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FOREIGN AND COMMONWEALTH SECRETARY

VAT MARGIN SCHEME ON SECONDHAND GOODS: REASONED OPINION

Last Summer the European Commission issued a warning letter under Article 169 of the Treaty of Rome alleging that the two most recently introduced VAT secondhand schemes, those for firearms and for horses and ponies, were in breach of the Sixth VAT Directive. This has now been followed by a Reasoned Opinion, the step before infraction proceedings are brought before the European Court. Although the matter is not in itself of wide importance, our deadline for reply is such that there is insufficient time for discussion in OD(E) in the normal way. I am therefore writing to seek your consent, and that of colleagues in the Committee, to the proposed line of our reply.

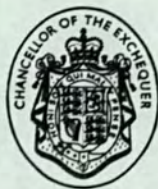
Background

2. The alleged infraction revolves around the interpretation of Article 32 of the Sixth Directive, which permits Member States to retain existing special systems for used goods pending agreement on a Community system. Our interpretation has been that this would permit new schemes to be introduced after the adoption of the Sixth Directive in 1977, provided that the basic system of relief (that of charging tax only on the profit margin) was not changed. The Commission did not challenge this view when the firearms scheme was introduced in December 1981, but

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did so immediately the horses and ponies Order came into force in October 1983, claiming that Article 32 was a standstill provision.

3. Our legal advice was that our interpretation would be unlikely to succeed before the European Court, and in replying to the Article 169 warning letter we offered a possible compromise, a firm commitment that the UK would introduce no new schemes if proceedings were dropped. The issue of the Reasoned Opinion marks the rejection of this offer and leaves us only with the options of withdrawing the schemes or defending them against proceedings in the Court.

Analysis

4. There are practical reasons, concerned with the application of the tax, which persuaded Treasury Ministers to introduce these recent schemes in the first place; for these reasons we would be reluctant to withdraw them.

5. Although our legal argument is not likely to find favour with the European Court, there are tactical reasons for not yielding at this stage. Article 32 requires the Council to adopt "... before 31 December 1977 a Community taxation system to be applied to used goods", ie a system of general application. This has not yet been done, although the Commission has had proposals (the draft Seventh Directive) in train since 1978. The Luxembourg Presidency has progress on the Seventh Directive as one of its objectives and the Commission, in Lord Cockfield's recent White Paper on the Internal Market, has indicated a commitment to securing its adoption this year. Even if early adoption is not achieved, renewed discussion of the draft



Directive could well help us by persuading the Commission of the undesirability of pursuing one Member State over two particular schemes while at the same time pressing for a Community-wide scheme of universal application.

Line Proposed

6. We suggest that our reply should mount as robust a defence to the arguments of the Reasoned Opinion as possible. In the discussions on the draft Seventh Directive we should try to persuade the Commission to soft-pedal its proceedings, reviewing the position later in the year but with the expectation that we shall let them progress to the European Court if discussion of the Seventh Directive founders.

Timetable

7. Our already extended deadline for reply to the Commission is 6 September but informally we are seeking a few days grace through UKREP. I should therefore be grateful for very urgent comments on the line we propose.

8. I am copying this to the Prime Minister, colleagues in OD(E) and Sir Robert Armstrong.

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4 September 1985