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EU **Tax Law** Highlights of 2020

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Highlights in this edition

In the course of 2020 there were several developments in EU tax law. This annual edition of EU Tax Alert provides an overview of those developments, in which we highlight:

- The Commission initiatives to address COVID-19 financial support and on State Aid matters
- The ECOFIN Council agreement for exchange of information by digital platforms (DAC7)
- The EU General Court annulment of the Commission decision in the Apple State aid case
- The CJ judgments in the direct taxation cases *AURES Holdings* and *Deka*
- The CJ judgments in the indirect taxation cases *Vodafone* and *Tesco*
- The CJ judgments in the VAT cases *Vos Aannemingen*, *Sonaecom* and *Dong Yang Electronics*

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State Aid/WTO

EU General Court annuls European Commission's decision in Apple State aid case (Apple)

The General Court's judgment confirms the Commission's right to investigate tax rulings under EU State aid rules and the applicability of the arm's length principle but finds that the Commission did not sufficiently demonstrate that a selective advantage was granted to these companies.

On 15 July 2020, the General Court of the EU delivered its judgment in Cases T-778/16, *Ireland v Commission*, and T-892/16, *Apple Sales International and Apple Operations Europe v Commission.* The Court annulled the Commission's decision of 30 August 2016, finding that Ireland had granted illegal State aid to two Irish-incorporated Apple group companies. Apple had to repay a record amount in excess of EUR 13 billion.

The Commission may appeal the judgment before the Court of Justice. The judgment analyses transfer pricing arguments in depth and therefore, will likely have an impact on the interpretation of transfer pricing rules in the EU.

Factual background

The tax rulings of 1991 and 2007 issued by the Irish tax authorities confirmed that nearly all sales profits recorded by two Apple group companies incorporated but not tax resident in Ireland were attributable to head offices outside Ireland, rather than to their Irish trading branches. Ireland only taxed the profits of the branches.

The Commission's decision argued that the allocation of profit to the foreign head offices was not at arm's length, based on three lines of reasoning:

- The primary line of reasoning relied on the fact that the foreign head offices had no employees or substance and therefore, could not perform the functions or bear the risks related to certain IP assets that are key value-generating assets. The Commission argued that the functions and risks, therefore, had necessarily to be allocated to the Irish branches which, in its view, performed much more than low value-adding routine functions.
- The subsidiary line of reasoning accepted the allocation of the IP assets (and related share of profits) outside of Ireland but claimed there were several mistakes in the application of the transfer pricing method known as 'TNMM' (transactional net margin method).
- The alternative line of reasoning in part relied on the subsidiary line and in part, argued that the discretion of the Irish tax authorities in granting the rulings was excessively broad, thereby resulting in a selective advantage granted to the two Apple group companies.

Motives for the annulment

In the judgment, the General Court first confirmed its earlier Fiat and Starbucks judgments (see our tax flash of 24 September 2019) that the Commission may check the compatibility of tax rulings with EU State aid rules. It also confirmed that the tax treatment of the beneficiaries of the rulings should be assessed against the general tax system in force in Ireland.

It then dismissed the three lines of the Commission:

- On the primary line, the General Court accepted that the Commission can use the arm's length principle as a tool to check whether the profit allocation reflects market values. It also accepted the use of the authorised OECD approach to assess the split of profits allocable to the head office and to a branch under transfer pricing rules. However, it found that the Commission did not properly apply the rules by presuming, rather than showing, that the functions and risks related to the value-generating IP were in Ireland.
- The General Court accepted Ireland's and Apple's arguments that the key functions were performed outside of Ireland (essentially in the United States).
- On the subsidiary line, the General Court pointed to a contradiction between the acceptance to allocate the complex, value-generating IP to the head offices and the claim that the Irish branches would have a more complex functional profile than the head offices. The lack of transfer pricing documentation when the rulings were granted was 'regrettable' but cannot lead to a presumption of aid. Also, the Commission failed to demonstrate that the choice of profit level indicator (operating costs) was inappropriate; the Commission had, furthermore, wrongly allocated certain risks to the Irish branches. Finally, the Commission did not establish that the level of return on costs was too low and did not demonstrate that the transfer pricing studies submitted by Apple were unreliable.
- As regards the alternative line of reasoning, to the extent it relied on the subsidiary line, it was also necessarily annulled. On the second part, the General

Court found that the Commission had failed to show that the Irish tax authorities had exercised (too) broad discretion in this case.

Consequences

Taxpayers engaged in intragroup transactions in the EU should review the General Court's positions, as the reasoning may affect transfer pricing analyses and audits going forward. The judgment should also be considered in the context of State aid risk assessments (e.g., as part of FIN48 analyses).

Next steps

The Commission may appeal the judgment on matters of law before the Court of Justice. As the General Court dismissed the factual findings of the Commission, it is quite uncertain whether an appeal would be successful.

Status of other State aid cases

An appeal of the Commission in the Belgian Excess profit ruling case and of Fiat in the *Fiat* case are already pending before the Court of Justice. The *Amazon* and *ENGIE* cases are still pending before the General Court. The Commission also, still has formal investigations pending into the tax treatment of Nike and Inter IKEA in the Netherlands, Huhtamäki in Luxembourg and 39 Belgian companies which benefited from an Excess profit ruling. It is rumoured that more investigations will be opened shortly.

The Commission's decision to extend the scope of its formal investigation into tax rulings granted to Inter IKEA in the Netherlands was recently published. It takes into account changes of facts compared to those described in the tax ruling, but the challenge remains essentially the same: the Commission considers that a Netherlands entity purchased IP rights for an excessively high price, which was left outstanding and converted into a loan. As a result, the Netherlands company was allegedly wrongly entitled to deduct an excessive amount of interest (because the principal amount is too high), part of which should be requalified into a hidden profit distribution. For the same reason (excessively high purchase price), the Commission considers that the amortization expenses are excessive and should partly not be deductible.

Commission communication on COVID 19 financial support and non-cooperative jurisdictions

On 14 July 2020 the Commission issued a Communication on making State financial support to undertakings in the Union conditional on the absence of links to non-cooperative jurisdictions. The COVID-19 outbreak has prompted unprecedented action at national and Union level to support Member States' economies and facilitate their recovery. This includes State intervention to ensure liquidity and access to finance for undertakings, considerable part of which has been subject to Union State aid rules.

In order to ensure that the financial support can flow to eligible undertakings, the Commission is of the view that Member States should establish reasonable requirements to demonstrate the absence of links to a jurisdiction that features on the EU list of non-cooperative jurisdictions. At the same time, it is essential to guarantee that undertakings cannot circumvent the requirements for entitlement to financial support.

Therefore, the Commission recommendation sets out a coordinated approach to making the granting of financial support by Member States conditional on the absence of links between the recipient undertaking and jurisdictions which feature on the EU list of non-cooperative jurisdictions. According to the Commission and in order to receive financial support, undertakings should not be:

a. be resident for tax purposes in, or incorporated under the laws of, jurisdictions that feature on the EU list of non-cooperative jurisdictions;
b. be controlled, directly or indirectly, by shareholders in jurisdictions that feature on the EU list of non-cooperative jurisdictions, up to the beneficial owner, as defined in Article 3 point 6 of Directive 2015/849;
c. control, directly or indirectly, subsidiaries or own permanent establishments in jurisdictions that feature on the EU list of non-cooperative jurisdictions; and
d. share ownership with undertakings in jurisdictions that feature on the EU list of non- cooperative jurisdictions. The recommendation also includes carve-outs. In accordance, Member States may disregard the existence of links to the listed non-cooperative jurisdictions, when the undertaking provides evidence that one of the following circumstances is met:

a. where the level of the tax liability in the Member State granting the support over a given period of time (e.g. the last three years) is considered adequate when compared to the overall turnover or level of activities of the undertaking receiving the support, at domestic and group level, over the same period.
b. where the undertaking makes legally binding commitments to remove its ties to EU listed non-cooperative jurisdictions within a short timeframe, subject to appropriate follow-up and sanctions in case of non-compliance.

In any case, the Commission adds that Member States should disregard the existence of links to the listed non-cooperative jurisdictions where the undertaking has substantial economic presence (supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances) and performs a substantive economic activity in listed non-cooperative jurisdictions.

Commission issues White Paper on dealing with foreign subsidies (and tax incentives)

On 17 June 2020, the Commission adopted the 'White Paper on foreign subsidies in the Single Market' to consult stakeholders as part of its new industrial strategy. Current EU rules dealing with State aid and subsidies to avoid distortion of the internal market do not suffice to deal with subsidies (including tax incentives) granted by non-EU governments. The Commission, therefore, is looking into several possible options.

First is a module to deal with foreign subsidies, such as redressive payments, if such subsidies have a negative impact on the internal market. This would likely go beyond current international trade rules on subsidies. Second, companies receiving foreign subsidies if attempting to acquire EU-based companies of a certain size should report to the Commission as supervisory authority, possibly blocking transactions facilitated by foreign subsidies. Third, recipients of foreign subsidies could be excluded from public procurement biddings, EU public tenders or EU grants, if those subsidies have unfairly affected such procedures. Imposing a notification obligation on companies that received foreign subsidies is being considered as part of these modules.

If current EU rules on State aid and subsidies may serve as a reference for these proposals when it comes to defining what subsidies are, this development is of particular importance to foreign State-owned enterprises not subject to normal tax at home, to companies mainly involved in providing services (trade in goods is covered in part by the current EU anti-subsidy regulation) as well as to other companies receiving substantial investment incentives or other kinds of extraordinary tax breaks abroad not generally available in the country providing the benefit. It may take several years before it is clear which of the modules mentioned will be implemented, and in what form.

Commission concludes that Madeira Free Zone regime is in breach of State Aid rules

Since 1987, the Commission has approved several versions of a corporate income tax reduction scheme notified by Portugal for companies in the Madeira Free Zone. The Regime III regional aid scheme was set up by Portugal in order to attract investments and create jobs in Madeira. The Commission's approval decision required explicitly that the aid would be granted to companies generating economic activity and real jobs in the Madeira region itself.

The objective of the approved measure was to contribute to the economic development of the outermost region of Madeira through tax incentives. These regions included Madeira, the Azores, the Canary Islands, Guadeloupe, French Guiana, Martinique, Réunion, Saint-Barthélemy and Saint Martin. To take into account their specific handicaps, such as remoteness and economic dependence on small products, Article 349 TFEU allows an exceptional treatment of those regions, including under EU State Aid rules.

