

New co-financing approach in grants

1. Why has the approach changed?

One principle for grants is that the grant beneficiary normally has to co-finance part of the cost of an action. The minimum percentage of co-financing is fixed in the contract. Under the previous system for calculating co-financing, the Commission would however only take into consideration costs that are considered eligible for EU-financing (article 14 of the contract general conditions) and ignore other eventual costs.

Some of our programme Regulations or financing decisions/Financing Agreements with Beneficiary Countries¹ excluded specifically financing of taxes (including VAT) in beneficiary countries, even when the grant beneficiary could not reclaim them². These costs would therefore be ineligible for EU-financing. This meant that the grant beneficiary had to cover these costs itself and at the same time the EU did not recognise it as co-financing.

Example: A contract where the estimated total eligible costs are €100.000

Maximum EU-contribution: €80.000 representing 80% of eligible costs. Co-financing by the grant beneficiary €20.000 representing 20%

If at the end the real total eligible costs are €95.000 plus ineligible costs (non-reclaimable VAT) of €15.000, the EU-contribution would be limited to 80% of the eligible costs, i.e. $80\% \times €95.000 = €76.000$.

The real total costs amounted to €110.000, which means that the real EU-contribution represents 69% and the real costs to be financed by the grant beneficiary is €34.000, representing 31%

Therefore, a new approach was introduced to recognise the payment by the grant beneficiary of ineligible taxes as co-financing when it cannot reclaim them: the EU-contribution to the eligible costs could be increased while at the same time the co-financing requirement would be fulfilled by the grant beneficiary's payment of such taxes.

2. What is considered as "taxes" in this context?

"Taxes" include indirect taxes such as value added taxes, customs and import duties, other fiscal charges and duties in beneficiary countries* (*except under the European Neighbourhood and Partnership Instrument (ENPI) Regulation, which does not specifically limit to beneficiary country(ies)).

Taxes in this context do not include direct taxes, such as income tax of staff working on the action. Such tax forms part of the gross salary. The gross salary is an eligible cost and should be entered in the budget heading 1. "human resources".

¹ At the same time, although other instruments may allow financing of taxes (i.e. Cotonou Agreement, ENPI), the existing Financing Agreement entered into between the Beneficiary country and the EU may exclude the financing of taxes.

² Beneficiary countries, as sovereign states, have the right to establish their own tax system (ACP countries, however, are bound by Article 31 of Annex IV to the Cotonou Agreement). It depends thus on their sovereign will to establish mechanisms for exemption from taxes on financing received from the EU and the applicable rules in each country are (or shall be) defined in an agreement between the European Commission and the Beneficiary country concerned.

3. How does the new system work?

The new approach will only be used where the regulation for the programme which finances the contract excludes payment of taxes (including VAT) or when the regulation for the programme does not exclude their payment, but the financing decision/Financing Agreement between the Beneficiary country and the EU or the Special Conditions exclude it **and** where the grant beneficiary can show it cannot reclaim them. The costs will in this case be recognised as ineligible costs, entered in the budget under heading 12 "taxes" and form part of the total accepted costs. The total accepted costs will be the reference for checking the required co-financing of the grant beneficiary.

However, if the grant beneficiary fails to show it cannot reclaim such taxes and where the few exceptions to this obligation foreseen in the contract do not apply, these taxes will be declared simple ineligible costs, which are ignored when checking the co-financing of the grant beneficiary. An official document (declaration or a refused claim for reimbursement) by the competent tax authority, extract of the relevant law and the grant beneficiary's annual accounts are some examples of documents that may be submitted as proof that the grant beneficiary cannot reclaim taxes.

To be able to do this, two (maximum) co-financing rates must be specified in the Guidelines for applicants;

- One percentage which relates to **eligible costs**. This is used to calculate the actual amount of the EU-contribution; and
- One percentage which relates to the **total accepted costs**. This is used to calculate the required amount of co-financing by the grant beneficiary. If the amount does not reach the minimum percentage fixed in the contract, than the EU-contribution will be reduced proportionately.

