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DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

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VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 1072

CONSULTATION
PROVIDED FOR UNDER DIRECTIVE 2006/112/EC

ORIGIN:	**Czechia**
REFERENCE:	**Article 177**
SUBJECT:	**Partial exclusion of the right of deduction upon acquisition of certain passenger motor vehicles**

1. INTRODUCTION

The Czech authorities have informed the Commission services that they wish, in accordance with Article 398 of the VAT Directive[1], to consult the VAT Committee on the partial exclusion of the right of deduction of VAT paid upon the acquisition of certain passenger motor vehicles pursuant to Article 177 of the VAT Directive.

The text of the consultation is annexed to this document.

2. SUBJECT MATTER

2.1. Justification of the measure

Article 177 of the VAT Directive allows Member States, after consulting the VAT Committee, to exclude, totally or partly, all or some capital goods or other goods from the system of deductions for cyclical economic reasons.

Czechia explains in its request that the economic recession due to the Covid-19 outbreak, followed by the inflation and rising energy costs as a result of Russia's invasion of Ukraine, has impacted significantly Czechia's economy, which is experiencing a relatively weak recovery after such a deep recession.

The Czech government has proceeded to draw up and approve a package of adjustment measures to reduce the subsequent high structural deficit. One of the measures included in the package is the partial exclusion of the right of deduction of VAT paid upon acquisition of certain passenger motor vehicles.

In this regard, Czechia points out that the acquisition of expensive passenger motor vehicles is more advantageous for companies rather than individuals, not only in terms of income tax but also due to the possibility of claiming VAT deductions. As an example, in 2020, 96 out of 101 new Ferrari vehicle registrations in Czechia were made in the name of a company.

2.2. Description of the measure

The proposed measure establishes a ceiling to the maximum amount of VAT that a taxpayer can deduct on the acquisition of certain passenger motor vehicles and any subsequent technical improvements carried out on them. This ceiling is set at CZK 420 000.

Therefore, if the VAT paid on the acquisition of the vehicle and technical improvements is below CZK 420 000, the taxpayer will be able to deduct that amount in full. If the VAT paid on the acquisition of the vehicle is, for instance, CZK 500 000, the taxable person can deduct CZK 420 000 of that VAT and will not be able to deduct the remaining CZK 80 000, nor any VAT paid on subsequent technical improvements. If the VAT paid on the acquisition of the vehicle is CZK 400 000, the taxable person can deduct that

[1] Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1)

amount in full, but will only be able to deduct VAT paid on subsequent technical improvements up to an amount of CZK 20 000.

In relation to the scope of this measure, the road passenger motor vehicles affected by this partial exclusion of the right to deduct VAT are vehicles of category M1 according to Regulation 2018/858 of the European Parliament and of the Council governing the approval of motor vehicles and their trailers[2], which are neither an ambulance nor a hearse, nor are they acquired for the purpose of operating road motor transport on the basis of a concession.

The envisaged entry into force of the measure is 1 January 2024 and it will be applied for three years.

2.3. Impact of the measure

The proposed measure is part of a package aimed at limiting the impact of the excessive deficit. An overall improvement of the state budget balance by CZK 70 billion is expected.

3. COMMISSION SERVICES' OPINION

The first paragraph of Article 177 of the VAT Directive permits the exclusion of the right of deduction on certain goods for cyclical economic reasons.

The measure foreseen by Czechia sets a limitation on the right to deduct VAT on the acquisition of certain passenger motor vehicles; with some exceptions when these vehicles are used, in general, for the transport of passengers for commercial purposes. This measure would be applicable for three years as from 1 January 2024 and is a means chosen by Czechia to ease the difficult public budget situation.

The Commission services conclude that the measure envisaged by Czechia in principle falls within the scope of the possibility to exclude the right of deduction for cyclical economic reasons provided for in the first paragraph of Article 177 of the VAT Directive. However, the Commission services take the view that this is a one-off measure in the light of the current economic downturn and not suitable for systematic extension for which Article 177 of the VAT Directive by its very nature leaves no room.