The Commission's investigation has shown that the tax reductions were applied to companies that have made no real contribution to the development of the region, including on jobs created outside Madeira (and even the EU), in breach of the conditions of the decisions and EU State Aid rules. Furthermore, part-time jobs were accounted for as full time jobs, and board members were counted as employees in more than one company benefitting from the scheme, without an adequate and objective method of calculation. Lastly, the profits benefitting from the tax reduction were not limited to those linked to activities performed effectively and materially in Madeira.

Following the decision, the companies concerned in the recovery are those that (i) received more than EUR 200 000 under Regime III, and (ii) cannot show that their taxable earnings or jobs created are linked to activities effectively performed in the region. It is for Portugal to determine the amount to be recovered from each individual beneficiary, in line with the methodology set out in the Commission decision adopted today. Portugal has to identify among the beneficiaries those who did not respect the conditions of the Commission State Aid decisions of 2007 and 2013 approving Regime III.

Direct taxation

Legislation

Council approves conclusions on strengthening administrative cooperation especially as regards digital platforms

On 2 June 2020, the Council adopted conclusions aimed at strengthening the efforts to improve administrative cooperation to fight tax fraud and tax evasion. In particular, the Council requested the Commission to come with proposals aimed at addressing the identified shortcomings of existing elements of Directive 2011/16/EU (Directive on Administrative Cooperation: 'DAC') and provide the tax authorities of the Member States with useful and relevant information on taxpayers who generate income (revenue) through the digital platform economy;

While noting that the Member States have already begun to apply measures in their national law as regards reporting of income (revenue) generated through digital platforms, the Council stressed the need to establish a common standard at EU level for the reporting and tax information exchange mechanisms in this area;

In this regard, it is worth recalling that recent amendments have been made to Council Implementing Regulation 282/2011/EU establishing data collection and record-keeping obligations for digital platform operators as regards taxpayers who generate income (revenue) through such digital platforms.

However, the Council reiterates the importance of an effective and coherent EU regulatory framework and of aligning Directive 2011/16/EU and Council Implementing Regulation 282/2011/EU where appropriate in order to increase efficiency, utility and cost-effectiveness by making use of data that are already available with due consideration to the differences and specific challenges in the field of direct taxation;

Furthermore, any new EU-level measures in this area should also aim to create and maintain a level playing field between EU and non-EU based digital platforms, which are subject to taxation in Member States, through which income (revenue) is generated;

ECOFIN Council reaches agreement for exchange of information by digital platforms (DAC7)

During the ECOFIN Council of 1 December, a political agreement was reached on the sixth amendment of the Directive on Administrative Cooperation (DAC7) concerning the exchange of tax information between the EU Member States. Adoption of the directive will be approved by the ECOFIN Council by means of a written procedure after the discussion.

The proposed directive relates to the obligation for digital platforms to provide tax information about their users (e.g. landlords, platform workers, sellers of goods) and the exchange of this information between the tax authorities of the EU Member States. This concerns information about the revenue generated by providers on the platform from the rental of real estate, transportation and the sale of goods and services. A balanced outcome has been achieved both in terms of the scope of the obligation to provide information and a workable implementation period for the tax authorities.

The proposed DAC7 furthermore proposes some changes to improve the functioning of the existing articles in the Directive on Administrative Cooperation. An important point concerns an emergency stop in the event of a 'data breach' in another Member State: in order to protect the personal data of taxpayers, as guaranteed in the General Data Protection Regulation, Member States may request the Commission to suspend the exchange of information with a Member State in which those data is no longer properly protected. Furthermore, the proposal to mandatorily include the foreign Tax Identification Number.

Council Conclusions on Fair and Effective Taxation in Times of Recovery: support for OECD work to reach global consensus solution while ready to address the tax challenges of the digital economy in the absence of such consensus

On 1 December 2020, the Council approved conclusions setting out its comprehensive assessment of the main tax policy issues to be addressed over the coming years, to shape the EU policy agenda in the field of taxation. The conclusions outline the Council's priorities and provide guidance to the Commission in different areas of EU action, including addressing the challenges of the digitalisation of the economy, enhancing administrative cooperation between Member States' tax authorities and promoting tax good governance in the EU and beyond.

In the conclusions, the Council underlines that fair and effective taxation systems in Member States are central to the sustainable recovery of the EU from the COVID-19 crisis, requiring tax policies that generate revenues for both national and EU budgets. Such systems can also support a smooth transition towards the policy goals of sustainable competitiveness, the European Green Deal and full use of the potential of digitalisation in a global economy.

The Council stresses that reducing tax obstacles for business in the EU single market, fighting tax fraud and other unfair practices as well as promoting more effective cooperation between tax authorities in ensuring control and preventing and combating fraud are among the main objectives of the EU's tax policy. It is highlighted that any further measures and initiatives for fair and effective taxation should deliver on the objectives of fighting aggressive tax planning and tax evasion and making taxation simple and effective, taking into account the specific conditions and needs of Member States and the digitalization of their economies, and respecting Member States' competence in the field of taxation. The Council recognizes that, while work on new tax policy initiatives should be pursued, emphasis should also be placed on ensuring that the existing tax legislation is enforced and on improving tax compliance and cooperation.

The Council welcomes the significant progress made at the level of the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) on updating the international corporate taxation framework and confirms its continued support for this work, aimed at reaching a global consensus-based solution at the latest by mid-2021.

It expresses the willingness of the EU and its Member States to look into the possibilities for implementing the global agreement as soon as possible and recalls that the European Council will assess the issue in March 2021.

The Commission is requested to engage in the relevant preparatory work in the Council on the way forward in line with EU law, in order to address the tax challenges of the digital economy in the absence of an international consensus by mid-2021.

Finally, The Council underlines the important progress made under the Council's Code of Conduct for Business Taxation in promoting tax good governance standards in the EU and beyond, including with the use of the EU list of non-cooperative jurisdictions for tax purposes.

It reiterates its readiness to continue to discuss the scope of the mandate of the Code of Conduct Group (Business Taxation) as soon as there are relevant developments at international level, but no later than by the beginning of 2022.

Report on the implementation of ATAD

The European Parliament and the Council published a report on the implementation of ATAD. Article 10 of the ATAD requires that the Commission evaluate the implementation of the ATAD, in particular the interest limitation provisions, by 9 August 2020, and report to the Council on it. By derogation, the provisions in respect of the hybrid mismatches are required to be evaluated by the Commission by 1 January 2022.

This report is the first step in the evaluation of the impact of the ATAD and provides an overview of the implementation of the early applicable ATAD measures (interest limitation, GAAR, CFC) across Member States. The next step will consist of the delivery of a comprehensive evaluation report of the ATAD measures, including overview of the implementation of those ATAD measures that were not included in this report.

Commission presents new tax initiatives (*Tax Package*)

On 15 July 2020, the European Commission presented various initiatives that are intended to further increase tax transparency and compliance with tax obligations, simplify certain tax rules and procedures (notably with respect to VAT) and promote "fair taxation". The effectiveness of these initiatives will depend on EU Member States' willingness to adopt the appropriate EU and national legislation.

The Tax Package contains three separate but related initiatives:

1. a Tax Action Plan;
2. a proposal to amend the Directive on Administrative Cooperation; and
3. Communication on Tax Good Governance.

   The Tax Package does not cover the taxation of digital services or minimum effective taxation. These topics are currently being developed at OECD level (see our publication of 17 February 2020).

Tax Action Plan

The Tax Action Plan contains a set of 25 actions that the Commission will propose and implement until 2024. The actions are aimed at:

- reducing administrative obstacles for businesses operating within the EU; and
- helping EU Member States to exploit the potential of data and new technologies to better fight tax fraud, improve compliance and reduce administrative burdens.

  The actions are mostly related to VAT. Among others, the Commission proposes to move towards a single EU VAT registration system, to extend the scope of the VAT One Stop Shop (OSS), to modernize the VAT rules in order to ensure that they are adapted to the online platform economy and to introduce a mechanism to prevent and solve VAT disputes. Other noteworthy actions are establishing an expert group on transfer pricing and assessing the harmonization of the criteria to determine tax residence within the EU.

Communication on Tax Good Governance

The Communication on Tax Good Governance states how the EU can further promote the principles of transparency and fair taxation.

The Commission intends to start a reform of the Code of Conduct for Business Taxation (the Code), while awaiting the outcome of the international tax reform discussions at OECD level. The Code is a soft law instrument that sets out principles for fair tax competition and is used to determine whether a tax regime or measure is harmful. The Commission proposes to widen the scope of the Code to cover additional types of tax measures and general aspects of national corporate tax systems, as well as relevant taxes other than corporate tax.

The Commission also intends to modify the selection process and screening criteria of non-EU jurisdictions for purposes of the EU list of non-cooperative jurisdictions. The Commission proposes to update the scoreboard being used to select the most relevant jurisdictions to screen by the end of 2020.

The EU list of non-cooperative jurisdictions is already used for two types of countermeasures. First, key EU funding legislation prevents EU funds from being invested in or channeled through listed jurisdictions. Second, EU Member States committed themselves in December 2019 to adopt as from 2021 at the latest at least one defensive tax measure recommended by the EU Code of Conduct group (e.g., denial of deductions of certain payments made to entities in listed jurisdictions or a withholding tax on such payments).

In the Communication, the Commission also urges EU Member States to mirror the EU efforts when it comes to the use of their own funds. It will seek alignment of EU and national funding policies and consider alignment between the use of funds and the application of EU Member States' defensive measures. The Commission aims to conduct an evaluation of the defensive measures used by EU Member States by 2022. The Commission may then consider putting forward a legislative proposal to coordinate defensive measures.

Commission proposes two possible new EU taxes as part of the recovery plan

On 27 May 2020, the Commission put forward its proposal for a major recovery plan. As part of this plan, the Commission proposes two possible new EU own (tax) resources to fund this recovery plan.

A levy based on the operation of large companies that draw huge benefits from the EU single market (levied at EU level) (expected revenue around EUR 10 billion on an annual basis; and
An EU new digital tax that will be levied at EU level.
A digital tax applied on companies with a turnover above EUR 750 million could generate up to EUR 1.3 billion per year for the EU budget.

The year 2024 is suggested as the introduction date of these new taxes.

Please note that that these taxes will flow directly into the EU treasury (EU own resources), thus strengthening the EU budget. This is a new development for direct taxation.

In relation to the fight against tax fraud, the Commission states that CCCTB would provide business with a single rulebook to compute their corporate tax base in the EU considering that 'Tax simplification can improve the business environment and contribute to economic growth.'

