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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.4.2009  
COM(2009) 194 final

2009/0060 (COD)

Proposal for a

**REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**amending Regulation (EC) No 1905/2006 establishing a financing instrument for development cooperation and Regulation (EC) No 1889/2006 on establishing a financing instrument for the promotion of democracy and human rights worldwide**

## EXPLANATORY MEMORANDUM

The various Community financial instruments for external cooperation contain inconsistencies regarding the eligibility for Community financing of costs related to taxes, duties and other charges.

The Development Cooperation Instrument (DCI) and the European Instrument for Democracy and Human Rights (EIDHR) are the only ones not to provide for an exception to the principle of the non-eligibility of such costs for funding. The other instruments lay down that Community support may not be used to finance these costs in principle. They therefore allow for flexibility on a case-by-case basis and the authorising officer responsible may, where appropriate, decide to accept their being financed in the interests of proper implementation of programmes and projects.

Such flexibility is essential for certain recurring situations where deadlock occurs because exemption mechanisms are absent or impractical (owing, for example, to the extreme complexity of procedures in the beneficiary country). In these situations, the rigid formulation of the DCI and EIDHR instruments may make the action financed by external aid extremely difficult, particularly in the context of EIDHR projects. Note also that with the current wording the prohibition on financing for the payment of taxes concerns only those paid "in beneficiary countries", which adds difficulty of interpretation to the problem of eligibility (especially in the case of regional projects). Another example is the levying of local taxes (equivalent to VAT) which cannot be recovered because of a lack of machinery for relief and then have to be borne by the contractor because of the strict prohibition on covering taxes.

By way of example, difficulties as regards eligibility arise in, but are not limited to, the following cases:

- Local purchases of low value and/or reimbursables where the beneficiary country's machinery for VAT exemption is sometimes difficult to apply or non-existent.
- Financing of value-added taxes by a Community grant, provided that such taxes are not refundable and that the basic act does not exclude it, is provided for in the implementing rules of the Financial Regulation (Article 172a(2)(c)). Any grant awarded under centralised management does not require the prior consent of the country where the project is implemented. If the law of that country does not provide for any exemption machinery, the grant beneficiary has to bear the value-added tax or equivalent local tax and cannot be reimbursed from EC funds.
- In the case of EIDHR projects, given the particular circumstances in which they are carried out, some countries are reluctant to grant exemptions for projects they do not support. In the absence of tax-exemption agreements for Community-financed projects, these taxes are paid by the beneficiary organisations. This may act as an impediment to the implementation of projects that are highly politically sensitive.

Finally, note that even though full funding of an external action may be considered under certain circumstances, this is not always enough to make it possible to cover taxes, which remain ineligible costs. In any case, full funding applies only to the eligible costs of the action.

In view of the above and of the evolving nature of tax rules in the beneficiary countries, it is essential to preserve sufficient flexibility to enable authorising officers to determine, on a case-by-case basis, whether there is need to accept the eligibility of taxes for Community financing under the EIDHR and DCI, as they may do for other instruments of EC external assistance, where such taxes are lawful.

Therefore it is proposed to align the relevant provisions of both these instruments on the other instruments.

Proposal for a

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**amending Regulation (EC) No 1905/2006 establishing a financing instrument for development cooperation and Regulation (EC) No 1889/2006 on establishing a financing instrument for the promotion of democracy and human rights worldwide**

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 179(1) and the first paragraph of Article 181 thereof,

Having regard to the proposal from the Commission,

Acting in accordance with the procedure laid down in Article 251 of the Treaty<sup>1</sup>,

Whereas:

- (1) A new framework for planning and delivering assistance was established in 2006 in order to make the Community's external assistance more effective and transparent. It contains Council Regulation (EC) No 1085/2006 of 17 July 2006 establishing an Instrument for Pre-Accession Assistance<sup>2</sup>, Regulation (EC) No 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down general provisions establishing a European Neighbourhood and Partnership Instrument<sup>3</sup>, Council Regulation (EC) No 1934/2006 of 21 December 2006 establishing a financing instrument for cooperation with industrialised and other high-income countries and territories<sup>4</sup>, Regulation (EC) No 1717/2006 of the European Parliament and of the Council of 15 November 2006 establishing an Instrument for Stability<sup>5</sup>, Council Regulation (Euratom) No 300/2007 of 19 February 2007 establishing an Instrument for Nuclear Safety Cooperation<sup>6</sup>, Regulation (EC) No 1889/2006 of the European Parliament and of the Council of 20 December 2006 establishing a financing instrument for the promotion of democracy and human rights worldwide<sup>7</sup>, and Regulation (EC) No 1905/2006 of the European Parliament and of the Council of 18 December 2006 establishing a financing instrument for development cooperation<sup>8</sup>.

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<sup>1</sup> Opinion of the European Parliament of XX (not yet published in the Official Journal), Council Common Position of XX (not yet published in the Official Journal) and Common Position of the European Parliament of XX (not yet published in the Official Journal).

<sup>2</sup> OJ L 210, 31.7.2006, p. 82.

<sup>3</sup> OJ L 310, 9.11.2006, p. 1.

<sup>4</sup> OJ L 405, 30.12.2006, p. 37.

<sup>5</sup> OJ L 327, 15.11.2006, p.1.

<sup>6</sup> OJ L 81, 22.3.2007, p. 1.

<sup>7</sup> OJ L 386, 29.12.2006, p. 1.

<sup>8</sup> OJ L 378, 27.12.2006, p. 41.

- (2) In implementing these Regulations inconsistencies have emerged regarding exceptions to the principle of non-eligibility for Community financing of costs related to taxes, duties and other charges. It is therefore proposed to amend the relevant provisions of Regulations (EC) Nos 1905/2006 and 1889/2006 in order to align them on the other instruments.
- (3) This Regulation does not go beyond what is necessary in order to achieve the objective pursued, in accordance with the third paragraph of Article 5 of the Treaty,

HAVE ADOPTED THIS REGULATION:

*Article 1*

Article 25(2) of Regulation (EC) No 1905/2006 is replaced by the following:

"2. Community assistance shall not in principle be used for paying taxes, duties or charges in beneficiary countries."

*Article 2*

Article 13(6) of Regulation (EC) No 1889/2006 is replaced by the following:

"6. Community assistance shall not in principle be used for paying taxes, duties or charges in beneficiary countries."

This Regulation shall enter into force on the day following that of its publication in the Official Journal of the European Union.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 21.4.2009

*For the European Parliament*  
*The President*

*For the Council*  
*The President*