

**EXPLANATORY MEMORANDUM FOR EUROPEAN UNION LEGISLATION
WITHIN THE SCOPE OF THE UK/EU WITHDRAWAL AGREEMENT AND
NORTHERN IRELAND PROTOCOL**

EU 6145/21

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Proposal for a COUNCIL IMPLEMENTING DECISION authorising the United Kingdom in respect of Northern Ireland to apply a special measure derogating from Articles 16 and 168 of directive 2006/112/EC on the common system of value added tax

Submitted by HM Treasury

5 March 2021

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 would authorise the UK in respect of Northern Ireland to continue to provide a simplification measure that permits businesses to apply a flat rate when accounting for 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. In 2018, the European Union (EU) through Council Decision 2018/0334 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 in company cars. This authorisation ran from 1 January 2019 until 31 December 2020.

5. On 31 January 2020, the UK left the EU. In accordance with the Withdrawal Agreement, the UK is now a third country to the EU. Following the end of the transition period EU VAT legislation is no longer applicable in GB. However, on the basis of the Protocol on Ireland/Northern Ireland (hereafter the 'Protocol'), which forms part of the Withdrawal Agreement, Northern Ireland remains subject to EU VAT legislation regarding goods.
6. Under European 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.
7. 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.
8. Under the normal Value Added Tax (VAT) rules, as contained in Article 168 of the VAT Directive, VAT is deductible only in so far 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.
9. 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.
10. The proposal would allow the UK in respect of NI to continue to derogate from the VAT Directive until 31 December 2023, when its application would need to be reassessed.

SCRUTINY HISTORY

11. This is a longstanding derogation. The previous Explanatory Memorandum was submitted for and cleared scrutiny, in both houses, on 31 October 2018.

MINISTERIAL RESPONSIBILITY

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

INTEREST OF THE DEVOLVED ADMINISTRATIONS

13. The UK's tax policy is a reserved matter under the UK's devolution settlements. However, due to the Northern Ireland Protocol, this is of interest to Northern Ireland devolved administration. The 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 (2206/112/EC).
- Justice and Home Affairs opt-in is not a consideration.

ii. Voting Procedure

- Unanimity.

iii. Timetable for adoption and implementation

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

POLICY IMPLICATIONS

14. 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.

15. 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.

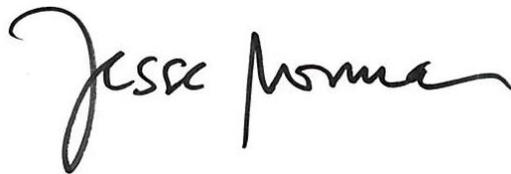
CONSULTATION

16. Not applicable.

FINANCIAL IMPLICATIONS

17. 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

A handwritten signature in black ink, reading "Jesse Norman". The signature is written in a cursive, flowing style.

Rt Hon Jesse Norman MP

FINANCIAL SECRETARY TO THE TREASURY