In addition to the information already provided, the Commission services would like to know more about the following:

(i) the extra revenue which is expected from this measure as the information submitted by Czechia refers only to the revenue expected from the whole package of measures and not to the revenue expected from this particular measure;

[2] Regulation (EU) 2018/858 of the European Parliament and of the Council of 30 May 2018 on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles, amending Regulations (EC) No 715/2007 and (EC) No 595/2009 and repealing Directive 2007/46/EC (OJ L 151, 14.6.2018, p. 1).

(ii) the content of the package of fiscal measures as to be able to assess the proposed measure on the exclusion of the right of deduction in light of the overall programme to fight the current crisis;

(iii) as regards the definition of the categories of motor vehicles affected by the measure, some further clarification on the vehicles excluded from the scope, e.g. regarding the status of taxis, VTCs and driving school vehicles;

(iv) as regards the technical improvements which are affected by the exclusion of the right to deduct, some further clarification on the definition of what these technical improvements are, and if there is a deadline as from which they can be performed without restriction of the right to deduct, e.g. if they are under the limitation only when performed at the time of acquisition or also if they are performed years later.

According to Article 110 of the Treaty on the Functioning of the European Union[3]:

> "*No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.*
> *Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products*."

To ensure that the measure does not favour cars produced in Czechia compared to those produced in other Member States, the Commission services would therefore also like to receive information on how this measure will impact cars produced in Czechia and cars produced in other Member States.

4. DELEGATIONS' OPINION

Delegations are invited to give their opinion on this matter.

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[3] OJ C 202, 7.6.2016, p. 1.

ANNEX

Consultation by the Czech Republic

Ministry of Finance of the Czech Republic informs the Commission that the Czech Republic wishes, in accordance with Article 177 and Article 398 of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereafter the 'VAT Directive'), to consult the Committee on the partial exclusion of the right of deduction of VAT on selected road passenger motor vehicles.

This measure would be applicable during three years as from 1 January 2024 and is one of the means that Czech Republic has chosen to ease the difficult public budget situation. The draft Act No. 235/2004 Coll., on Value added Tax (hereafter the “VAT Act”) forms part of a package of adjustment measures in draft Act on consolidation of public budgets whose aim is to reduce the budget deficit and allow state debt to be repaid.

1. BACKGROUND AND SCOPE

Pursuant to Article 177 of VAT Directive, after consulting the VAT Committee, each Member State may, for cyclical economic reasons, totally or partly exclude all or some capital goods or other goods from the system of deductions.

The covid-19 pandemic in 2020 and 2021 has led to a strong fiscal expansion in most of the developed world. The Czech Republic has been in a negative output gap since the outbreak of the pandemic. Although the specific numbers differ between the Ministry of Finance of the Czech Republic and the Commission services, the depiction of the "phase" of the economic cycle is identical. The European Commission's May 2023 forecast indicates a peak of the positive output gap in 2019 of 2.7% of potential GDP followed by a sharp decline to -4.3%.

The recovery of the world economy was then negatively affected by Russia's invasion of Ukraine, followed by the energy crisis and high inflation.

The Commission estimates -2.3% of potential GDP for this year and -1.3% for 2024. In addition, the Commission's estimate for the rate of potential output of around 1.5% in 2023 and 2024 has to be taken into account. This is less than 60% growth compared to the 2014-2018 period. The Czech Republic is thus experiencing a relatively weak economic recovery following the recession in 2020 and the subsequent relatively strong fiscal stimulus provided by the government's discretionary measures. From a cyclical perspective, it is losing ground due to both a negative output gap and relatively lower potential output growth.

This unfavourable situation is also reflected in the state of public finances, which are running deficits in breach of the Maastricht criterion of 3% of GDP. The government has proceeded to draw up and approve a so-called adjustment package or package of adjustment measures to reduce the high structural deficit. This is beneficial in itself, as long-term sustainable public finances are one of the necessary conditions for economic growth.

