

EXPLANATORY MEMORANDUM FOR EUROPEAN UNION LEGISLATION WITHIN THE SCOPE OF THE UK/EU WITHDRAWAL AGREEMENT

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Proposal for a COUNCIL IMPLEMENTING DECISION amending Implementing Decision (EU) 2021/512 authorising the United Kingdom to apply, in respect of Northern Ireland, a special measure derogating from Articles 16 and 168 of Directive 2006/112/EC on the common system of value added tax as regards an extension of the authorisation

Submitted by HM Treasury

12 December 2023

SUBJECT MATTER

1. This Explanatory Memorandum outlines a European Commission ('Commission') proposal, at the request of the United Kingdom (UK), to renew the existing derogation from Articles 16 and 168 of Directive 2006/112/EC (hereafter 'the VAT Directive') in respect of Northern Ireland. This derogation related to the UK decision to continue to provide a simplification measure that permits businesses to apply a flat rate when accounting for Value Added Tax (VAT) on fuel used when company vehicles are used for private journeys.
2. The UK has operated this simplification since 1986. Council decision 86/356/EC, which was without time limit, permitted a derogation that calculated the flat rate private use charge by reference to the engine capacity and fuel type of the company car.
3. This original derogation was replaced and from 1 April 2007, under Council Decision 2006/659/EC, the UK's flat rate private use charge has been based on a car's CO2 emission rating and a time limit was placed on each renewal of the derogation.
4. Under EU legislation, on approval by the EU through the Council, EU Member States and the UK in respect of Northern Ireland may introduce special measures to derogate from the VAT Directive in order to simplify the procedure for charging tax, or to prevent certain types of tax evasion or avoidance.
5. Therefore, in order that a flat-rate charge continues to be applied in Northern Ireland, a further grant of a derogation pursuant to Article 395(1) of the VAT Directive is needed.

6. In 2021, the EU, through Council Decision 2021/512, authorised the UK to continue with its long-standing derogation to allow a flat-rate charge to simplify procedures to determine the proportion of VAT relating to the private use of road fuel bought for business purpose. This authorisation ran from 1 January 2021 until 31 December 2023.
7. Under the normal VAT rules, as contained in Article 168 of the VAT Directive, VAT is deductible only insofar as it relates to business supplies which bear VAT. In the case of fuel, the business/private use of each car would need to be determined in order that the right VAT is deducted. In practice, this would involve taxpayers maintaining full mileage records for each car.
8. The derogation permits businesses to deduct VAT incurred on fuel in full and to account for the private use of the fuel by paying back a flat rate charge. This simplifies accounting by removing the need for full mileage records. Such a charge already arises under Article 16 of the VAT Directive, but a derogation is needed to provide for the flat rate element. The charge is based on the average annual private mileage combined with the CO2 emissions of the car and the retail price of road fuel – cars with high CO2 emissions have higher fuel consumption and therefore higher fuel expenditure, meaning a higher flat rate charge.
9. The proposal would support the UK decision to continue to derogate from the VAT Directive until 31 December 2026.

SCRUTINY HISTORY

10. This is a longstanding derogation. The previous Explanatory Memorandum was submitted for and cleared scrutiny, in both houses, on 17 March 2021 and 22 April 2021.

MINISTERIAL RESPONSIBILITY

11. The Chancellor of the Exchequer has responsibility for this proposal.

INTEREST OF THE DEVOLVED ADMINISTRATIONS

12. The UK's tax policy is a reserved matter under the UK's devolution settlements. However, due to the interest of the Northern Ireland devolved administration, this EM has been shared with Northern Ireland Officials.

LEGAL AND PROCEDURAL ISSUES

i. Legal Base

- Article (113) of the Treaty on the Functioning of the EU (TFEU).
- Article 395 of the VAT Directive (2006/112/EC).
- Justice and Home Affairs opt-in is not a consideration.

ii. Voting Procedure

- Unanimity.

iii. Timetable for adoption and implementation

- The Windsor Framework provides that EU VAT law, in regards to goods will continue to apply to Northern Ireland.

POLICY AND LEGAL IMPLICATIONS

13. This measure reduces administrative burdens and compliance costs for Northern Ireland businesses by removing the need to keep detailed mileage records for each car in order to calculate the VAT due in respect of private motoring. Higher administration costs would inevitably result in a number of businesses opting out of deducting VAT on fuel.

14. The simplification also reduces burdens for the UK tax authorities, which would otherwise have to agree and audit individual agreements. In practice verifying mileage is difficult and providing a flat rate reduces the risk of business mileage being overstated.

CONSULTATION

15. Not applicable.

FINANCIAL IMPLICATIONS

16. None. As this measure continues to apply a long-standing optional simplification (to enable businesses to account for VAT on fuel used in cars for private motoring on a flat-rate basis) there is no additional impact

MINISTERIAL NAME AND SIGNATURE



Nigel Huddleston MP

FINANCIAL SECRETARY TO THE TREASURY