Commission requests Luxembourg to amend its implementation of the ATAD interest deduction limitation rule

In a formal notice of 14 May 2020, the Commission has requested that Luxembourg amend the way it has implemented the interest deduction limitation rule (**IDLR**) into its domestic tax law. When transposing the first anti-tax avoidance directive (**ATAD I**), Luxembourg included securitization special purpose entities falling within the scope of EU Securitisation Regulation (No 2017/2402) (**SSPEs**) into the definition of financial undertakings that are exempt from the IDLR. This rule has been applicable since the tax year 2019.

The Commission considers that the carve-out granted to SSPEs goes beyond what is allowed under the financial undertaking exemption and requires Luxembourg to adapt its legislation to its reading of ATAD I within the next four months. Failing to do so may lead to the Commission sending a reasoned opinion to Luxembourg, potentially followed by an infringement procedure before the European Courts. A likely outcome is that the Luxembourg IDLR rules will be amended to exclude SSPEs from the scope of the financial undertaking exemption. It is currently unclear when a change of law would take effect, i.e., as of 1 January 2020, as of the date on which the amending law enters into force or as of another point in time.

If an SSPE no longer qualifies as an exempt financial undertaking under ATAD I and earns taxable income other than interest and economically equivalent income, it may no longer be able to deduct all of its interest expenses and/or commitments towards its investors. Their interest deductions would be, subject to certain grandfathering rules, capped at the higher amount of 30% of EBITDA or EUR 3 million. This may notably be the case for SSPEs that invest in distressed or discounted debt with a view to realizing capital gains. Such SSPEs may thus face a substantially higher tax burden than initially projected. This would only be different if capital gains on the distressed or discounted debt were viewed as interest or economically equivalent income or if the deductions taken by the SSPE would not qualify as interest or interest equivalent. So far, there is no clear guidance on these questions.

Case law

CJ rules that impossibility to deduct tax losses incurred in another Member State prior to the transfer of corporate tax residence is not a breach to the fundamental freedoms (*AURES Holdings*)

On 27 February 2020, the CJ delivered its judgment in case AURES Holdings a.s. v Odvolací finanční ředitelství (C-405/18). The case deals with the transfer of a company's place of effective management to a Member State other than its registered seat and the fact that the national legislation at stake does not allow a tax loss incurred in the Member State of incorporation before the transfer of its seat to be claimed.

AURES Holdings, is a company incorporated under Netherlands law whose registered seat and place of effective management were in the Netherlands, by virtue of which it was a tax resident of the Netherlands. In the 2007, Aures incurred a loss in the Netherlands. On 1 January 2008, Aures set up a branch in the Czech Republic which, under Czech law, constitutes a permanent establishment of that company without legal personality and whose activity is taxable in that Member State. On 1 January 2009, Aures transferred its place of effective management from the Netherlands to the Czech Republic. Following that transfer, Aures also transferred its tax residence from the Netherlands to the Czech Republic. However, Auresretained its registered seat and its entry in the commercial register in Amsterdam. Thus, it continued to be governed, as regards its internal relations, by Netherlands law. In the light of that transfer of place of effective management and, consequently, of its tax residency, Aures applied to the Czech tax authorities for deduction of the loss which it had incurred in the Netherlands on the basis of the 2007 tax year from the corporation tax base for which it was liable on the basis of the 2012 tax year. The Czech tax authorities considered that that loss could not be invoked as a deductible element of the tax base on the basis of Paragraph 38n of the Law on income tax. According to those authorities, Aures is, as a Czech tax resident, taxable on its worldwide income under Czech tax law. However, it can deduct from the tax

base only a loss arising from an economic activity in the Czech Republic. Aures appealed against this decision. It claimed in the appeal before that by the cross-border transfer of its place of effective management it exercised the freedom of establishment and that the impossibility for it to deduct the 2007 tax loss in the Czech Republic, which it can no longer claim in the Netherlands, amounts to an unjustified restriction on that freedom.
The CJ started by observing that, to exclude a loss incurred by a company resident in one Member State but incorporated in another Member State under the latter's law during the tax year in which that company was resident in the Member State of incorporation from the benefit of that advantage, whereas that advantage is granted to a company resident in the Member State of residence which incurred a loss in the same tax year, constitutes a difference in tax treatment. Therefore, and by reason of that difference in treatment, a company incorporated under the law of a Member State might be dissuaded from transferring its place of effective management to another Member State in order to pursue its economic activities there.

Such a difference in treatment resulting from a Member State's tax legislation to the detriment of companies exercising their freedom of movement can be permissible only if it relates to cases which are not objectively comparable or if it is justified by an overriding reason in the public interest. According to the Court, by providing that a company may not claim, in the Member State in which it is now resident, a loss incurred in a tax year in which it was a tax resident of another Member State, the Czech legislation is conducive, in essence, to preservation of the allocation of the power to impose taxes between the Member States and to prevent the risk of double deduction of losses.

In this regard, the CJ noted that a company resident in a Member State which has incurred a loss in that Member State and a company which has transferred its place of effective management and, consequently, its tax residency to that Member State having incurred a loss during a tax year during which it was a tax resident of another Member State, without any activity in the former Member State are not, in principle, in a comparable situation. The situation of a company which effects such a transfer is subject successively to the tax jurisdiction of two Member States, namely, first, the Member State of origin, in respect of the tax year during which the loss is incurred, and, second, the host Member State, in respect of the tax year for which that company applies for that loss to be deducted.

Therefore and for the CJ, where the host Member State has no tax jurisdiction over the tax year during which the loss at issue arose, the situation of a company, which has transferred its tax residency to that Member State and subsequently claims a loss there previously incurred in another Member State, is not comparable to that of a company the turnover of which was subject to the tax powers of the previous Member State on the basis of the tax year during which that company incurred that loss. In addition, the fact that a company which has transferred its tax residency from one Member State to another falls successively within the tax jurisdiction of two Member States is liable to give rise to a greater risk of that loss being taken into account twice, since such a company might claim the same loss in respect of the authorities of both Member States.

Overall, the CJ concluded that the Member State to which a company transfers its place of effective managementcannot be required to take into account a loss incurred before that transfer which relates to tax years in respect of which that company did not fall within the tax jurisdiction of that Member State.

CJ rules that Netherlands tax rules on dividends paid to non-resident UCITS partly violate EU law (*Deka*)

On 30 January 2020, the Court of Justice of the European Union ('CJ') issued its judgment in the case of Köln Aktienfonds Deka ('KA Deka'). The CJ answered two preliminary questions from the Netherlands Supreme Court on the compatibility with EU law of differences in the Netherlands dividend withholding tax regime, depending on whether the recipient is a non-resident UCITS or a Netherlands resident UCITS qualifying as a so-called 'fiscal investment fund' (fiscale beleggingsinstelling, 'FBI').

The judgment makes clear that the Netherlands FB regime is at least partly not in line with the TFEU. The Netherlands Supreme Court will now need to apply the CJ findings to the specific case. This judgment is relevant for funds and other interested parties in a similar position. Furthermore, it may impact several cases pending before the Netherlands courts in which non-resident UCITS claim a refund of Netherlands dividend withholding tax based on the free movement of capital under the TFEU.

Netherlands FBI regime

Under Netherlands tax law, UCITS qualifying as an FBI may claim a refund of Netherlands dividend withholding tax. This requires meeting in particular the following two conditions:

i. The shareholders or participants must meet certain requirements, generally related to the percentage of investment (the 'shareholder requirements').
ii. The UCITS must distribute all proceeds eligible for distribution within 8 months after the relevant financial year (the 'redistribution requirement').

Judgment of the CJ

The CJ first decided that the shareholder requirements comply with the free movement of capital, under two conditions:

i. the requirements should not 'de facto' constitute a less favourable treatment for non-resident UCITS, and
ii. the tax authorities should require proof from both resident and non-resident UCITS that they comply with the shareholder requirements.
It will be for the Netherlands national court to investigate whether these conditions are met.

Further, the CJ ruled that the redistribution requirement is in conflict with the free movement of capital, if two conditions are met. First, in the home State of the UCITS, the proceeds should be deemed distributed or are included in the shareholders' or participants' tax base in that State, as if they were distributed. Second, in view of the objective pursued by the requirement, the non-resident UCITS is in a situation comparable to that of an FBI, which again will have to be investigated by the Netherlands national court. The CJ confirmed that, if the objective of the redistribution requirement is taxing the proceeds at the level of the participant, a non-resident UCITS is comparable to an FBI.

Additional remarks

Following this CJ judgment, the domestic procedure will resume. Shortly, the Netherlands Supreme Court can be expected to answer the preliminary questions of the Lower Court. It is then up to the Lower Court to determine how to precisely apply the framework laid down by the CJ (and the Supreme Court) in the case of KA Deka. The judgment only deals with years before the introduction of the 'remittance reduction' (afdrachtsvermindering) in Netherlands tax law (years prior to 2008). It is currently not yet clear whether the outcome of the case would be different under the new remittance reduction regime. The CJ's ruling is of relevance for other cases with a similar fact pattern. The KA Deka case, however, does not cover situations where the shareholders or participants are resident in a State that is neither the home State of the UCITS, nor the investment State. It is therefore still open whether the ruling of the CJ on the redistribution requirement in this case would also apply to such 'triangular situations'.

CJ rules on the Belgian legislation applying the PSD as regards the order in which the deductible income must be deducted from taxable profits (*Brussels Securities*)

On 19 December 2019, the CJ delivered its judgment in case Brussels Securities SA v État Belge (C-289/19). The case deals with the application of the ParentSubsidiary Directive (PSD) and the order in which the deductible income must be deducted from taxable profits.

According to Belgian legislation for determining the definitive taxed income (DTI), 95% of the amount collected or received from a subsidiary should be deducted pursuant to the PSD regime,. In so far as it has not been possible to deduct that amount, it is to be carried forward to subsequent tax years. In turn and in regard to deduction for risk capital ('DRC') in respect of a tax period, the risk capital to be taken into account corresponds, to the amount of the company's equity capital at the end of the previous tax period, determined in accordance with accounting legislation and the annual accounts as shown on the balance sheet.

