# VAT and the Circular Economy

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## Introduction

The transition towards a circular economy is a central element of the European Union's wider agenda for competitiveness, climate neutrality and resilience. Reducing resource dependencies and keeping materials in productive use for longer are important not just for the achievement of the EU's environmental objectives, but also for promoting its industrial competitiveness and economic security. This is reflected in the Clean Industrial Deal, in which the Commission identified circularity as one of the key enablers of a competitive and decarbonised European economy. However, the circular economy — a model of production and consumption aimed at extending the life cycle of goods and retaining the value of materials through sharing, leasing, reusing, repairing, refurbishing, remanufacturing or recycling — is not explicitly reflected in Directive 2006/112 /EC (VAT Directive), despite being a central pillar of EU policy. To some extent, this is understandable, as the VAT system is intended to remain neutral with regard to different forms of value chain organisation. However, the system was originally designed around linear production cycles, in which VAT is charged and deducted at each stage of the value chain until it is ultimately borne by the final consumer upon consumption of a good. Circular business models, by contrast, involve goods exiting and re-entering the production chain at various levels, which can give rise to practical difficulties for businesses in the application of VAT and tax-induced disincentives. This may inadvertently hinder the development of circular activities. To support circular business models and sustainable consumption, it is therefore important to address these issues and ensure coherence between the VAT framework and the EU's broader policy objectives. The importance of the circular economy for realising the EU's competitiveness ambition and achieving economic security will also be reflected in the forthcoming Circular Economy Act (CEA), which aims to strengthen the single market for secondary raw materials and is scheduled for adoption in 2026. To support the circular economy and complement the forthcoming CEA, the Commission is analysing the introduction of targeted amendments to the VAT Directive to support the transition towards a circular economy. In preparation for the revision of the VAT Directive, this public consultation is aimed at a broad range of stakeholders, including citizens, companies of all sizes, self-employed people, consumers' associations, business organisations representing different sectors, VAT experts, academic institutions and public bodies to collect views and information on the current situation and possible policy changes. The feedback received will contribute to the evidence base underpinning the impact assessment that will accompany the legal proposal amending the VAT Directive and support the Commission in making well informed decisions in the context of the planned revision of the current rules.

## About you

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- ◉ English
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- Non-governmental organisation (NGO)
- Public authority
- Trade union
- Other

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*255 character(s) maximum*

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- Lesotho
- Liberia
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- Romania
- Russia
- Rwanda
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## Section 1: Second-hand goods in the circular economy

The current VAT system addresses the specific features of circular economy models primarily through the second-hand goods margin scheme, which has been in place since 1995 and is set out in Articles 312–325 of the VAT Directive. The scheme, optional for businesses, applies when a business resells goods that were purchased without recoverable VAT, typically from private individuals (final consumers) or from taxable persons who did not charge VAT on the sale. Instead of charging VAT on the full selling price, VAT is calculated only on the profit margin (i.e. the difference between the purchase price and the selling price). This should prevent VAT from being charged twice on the same goods. Since the introduction of the second-hand goods margin scheme in 1995, both the VAT system and the second-hand market have evolved. Today, the number of final consumers selling second-hand goods has exponentially increased, new business models (especially online) have emerged, cross-border trade in second-hand goods is increasing, and there is a growing emphasis on circular economy principles. As the introduction says, the circular economy is a production and consumption system that maximises resource efficiency, minimises waste and keeps materials in their optimal and highest value function for as long as possible by extending the life cycle of products and assets – it's about getting more out of less. For this survey's purposes, the circular economy refers to activities related to reuse, refurbishment and remanufacturing.

### 1.1 How familiar are you with the second-hand goods margin scheme. Have you used the scheme?

- ◉ I am familiar with the scheme and have used it
- ○ I am familiar with the scheme in theory, but have not used it in practice [go to next question]
- ○ I am not familiar with the scheme/have not used it in practice

### 1.2 Have the current rules discouraged you from using the scheme?

- ○ Yes
- ○ No
- ◉ No opinion

1.3 Do you think that there are problems with the application of the current scheme?

- (●) Yes
- ( ) No
- ( ) No opinion

1.4 If yes, dependent multiple-choice question:

What do you think are the main problems with the application of the current scheme with regard to the circular economy for the use of second-hand goods, refurbished goods or remanufacturing? Please scale the severity of the problem from 1 to 5.

