

*VAT treatment of private use
of company passenger cars as
from 1 December 2014*

As from 1.1.2014, amendments to Value Added Tax Act ('VAT Act') will take effect limiting deductibility of input VAT on company passenger cars that are used for both business and private use. The changes concern recovery of input VAT paid on purchase, hire and lease as well as running and maintenance costs of passenger cars. These significant amendments, however, are awaiting for the approval of the Council of the European Union (expected this month) to take effect.

Contacts:

Villi Tõntson

E-mail: villi.tontson@ee.pwc.com

Ain Veide

E-mail: ain.veide@ee.pwc.com

Hannes Lentsius

E-mail: hannes.lentsius@ee.pwc.com

AS PricewaterhouseCoopers

Tax Services

Pärnu mnt 15, 10141 Tallinn, Estonia

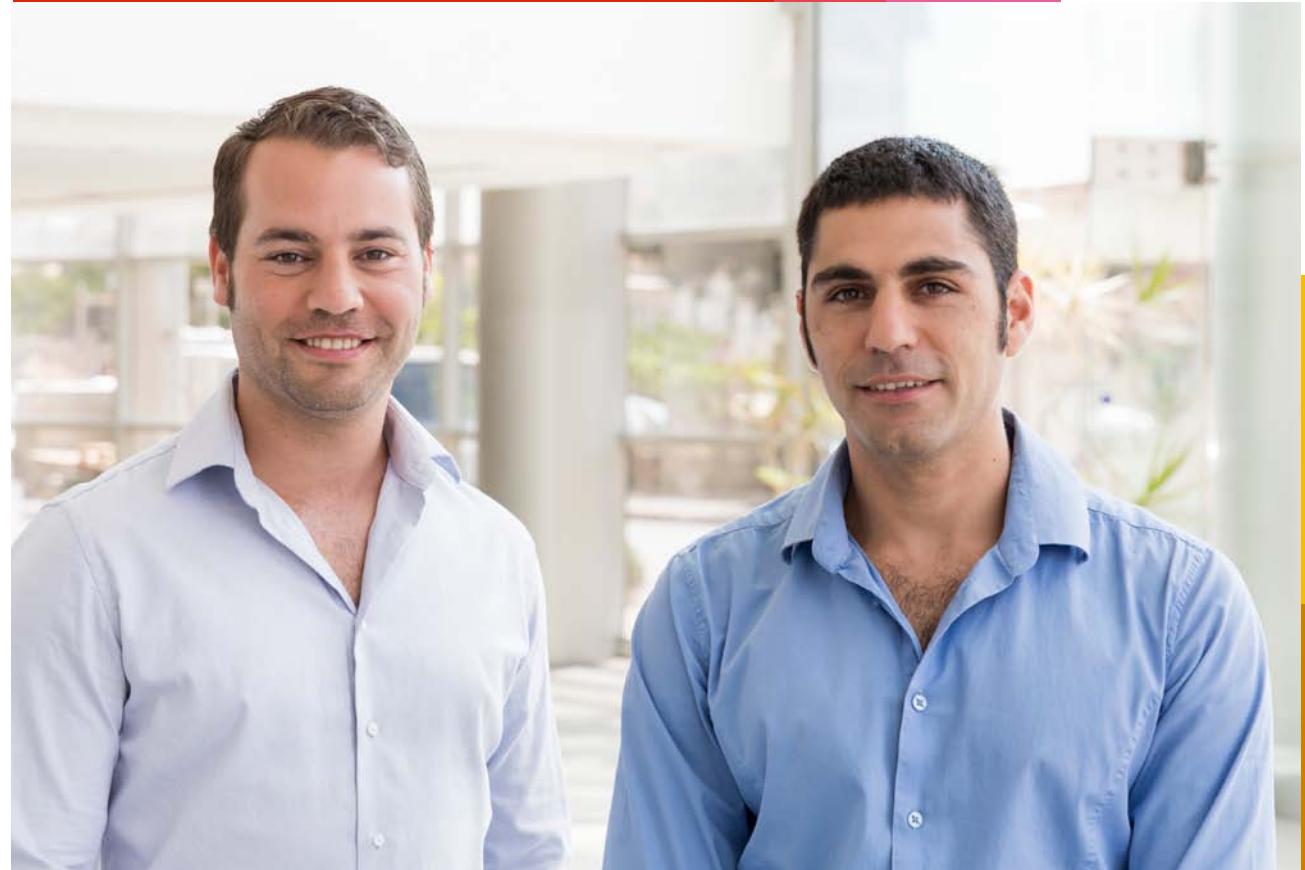
Tel: +372 614 1800

E-mail: tallinn@ee.pwc.com

www.pwc.ee

Tax alert

**VAT – cars special
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Passenger cars

Passenger cars are defined as vehicles of category M1 (including M1G) used for the carriage of passengers and which have maximum eight seats in addition to the driver's seat and which maximum weight does not exceed 3.5 tons (VAT Act § 2 (12)). The vehicles of category N1 (including N1G), also known as pick-up trucks, are not considered as passenger cars and therefore not affected by the amendments to VAT deductibility rules.

