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Amtsgericht Düsseldorf,
Vereinsregister VR 3850

European Commission
DG TAXUD (Unit C1 and Unit C5)
1049 Brussels
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VAT and the Circular Economy
Position paper in response to the European Commission's call for evidence for an evaluation and impact assessment

Dear Sir or Madam,

The Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW) appreciates the opportunity to comment on the European Commission's initiative "VAT and the Circular Economy".

The IDW welcomes the European Commission's objective of examining whether the existing VAT framework creates distortions, uncertainty, complexity or fragmentation that hinder circular economic activities. The impact assessment should address two priorities: VAT-related obstacles affecting circular business models in the industrial sector beyond the margin scheme for second-hand goods and the VAT disadvantage associated with donating viable goods rather than destroying them. These issues should be assessed against the principles of VAT neutrality, legal certainty, proportionate compliance costs, ease of administration and the proper functioning of the internal market.

VAT should remain neutral between different forms of economic organization and business models. Circular business models should therefore not face avoidable VAT burdens, legal uncertainty or disproportionate compliance costs compared with linear business models. Reform should focus on removing such obstacles rather than assigning additional policy-steering functions to VAT. This requires clear, practicable and consistently applied rules across the European Union, especially for cross-border transactions.

The three areas identified by the Commission do not capture all significant VAT obstacles to the circular economy. In the industrial sector in particular, material VAT challenges arise outside the margin scheme for second-hand goods. We therefore welcome the examination of different policy options and recommend that the impact assessment also addresses these wider practical obstacles.

Second-hand goods and circular business models in the industrial sector

We recommend broadening the assessment beyond reform of the margin scheme for second-hand goods. It should also address VAT-related obstacles affecting industrial circular business models, including the classification of supplies, the taxable amount and the chargeable event in repair, recycling, refurbishment, remanufacturing, upcycling and material recovery transactions.

The Commission's proposed review of the margin scheme for second-hand goods is appropriate in principle. In practice, uncertainty arises when businesses must determine whether an item remains a second-hand good after repair, refurbishment or further processing or has become a new good. That classification affects whether the normal VAT arrangements or the margin scheme applies and may require separate operational and accounting treatment. An incorrect classification may also lead to invoicing errors and corresponding VAT risks.

The impact assessment should also cover industrial circular processes that do not involve the resale of second-hand goods. These include the reuse and processing of raw materials and residual materials as well as repair, recycling, refurbishment, remanufacturing and upcycling. Such activities can raise complex questions about the classification of supplies, the taxable amount and the chargeable event.

A central difficulty is distinguishing between supplies of goods and supplies of services in repair and processing transactions. Where waste materials have economic value, a waste treatment service may also be linked to the transfer of recoverable materials. Businesses must then determine the VAT treatment of the reciprocal supplies, allocate value to each supply and identify the relevant chargeable event. These determinations become especially difficult where the composition or value of the transferred materials is established only later or depends on variable market prices.

Cross-border material flows amplify these difficulties, because Member States may classify the same economic transactions differently. Divergent classifications can trigger additional evidentiary requirements, adjustments and reporting obligations, thereby increasing legal uncertainty. Uniform EU definitions, standardized rules and practicable simplifications should therefore be considered for circular economy transactions.

Reform of the margin scheme may help addressing some of these issues, but it should not be treated as the sole approach to VAT in the circular economy. Any extension or further development of the scheme should be assessed by whether it reflects modern material flows and value chains appropriately, ensures VAT neutrality and remains administratively practicable. The choice of a particular taxation method should follow from those criteria, not constitute an end in itself.

Donation of goods compared with their destruction

We recommend a uniform EU framework that directly removes the VAT disadvantage associated with donating viable goods and provides legal certainty. Restricting input VAT deduction when goods are destroyed would merely make destruction more costly; it would not resolve the VAT burden arising when goods are donated for further use.

The IDW agrees with the Commission's underlying premise that the VAT system should not create economic incentives to destroy goods that remain viable merely for VAT reasons rather than

making them available for further use. This issue is particularly significant where EU law restricts the destruction of specific categories of unsold consumer products. In its call for evidence, the Commission itself establishes a link with the Ecodesign for Sustainable Products Regulation.

The current rules may produce different VAT consequences depending on whether viable goods are passed on for further use or destroyed. Under the first paragraph of Article 16 of the VAT Directive, the disposal free of charge of goods forming part of a taxable person's business assets is, in principle, treated as a supply of goods for consideration where the VAT on those goods or their component parts was wholly or partly deductible. By contrast, under Article 185 (2) of the VAT Directive, no adjustment of the initial deduction is, in principle, made where destruction of property is duly proven or confirmed.

The issue is not confined to donations in the narrow sense; it also affects free transfers within the business sector. In its judgment of 25th April 2024 in Case C-207/23, Finanzamt X, the Court of Justice of the European Union confirmed, in relation to heat transferred free of charge to other taxable persons for use in their economic activities, that the first paragraph of Article 16 of the VAT Directive may apply even where the recipients use the goods for business purposes.

In addition to the resulting VAT burden, businesses may face practical difficulties in determining the taxable amount, because a reliable current value may be difficult to establish. This is particularly relevant for goods that have been used in the business for an extended period and for goods whose marketability or economic value is significantly impaired when they are transferred free of charge.

Merely restricting the right of deduction where goods are destroyed does not appear to be the preferable solution. Such an approach would impose an additional tax disadvantage on the destruction of goods without directly addressing the VAT burden associated with donations and could give rise to further questions of classification and evidence.

We therefore consider it preferable to address the VAT treatment of donations directly. One option would be to extend and harmonize at EU level the existing rules for gifts of small value under Article 16 of the VAT Directive. Another would be a specific arrangement for donations to charitable organizations identified by objective criteria. Under either approach, relief from VAT on the disposal of goods must not be offset by restricting the right of deduction or requiring an adjustment of deductions; otherwise, the VAT burden would merely be shifted rather than removed.

Overarching requirements for reform

The Commission's objective of better supporting circular business models should be pursued in a manner consistent with the fundamental principles of the common system of VAT.

Reform should give priority to removing existing tax-related obstacles rather than creating new tax-based policy-steering instruments. New special rules risk generating further classification questions and compliance costs. By contrast, uniform EU provisions can improve legal certainty and simplify cross-border circular economy activities where divergent national rules or interpretations currently create difficulties.

This also applies to the Commission's consideration of changes to the rules governing the right of deduction for passenger cars. Any changes in this area should not create additional classification

issues or lead to further fragmentation of the VAT system. VAT neutrality, legal certainty and ease of administration should remain the relevant criteria.

In summary, we recommend that the following aspects should be considered in the further impact assessment:

- broaden the assessment beyond the margin scheme for second-hand goods to cover VAT-related obstacles affecting industrial circular business models, including recycling, refurbishment, remanufacturing, the use of secondary raw materials and waste or residual materials with an economic value,
- develop practicable EU rules that provide legal certainty on the classification of supplies, the taxable amount and the chargeable event in circular economy transactions,
- remove the VAT disadvantage of donating viable goods rather than destroying them by reforming the VAT treatment of donations directly and
- design new rules to preserve VAT neutrality while avoiding disproportionate compliance, documentation and evidentiary burdens.

Taken together, these measures would remove tax-induced distortions, improve legal certainty and make the European VAT framework more practicable for circular business models, particularly in cross-border settings.

We respectfully ask the Commission to take these comments into account in its further deliberations. We remain available to discuss our recommendations at a meeting or hearing.

Please do not hesitate to contact us if you have any questions.

Yours faithfully,

Dr. Moser

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