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| It does not fully eliminate double taxation in practice | ( ) | ( ) | ( ) | (●) | ( ) |
| It creates too many opportunities for fraud | ( ) | ( ) | (●) | ( ) | ( ) |
| It is too administratively complex | ( ) | ( ) | ( ) | (●) | ( ) |
| It discourages the re-use of goods | ( ) | ( ) | ( ) | (●) | ( ) |

| | | | | | |
|---|---|---|---|---|---|
| It creates a competitive disadvantages for non-EU countries | ○ | ◉ | ○ | ○ | ○ |
| It creates competitive disadvantages for other EU countries | ○ | ◉ | ○ | ○ | ○ |
| It creates issues with regard to cash flow and hidden VAT | ○ | ○ | ○ | ◉ | ○ |
| It leads to cases of non-taxation | ○ | ◉ | ○ | ○ | ○ |

1.5 Please list any other problem not mentioned above (optional).

The below is a short list of a number of issues identified by our members:

1. In respect of the issue of fraud, we are aware that some refurbished goods are described as second-hand so that output VAT is only charged on the margin rather than on the full value of the refurbishment work.
2. The fact that the margin scheme cannot be used for imported goods creates a competitive disadvantage for third countries. The €3 EU import level could also disproportionately impact the import of second-hand goods from third countries, particularly lower value items such as books and clothing.
3. The fact that the One Stop Shop cannot be used for the supply of second-hand goods also creates distortions within the Single Market as it can discourage the cross-border supply of second-hand goods.
4. There is no relief for margin scheme losses from one period to the next. If a margin is negative in one VAT accounting period there is no automatic right to carry forward the loss to the next period to offset against any future positive margin (and depending on a Member State's own legislation a global margin within a period may not be allowed). In addition, any negative margin cannot give rise to a right to a VAT refund.
5. The current second-hand scheme does not apply to basic materials (which might have been extracted from a second-hand good) creating a disincentive to re-use second-hand materials.
6. There are a substantial number of hobby or part-time traders that are not registered for VAT and this can result in non-taxation for both direct and indirect taxes.

1.6 Please provide additional details on the reasons for your reply in relation to the problems in question, for example by describing specific problems you have encountered (optional).

1.7 Do you think that the current scheme hinders the uptake/development of economic activities relevant for the circular economy?

- ◉ Yes
- ○ No
- ○ No opinion

1.8 Please list any problem with the current scheme and the uptake/development of economic activities relevant for the circular economy (optional).

A wholistic approach to the circular economy is required that balances the revenue needs of Member States with the social good derived from re-using goods in circulation, rather than virgin raw materials or new goods. Every aspect of the circular economy needs to be examined, recognising the contribution made and the problems faced by the sub-sections of the circular economy, such as re-sellers, repairers, upcyclers and recyclers, for example.

Currently there is no deduction of input VAT for re-sellers when they acquire second-hand goods or materials from private individuals and non-VAT registered traders. This can cause situations where it is cheaper for re-sellers active in the circular economy to purchase new goods or materials rather than pre-used. Additionally, it can negatively impact the margin for circular economy re-sellers compared to those that use new inputs.

Additionally, many elements of the circular economy are very labour intensive, which when subject to standard rating for VAT purposes, results in the end-product being uncompetitive. This drives potential purchasers to use virgin raw materials or cheaper imported alternatives – for example, cheap vehicle tyres imported from third countries rather than tyres reconditioned in the EU.

Some Member States provide reduced rates on certain circular economy activities – bicycle repair for example – but this is by no means universal. Consequently, we believe that the Commission should study the benefits and issues arising from allowing reduced VAT rates or zero rate for certain circular economy services and not just on goods for resale in addition to those listed in Annex III of Directive 2006/112/EC (points 19 and 25).

Goods sent for repair from one Member State to another must be returned to the original Member State (there might be other Member States involved in the repair process) to avoid registration and compliance obligations outside of the first Member State. This creates a disincentive to have second-hand goods repaired outside of the first Member State (Cases C-606/12 and C-607/12) even where the repair might be more cost effective in the second Member State.

1.9 Please provide additional details on the reasons for your reply in relation to the problems in question, for example by describing specific problems you have encountered (optional).

1.10 The second-hand goods margin scheme’s primary objective is to avoid double taxation of the same goods. When private individuals or second-hand dealers sell used goods, no VAT is applied since they did not reclaim VAT on the original purchase. Instead, VAT is only paid on the profit margin (sale price minus original cost). How effective is the scheme in achieving its objective and addressing double taxation by allowing for the taxation of the profit margin only?

- ○ Very effective
- ○ Effective
- ◉ Somewhat effective

- ○ Not effective
- ○ No opinion

1.11 The scheme is:

- ○ Very easy to comply with
- ○ Easy to comply with
- ◉ Not easy to comply with
- ○ No opinion

1.12 How many hours a month does your business spend calculating the profit margin for individual transactions under the scheme, excluding applying the global margin calculation where relevant:

- ○ Fewer than 5 hours
- ○ 5 to 10 hours
- ○ 10 to 20 hours
- ○ More than 20 hours
- ◉ No opinion

1.13 How many hours a month does your business spend calculating the profit margin for transactions under the scheme, including applying the global margin calculation where relevant:

- ○ Fewer than 5 hours
- ○ 5 to 10 hours
- ○ 10 to 20 hours
- ○ More than 20 hours
- ◉ No opinion

1.14 According to the current rules, second-hand goods are in essence movable tangible property suitable for further use as they are or after repair. However, works of art, collectors' items, antiques, precious metals, precious stones are excluded from the second-hand goods margin scheme. To what extent do you think that the current definitions that distinguish between 'second-hand goods' and 'new goods' make it possible to apply the scheme to non-qualifying goods and create incentives

for fraud?