Example: A contract where the estimated total eligible costs are €80.000 and the estimated total accepted costs are €100.000.

Maximum EU-contribution: €80.000 representing 100% of eligible costs

The contribution is further limited to 80% of the total accepted costs of the action.

This means that the grant beneficiary must contribute a minimum of 20% of the total accepted costs of the action, in this case 20.000.

If at the end the real total accepted costs are €95.000 and the real total eligible costs €80.000, the EU-contribution cannot cover 100% of the eligible costs but will be reduced (to €76.000) as the limitation of 20% co-financing by the grant beneficiary is otherwise not respected.

The **only** ineligible costs that may be included in the total accepted costs are taxes including VAT, where the programme regulation and/or the financing decision/Financing Agreement with the Beneficiary country or the Special Conditions exclude their financing.

Note that the Guidelines for applicants will specify the maximum rates. The rates that will be fixed in the contracts will depend on the contribution asked by the applicant. Like under the old system, and subject to the maxima laid down in the contract, the actual rates will be based on actual costs that are only known at the time of the approval of the final report.

The new system will not be used for contracts that are financed from programme regulations that do not explicitly forbid financing of taxes (e.g. the European Development Fund (EDF), ENPI etc) as long as the existing financing decision/Financing Agreement with the Beneficiary country or the Special Conditions so allow. In this case, we will continue to use the old system and taxes that cannot be reclaimed will be accepted as eligible costs.

4. How do you decide the two co-financing percentages?

Two rates need to be fixed in the Guidelines for applicants only where the programme regulation excludes financing of taxes³. The rates are to be decided with due consideration to the specificities of each programme:

- The co-financing percentage referring to the total accepted costs is fixed in the financing decision. The rate that was previously applied on eligible costs will now be applied to the total accepted costs (i.e in the normal case maximum 80%);
- The maximum rate applied to the eligible costs is decided during the preparation of the Guidelines for applicants. For the new system to have the expected impact, it must be a higher rate than the one described in the previous point (it can reach 100%).

Note that for contracts under some programme regulations (i.e. EDF, ENPI etc), taxes including VAT will be accepted as eligible costs where the grant beneficiary cannot reclaim them, provided the financing decision/Financing Agreement with the Beneficiary country or the Special Conditions do not exclude financing of taxes. Consequently, only one percentage needs to be fixed, which will be the one laid down in the financing decision (which in the normal case would be 80% of the total eligible costs.)

5. The financing decision was taken before 1 November 2010, can the current PRAG templates still be used?

Yes they can. The template financing decision in force at that time only mention "costs" where the co-financing percentage is laid down. It is therefore not specified on which costs co-financing is to be calculated (total eligible or total eligible + ineligible). Consequently, you may decide in the Guidelines for applicants to calculate it on the basis of eligible costs + non-reclaimable taxes including VAT, for programme regulations and/or financing decision/Financing Agreement with the Beneficiary country or Special Conditions which exclude their financing.

The revised template financing decision clarifies that the co-financing percentage refers to total accepted costs.

6. What is the situation where the programme regulation does not exclude the financing of taxes including VAT when the grant beneficiary cannot reclaim, or when the grant beneficiary can reclaim taxes?

Where the programme regulation does not exclude payment of taxes (e.g. ENPI, EDF etc) and where the existing financing decision/Financing Agreement with the Beneficiary country or

³ Or when the regulation for the programme does not exclude their payment, but the Financing Agreement between the Beneficiary country and the EU excludes it.

the Special Conditions so allow we will fix only one percentage that relates to eligible costs. That is

- a) where the grant beneficiary can reclaim taxes: it is not a cost to the action as the grant beneficiary will subsequently be reimbursed. It will consequently not appear as a cost in the budget;
- b) where the grant beneficiary can show it cannot reclaim taxes : in such case the non-reclaimable tax will be considered as an eligible cost and they will be included in the calculation of the EU-contribution. The costs will in this case be entered in the budget, integrated under the heading(s) concerned and form part of the total eligible costs.

