



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.8.2005
COM(2005) 376 final

Proposal for a

COUNCIL DECISION

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

(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 on 16 March 2005, Latvia has requested authorisation to extend the application of a derogation measure on timber transactions previously granted for a limited period by the Act of Accession. In accordance with Article 27(2) of Directive 77/388/EEC, the Commission informed the other Member States by letter dated 10 May 2005 of the request made by Latvia. By letter dated 31 May 2005, the Commission notified Latvia that it had all the information it considered necessary for appraisal of the request.

- **General context**

The timber market in Latvia is dominated by small local companies and individual suppliers, which have often proved to be transitory businesses, difficult for the tax administration to control and vehicles for tax evasion. The most common form of evasion involves the invoicing of supplies followed by the disappearance of the business without paying tax but leaving the customer in receipt of a valid invoice for tax deduction. In order to prevent evasion of tax, a special provision was included in Latvia's law on VAT. This provision, derogating from Article 21 of Directive 77/388/EEC, stipulates that in the case of transactions in relation to timber, the recipient of goods or services is, under certain circumstances, the person liable to account for the VAT. This system is applied for supplies of goods and services within the territory of Latvia and has no impact on cross-border transactions.

The Commission understands that this arrangement has effectively enabled Latvia to reduce the risk of VAT evasion and to simplify the procedure for charging the tax in the timber market.

The Commission therefore considers it appropriate for Latvia to be authorised to continue to apply the special measure.

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

Derogation previously granted in the Act of Accession, Chapter 7, point 1(b) of Annex VIII.

- **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 Decision proposal aims at combatting potential VAT evasion in the timber market of Latvia and has therefore a potential positive economic impact.

Impact will in any case be limited because of the narrow scope of the derogation.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

Authorisation for Latvia to extend the application of a measure derogating from Article 21 of the Sixth Council Directive 77/388/EEC as regards the use of a reverse charge mechanism for timber transactions.

- **Legal basis**

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.

- **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 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 instruments**

Proposed instruments: other.

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

According to Article 27 of the Sixth Council Directive 77/388/EEC on the harmonisation of the laws of the Member States relating to turnover taxes, only a Council Decision is possible.

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 Latvian version is authentic)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to 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 assessment¹, and in particular Article 27 thereof,

Having regard to the proposal from the Commission²,

Whereas:

- (1) Under Article 27(1) of the Sixth Council 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) By letter registered with the Secretariat-General of the Commission on 16 March 2005, Latvia has requested authorisation to extend the application of a derogation measure on timber transactions.
- (3) In accordance with Article 27(2) of Directive 77/388/EEC, the Commission informed the other Member States by letter dated 10 May 2005 of the request made by Latvia. By letter dated 31 May 2005, the Commission notified Latvia that it had all the information it considered necessary for appraisal of the request.
- (4) The timber market in Latvia is dominated by small local companies and individual suppliers. The nature of the market and businesses involved have generated tax fraud which the tax authorities have found difficult to control. In order to combat this abuse, a special provision was included in Latvia's law on VAT, laying down that the person liable to pay tax is, under certain circumstances, the taxable person for whom the taxable supply of goods or services is carried out.

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

² OJ C [...], [...], p. [...].

- (5) Article 21(1) of Directive 77/388/EEC, in the version set out in Article 28g of the said Directive, stipulates that under the internal system, the taxable person supplying goods or services is normally liable for payment of the tax. However, the Act of Accession of 2003³, and in particular Chapter 7, point 1(b) of Annex VIII thereof, authorised Latvia for a limited period to continue to apply their procedure for charging VAT on timber transactions.
- (6) The Commission understands that this arrangement has effectively enabled Latvia to reduce the risk of VAT evasion and to simplify the procedure for charging the tax in the timber market.
- (7) The derogation has no adverse impact on the Communities' own resources accruing from VAT,

HAS ADOPTED THIS DECISION:

Sole Article

By way of derogation from Article 21(1)(a) of Directive 77/388/EEC, in the version set out in Article 28(g) thereof, Latvia is hereby authorised to continue to designate the recipient as the person liable to pay VAT in the case of timber transactions until 31 December 2009.

This Decision is addressed to the Republic of Latvia.

Done at Brussels,

*For the Council
The President*

³ OJ L 236, 23.9.2003, p. 33