- ○ Fully agree
- ◉ Somewhat agree
- ○ Somewhat disagree
- ○ Disagree
- ○ No opinion

1.15 If targeted legislative improvements to update the scheme were envisaged, on a scale from 1 to 5, please say whether the following amendments would achieve the objective of creating a more coherent VAT framework to support the tackling of issues liable to prevent the uptake/development of economic activities relevant for the circular economy.

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Introduction of harmonised and digitalised record-keeping and reporting | ○ | ○ | ◉ | ○ | ○ |
| Mandatory harmonised availability of the global margin | ○ | ○ | ○ | ○ | ◉ |
| Application of the destination principle | ○ | ○ | ◉ | ○ | ○ |
| A harmonised, extended definition of second-hand goods to include reuse, refurbishment and remanufacturing | ○ | ○ | ○ | ○ | ◉ |

1.16 Please rank the possible consequences of this policy choice according to the following five criteria, from high benefits = 5 to low benefits = 1 and no benefit = 0.

| | VAT fraud reduction | Increased VAT revenue | Improved market functioning | Reduced administrative complexity and compliance costs | Promotion of the principles of the circular economy (for example minimising waste and extending the life cycle of products and assets) by addressing issues liable to prevent the uptake/development of economic activities relevant for the circular economy |
|---|---|---|---|---|---|
| Introduction of harmonised and digitalised record-keeping and reporting | 3 | 2 | 3 | 3 | 2 |
| Mandatory harmonised availability of the global margin | 2 | 1 | 3 | 5 | 2 |
| Application of the destination principle | 4 | 2 | 3 | 3 | 2 |
| A harmonised, extended definition of second-hand goods | 3 | 1 | 3 | 4 | 5 |

1.17 If the scheme were to be replaced by the introduction of a notional input VAT deduction for the taxable dealer in national or cross-border transactions that would equal the VAT that would have been due if the supply of the second-hand good by the final consumer had been subject to VAT (e.g. 16.67% of the purchase price in a country with a VAT rate of 20%), on a scale from 1 to 5, please say whether the introduction of this notional deduction would achieve the objective of creating a more coherent VAT framework and support the uptake or development of economic activities relevant for the circular economy.

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Introduction of a notional input VAT deduction | ○ | ○ | ○ | ◉ | ○ |

1.18 Please rank the possible consequences of this policy choice according to the following five criteria, from high benefits = 5 to low benefits = 1 and no benefit = 0.

| | VAT fraud reduction | Increased VAT revenue | Improved market functioning | Reduced administrative complexity and compliance costs | Promotion of the principles of the circular economy (for example minimising waste and extending the life cycle of products and assets) by addressing issues liable to prevent the uptake/development of economic activities relevant for the circular economy |
|---|---|---|---|---|---|
| Introduction of a notional input VAT deduction | 2 | 2 | 3 | 4 | 4 |

1.19. Would you consider it necessary to introduce specific anti-fraud measures together with the introduction of a notional input VAT deduction rule?

- ○ Yes
- ○ No
- ◉ No opinion

1.20. Which specific anti-fraud measures would you propose to accompany the introduction of a notional input VAT deduction rule? (optional)

Several non-EU countries apply a 'notional' input tax deduction and their experiences should be carefully studied to determine the advantages/disadvantages of their systems - to be able to propose a 'best in class' solution in this area.

Detailed records would need to be kept, ensuring that the goods being supplied are 'second-hand' goods to benefit from the notional input tax deduction. This would presumably also be the case should, for example, favourable VAT rates were introduced for upscaling and refurbishment activities.

The record keeping should be as simple as possible and leverage other EU digital initiatives. For example, this could be done through the serial numbers of telephones or vehicles (sectors particularly prone to margin scheme fraud) and recorded in a centralised database as, for example the one to be created to record/report intra-EU supplies of goods and services from 2030.

Additionally, the solution should leverage the Digital Product Passport (DPP) required under the Ecodesign for Sustainable Products Regulation (ESPR), so that each circular good receiving notional input VAT deduction and / or a special VAT regime has a unique identifier, thereby preventing the fraudulent passing off of new goods as second-hand.

Broadly, the EU's VAT framework (and the tax administrations systems) should be capable of recognising activities such as upcycling and refurbishment and not disadvantage them in respect of the entire process – for example, collection, assessment, repair or upgrade and selling it back into use across borders. Traceability of such products is necessary to avoid abuse but should be proportionate, especially considering that many of the businesses offering such goods and services are SMEs.