7. How should the grant applicant complete all the percentages and amounts in the application form?

In the concept note phase, the applicant will only need to enter the requested amount. In accordance with the template Guidelines for Applicants, this amount may change by not more than 20% in the full application phase, while of course respecting the minimum and maximum amounts and percentages defined in the Guidelines for Applicants.

For a contract financed under a programme regulation and/or a financing decision/Financing Agreement with the Beneficiary country or Special Conditions that exclude the financing of taxes, where the estimated total eligible costs are €120.000 and the estimated total accepted costs are €150.000, the sources of funding and summary of cost sheet of the budget should be completed as follows:

Expected sources of funding & summary of estimated costs

	Amount	Percentage
	EUR	%
Contributions		
EU/EDF contribution sought in this application (A) (Other contributions...)	120.000	
Costs		
Estimated TOTAL ELIGIBLE COSTS (B)	120.000	
EU/EDF contribution expressed as a percentage ³ (A/B x 100)		100%
Estimated TOTAL ACCEPTED COSTS (C)	150.000	
EU/EDF contribution expressed as a percentage ³ (A/C x 100)		80%

Note that this is just an example; in reality taxes will not always match the co-financing requirement and in many cases the co-financing will also cover part of the eligible costs. The actual percentages will be adapted in relation to the real requested contribution.

8. With the new system, how do you calculate the EU contribution (final amount) in the end?

See the following examples for both systems to understand the consequences for applying one or the other system to Actions bearing non eligible taxes.

OLD (ELIGIBLE COSTS) SYSTEM

Estimation as per the contract	Example Contract 1 (overspending eligible costs)	Example Contract 2 (underspending eligible costs)
Estimated total costs	100.000	100.000
Maximum EU Co-financing percentage of eligible costs	78%	78%
Maximum amount of EU-financing	78.000	78.000

Final expenditure		
<i>Expenditure verification: real amount of eligible costs (A)</i>	102.840	78.840
<i>Expenditure verification: Non-reclaimable VAT (B)</i>	18.000	15.000
<i>Real total costs (A+B)</i>	120.840	93.840

Calculation of final EU contribution		
Maximum EU contribution <i>(Overspending: the maximum amount laid down in the contract; Underspending: the maximum percentage related to eligible costs as laid down in the contract: i.e the EU will always pay the lowest amount of the two and within the limit of the maximum fixed amount)</i>	78.000	61.495

Final amount of the grant**78.000****61.495**

Effective EU rate of total eligible costs

75,8%

77,9%

Effective EU rate of total costs

64,5%

65,5%

ACCEPTED COSTS SYSTEM

<i>Estimation as per the contract</i>	Example Contract 3 (overspending eligible costs)	Example Contract 4 (underspending eligible costs)
Estimated total		
1. eligible costs	100.000	100.000
2. accepted costs	120.000	120.000
Maximum EU Co-financing percentage <i>to be calculated on the basis of total estimated</i>		
1. eligible costs		96%
2. accepted costs	96%80%	80%
Maximum amount of EU-financing	96.000	96.000

Final expenditure		
<i>Expenditure verification: real amount of eligible costs (A)</i>	102.840	78.840
<i>Expenditure verification: Non-reclaimable VAT (B)</i>	18.000	15.000
<i>Real total accepted costs (A+B)</i>	120.840	93.840

Calculation of final EU contribution		
Maximum EU contribution <i>(Overspending: the maximum amount laid down in the contract; Underspending: the maximum percentage related to eligible costs as laid down in the contract)</i>	96.000	75.686
Limitation total accepted costs 80% (20% co-financing required by grant beneficiary): Max contribution authorised (Example 3: 80% of 120.840, Example 4: 80% of 93.840) : <i>i.e the EU will always pay the lowest amount of the three limits (maximum amount, the two percentages)!</i>	96.672 = no reduction of EU contribution as minimum co-financing respected	75.072 = reduction of EU contribution required as minimum co-financing otherwise not respected

Final amount of the grant**96.000****75.072**Effective EU rate of eligible costs
Effective EU rate of total accepted costs93,3%
79,4%95,2%
80%