VAT focus

The VAT review for December

Speed read

This month's VAT review revisits some familiar topics. The *C&D Foods* case is in many ways another re-run of the 1995 *BLP* case on the recovery of input VAT incurred in relation to a share sale and whilst the outcome may have been similar, the manner of reaching that outcome indicates that the approach of the CJEU has developed significantly since 1995. Meanwhile, the *Wellcome Trust* case is a development from the 1996 CJEU decision on economic activity in the context of investments in securities and decides that a lacuna in the 2006 VAT Directive means that services 'imported' from outside the EU used for non-economic business activities are not subject to the reverse charge. The *MEO* case may help identify the borderline between compensation and consideration for VAT purposes, confirming that a fixed minimum contractual fee for cancelling a contract with an agreed minimum term will be consideration for services where it is equivalent to the amount that would have been paid under the contract for services, had the contract not been cancelled. Finally, the EU Council has approved changes to the VAT Directives to allow member states to remove the distortion between the VAT treatment of physical and electronic publications.

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Input VAT and aborted share sales

The decision of the CJEU in *C&D Foods Acquisitions ApS v Skatteministeriet* (Case C-502/17) is by no means the first to consider the ability of a seller of shares to recover input VAT on associated costs. As far back as 1995, the court held in *BLP* (Case C-4/94) that it was not permissible to look through to the seller's ultimate motive in applying the direct and immediate link test for input VAT recovery. In fact, the *C&D Foods* and *BLP* cases share much in common, both concerning a sale of shares in a subsidiary to raise funds to deal with financial difficulties and to pay off debts owed by the business. But while the decision reached by the CJEU was ultimately very similar, the court appears to have reached that point by somewhat different reasoning and with much greater reliance on its later decision in *AB SKF* (Case C-29/08).

In particular, and in stark contrast to the *BLP* decision, the court focused on the intention of the seller (which formed part of the 'objective content' for applying the direct and immediate link test). Here the intention was simply to raise monies to pay off debt and a sale of shares for this purpose could not be regarded as made either for the purposes of the taxable activities of the group or an extension of those activities. Therefore, the input VAT could not be attributed to the wider taxable activities of the business. Notably, there was no suggestion that it was simply a case of allocating the input VAT to an exempt supply (the position taken by the Danish tax authorities).

It made no difference to the analysis that C&D Foods had carried on an economic activity in supplying management and IT services to its subsidiary nor that the share sale did not actually take place. Just as input VAT can be attributed to an aborted taxable activity, it can be attributed to an aborted activity which is not a taxable activity.

Why it matters

Given the similarity in facts, it may appear surprising that the court did not even refer to the *BLP* decision. However, the strict rejection of motive in that case has since been gradually eroded and there are now a number of cases which have admitted the seller's intention (at least as determined objectively) as a relevant factor in attributing input VAT. Even so, the decision does not necessarily make the task of identifying in what circumstances the motive of the seller will actually override the potential 'chain breaking' effect of a more immediate transaction any easier.

Arguably, the decision goes even further than the earlier *AB SKF* case. In that case, the court appeared to accept that the share sale was, in principle, an exempt supply. In *C&D Foods*, the court appears to have considered that the share sale may not even have been an economic activity to which input VAT could be attributed at all – at least on these facts.

Ultimately, the decision raises as many, if not more, questions as it answers. Not least, if the share sale was not a 'chain breaking' economic activity and the purpose was to raise funds for the settling of a business debt, then shouldn't the input VAT have been residual?

Nevertheless, businesses incurring input VAT on share sales should consider the possibility of deducting that input VAT, especially in circumstances where they can show that the objective pursued by the sale was ultimately to benefit the ongoing taxable business of the seller.

VAT and contractual termination payments

In the *MEO* case, the CJEU has indicated that the payment of a contractual cancellation fee will amount to consideration for services where the supplier receives the same amount as they would have received for their supplies under the contract had the contract continued for the minimum contractual term.

The case involved the supply of telecom services by MEO, a Portuguese company, under contracts which required customers to pay fixed monthly instalments during a minimum contract term. Where a customer failed to make payments in accordance with the contract or wished to cancel the contract then the customer was required to pay an amount equal to the monthly fee multiplied by the number of months which remained to the end of the minimum contract period. MEO did not continue to provide telecom services for the minimum period in those circumstances. MEO argued that payments it received in such circumstances were compensation and outside the scope of VAT.

On a reference from the Portuguese courts, the CJEU has indicated that, in circumstances where the contractual cancellation fee payable by the customer was equivalent to the full monthly fees for the minimum contract period, such that MEO would, in principle, receive the same amount as if the customer had not terminated the contract early, then the economic and commercial reality of the situation required the payment to be treated as consideration for supplies of services by MEO. The CJEU stressed that if the payments by a customer were treated as compensation payments, then this would lead to a difference in treatment between a customer who used the services for the whole of the minimum contract period and one who terminated the contract early, even though they paid the same amount.