If the notional input tax solution were to be adopted, this should not create barriers to non-established businesses being able to claim that VAT back under Directive 2008/9/EC for EU established businesses. The VAT Directive could be amended with unanimous agreement to allow the offset of this notional input VAT against any VAT declared on the subsequent sale if the supplier uses the OSS.

For imported goods (originating from a third country/territory) consideration should be given as to how they should be treated as, in principle, they would not benefit from the 'notional' input tax deduction.

1.21. Another way to achieve the objective of creating a more coherent VAT framework which does not hinder the uptake or development of circular economic activities would be to abolish the current scheme and apply the normal VAT rules, including the application of reduced EU VAT rates set at national level. On a scale from 1 to 5, please say whether this would fulfil the objective of creating a more coherent VAT framework and supporting the uptake or development of economic

activities relevant for the circular economy.

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Replacement of the margin scheme with the normal VAT rules and application of reduced VAT rates | ○ | ○ | ○ | ◉ | ○ |

1.22. Please rank the possible impacts of this policy choice according to the following five criteria, from high benefits = 5 to low benefits = 1 and no benefit = 0.

| | VAT fraud reduction | Increased VAT revenue | Improved market functioning | Reduced administrative complexity and compliance costs | Promotion of the principles of the circular economy (for example minimising waste and extending the life cycle of products and assets) by addressing issues liable to prevent the uptake/development of economic activities relevant for the circular economy |
|---|---|---|---|---|---|
| Replacement of the margin scheme with the normal VAT rules, including the application of reduced VAT rates | 2 | 1 | 4 | 4 | 3 |

### 1.23 Would you suggest any other solutions that could address the weaknesses of the current rules?

The current rules were not drafted with the circular economy in mind and fail to adequately address the issues of this fast-growing and evolving business sector.

New business models have arisen without any changes in the VAT system. For example, businesses now offer consumers the choice of leasing goods that would previously have been bought, as part of a cycle of use, refurbishment and re-use. There are no specific regimes for VAT that reflect the refurbishment and subsequent leasing or sale of such second-hand goods.

In order to promote cross-border trade in circular goods there needs to be further harmonisation of key terms prevalent in the sector. For example, there is currently no standardised definition of ‘second-hand goods’, ‘remanufactured goods’ etc., which as a consequence, differs between Member States. Equally, terms such as recycle, refurbish, upcycle and others relevant for the sector should have a harmonised definition and treatment across borders. Additionally, it should be specified whether such definitions and treatments apply globally or just for taxable persons, as many second-hand goods are resold or upcycled by “hobbyists” and then sold via online platforms.

For the purposes of cross-border trade, mandatory harmonised definitions are the starting point to ensure that transactions are appropriately taxed.

Also for the purposes of making the cross-border sale of circular economy goods financially feasible, the current rules should be changed to allow the use of the One-Stop Shop for sales made using the margin scheme.

Where Member States allow the use of a global margin scheme (and not all do so) the manner in which the global scheme is applied varies and should be harmonised.

A number of changes, in addition to the harmonisation of definitions, could be introduced to the current regime to limit the scope for fraud and to ensure VAT collection without fundamentally changing the existing structure of the margin scheme. For example, fraud could be combatted by using digital tools to track goods being sold via the scheme, using the infrastructure being built for the introduction of ViDA for reporting intra-EU flows of goods and services.

## Section 2: The VAT implications of donating versus destroying goods

The Circular Economy Action Plan emphasises the long-term importance of making sustainable business models the norm and transforming consumption patterns so that ‘no waste is produced in the first place’. The Clean Industrial Deal, in which the Commission identified circularity as one of the key enablers of a competitive and decarbonised European economy and announced a future ‘green VAT initiative’ (also labelled ‘Circular VAT’) is also highly relevant. However, many businesses, in the course of their operations, produce, purchase or otherwise obtain goods (for example returned) that they ultimately choose not to sell or use themselves.

Producing goods entails costs, so businesses usually try to produce only the goods they expect to sell. In practice, however, businesses are routinely led to generate surplus goods for a variety of reasons, including to maintain value through scarcity, forecasting difficulties, production efficiency, distributional considerations, rapid production life cycles, and returns and defects. Many of these factors are unfortunately unavoidable to some extent.

Once in possession of surplus goods, businesses have several ways of managing them. Some involve putting the goods back into the sales chain, for example through distribution via discount outlets or by remanufacturing the goods, as is the case with the remanufacturing of industrial electric motors for resale. Goods can also be donated for redistribution by charities or other organisations. However, a proportion of surplus goods is destroyed. While several factors may influence decisions on whether to destroy or donate surplus goods, including reputational considerations and environmental impacts, cost remains by far the most significant factor. This in turn is determined by a range of additional factors, such as operational feasibility, logistics, and differences in tax treatment, particularly VAT rules that may also affect cost.