Brussels Securities, a company established in Belgium, is subject to corporation tax in that Member State. In its tax return for the 2011 financial year, Brussels Securities stated that it had determined its tax base by deducting first, the DRC and second, the DTI. It also claimed the right to carry forward deductions to the 2012 tax year in respect of DTI, DRC and tax losses. In a correction notice dated 21 May 2013, the tax authorities stated that they intended to review the amount of DRC which could be carried forward at the beginning and at end of the 2011 tax year on the basis of the order in which tax deductions are to be applied. According to that order, first DTI must be deducted from the taxable profits, then the DRC, and finally the losses to be carried forward. Since Brussels Securities had not made the deductions in that order in respect of the tax years 2005 to 2011, the tax authorities considered that no amounts could be carried forward to the 2012 tax year in respect of DTI and that the amount of the DRC should be increased. The losses to be carried forward were maintained.

Brussels Securities appealed this decision. It considered that 'According to Brussels Securities', the order in which tax deductions are to be applied, would mean that a company covered by the DTI system would lose the benefit of the tax advantage represented by the DRC, up to the amount of DTI that it may deduct. Therefore, and in its view, the national legislation does not comply with Article 4 of the PSD. The case was referred to the CJ.

The CJ started by observing that the first indent of Article 4(1) of the PSD prohibits Member States from taxing the parent company in respect of the profits distributed by its subsidiary, without drawing a distinction based on whether the chargeable event of the taxation of the parent company is the receipt of those profits or their redistribution (and that that prohibition also applies to national legislation which, although it does not tax the dividends received by the parent company in themselves, may have the effect that the parent company is subject indirectly to taxation on those dividends). Such legislation is compatible neither with the terms, nor with objectives and scheme of PSD, since it does not allow the objective of preventing economic double taxation, as set out in the rule established at the first indent of Article 4(1) of that directive, to be fully attained.

In accordance with the Belgian legislation, the part of the DTI that cannot be deducted in the relevant tax year due to insufficient profits may now be carried forward to subsequent tax years. In addition, the ability to carry forward is not limited in time. It is therefore apparent that the reduction in losses which may be carried forward, due to the inclusion of dividends in the parent company's tax base, is now offset by an unlimited ability to carry forward DTI in the same amount. However, DTI carried forward must be deducted as a priority from the positive results achieved by the parent company in subsequent years, other deductible items, in particular, the DRC and losses, being deductible only if, and to the extent that, that continues to be possible after the DTI has first been deducted. In particular, the parent company's tax base is established by deducting from its profits, first DTI carried forward, then, to the extent that there remain taxable profits, DRC carried forward, if the time limit for its use has not expired, and finally, losses carried forward. Therefore, the CJ observed that, the deduction as a priority of DTI may reduce or even extinguish, the tax base, which may have the effect of depriving the taxpayer, totally or partially, of another tax advantage. While, in accordance with the national legislation applicable to the dispute in the main proceedings, losses may be carried forward indefinitely, DRC may be carried forward only to the following seven tax years. In those circumstances, the order in which deductions must be applied, as described in paragraph 41 above, may result in the expiry of the right to use the deferred DRC, up to the amount of DTI that has been deducted as a priority from the parent company's taxable profits. Therefore, the CJ considered that the combination of the DTI scheme applicable to dividends received, the order of deductions set out in national legislation, and the time limit on the ability to use DRC can have the effect that receiving dividends is likely to result in the parent company losing another tax advantage provided for by national legislation, and, therefore, that company being taxed more heavily than would have been the case if it had not received dividends from its non-resident subsidiary or if, as the referring court states, the dividends had simply been excluded from the parent company's tax base. The CJ noted that the Belgian legislation is contrary to the objective pursued by the first indent of Article 4(1) of the PSD, the receipt of such dividends is not fiscally neutral for the parent company.

Therefore, the CJ concluded that the PSD must be interpreted as precluding the Belgian legislation which provides that dividends received by a parent company from its subsidiary must first be included in the tax base of the parent company, before 95% of the amount of the dividends is then deducted, and any surplus may be carried forward to subsequent tax years indefinitely, that deduction having priority over another tax deduction which may only be carried forward for a limited time.

CJ rules Luxembourg fiscal unity regime infringes EU law (*B & others*)

On 14 May 2020, the CJ delivered its judgment in case *B and Others v Administration des contributions directes* (C-749/18). The Court concluded that the Luxembourg fiscal unity regime, which still now separates vertical and horizontal fiscal unities, is contrary to the freedom of establishment.

Legal background

Luxembourg's fiscal unity regime allows offset of the individual taxable results of the entities forming part of the fiscal unity.

Up to and including 2014, Luxembourg law only accommodated so-called vertical fiscal unities, i.e., between an integrating Luxembourg company and one or more of its subsidiaries. As from 1 January 2015, following the CJ's 2014 judgment in case *SCA Group Holding* (joined cases C-39/13 to C-41/13), Luxembourg amended its legislation to also accommodate horizontal fiscal unities, i.e., between sister companies held by a common non-integrating parent. However, Luxembourg tax law does not provide for a combination of a vertical and a horizontal fiscal unity: it is thus not possible to include sister companies of the integrating Luxembourg company in an existing vertical fiscal unity, even if the conditions of the horizontal fiscal unity are met.

Factual background

The case concerned a multinational group with a series of Luxembourg subsidiaries all held directly or indirectly by the same French parent company. The group had initially formed a vertical fiscal unity headed by a Luxembourg company. In 2014, further to the *SCA Group Holding* judgment, the group filed requests to extend the existing fiscal unity to sister companies of the Luxembourg integrating company for the years 2013 and 2014. Those requests were rejected. The Luxembourg courts rejected the subsequent appeal as regards 2013; for 2014, the court of first instance sided with the group. The administrative court, in appeal, referred three questions to the CJ.

CJ ruling

The CJ first found, in line with the existing case law, that the pre-2015 regime was contrary to EU law insofar as it did not accommodate horizontal fiscal unities. The CJ confirmed that this created an unjustified discrimination between Luxembourg and EU (but non-Luxembourg) resident parent companies.

Second, which is also relevant to the current regime: the CJ found that the strict separation between vertical and horizontal fiscal unities is contrary to EU law. Where there is a Luxembourg (integrating) parent company, it can add to the fiscal unity subsidiaries which are sisters of the existing integrated companies. On the contrary, Luxembourg law would (even now) still prevent a similar addition of sister subsidiaries (of the integrating Luxembourg company of a vertical unity) when there is a foreign (non-integrating) parent company, unless the vertical fiscal unity is first broken up. This may have an adverse impact in the case a break-up of a fiscal unity occurs during the relevant 5-year minimum period.

Finally, the company had not filed a request to form the fiscal unity in 2013 until the end of 2014, i.e., after the deadline laid down in the law. The CJ rejected the taxpayers' argument that filing a request before the *SCA Group Holding* judgment was useless and considered that the requirement to file the request prior to the end of the relevant year was not contrary to the principles of equivalence and effectiveness.

Impact and next steps

The case will return to the Luxembourg administrative court, which should rule in line with the positions of the CJ. Because of the primacy of EU law, the current restrictions, including those in the Luxembourg rules which were found contrary to EU law, would need to be set aside, even without a change of law. Hence, other taxpayers who are looking at 'combining' a horizontal and vertical fiscal unity, e.g., by including a sister company of the integrating company in an existing vertical fiscal unity, will be able to rely on the CJ judgment, provided a request to that effect is filed in time. If not filed beforehand, the request needs to be filed before the end of this year in order to enjoy the benefit of a combined vertical and horizontal fiscal unity for the year 2020.

CJ rules that allocation of taxing rights on pensions pursuant to a tax treaty is not in breach of the TFEU (*Istitulo Nationale della Previdenza Sociale*)

On 30 April 2020, the CJ delivered its judgment in case *HB, IC v Istituto nazionale della previdenza sociale (INPS)*, (Joined cases C-168/19 & C-169/19). The case deals with the taxation of two Italian nationals, former employees of the Italian public sector, who moved to Portugal and the alleged difference in tax treatment under the tax treaty between Portugal and Italy of Italian pensioners in the private sector and Italian pensioners in the public sector resident in Portugal.

HB and IC, of Italian nationality, are former employees of the Italian public sector. They are each in receipt of a retirement pension paid by the INPS. After transferring their residence to Portugal, they requested the INPS, in 2015, that they receive, pursuant to Article 18 and Article 19(2) of the Italian-Portuguese tax treaty, the gross amount of their monthly retirement pension, without deduction of tax at source by the Italian Republic. The INPS rejected those requests, taking the view that, pursuant to Article 19 of the Italian-Portuguese tax treaty, unlike Italian pensioners in the private sector, retired employees in the Italian public sector must be taxed in Italy, and only in that Contracting State. HB and IC each brought actions against those decisions claiming that the Italian-Portuguese tax treaty introduces inequality of treatment between Italian pensioners in the private sector and Italian pensioners in the public sector resident in Portugal, in so far as the former indirectly enjoy more advantageous tax treatment than the latter, which constitutes, according to that court, an obstacle to the freedom of movement guaranteed to every EU citizen.

The CJ started by observing that the objective of tax treaty is to prevent the same income from being taxed in each of the two States. It is not to ensure that the tax to which the taxpayer is subject in one State is no higher than that to which he or she would be subject in the other contracting State. Therefore, it is not unreasonable for Member States to use the criteria followed in international tax practice and, in particular, as the Italian Republic and the Portuguese Republic have done in the present case, the Model Tax Convention on Income and on Capital drawn up by the OECD, Article 19(2) of which, in the 2014 version, provides for connecting factors such as the paying State and nationality. Therefore, for the CJ, where, in a tax treaty concluded between the Member States, the criterion of nationality appears in a provision which is intended to allocate fiscal sovereignty, there is no justification for considering such differentiation on the basis of nationality as constituting prohibited discrimination. Similarly, the designation of the State responsible for payment of the retirement pension (the 'paying State') as being competent to tax pensions received from the public sector cannot, in itself, have negative repercussions for the taxpayers concerned, in so far as the favourable or unfavourable nature of the tax treatment of those taxpayers does not derive strictly speaking from the choice of connecting factors, but from the level of taxation of the competent State, in the absence of harmonisation, at EU level, of the scales of direct taxes. Therefore, the CJ concluded, that the difference in treatment which the applicants in the main proceedings claim to have suffered arises from the allocation of the power to impose taxes between the parties to the Italian-Portuguese tax treaty and from the disparities existing between the respective tax systems of those contracting parties. The choice of various connecting factors, made by those parties for the purpose of allocating powers of taxation between them, such as, in the present case, the State responsible for paying the retirement pension and nationality, must not be regarded, as such, as constituting discrimination prohibited by the TFEU.