Neither the classification of the payment under national law (for example as a fine) nor the fact the purpose of the payment was to dissuade customers from ending the contract early and compensate MEO affected the CJEU's conclusion.

Why it matters

The case bears similarities to *Esporta v HMRC* [2014] EWCA 155, in which the UK Court of Appeal held that fees paid late to a sports club remained consideration for services even where the customer could not use the facilities due to the late payment. In that case, the court applied a contractual analysis to the payments, considering that they were simply for making the facilities available, not tied to actual use. In contrast, the CJEU appears to have considered the position from the perspective of the 'commercial and economic reality', irrespective of the contractual position. (The decision was, unfortunately, not available in English at the time of writing.)

Either way, suppliers with contracts that tie-in customers for a minimum period should consider the VAT treatment of any cancellation or termination fees they charge. Unless they can show that such fees genuinely seek to compensate for the loss suffered rather than merely enforcing the anticipated charges for the agreed minimum contract period in full, then such fees appear likely to be subject to VAT.

Services received for non-economic business activities

It will be recalled that Wellcome Trust (WT) was the subject of the 1996 decision in which the CJEU held that an activity consisting of buying and selling shares and other securities in the course of managing the assets of a charitable trust was not an economic activity for VAT purposes. As a result, WT was not entitled to input VAT recovery in relation to costs incurred on a disposal of part of its portfolio to non-EU investors.

The FTT has now had to determine, in the context of WT's activities (which it was accepted remained largely unchanged since 1996), the correct treatment of investment management fees paid by WT to investment managers outside the EU (*The Wellcome Trust Ltd v HMRC*).

HMRC argued that, under article 44 of the 2006 VAT Directive, the place of supply was the UK and that WT was required to account for VAT under the reverse charge mechanism on such supplies.

WT, in contrast, pointed out that article 44, which provides that the normal place of supply of services in a B2B scenario is the place where the recipient has established its business, only applies where the taxable person is 'acting as such'. WT argued, in reliance on the 1996 decision of the CJEU, that it was not acting as a taxable person in receiving such supplies, such that article 44 did not apply. The FTT has accepted that argument. It was clear that WT received these supplies for the purposes of its non-economic business activities and so was not acting as a taxable person in doing so.

In doing so, the FTT accepted that the VAT Directive contains a gap. Article 44 deals with the position of taxable persons 'acting as such' when receiving supplies and article 45 covers the position of persons receiving supplies in a private capacity. Neither covers the position of a business receiving supplies in the context of its 'non-economic business activities'.

Why it matters

The point is a narrow one but will be relevant to any VAT registered business which also has non-economic business activities. In particular, any such businesses should consider seeking a repayment of any VAT they have accounted for under the reverse charge mechanism where services from outside the EU were received for the purposes of their non-economic business activities.

It should be noted, however, that the FTT considered that in the context of intra-community supplies, the gap in the VAT Directive does not give rise to a problem, since article 18 of the Implementing Regulation No. 282/2011 makes it clear that, in determining whether article 44 applies, a supplier is entitled to rely on whether or not its customer had provided a VAT registration number.

VAT and electronic publications

In 2015, the CJEU held that France and Luxembourg had failed to comply with the provisions of the VAT Directives by applying the same rate of VAT to paper and electronic books (*Commission v France* and *Commission v Luxembourg* (Cases C-479/13 and C-502/13)).

Following on from political agreement that member states should be entitled to apply the same rates of VAT to electronic books as are applied to physical books, the EU Council has now adopted a Directive allowing member states to align the rates on physical and electronic publications. The Directive will enter into force on 4 December 2018.

Why it matters

The Directive will permit member states to apply the same reduced rates on supplies of electronic books and publications as they currently apply to physical books, including, in the UK, the zero-rate of VAT.

What to look out for

- A revised version of the SI to prevent offshore looping avoidance in the insurance sector by modifying the specified supplies order will be laid before Parliament in December 2018 and will come into force from 1 March 2019.
- From 1 January 2019, the place of supply for cross-border B2C supplies of digital services will change to the UK where: the supplier is not established in any other EU member state; and the total value of the cross-border digital sales is less than £8,818 in the current year and previous calendar year.
- The publication of a number of SIs under the Taxation (Cross-border Trade) Act 2018 and the EU Withdrawal Act 2018 to ensure that the UK's VAT regime (and customs and excise duty regimes) continues to function after the UK leaves the EU. The first such SI, the VAT (Disclosure of Information Relating to VAT Registration) (EU Exit) Regulations, SI 2018/1228, was laid on 27 November 2018. ■

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- Cases: *C&D Foods Acquisition ApS* (18.11.18)
- Cases: *The Wellcome Trust v HMRC* (23.10.18)