Under EU VAT rules, the destruction of goods, under certain conditions, qualifies for input VAT deduction with no VAT charged on the goods destroyed, unlike in the case of the donation of goods. Moreover, rules on donation focus mainly on fraud prevention and are fragmented, complex and restrictive. This means that the VAT rules are not aligned with recent EU sustainability policies that focus on promoting circular production and consumption cycles as a key way of reducing waste and environmental impacts. In particular, the destruction of unsold but viable consumer goods is explicitly addressed in the Ecodesign for Sustainable Products Regulation (ESPR), including a ban (under specific exemptions) on the destruction of certain unsold consumer products, currently covering apparel, clothing accessories and footwear, and a general principle that economic operators must take all necessary measures which can be reasonably expected to prevent the need to destroy unsold consumer goods.

## 2.1. How familiar are you with the VAT rules on input VAT deduction for the destruction and donation of goods? Have you applied the current rules?

- ○ I am familiar with the current rules and have applied them in cases of the destruction and/or donation of goods
- ◉ I am familiar with the current rules in theory, but have not used them in practice [go to next question]
- ○ I am not familiar with the scheme/have not used it in practice

## 2.2 Have the current rules discouraged you from using the scheme?

- ○ Yes
- ○ No
- ◉ No opinion

2.3 How would you assess the administrative burden of complying with the VAT rules on input VAT deduction in the case of the destruction of goods?

- ○ Very low
- ○ Low
- ◉ Moderate
- ○ Very high
- ○ No opinion

2.4. How many man hours a month does your business spend to comply with the current rules on input VAT deduction in the case of the destruction of goods?

- ○ Fewer than 5 hours
- ○ 5 to 10 hours
- ○ 10 to 20 hours
- ○ More than 20 hours
- ◉ No opinion

2.5 How would you assess the administrative burden of complying with the VAT rules on input VAT deduction in the case of the donation of goods?

- ○ Very low
- ○ Low
- ○ Moderate
- ◉ Very high
- ○ No opinion

2.6. How many man hours a month does your business spend to comply with the current rules on input VAT deduction in the case of the donation of goods?

- ○ Very low
- ○ Low
- ◉ Moderate
- ○ Very high
- ○ No opinion

2.7. In your experience, under the current VAT rules, is it easier to donate the goods than to destroy them, or vice versa?

- ○ Donation much easier
- ○ Donation somewhat easier
- ○ About the same
- ◉ Donation somewhat more difficult
- ○ Donation much more difficult
- ○ No opinion

2.8 Please list any problem with the current rules on input VAT deduction on donation and destruction and the uptake/development of economic activities relevant for the circular economy (optional).

In principle, the VAT system should not make the destruction of goods or materials more financially attractive than donating them - which the current system often does.

VAT is due if the donated goods have a market value (deemed supply). It is often quite a difficult and arbitrary process to value a deemed supply, particularly when the deemed supply in question relates to products that have value in only limited circumstances and to limited acquirers or donees.

For donated goods / services, this can mean that destruction of goods of negligible value to the donating entity (when they have full input tax deduction) is more cost effective than donating the goods / services and having to account for deemed output VAT when no actual consideration is received (highlighted by the Finanzamt X case (C-207/23)).

This issue is exemplified in the Austrian legislation, as an example. An input VAT deduction is allowed on the destruction of goods unless there is no evidence of the destruction – in which case output VAT on the deemed supply could become due.

For imported goods (originating from a third country/territory) consideration should be given as to how they should be treated as, in principle, they would not benefit from the ‘notional’ input tax deduction.

Documentation requirements are not harmonised and often onerous - in some Member States the documentation required to demonstrate that no output VAT is due can encompass proving the existence of insurance claims or even destruction of the goods in question before a notary.

Even when donations are encouraged by, for example, zero rating (with input VAT recovery) these provisions can be very restrictive. For example, in Austria donations of food and non-alcoholic drinks are zero-rated (with input VAT deduction) if given to a charitable organisation, only. All other donations are subject to VAT on the deemed supply.

France under article 273 septies D of the General Tax Code does not require either an adjustment to the input tax deducted or an output tax charge on the donation of unsold new food and non-food items that have been donated to recognised public-interest organisations serving a general purpose of a humanitarian, educational, social or charitable nature, under conditions laid down by decree.

As noted, the issue here is the non-harmonisation of the VAT rules, meaning that it is difficult for donations to be made and, in particular, donations made across-borders without creating a VAT charge. Currently Member States wishing to apply specific exemptions from VAT on donated goods will probably need to request a derogation from the Directive. Options to ameliorate this issue could include extending and harmonising at an EU level the existing rules for small value gifts under Article 16 and / or introducing harmonised and objective criteria for donations to charities.

In any event, the record keeping requirements in respect of donations (but which may need to be kept for other purposes, e.g. for public health reasons in relation to donated food items) and destruction of goods should be proportionate and leverage the current various electronic systems being developed in the EU.