VAT

Legislation

Small Business Exemption extended to cross-border activities

On 18 February 2020, the Council of the EU agreed to extend and simplify the VAT exemption for small businesses (SMEs).

Currently, Member States are allowed to exempt supplies by SMEs with an annual turnover not exceeding a given (Member State specified) threshold. This relieves the SMEs from the administrative burden of VAT filing obligations and relatively high compliance costs. At the same time, it provides the Member States' tax authorities with the same relief (i.e. not having to administratively process every small business whose actual VAT taxable turnover is insignificant).

Currently, cross-border supplies cannot benefit from the SME exemption, no matter how small the (VAT taxed) business. After the extension however, a Member State may exempt an SME from its VAT filing obligations, despite the SME not being established in the Member State concerned (where the supply is taking place), provided that the turnover in concern stays below the national threshold and as long as the SME's annual turnover in the Union as a whole stays below EUR 100,000.

SMEs will be able to declare their transactions using a 'single registration window' in their Member State of establishment. This way, no additional VAT registration and reporting is required of the SME. All in all, this should contribute to a level playing field for businesses, regardless of where they are established in the EU. The new and improved VAT (filing) exemption for SMEs is intended to enter into force on 1 January 2025.

New payment data exchange requirements adopted

On 18 February 2020, the Council of the EU agreed to new measures to facilitate the detection of tax fraud in cross-border e-commerce transactions.

The new measures supplement the EU's 'e-commerce package' which enters into force on 1 January 2021. The supplementary rules require payment service providers (most notably banks) to establish and maintain a register of cross-border payments. The information gathered has to be suitable for electronic submission to the Member States' Tax Authorities. The information collected by the Member States will be stored centrally in what has been dubbed the 'central electronic storage system of payment information' ('CESOP'). From this system, all Member States will be able to extract the necessary information for processing by the national anti-fraud officials.

The additional rules for collection and storage of information naturally also require additional rules on the protection of personal data. In this light, information may, for example, only be stored for a limited time and only the information necessary for combatting VAT fraud may be collected. Moreover, stored information will only be accessible to designated VAT fraud investigation officials. The new measures are intended to enter into force as of 1 January 2024.

Case law

CJ rules that Hungarian progressive tax having greater impact on undertakings owned by non-residents is not in breach of EU Law (*Vodafone*)

On 3 March 2020, the CJ delivered its judgment in case Vodafone Magyarország Mobil Távközlési Zrt. V Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága/ (C-75/18). The case deals with the Hungarian tax on the turnover of telecommunications operators that is a progressive tax that causes a greater impact on undertakings owned by natural or legal persons of other Member States than on national undertakings.

Vodafone is a public limited company governed by Hungarian law, active in the telecommunications market, whose sole shareholder is Vodafone Europe BV, established in the Netherlands. Vodafone was the subject of a tax inspection that led to an additional assessment. Vodafone appealed against this decision claiming that the legislation relating to that tax constitutes prohibited State aid and is contrary to Article 401 of the VAT Directive. It considered that the effect of that tax, which is based on turnover and is calculated in accordance with a scale that comprises progressive rates applicable to various tax bands, may be indirectly discriminatory vis-à-vis taxable persons owned by foreign natural persons or legal persons and, therefore, be contrary to Articles 49, 54, 107 and 108 TFEU particularly since, in practice, only the Hungarian subsidiaries of foreign parent companies pay the special tax at the rate laid down for the highest band of turnover.

The CJ started by recalling that the freedom of establishment aims to guarantee the benefit of national treatment in the host Member State to nationals of other Member States by prohibiting any discrimination based on the place in which companies have their seat. In order to be effective, the scope of freedom of establishment must mean that a company may rely on a restriction on the freedom of establishment of another company which is linked to it in so far as that restriction affects its own taxation. In this case, Vodafone has its registered office in Hungary but is 100% owned by Vodafone Europe, which has its registered office in the Netherlands.

Furthermore, not only overt discrimination based on the location of the seat of companies, but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result are, in that regard, prohibited. Therefore, a compulsory levy which provides for a criterion of differentiation that is apparently objective but that disadvantages in most cases, given its features, companies that have their seat in another Member State and which are in a situation comparable to that of companies whose seat is situated in the Member State of taxation, constitutes indirect discrimination based on the location of the seat of the companies, which is prohibited under Articles 49 and 54 TFEU.

In this case, the law on the special tax on certain sectors makes no distinction between undertakings according to where they have their registered office. All the undertakings operating in Hungary in the telecommunications sector are subject to that tax, and the tax rates that are, respectively, applicable to the various bands of turnover defined by that law apply to all those undertakings. That law does not, therefore, establish any direct discrimination. However, Vodafone and the Commission maintain that the fact that the special tax is progressive is, in itself, to the advantage of taxable persons owned by Hungarian natural persons or legal persons and to the disadvantage of taxable persons owned by natural persons or legal persons of other Member States, with the result that the special tax constitutes, taking into consideration its characteristics, indirect discrimination.

According to the CJ and contrary to what is maintained by the Commission, progressive taxation may be based on turnover, since, on the one hand, the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay. Following the preamble of the relevant legislation, its aim is to impose a tax on taxable persons who have an ability to pay that exceeds the general obligation to pay tax. For the CJ, the fact that the greater part of such a special tax is borne by taxable persons owned by natural persons or legal persons of other Member States cannot be such as to merit, by itself, categorisation as discrimination. That situation is due to the fact that the Hungarian telecommunications market is dominated by such taxable persons, who achieve the highest turnover in that market. Accordingly, that situation is an indicator that is fortuitous, if not a matter of chance, and which may arise, even in a system of proportional taxation, whenever the market concerned is dominated by undertakings of other Member States or of non-Member States or by national undertakings owned by natural persons or legal persons of other Member States or of non-Member States.

Therefore, the CJ concluded that the progressive rates of the special tax do not, inherently, create any discrimination, based on where companies have their registered office, between taxable persons owned by Hungarian natural persons or legal persons and taxable persons owned by natural persons or legal persons of other Member States.

CJ rules that Hungarian progressive tax having greater impact on undertakings owned by non-residents is not in breach of EU Law (*Tesco*)

On 3 March 2020, the CJ delivered its judgment in case Vodafone Magyarország Mobil Távközlési Zrt. V Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága/ (C-323/18). The case deals with the Hungarian tax on the turnover in the store retail trade sector that is a progressive tax that causes a greater impact on undertakings owned by natural or legal persons of other Member States than on national undertakings. Identically to the decision followed in the Vodafone case (C-75/18) dealt with in this edition, the CJ confirmed that the progressive rates of the special tax do not, inherently, create any discrimination, based on where companies have their registered office, between taxable persons owned by Hungarian natural persons or legal persons and taxable persons owned by natural persons or legal persons of other Member States.

CJ rules on Hungarian obligation to submit a tax declaration on suppliers of advertising services established in another Member State (*Google Ireland*)

On 3 March 2020, the CJ delivered its judgment in case Google Ireland Limited v Nemzeti Adó- és Vámhivatal Kiemelt Adó- és Vámigazgatósága (C-482/18). The case deals with a series of fines on that company for having infringed the obligation to submit a tax declaration of persons exercising an activity subject to the tax on advertisements laid down in Hungarian legislation.

By decision of 16 January 2017, the Hungarian tax authority found, first, that Google Ireland was exercising an activity which fell within the scope of the law and, second, that it had not registered with the tax authority within 15 days of commencing its activity. Consequently, the tax authority imposed a fine. By decisions adopted on the following four days, the tax authority imposed four new fines on Google Ireland. Google Ireland brought an action for the annulment of those decisions before the referring court.

In support of its action, Google Ireland submits, first of all, that the imposition of fines on the ground of a failure to comply with the obligation to register laid down in the Law on the taxation of advertisements is contrary to the freedom of provide services. Furthermore, it submits that companies established in Hungary may satisfy the obligations laid down by that law more easily than those established outside Hungary. Lastly, it maintains that fines imposed on companies established outside Hungary on the ground that they fail to comply with their obligations to submit a tax declaration differ from those applicable to companies established in Hungary which fail to comply with a similar obligation, and are disproportionate to the seriousness of the infringement committed, thereby constituting a restriction on the freedom to provide services in the EU.

The CJ started by observing that under the law on the taxation of advertisements, a person liable to the tax on advertisements who is not registered with the tax authority as a taxpayer for the purposes of some form of tax must register with the tax authority by submitting the relevant form within 15 days of commencing the taxable activity. According to the Court, it follows, first, that the obligation to submit a tax declaration, laid down in the law, does not impinge on the exercise of the activity of advertising online in Hungary and, second, that a supplier of advertising services who, before commencing its advertising activity which is taxable, has not registered for tax purposes in Hungary is subject to that obligation, whereas that obligation does not apply to a supplier of advertising services who is already registered for tax purposes in that Member State for the purposes of some form of tax, that being so irrespective of either supplier's place of establishment. Therefore, the Court was of the view that the obligation to submit a tax declaration, which is an administrative formality, does not per se constitute an obstacle to the freedom to provide services.

Subsequently the CJ dealt with the Hungarian fines for failure to comply with similar obligations to submit a tax declaration and to register required of them under the general provisions of the national tax legislation. According to the Court, the system of penalties, of the Law on the taxation of advertisements, enables significantly higher fines to be issued than those resulting from the application of the Law on general tax procedures in the event of infringement, by a supplier of advertising services established in Hungary. Furthermore, the amount of the fines imposed under that system is not increased for continued non-compliance with the corresponding obligation to register to such an extent, nor necessarily within such a short period of time, as that applied under the system of penalties laid down in the Law on the taxation of advertisements. Therefore, and having regard to the difference in treatment introduced between suppliers of advertising services according to whether or not they are already registered for tax purposes in Hungary, the system of penalties at issue in the main proceedings constitutes a restriction on the freedom to provide services.

Such a restriction may nevertheless be warranted if it is justified by overriding reasons of public interest and, provided that that is the case, its application is suitable for securing the attainment of the objective which it pursues and does not go beyond what is necessary in order to attain it. In the present case, the Hungarian Government invoked the need to preserve the integrity of its tax regime, essentially relying on grounds based on ensuring the effectiveness of fiscal supervision and the effective collection of tax.

