature of the market and of businesses involved has generated VAT fraud, which the Latvian tax authorities have found it difficult to control. In order to combat that abuse, the Latvian tax authorities have introduced the reverse charge mechanism for the payment of VAT in timber transactions, which has proven to be very effective and has decreased fraud in that market significantly according to the report submitted by Latvia.

(5) Derogations are in general granted for a limited period of time to allow an assessment of whether the special measure is appropriate and effective. Derogations grant Member States time to introduce other conventional measures at national level to monitor the movement of materials, the payment of VAT, and the compliance of taxable persons which should tackle the respective problem until the expiry of the derogating measure, thus making an extension of the derogation redundant. A derogation allowing the making use of the reverse charge mechanism is only granted exceptionally for specific fraudulent areas and constitutes a means of last resort.

(6) Latvia is committed to applying different measures to tackle VAT fraud in the sector. It intends to impose an obligation of non-cash payments, and a specific tracking tool that will help to control transactions and production processes more efficiently. Furthermore, by 2026, the national authorities plan to introduce e-invoicing requirement for B2B transactions for companies registered in Latvia.

(7) Therefore, before the expiry of the extension of the special measure under this Decision, Latvia should be able to implement other conventional measures to fight and prevent VAT fraud in the timber market, so that another extension of the special measure would not be necessary.

(8) Latvia should therefore be authorised to apply the special measure only until 31 December 2026.

(9) The special measure will have no adverse impact on the Union's own resources accruing from VAT.

(10) Implementing Decision 2009/1008/EU should therefore be amended accordingly,

HAS ADOPTED THIS DECISION:

Article 1

Article 2 of Implementing Decision 2009/1008/EU is replaced by the following:

‘Article 2

This Decision shall apply until 31 December 2026.’

Article 2

This Decision is addressed to the Republic of Latvia.

Done at Brussels,

For the Council
The President