2.9 Please provide additional details on the reasons for your reply in relation to the problems in question, for example by describing specific problems you have encountered (optional).

2.10 Please list any problem, more generally speaking, with the VAT rules on the donation and destruction of goods and the uptake/development of economic activities relevant for the circular economy (optional).

There are reported instances of certain businesses over-producing goods to meet a perceived market demand (or trends) which does not materialise - resulting in these surpluses being donated and potentially finding their way back into the economy without any VAT being accounted for, but with the input tax having been fully deducted by the donor.

2.11 Please provide additional details on the reasons for your reply in relation to the problems in question, for example by describing specific problems you have encountered (optional).

2.13 How coherent are the VAT rules on the destruction of goods with the ESPR and other relevant legislation (e.g. on waste management, environmental protection or consumer protection)?

- ○ Wholly incoherent
- ○ Somewhat incoherent
- ○ Neutral
- ○ Somewhat coherent
- ○ Fully coherent
- ◉ No opinion

2.14 What do you think would be the most appropriate reform to make VAT rules less complex and more favourable to the donation of goods rather than their destruction?

- ○ Removing the right of deduction for viable goods that are intentionally destroyed

- (●) Expanding and harmonising the scope of the ‘small gifts’ exception to allow VAT-free donations for low-value goods
- ( ) Introducing harmonised provisions on VAT relief for donations to registered charities

2.15 Please rank the possible impacts of each policy response according to the following five criteria, from high benefits = 5 to low benefits = 1 and no benefit = 0.

| | VAT fraud reduction | Increased VAT revenue | Improved market functioning | Reduced administrative burden | Less overproduction /more donation |
|---|---|---|---|---|---|
| Removed right of deduction for intentional destruction | 1 | 2 | 2 | 2 | 3 |
| VAT-free donations for low-value goods | 1 | 0 | 2 | 4 | 4 |
| VAT-free donations to registered charities | 1 | 0 | 2 | 3 | 3 |

### 2.16 Would you suggest any other solutions to address the weaknesses of the current rules?

The European Commission should extend the scope of this review past possible amendments to the margin scheme and VAT treatment of donations to consider the broader VAT challenges that arise from second-hand goods, particularly in industrial processes where the issue is broader than just the sale of second-hand goods.

Industrial circular processes include the reuse and processing of raw materials and residual materials as well as repair, refurbishment, manufacturing and upcycling. Identifying the correct VAT classification and treatment of such processes is complex, particularly in respect of classification of supplies, the taxable amount and the chargeable event.

Difficulties arise in distinguishing between supply of goods and supplies of services in repair and processing transactions. Where waste materials have an economic value businesses must determine the VAT treatment of these supplies, allocate value to them and identify the relevant chargeable event.

These difficulties are amplified in cross-border material flows because of differences in classifications, evidence requirements and reporting requirements between Member States. These reduce the incentive to undertake such material flows and result in a lack of legal certainty.

In respect of question 2.14, the situation would be improved by both harmonising the definition of small gifts and harmonising the definition of ‘charity’ across all Member States and the goods that can be donated, without triggering a VAT charge.

The European Commission should also review initiatives in countries outside the EU to assess their effectiveness. In New Zealand, for example, the donation is treated as zero-rated but records are then kept by the charity as to how the goods received are subsequently used/disposed of by the charity to avoid distortions of competition.

## Section 3: Reforming the VAT deduction rules for passenger cars

Unlike all other vehicles used exclusively for business purposes, such as trucks, in which case the current rules allow full deduction of input VAT, passenger cars with fewer than nine seats used for business purposes (leasing or car rentals for example) remain subject to EU country-specific restrictions or even complete exclusions from input VAT deduction. This unequal treatment reflects the current VAT rules that allow limitations on or derogations from deduction rights, notably because passenger cars are considered liable to be used for both business and private purposes. The current framework draws no distinction, as far as the above is concerned, between conventional passenger cars or zero-emission vehicles (ZEVs). In practice, this has led to a fragmented landscape across EU countries. A coherent circular economy VAT initiative should therefore consider whether and how these rules on input VAT deduction passenger cars can be aligned with broader sustainability and neutrality objectives (e.g. by possibly allowing MS to provide more favourable treatment for ZEVs than for conventional passenger cars). This is not relevant for vehicles used exclusively for business purposes, as input VAT deduction is allowed for them under the current rules.

This section on targeted amendments to the VAT rules addresses passenger cars purchased or leased for business purposes, specifically the rules on the deduction of related input VAT under the VAT Directive[1]. From an environmental perspective, the topic has also gained renewed prominence in light of the recent

Commission Communication on the decarbonisation of corporate fleets. The Communication addresses opportunities that can help accelerate the uptake of ZEVs in corporate fleets, mentioning corporate cars that are relevant for the rules under consultation, as well as vans and heavy-duty vehicles (trucks, buses and coaches).