In that regard, the Court has previously accepted that the need to ensure the effectiveness of fiscal supervision and EU Tax Alert 15 the effective collection of tax may constitute overriding reasons in the public interest capable of justifying a restriction on the freedom to provide services. It has also held that the imposition of penalties, including criminal penalties, may be considered to be necessary in order to ensure compliance with national rules, subject, however, to the condition that the nature and amount of the penalty imposed is, in each individual case, proportionate to the gravity of the infringement which it is designed to penalise. The CJ observed that that legislation introduces a system of penalties under which a supplier who has not complied with that administrative formality may, within a few days, at intervals of only one day apart, be fined, from the second day, in amounts which are tripled in relation to the amount of the previous fine without the competent authority giving the supplier the time necessary to comply with its obligations or the opportunity to submit its observations, or having itself examined the seriousness of the infringement. In those circumstances, such legislation is disproportionate. The CJ further added that a fine is no less disproportionate merely because the authorities of a Member State may, at their sole discretion, reduce its amount.

CJ rules on VAT on secondment services (*San Domenico*)

On 11 March 2020, the CJ delivered its judgment in the case *San Domenico Vetraria* (C-94/19). The case concerns an Italian company called San Domenico Vetraria SpA ('San Domenico'), which received secondment services from its parent company 'Avir' in 2004. The secondment concerned a director of Avir who was seconded to one of San Domenico's branches. For its services, Avir charged San Domenico amounts equal to the costs borne at the level of Avir in connection with the seconded director. Furthermore, Avir issued invoices including VAT and San Domenico recovered said input VAT in its VAT returns. However, the Italian Tax Authorities ('ITA') took the view that the secondment between Avir and San Domenico qualified as being outside of the scope of VAT based on national VAT legislation. This is because the Italian VAT legislation states that secondment, for which the compensation is only made up of cost reimbursements (and no additional fee or mark-up), is regarded as not relevant for VAT purposes (i.e. out of scope). This dispute eventually ended up before the 'Corte suprema di cassazione' (the High Court), which decided to stay the proceedings and refer to the CJ for a preliminary ruling on the question whether the Italian rule with respect to secondment against sole reimbursement of costs is compatible with the Sixth Directive, which was still applicable in the period of the dispute (in particular, Articles 2 and 6 of the Sixth Directive, which provisions provided the definitions of respectively taxable activities and services).

The CJ started by recalling that supplies of goods or services effected for consideration within the territory of the country by a taxable person acting as such are subject to VAT. Also, any transaction that does not constitute a supply of goods constitutes a supply of service(s). In this respect, it was not in discussion whether Avir could be considered a taxable person (which it is). Furthermore, the referring court had already established that the services took place within the country concerned. Thus, the only question that remained to be answered is whether the services were effected 'for consideration', as required by Article 2 of the Sixth Directive.

The CJ considered that a supply of service is effected for consideration if there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance. In other words, if one can determine a direct connection between a supply of goods or services on the one hand and the consideration received on the other hand. The CJ noted that Avir's services were carried out on the basis of a legal relationship of a contractual nature between Avir and San Domenico Vetraria. Furthermore, the CJ acknowledged a reciprocal performance, namely the secondment of a director from Avir to San Domenico Vetraria, on the one hand, and the payment by San Domenico Vetraria to Avir of the amounts invoiced to it, on the other. The CJ dismissed the European Commission's view that the services were not provided for consideration because the remuneration for Avir's services did not surpass the costs borne by Avir. In this respect, it is not relevant whether the consideration is higher or lower than the costs borne by the service provider. The only requirement relevant in this respect is that the services and the consideration are interdependent. In other words, the consideration is only paid because the services were supplied (and vice versa). Thus, in conclusion, (secondment) services supplied against consideration are *not* out of scope for VAT purposes if the consideration only constitutes the reimbursement of costs borne by the service provider.

CJ rules on conditions for VAT zero-rated intra-EU supplies (*Herst*)

On 23 April 2020, the CJ delivered its judgment in the case *Herst* (C-401/18). In essence, the case focuses on which transaction in a cross-border supply chain of goods should be regarded as the VAT exempted intra-Community supply when there is only one physical movement of goods to the final customer.

The Czech company, Herst, is active in the transport sector and owns several petrol stations. Using its own vehicles, Herst transports fuel under suspension of excise duties from other EU Member States to the Czech Republic. The goods are resold multiple times, but only transported once by Herst to the final customer in the Czech Republic. Upon arrival in the Member State of destination, the fuel was brought into free circulation in the EU. The Tax Authorities in the Czech Republic are of the opinion that the supplies made to Herst were carried out in the Member State of departure of the goods and qualify as VAT zero-rated intra-EU supplies. Because of this, the issued invoices stating Czech VAT would not entitle Herst to deduct input VAT. In order for a specific transaction to qualify as intra-EU supply, it should be determined when and where the power to dispose of the goods as owner is transferred.

In its judgment, the CJ ruled that a taxable person who carries out a single intra-Community transport of goods under the excise-duty suspension arrangements, with the intention of acquiring those goods for the purposes of his economic activity once they have been released for free circulation in the Member State of destination, shall obtain the power to dispose of those goods as an owner, provided that he is able to take decisions which may affect the legal situation of those goods, including, in particular, the decision to sell them. In the case of Herst, this criterion is met, which means that the supplies made to Herst should indeed be regarded as VAT zero-rated intra-EU supplies. This judgment is in line with previous case law from the CJ (e.g. *AREX CZ*, C-414/17).

CJ rules on interest paid on late VAT refunds (*Sole-Mizo Dalmandi*)

On 23 April 2020, the CJ delivered its judgment in the combined case *Sole-Mizo Dalmandi* (C-13/18 and C-126/18). The cases revolve around the Hungarian tax authorities' ('HTA') administrative practice of paying taxpayers interest on late refunds of VAT. This practice follows from an unpublished ruling of the CJ in 2014, in which the CJ ruled that EU law prohibits the HTA from not refunding interest on excess input VAT that could not be refunded within a reasonable time span due to national legislation declared incompatible with EU law. The Hungarian Supreme Court tested the conditions applicable with respect to these refunds of interest. Regular tax rules for refunding interest apply between the deadline for submitting the VAT return and the deadline for submitting the next VAT return. This interest is based on the base rate of the Hungarian Central Bank. The regular rules for the refund of interest for late payment apply for the period from the date on which the tax authorities became liable for the interest to be paid until the date on which this interest is actually paid. This interest is based on twice the base rate of the Hungarian Central Bank. Two Hungarian companies, 'Sole-Mizo' and 'Dalmandi' requested the HTA to pay them (i.) interest following the late VAT refunds, and (ii.) late payment interest following the fact that the HTA had also not met their obligations in timely paying the prior mentioned interest. In short, the HTA granted the companies the VAT refund interest, but denied the requested interest for late payment by the HTA. Those disputes were eventually referred to the CJ for a combined preliminary ruling, in which a large number of questions from the referring courts are answered (together, where so deemed appropriate by the CJ).

The first question is essentially whether EU law precludes a tax authorities' practice whereby interest on excess deductible VAT which has been withheld for more than a reasonable period is calculated on the basis of an interest rate corresponding to the base rate of the national central bank. The second question was whether EU law precludes the application of a limitation period of five years to requests for payment of interest on excess deductible VAT which has been withheld by the HTA contrary to EU law. Furthermore, the CJ was asked whether EU law precludes a practice whereby the taxable person must submit a special request for payment of interest and that interest is only applied starting after a period of 30 or 45 days for the tax authorities to process the taxpayer's request. Finally, the last question posed by the referring courts was whether EU law precludes a practice whereby interest for late payment is granted only to the extent that the taxable person has an excess of deductible VAT in *that* period concerned.

As to the first question, the CJ considered that the national Central Bank rate is not appropriate as this rate only applies to credit institutions. Taxpayers like Sole-Mizo and Dalmandi would face a higher rate of interest on loans to cover the cash flow disadvantage created by the HTA. Furthermore, as the taxpayers are not compensated for any monetary depreciation in the period between the end of the VAT return period and the actual moment the interest is paid, the taxpayers are not relieved from the economic burden of the amounts of VAT unduly withheld by the HTA. Thus, this practice is prohibited based on EU law and the principle of effectiveness in particular. As to the second question regarding the limitation period, the CJ considered that in the absence of specific rules in EU law, it is to the discretion of the Member States (taking into account the principles of EU law) to lay down the conditions under which interest is paid following amounts of VAT unduly taxed (or in this case, unduly withheld VAT refunds for an unreasonable period of time). The CJ thus ruled that EU law does not preclude the use of a limitation period of five years for the submission of an application for the refund of interest. Nor does it preclude the obligation to submit an application for the late payment interest, which interest only starts to accumulate after a period of 30 or 45 days after receipt of that application by the tax authorities.

CJ rules on retroactive adjustments to input VAT recovery (*CTT - Correios de Portugal)*

On 30 April 2020, the CJ delivered its judgment in the case *CTT Correios de Portugal* (C-661/18) on the possibility for taxable persons to perform retroactive adjustments to input VAT recovery in the case a supply has wrongly been treated as VAT exempt.

CTT operates on the market for postal services in Portugal. It has public service obligations on this market. CTT's transactions fall within the scope of the VAT postal services exemption and therefore, do not give rise to VAT deduction. CTT also performs VAT taxed activities that do give rise to input VAT recovery. The Portuguese postal services market was liberalized on 1 January 2013. In 2015, doubts first arose regarding the VAT consequences of the liberalization of the postal services market. CTT started to pay VAT on postal bill-payment services from April 2015. In a binding tax ruling of 20 November 2015, the Portuguese Tax Authorities clarified the impact of the liberalization of the market on the VAT exemption and specified that postal bill-payment services carried out from 1 January 2013 no longer fell within the scope of the VAT exemption for public postal services, in light of the CJ judgment of 23 April 2009, *TNT Post UK* (C-357/07). Consequently, CTT paid VAT in respect of postal bill-payment transactions carried out from 1 January 2013 and filed adjusted VAT declarations for the years 2013, 2014 and 2015. In addition, in those adjusted declarations, CTT changed the method used to calculate the VAT recovery ratio from the turnover based method to the actual use method. Following an audit, the Portuguese Tax Authorities pointed out that the deduction method may not be altered once a final proportion has been applied.