50% recovery status

As the new general rule (VAT Act § 30 (3)), 50% of input VAT on company passenger cars can be recovered. According to estimations of the Ministry of Finance, a vast number of company passenger cars are used also for private purposes. As the new rules limit deductibility of input VAT, the private use itself will no longer be subject to VAT. Therefore the article on private use of passenger cars will be abolished (VAT Act § 12 (7)) and in the future it will not be required to report and pay VAT on the taxable value of the private use of a company passenger car. Currently the maximum monthly VAT charge on private use of a company passenger car is 43 (256/1.20*0.20).

Reimbursement of private travels

Currently, any monetary compensation an employee pays for the private use of a company passenger car is subject to VAT. The legislator, however, is now of the opinion that making a passenger car available for private use in exchange for a monetary compensation cannot be considered as an economic activity of an employer within the meaning of VAT Act and therefore there is no taxable supply in such a case (VAT Act § 4 (2)(8))¹. As from 1.12.2014, reimbursement of private travels will not be subject to VAT and it is

important to notice that the reimbursement act itself does not grant the employer the right to recover 100% VAT on passenger car and related costs (VAT Act § 30 (4) 5)). This particular change was initiated by the Finance Committee of the Parliament during the readings of the draft law amendments.

100% recovery status

There are five exceptions still allowing the 100% of deduction of input VAT paid on passenger cars and onward running and maintenance expenses after 1.12.2014 (VAT Act § 30 (4) 1-5). The first group of exceptions (VAT Act § 30 (4) 1-2) includes passenger cars purchased for resale or subsequently used under a contract of use within the meaning of Law of Obligations Act (e.g. lease agreement, hire agreement, etc.).

The second group consists of the passenger cars that are mainly used as a taxi or for driving instruction (VAT Act § 30 (4) 3-4)).

And as the fifth exception, all input VAT can be reclaimed on passenger cars that are exclusively used for business purposes (VAT Act § 30 (4) 5)). During the readings of the draft law the clause "exclusive business use must be proved by the taxpayer" was excluded from the final text. This means that upon a tax dispute the parties have to validate their positions under the general proceeding and neither side is favoured. For example, if the taxpayer keeps a log book on travels of the company passenger car and submits this to the tax authorities as a proof, the correctness of such data is assumed. Should a doubt arise, the authorities then must gather all essential evidence, establish actual state of facts and issue an appropriately motivated assessment notice. From there it is again the taxpayer's obligation to prove the authorities' assessment is incorrect.

¹This does not apply on passenger cars which are mainly used as a taxi or for driving instruction. In such a case reimbursed private use is considered as economic activity.

The two-year adjustment period

If a taxpayer has reclaimed 100% VAT on purchase, the passenger car must be used for the respective purposes that allowed the full deduction. Should the purpose of the use of the car change during two years, an adjustment in the deducted VAT must be made in the month the change took place (VAT Act § 30 (7)). In principle, the change in the purpose of use is interpreted as private use of the car in that particular month.

For example, a passenger car was purchased in January 2015 and 100% of input VAT, e.g. at amount 4000 euros, was deducted in the same month. Private use occurring in December 2015 means that reporting this as a fringe benefit triggers a liability to repay 1083 euros ($4000 * 50\% * 13/24$). Thus, the adjustment depends on the proportion of the period left until the end of the two-year period before a change in intended purpose occurred. The two-year adjustment period concerns only the cars purchased or leased under a finance lease agreement as from 1.12.2014. The two-year adjustment period is not applied on passenger cars leased under an operating lease agreement.

Adjustments in input VAT upon the sale of a passenger car

During the readings of the draft law amendments, The Ministry of Finance noted that it will be possible to recalculate partially deducted input VAT (50%) if the passenger car will be sold within five years from recording the car as a fixed asset in taxpayer's books. Such sale would be subject to VAT (either at the rate of 20% or 0%). Any recalculations of partially deducted input VAT on fixed assets are made in accordance with the Regulation No. 39 of the Minister of Finance.

Amendments in the VAT return form

The VAT return will be complemented with the rows 5.3 and 5.4 for reclaiming input VAT on passenger cars and related goods and services either under the general rule (50%) or under one of the exceptions (100%).

Up to 50% recovery status

Where the majority of the taxpayer's activities is not considered as economic activities (such as non-profit organisations, state institutions, etc.) and therefore input VAT is deducted on a pro-rata bases which is less than 50%, then all input VAT on passenger cars and related running and maintenance costs should be deducted based on the same proportion.

Regulation No. 39 – adjustment of input VAT paid on fixed assets

Amendments to article 2 of the Regulation No. 39 of the Minister of Finance are pending. The article 2 sets forth the principles and procedure of recalculation of partially deducted VAT paid on fixed assets in the cases where respective assets are either sold or the ratio of the use for taxable supplies change. We will provide an overview of these changes in due course.

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