The Communication mentions VAT as a particular area for action, specifying that ZEVs should be incentivised 'by either reducing comparative benefits for conventional vehicles or improving the treatment of zero-emission vehicles', in particular by progressively removing any VAT deduction for conventional vehicles (international combustion engines).

Most EU countries apply restrictive input VAT deduction rules for passenger cars, regardless of their emissions or other characteristics. Twelve EU countries allow no or only very limited deductions. Among those that do, only three permit full VAT deduction, while another 12 cap deductions (typically at 40% to 60% of the cost). Only four EU countries provide preferential VAT treatment specifically for green cars.

The VAT deduction rules for passenger cars are highly fragmented. Leaving such considerations entirely to EU countries has also produced an incoherent framework that fails to support the achievement of the EU's objectives of greening corporate fleets, phasing out polluting vehicles, and using the VAT system to drive this transition.

[1] Articles 178, 176 and 395 of the VAT Directive.

### 3.1. How familiar are you with the input VAT deduction rules for passenger cars under the VAT Directive? Have you applied the current rules?

- ○ I am familiar with the current rules and have applied them in cases of the destruction and/or donation of goods
- ◉ I am familiar with the current rules in theory, but have not used them in practice [go to next question]
- ○ I am not familiar with the scheme/have not used it in practice

### 3.2. How big a role do VAT deduction rules play under the VAT Directive in encouraging businesses to transition to ZEVs and purchase passenger cars for business purposes?

- ○ Not big at all
- ○ A bit big
- ○ Fairly big
- ○ Very big
- ○ Extremely big
- ◉ No opinion

3.3. Have the current rules on input VAT deduction for passenger cars that restrict the right of input VAT deduction discouraged you from purchasing ZEVs for business purposes?

- ○ Yes
- ○ No
- ◉ No opinion

3.4 How would you assess the administrative burden of complying with the VAT rules on input VAT deduction for passenger cars in different EU countries?

- ○ Very low
- ○ Low
- ○ Moderate
- ○ Very high
- ◉ No opinion

3.5. How many man hours a month does your business spend to comply with the current rules on input VAT deduction for passenger cars used for business purposes?

- ○ Fewer than 5 hours
- ○ 5 to 10 hours
- ○ 10 to 20 hours
- ○ More than 20 hours
- ◉ No opinion

3.6 Do you think that the current rules on input VAT deduction hinder the uptake /development of ZEVs that are passenger cars for business purposes?

- ◉ Yes
- ○ No
- ○ No opinion

3.7 Please list any other VAT-related problem with the uptake/development of ZEVs that are passenger cars for business purposes.

Favourable VAT treatment (especially when linked to corporate income tax and personal income tax benefits such as accelerated capital allowances for business and reduced tax charges on employees) seems to be effective in driving the use of ZEVs as company cars.

However, the rules in respect of the VAT treatment of such vehicles can be complex. For example, in Austria, complete input VAT deduction for ZEVs is allowed up to a purchase price of 40 000 €. For a price between 40 000 € and 80 000 €, VAT is deductible for the first 40 000 € and for a price of 80 000 € or more no input VAT recovery is permitted at all. This complexity also feeds through to the rules regarding VAT on the private use of company vehicles and on the later disposal of the ZEV.

3.8 Please provide additional details on the reasons for your reply in relation to the problems in question, for example by describing specific problems you have encountered (optional).

In addition to differences between Member States in the VAT treatment of ZEVs, very significant differences exist between Member States in the incentives offered by them in respect of ZEVs which further complicate the decision-making process when businesses are operating across borders and are potentially distortive.

3.9. To which degree do you agree/disagree with the following sentence: The VAT deduction rules for passenger cars under the VAT Directive are outdated and highly fragmented.

- ○ Strongly agree
- ◉ Agree
- ○ Neutral
- ○ Disagree
- ○ Strongly disagree
- ○ No opinion/cannot answer due to lack of information

3.10. To which degree do you agree/disagree with the following sentence: The vast majority of EU countries provide limited incentives for businesses to choose greener alternatives for their corporate fleet vehicles involving passenger cars used for business purposes.

- ○ Strongly agree
- ◉ Agree
- ○ Neutral
- ○ Disagree

- Strongly disagree
- No opinion/cannot answer due to lack of information

3.11 The aim of the VAT rules on input VAT deduction for passenger cars is to ensure VAT neutrality and allow for input VAT deduction only if a car is used for business purposes. To what extent are the current rules effective in achieving their objective and ensuring VAT neutrality by allowing the right of deduction to be exercised only for the part allocated to the business purpose?

- Very effective
- Effective
- Somewhat effective
- (•) Not effective
- No opinion

3.12. How coherent are the VAT rules on input VAT deduction with the broader objective of promoting ZEVs that are passenger cars?