The CJ ruled that – in principle – the rules on VAT deduction must be interpreted as not precluding a Member State from prohibiting a taxable person from changing the deduction method once the final proportion has been fixed. However, the CJ also ruled that the VAT Directive, read in the light of the EU law principles of fiscal neutrality, effectiveness and proportionality, must be interpreted as precluding national legislation under which a taxable person who deducted VAT charged on the acquisition of goods and services used for both VAT-taxed and VAT-exempt transactions based on the turnover method ('pro rata'), is denied the opportunity to correct those deductions once the final proportion has been fixed in a situation where:

- the EU Member State concerned allows taxable persons to deduct VAT based on the actual use method;
- the taxable person was unaware and acting in good faith, that a transaction which it regarded as VAT exempt was in fact VAT taxed,
- the general limitation period fixed by the national VAT law for the purposes of adjusting the deductions has not yet expired, and
- the change in the deduction method makes it possible to establish more precisely the proportion of VAT relating to transactions in respect of which VAT is deductible.

  Given that all four above-mentioned criteria are met, the CJ ruled that CTT was indeed allowed to make retroactive adjustments to the input VAT recovery ratio.

CJ rules on VAT deduction concerning non-concluded contracts (*EUROVIA*)

On 30 April 2020, the CJ delivered its judgment in the case *EUROVIA Ipari, Kereskedelmi, Szállítmányozási és Idegenforgalmi Kft. ('Eurovia')*, C-258/19.

In 1996 and 1997, Eurovia concluded a number of contracts for the execution of works relating to an aerial telecommunications network. A dispute arose between Eurovia and the contractor concerning the amount of remuneration. As a result, Eurovia only paid a part of the total amount to the contractor. After a civil dispute with the contractor, Eurovia was ordered to pay more than HUF 19 million plus interest. On 15 June 2011, the contractor drew up an invoice, stating 6 June 2011 as the date of performance of the contracting works at issue in the main proceedings. In its VAT return for the second quarter of 2011, Eurovia deducted a VAT amount of HUF 3,940,679 on the basis of this invoice. The Hungarian tax authorities refused this input VAT deduction, arguing that the services were not rendered to Eurovia in 2011 and that the statute of limitation for retroactive VAT deduction on these services had already passed.

The CJ ruled that it deemed itself not competent to answer questions asked by the Supreme Court of Hungary because the relevant transaction had taken place and the procedure concerns a period prior to the accession of Hungary to the EU. This is in line with the CJ judgment of 27 June 2018 in *Varna Holideis* (C-364/17).

CJ rules on fixed establishment for VAT purposes (*Dong Yang Electronics*)

On 7 May 2020, the CJ delivered its judgment in the case *Dong Yang Electronics* (C-547/18). The case concerned the question whether a subsidiary that is established in the European Union should be regarded as a VAT fixed establishment of a parent company established outside the European Union and, if so, how a service provider should assess whether his services have been provided to the parent company or the fixed establishment.

Dong Yang entered into a service agreement with LG Korea concerning the assembly of circuit boards. Those circuit boards were provided to Dong Yang by LG Poland Production, a subsidiary of LG Korea. Once assembled, Dong Yang returned the circuit boards to LG Poland Production.

LG Poland Production assembled TFT-LCD modules from components owned by LG Korea under its own contractual obligations with LG Korea (toll manufacturing). The finished goods were sold by LG Korea to another Polish subsidiary after which, the goods were sold to the European market.

As a main rule, Dong Yang's services are taxable in Korea, because that is where Dong Yang's customer, LG Korea, has established its place of business. This would be different if LG Korea had a VAT fixed establishment in Poland. Because LG Korea did not employ staff in Poland and furthermore, did not own any property or technical equipment in Poland, LG Korea assured Dong Yang that it did not have a VAT fixed establishment in Poland. Therefore, Dong Yang did not charge Polish VAT on its services to LG Korea. However, the Polish tax authorities took the view that Dong Yang's services should have been subject to Polish VAT, because they were, in fact, supplied to a Polish VAT fixed establishment of LG Korea in the form of LG Poland Production.

The CJ ruled that it is possible that a VAT fixed establishment could exist through a parent-subsidiary relationship. However, the qualification of an establishment as a fixed establishment for VAT purposes depends on the fulfilment of the material conditions (i.e. sufficient degree of permanence and a suitable structure in terms of human and technical resources) laid down in the VAT implementing regulation. Those conditions should be assessed in the light of the economic and commercial reality. It follows from this that the existence of a VAT fixed establishment cannot be derived from the mere fact that LG Korea has a subsidiary company in Poland. Under the circumstances in this case, LG Poland Production, therefore, could not be considered as a fixed establishment of LG Korea.

The second part of the CJ's judgment focuses on the question whether or not Dong Yang is required to assess the contractual relations between LG Korea and LG Poland Production in order to determine the existence of a VAT fixed establishment (from which it follows in which country Dong Yang's services are taxed). The CJ ruled that no such obligation existed for Dong Yang. Therefore, Dong Yang can rely on the criteria laid down in the VAT implementing regulation, such as the nature and use of the service by the recipient, the VAT number communicated by the recipient, as well as the party that pays for the services (i.e. information provided by LG Korea).

CJ rules on conditions to defer VAT refund (*Agrobet CZ*)

On 14 May 2020, the CJ delivered its judgment in the case *Agrobet CZ, s.r.o.* (C-446/18). The case concerns the question whether or not tax authorities are allowed to defer a total VAT refund when only a small part of that refund is subject to an ongoing tax inspection.

Agrobet is a Czech entrepreneur involved in the trading of agricultural products. In its VAT return, Agrobet requested a VAT refund relating to the purchase of rapeseed oil which Agrobet had sold to a Polish taxable person free of VAT (0% rated intra-Community supply). The Czech tax authorities initiated a tax inspection because it had doubts with regard to the VAT treatment of the rapeseed oil transactions. Given those doubts, the tax authorities did not grant a VAT refund. After that, Agrobet offered to secure the part of the refund still under inspection, so that the amount of deductible VAT not under review could be refunded in advance of completion of the inspection. The tax authorities declined that offer on the ground that the excess VAT was indivisible and related to the tax period as a whole. As a result, the tax authorities decided to withhold the full refund until the audit had been closed.

The CJ ruled that the right to recover VAT should not be understood in relation to the total amount, but rather in relation to an identifiable transaction. As a result, VAT amounts that are undisputed and require no further inspection must be paid promptly. Furthermore, the CJ stated that the excess VAT amount is not indivisible from the total VAT amount reclaimed, and therefore, the argument of the Czech tax authorities should be rejected. In short: it is, in principle, possible to distinguish between disputed and undisputed amounts of deducted VAT and to carry out a partial VAT refund accordingly.

CJ rules on VAT consequences of quantitative discounts (*World Comm Trading*)

On 28 May 2020, the CJ delivered its judgment in the case *World Comm Trading* (C-684/18) on the VAT consequences of quantitative discounts. In the case at hand, the dispute concerns the obligation for the recipient of such a discount to correct the amount of VAT initially deducted.

World Comm, established in Romania, engaged Nokia to supply mobile phone products. Nokia supplied these products to Romania from Finland, Germany, Hungary and Romania, charging VAT on the domestic supplies in Romania, and treating the other supplies as intra-community supplies (0% VAT rate). World Comm declared intra-community acquisitions for these supplies in its Romanian VAT return. World Comm deducted input VAT with regard to the domestic as well as the intra-community acquisitions.

Nokia granted World Comm discounts on a quarterly basis. These discounts were based on the total volume of products supplied irrespective of the Member State of dispatch of the goods. These discounts were documented in a single document that reflected a negative balance and included the Finnish VAT number of Nokia. This happened because Nokia Romania had ceased its economic activities and deregistered, so the whole discount was granted via the VAT registration number of Nokia Finland. World Comm accounted for the entire amount of the discounts in Romania via the mechanism for intra-community acquisitions, even though part of the discounts related to domestic supplies. World Comm, therefore, did not differentiate between inland supplies and intra-community supplies with regard to the VAT accounting on Nokia's discount invoice.

Because World Comm acted as if the discounts were entirely associated with intra-Community transactions, the adjustments for the VAT amounts remitted and the VAT amounts recovered were reported as intra-Community VAT. The Romanian tax authorities assessed World Comm for the input VAT that had been recovered with regard to the local Romanian purchases via the mechanism for intra-Community acquisitions (including penalties and interest). The CJ ruled that a price discount should always lead to a downward adjustment of World Comm's total VAT recovery, even in the absence of a (credit) invoice specifying the supplies to which the discount relates. For the adjustment of the VAT recovery, it is also irrelevant that Nokia could no longer issue a credit invoice because it has ceased its activities. Even in the absence of such an invoice, World Comm is required to adjust the VAT recovery applied initially. Further, the CJ ruled that the deductible VAT amount must also be adjusted, regardless of whether the supplier can claim reimbursement of the overpaid VAT.

CJ rules on VAT rules for fictitious intra-Community transactions CHEP Equipment Pooling (*CHEP*)

On 11 June 2020, the CJ delivered its judgment in the case *CHEP Equipment Pooling* (C-242/19) regarding the application of the VAT rules for fictitious intra-Community transactions.

CHEP is a Belgian company specialized in pallet rental services across Europe. CHEP subleases its pallet stock in certain EU Member States to companies that are also part of the CHEP concern (in the case at hand, CHEP Romania) and those companies, in turn, rent the pallets to the end customers. To perform this activity, CHEP purchased new pallets locally in Romania. CHEP also rented out pallets that had been transported to Romania from other EU Member States. To reclaim the VAT on the local pallet purchases in Romania, CHEP filed a VAT refund request under the Directive 2008/9 (i.e. VAT refund procedure for non-registered VAT taxable persons).

The Romanian tax authorities argued that CHEP should have been registered for VAT purposes in Romania because the transport of pallets from the other EU Member States to Romania qualified as fictitious intra-Community transactions. As a result, CHEP should have registered for VAT in order to declare fictitious intra-Community acquisitions for the pallets in Romania and CHEP should also have reclaimed the input VAT on the local purchases via the Romanian VAT return (instead of via a refund request under Directive 2008/9). The referring court, therefore, asked the CJ to clarify whether the transport of pallets to Romania, with the aim of subleasing them, should be treated as a fictitious intra-Community transaction that triggers a VAT registration liability in Romania.

The CJ ruled that the transfer of the pallets should not be treated as a fictitious intra-Community transaction when the pallets are to be subleased in Romania only temporarily and they are dispatched or transported from the Member State in which the taxable person has established its business (i.e. Belgium). Whether or not this is the case, should be assessed by the referring court, taking into account the contractual relations between CHEP and CHEP Romania. If no registration obligation exists, CHEP is entitled to a VAT refund based on Directive 2008/9. However, the CJ also ruled that the provisions of Directive 2008/9 should be interpreted as precluding Romania from denying CHEP a right to a VAT refund on the sole ground that CHEP has been or should have registered for VAT purposes in Romania. As a result, CHEP is entitled to a VAT refund on the local pallet purchases in Romania under Directive 2008/9 even in the case a VAT registration obligation exists in Romania.