It is also necessary to comply with national and European fiscal rules and reduce the likelihood of a downgrade of the Czech Republic's credit rating. A downgrade would increase the risk margin on Czech assets, which would have a negative impact on economic growth and a renewed widening of the negative output gap.

In addition, the purchases of more valuable selected road passenger motor vehicles is more advantageous in the name of the company not only in terms of income tax but also due to the possibility of claiming VAT deductions. As an example, in 2020, 96 out of 101 new Ferrari vehicle registrations in the Czech Republic were registered in the name of a company, not an individual.

The new mechanism is designed in such a way that the taxpayer could claim a maximum aggregate amount of CZK 420,000 as a tax deduction, not only for the acquisition of such a vehicle, but also including the subsequent technical improvement. It corresponds to a tax base of CZK 2 million and a tax rate of 21 % and applies only to cars purchased after 1 January 2024.

2. IMPACT ASSESSMENT

The proposed measure is part of an overall package aimed at limiting the impact of the excessive deficit. The solution has been identified by the Czech Republic as a suitable measure and is comparable to other past and present measures applied by other Member State.

Consolidation should translate into lower deficits and debt. Therefore, an overall improvement of the state budget balance by CZK 70 billion is expected. However, it will depend on other factors.

3. NATIONAL LEGAL PROPOSAL

The following paragraphs 3 and 4 in section 72 are inserted:

“(3) In the case of the acquisition of a selected road passenger motor vehicle which is a fixed asset of the taxpayer, the amount of input tax is deemed to be:

(a) the amount of CZK 420 000 if the input tax under paragraph 2 is at least CZK 420 000 for the acquisition of that vehicle,

(b) the input tax referred to in paragraph 2, unless the amount of input tax is determined in accordance with subparagraph (a).

(4) In the case of the technical improvement of selected road passenger motor vehicle which is a fixed asset under section 4(4)(d)(4), the amount of input tax shall be deemed to be the amount of input tax for the purposes of value added tax

(a) an amount of CZK 0 if the sum of the input tax under paragraph 2 on the acquisition of the selected road passenger motor vehicle in respect of which the technical improvement has been carried out and the input tax under paragraph 2 on previous technical improvements is at least CZK 420 000,

(b) the input tax referred to in paragraph 2 in the event of a positive or zero difference between

1. the amount of CZK 420 000 and

2. the sum of the input tax under paragraph 2 on the acquisition of the selected road passenger motor vehicle for which the technical improvement was carried out and the input tax under paragraph 2 on the previous technical improvements and on this technical improvement,

(c) the input tax referred to in paragraph 2, reduced by the absolute value of the difference determined in accordance with the procedure referred to in point (b), if the difference determined in accordance with the procedure referred to in point (b) becomes negative after the technical improvement in question has been carried out.".

In Article, the following paragraph 9 (footnote no. 77 included) is inserted:

„(9) For the purposes of value added tax, a selected road passenger motor vehicle is a vehicle of category M1 according to the Regulation of the European Parliament and of the Council governing the approval of motor vehicles and their trailers[77]), which is neither an ambulance nor a hearse, nor is it acquired for the purpose of operating road motor transport on the basis of a concession.

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77) Regulation (EU) 2018/858 of the European Parliament and of the Council of 30 May 2018 on the approval and market surveillance of motor vehicles and their trailers, and of systems, components and separate technical units intended for such vehicles, amending Regulations (EC) No 715/2007 and (EC) No 595/2009 and repealing Directive 2007/46/EC.“

4. CONCLUSION

Pursuant to Articles 177 and 398 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, The Czech Republic would like to consult the VAT Committee with a view to securing its agreement to the partial exclusion selected road passenger motor vehicles from the system of deductions.

The Czech Republic intends to introduce the restriction in question on 1 January 2024. The measure will apply for three years.

Given the nature of the matter and the advisability of introducing the requested restriction from 1 January 2024, Czech Republic would like this request to be put to the VAT Committee as soon as possible before the autumn meeting this year.