- Wholly incoherent
- (•) Somewhat incoherent
- Neutral
- Somewhat coherent
- Fully coherent
- No opinion

3.13 If one were to argue that there are limited incentives under the VAT Directive in relation to the deduction system for businesses to choose non-polluting vehicles, as well as uncoordinated action by EU countries on deduction rules for non-polluting vehicles under their respective national taxation rules, to what extent do you think that the following consequences, relevant for reducing CO2 emissions from passenger cars, would be impactful?

| Please rate from 1 = not impactful to 5 = very impactful | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Slower uptake of non-polluting passenger cars | | | | | |
| Persistence of high emission levels from corporate fleets | | | | | |
| Uneven level playing field for businesses which purchase or lease passenger cars for business purposes due to different input VAT deduction rules in various EU countries | | | | | |

3.14 What do you think would be the most appropriate policy option for making the VAT tax system under the VAT Directive more coherent in relation to reducing CO2 emissions from passenger cars used for business purposes?

- **Option 1:** Under the VAT Directive, requiring all EU countries to allow full deduction on the purchase and leasing of non-polluting vehicles (i.e. ZEVs, including second-hand ZEVs) used for business purposes, and prohibiting VAT deductions for all other vehicles
- **Option 2**: Under the VAT Directive, requiring all EU countries to allow full deduction on the purchase and leasing of non-polluting vehicles (i.e. ZEVs, including second-hand ZEVs) used for business purposes, as in option 1. However, EU countries should remain free to decide whether they prohibit VAT deductions or not for all other vehicles
- **Option 3:** Under the VAT Directive, imposing unfavourable treatment for polluting vehicles: in contrast to the other options, this would not mandate favourable treatment for non-polluting vehicles but rather require EU countries to prohibit deductions for all other vehicles. EU countries would be free to decide whether to grant full or partial deduction rights for non-polluting vehicles used for business purposes

3.15 Please rank the possible impacts of each policy option according to the following five criteria, from high benefit = 5 to low benefit = 1 and no benefit = 0.

| | Market effects on the demand for passenger cars used for business purposes of an increase in the demand for ZEVs | Market effects on the demand for passenger cars used for business purposes by a decrease in the demand for ICE | VAT fraud reduction | Increased VAT revenue | Enhanced level playing field in the single market |
|---|---|---|---|---|---|
| Option 1 | 4 | 2 | 2 | 0 | 2 |
| Option 2 | 4 | 2 | 3 | 0 | 2 |
| Option 3 | 3 | 3 | 3 | 1 | 3 |

### 3.16 Would you suggest any other solutions to address the weaknesses of the current rules?

Although there are an increasing number of advanced software solutions using data directly from the vehicle to reduce the need for manual data entry, recording business and private mileage is a considerable burden for many SMEs. A standard proportionate deduction (effectively a safe harbour) for business use of vehicles also available for use privately (i.e. not including vehicles only to be used for business purposes, such as vans or lorries) could be a considerable simplification for businesses as it would avoid them having to keep detailed records of usage and distances travelled.

## Section 4: Subsidiarity check, additional evidence and comments

### 4.1 Do you consider the adoption of measures in the area of VAT at European level necessary to ensure greater support for the transition towards a circular economy?

- (●) Yes, to a large extent
- ( ) Yes, to some extent
- ( ) Not really
- ( ) It would be counterproductive
- ( ) No opinion

### 4.2 Please include your additional comments here:

There are many VAT issues negatively impacting the circular economy that can only be alleviated at an EU level, for example:

- Non-harmonisation of VAT rules make donation across borders too difficult for many businesses.
- Differences in Member States VAT, corporate income tax and personal income tax rules make the business decisions in respect of ZEVs unnecessarily complex and are distortive in terms of driving business decisions.

The VAT system should be neutral whether the business operates a ‘traditional’ business model or a circular business model. We recommend that the European Commission concentrates on identifying and rectifying those elements that are distortive against the circular economy rather than introduce additional rules that penalise the ‘traditional’ economy. Appropriate measures include:

- Improving the current margin scheme but also broadening the scope of the review to cover circular business models that are not solely based on the sale of second-hand goods
- Harmonisation of the global margin scheme between Member States would also simplify matters for cross-border businesses.
- Harmonising EU rules covering the definition of key terms and concepts central to the circular economy circular goods and services

and harmonising the VAT treatment of the processes - including reuse of materials and supplies of circular goods and services

- Remove the VAT disadvantages of donating viable goods and materials
- Reduce the compliance burden that arises from excessive and non-harmonised compliance procedures, documentation and evidential requirements

4.3 Please upload your files(s) if relevant, to support your answer regarding the negative/positive impacts of potential policy options and potential measures:

4.4 Do you have any additional materials or resources you would like to share?

- ○ Yes
- ◉ No

4.6 Would you agree to be contacted if we need to clarify some of your answers?

- ◉ Yes
- ○ No

4.7 Would you be interested in participating in a follow-up interview to discuss your thoughts on the VAT rules for circular economic activities in more detail?

- ◉ Yes
- ○ No

## Contact

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