CJ rules on VAT consequences of bad debts (*SCT*)

On 11 June 2020, the CJ delivered its judgment in the case *SCT* (C-146/19) regarding the VAT consequences of bad debts.

SCT issued invoices to one of its customers that remained unpaid due to the customers bankruptcy. SCT did not file the unpaid invoices with the Community bankruptcy register and, therefore, did not receive any compensation from the bankruptcy cash-pool. SCT requested a refund for the amount of VAT remitted to the tax authorities with regard to the unpaid invoice. This request was denied by the tax authorities on the ground that SCT should have tried to claim compensation via the bankruptcy cash-pool first. The referring court asked if the EU VAT rules on bad debts allow a Member State to deny a VAT refund to a taxable person in case of definitive non-payment of his customer, when the non-payment is effectively caused by the fact that the taxable person did not take proper action against its debtor.

The CJ ruled that it is not allowed to deny a taxable person the right to a VAT refund in the case the taxable person has failed to file a claim against the debtor in the debtor's bankruptcy proceedings. This judgment is based on the principle of neutrality, which states that taxable persons – as tax collectors on behalf of the EU Member States – must be fully relieved of the VAT which has been paid in the course of his VAT taxable activities. In the light hereof, it should not be accepted that a Member State does not grant a VAT refund in case the taxable persons' customer does not (fully) pay an invoice.

CJ rules on VAT treatment of termination fees (*Vodafone*)

On 11 June 2020, the CJ delivered its judgment in the case *Vodafone Portugal* (C-43/19) on the VAT treatment of termination fees.

Vodafone Portugal ('Vodafone') is involved in the supply of e-commerce services. Vodafone concludes services contracts with its customers, some of which include special promotions subject to conditions which tie those customers in for a minimum period ('the tie-in period'). Under those terms and conditions, customers commit to maintain a contractual relationship with Vodafone and to use the goods and services supplied by Vodafone for the tie-in period, in exchange for benefiting from advantageous commercial conditions, usually related to the price payable for the contracted services. Failure by customers to comply with the tie-in period for reasons attributable to themselves results in their paying the amounts provided for in the contracts. Those amounts seek to deter such customers from failing to comply with the tie-in period. According to national legislation, it was only allowed to ask for a reimbursement of the costs (i.e. Vodafone may not be compensated or receive another remuneration which could include profit elements as well).

Vodafone remitted VAT to the Portuguese tax authorities with regard to the termination fees in respect of non-compliance with the tie-in period. Subsequently, Vodafone filed an appeal challenging that VAT is due on the termination fees, arguing that such fees were not subject to VAT given the facts and circumstances. The referring court requested the CJ for a preliminary ruling.

The CJ brought to mind that the supply of services for consideration by a taxable person acting as such is to be subject to VAT. A supply of services is carried out 'for consideration' if there exists a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance. From previous case law, the CJ concluded that this criterion was met with regard to a predetermined amount received by a supplier when a service contract with a minimum commitment period is terminated early by its customer, even though that termination results in the end of the provision of the goods and services concerned.

Based on case law, the CJ ruled that the termination fees received by Vodafone in connection with the premature termination of a minimum contract should also be regarded as remuneration for a service provided for consideration. The termination fees reflect the recovery of some of the costs associated with the supply of the services by Vodafone. From the perspective of economic reality, the amount due upon termination of the contract seeks to guarantee the operator a minimum contractual remuneration for the services provided. Therefore, the amounts received constitute the remuneration for a supply of services subject to VAT. This does not depend on the fact that the termination fees do not enable Vodafone to obtain the same income as that it would have received if the customer did not terminate the contract. In short, the termination fees at hand are VAT taxed, because they were pre-agreed upon and quantified and identified in the contract.

CJ rules on interpretation of VAT concerning distance selling rules (*Krakvet*)

On 18 June 2020, the CJ delivered its judgment in the case *Krakvet Marek Batko (C-276/18)*. This case concerns the interpretation of the transport requirement for the application of the VAT distance selling rules.

Krakvet is a company established in Poland. Krakvet sells animal products which it markets via its website. Krakvet had several B2C customers in Hungary. It offered on that website the possibility for purchasers to conclude a contract with a transport company established in Poland for the purposes of delivering the goods, without Krakvet itself being a party to that contract. Purchasers could also choose a carrier other than the one recommended by Krakvet.

Krakvet was uncertain about where (Poland or Hungary) VAT was due on these sales. As a general rule, the sale of goods is taxed in the country of dispatch of the goods (Poland in this case). For B2C-sales, such as the sales at hand in this case, this would be different if the sale qualifies as a so-called distance sale. Distance sales are taxed in the country of arrival of the dispatch of goods (Hungary in this case). In order for a supply to qualify as a distance sale, the decisive criterion is that the goods are transported 'by or on behalf of the supplier' (transport requirement). This case concerns the question whether or not the transport requirement is also met when the supplier intervenes indirectly in the transport of the goods.

The CJ stated that the objective of the distance selling rules is that VAT is levied as far as possible in the Member State of consumption of the goods. Because of this, in combination with the fact that economic and commercial realities form a fundamental criterion for the application of the common system of VAT, the CJ ruled that the transport requirement is met in the case the supplier's role is predominant in terms of initiating and organizing the essential stages of the dispatch or transport of the goods. This is to be ascertained by the referring court, taking into account all the facts and circumstances of the dispute in the main proceedings.

The transport requirement is to be amended, entering into effect on 1 July 2021, as part of the VAT E-commerce Directive, so that it is unambiguously clear that the transport requirement will be met in the case the supplier intervenes indirectly in the transport of the goods. It basically follows from the *Krakvet* case that this was already the case under the current EU VAT rules. The codification of the transport requirement into the VAT Implementing Regulation, therefore, be regarded as a clarification of the interpretation of the transport requirement.

CJ rules on VAT treatment of fund management service (*BlackRock*)

On 2 July 2020, the CJ delivered its judgment in the case BlackRock Investment Management *(UK) Limited v Commissioners for Her Majesty's Revenue and Customs* (C-231/19). This case concerns the question whether a single fund management service can be split into a VAT taxed part and a VAT exempt part.

BlackRock manages special investment funds and other funds. The management of special investment funds is VAT exempt, whereas the management of the other funds is VAT taxed. The majority of funds managed by BlackRock are other funds. For the management of all its funds, BlackRock receives supplies of services from BlackRock Financial Management Inc. ('BFMI'), a group company established in the United States. Those services are provided through a software platform called 'Aladdin' and comprise a combination of hardware, software and human resources. Aladdin provides portfolio managers with market analysis to assist them in making investment decisions. Aladdin also monitors regulatory compliance and enables portfolio managers to implement trading decisions.

As BFMI is not established in the UK, BlackRock accounts for VAT under the reverse charge mechanism. BlackRock considered that the services used for the management of special investment funds should be exempt from VAT pursuant to Article 135(1)(g) of the EU VAT Directive, with the result that it accounted for VAT only on services used for the other funds, the value of those services being calculated pro rata in accordance with the amount of those funds within the total funds managed. On the contrary, the tax authority contends that all the services that BlackRock benefits from, by means of the Aladdin platform, must be VAT taxed, as most of those funds that the company manages are not special investment funds. The referring court requested the CJ for a preliminary ruling.

In the first place, the CJ ruled on whether or not the elements of the fund management services provided through Aladdin should be taken into account as one single supply (with one VAT treatment) or as separate supplies (each having their own VAT treatment). The CJ ruled that the services of analysing markets, monitoring performance, evaluating risk, monitoring regulatory compliance and implementing transactions correspond to successive steps, all of which are equally necessary to allow investment transactions to be made under good conditions. As a result, the elements must be regarded as a single supply comprising various elements of equal importance.

Next, the CJ ruled that the supply must be subject to one and the same VAT treatment. This treatment cannot be determined according to the nature of the funds managed. Because of that, the CJ rejected the position taken by BlackRock. Based on settled case law, the CJ stated that in order for the supply to be exempt from VAT, it should comprise of specific and essential functions of the management of special investment funds. BlackRock and the tax authority are in agreement that the service at issue was designed for the purpose of managing investments of various kinds and that, in particular, it may be used in the same way for the management of special investment funds as for the management of other funds. Therefore, that service cannot be regarded as specifically for the management of special investment funds. As a result, the CJ ruled that the supply is fully taxed with VAT.

CJ rules on VAT of colocation services provided by data centers (*A Oy*)

On 2 July 2020, the CJ delivered its judgment in the case of *A Oy* (C-215/19). This case concerns the VAT treatment of so-called colocation services provided by data centers.

A Oy provides colocation services to IT operators established in various EU Member States, who make telecommunications connections available to their own customers through servers. The servers are placed in data centers with the necessary telecommunications connections and where the humidity and temperature are precisely controlled. The colocation services include the provision of a server cabinet with lockable door, power supply and services to ensure the best operating environment for the use of the servers, such as temperature and humidity control, cooling, power failure protection and smoke detectors for fire prevention. A Oy's customers place their equipment in the server cabinets; that equipment is screwed into the floor and can be removed in a matter of minutes. The customers are not provided with their own key to the room in which their server is placed but can request a short-term key upon presentation of an identification document to the concierge.

In its judgment, the CJ first answered the question whether the colocation services qualify as the lease of real estate. If the colocation services do not qualify as rental services, the CJ was also asked to answer if the colocation services are to be regarded as real estate related services. When either of the two is the case, the colocation services are taxed in the Member State where the data room is physically located. If not, the VAT treatment of the colocation services is based on the B2B main rule, which states that the service is taxable in the country of establishment of the recipient of the service.

In the first place, the CJ ruled that the colocation services do not qualify as the lease of real estate, because A does not passively make available an area within the data room to its customer (due to the additional supplies) and also does not grant the customer an exclusive right to this area. Also relevant is the fact that, according to the CJ, the server cabinets are not an integral part of the building in which they are located.

In the second place, the CJ ruled that the colocation services also do not qualify as real estate related services. For this to be the case in this specific situation, it also was required that A would grant its customers an exclusive right to use that part of the building in which the servers are located. As a result, VAT will be due on the colocation services in the country of establishment of the recipient of such services.

CJ rules on correction of VAT invoices (*Terracult*)

On 2 July 2020, the CJ delivered its judgment in the case *SC Terracult SRL* (C-835/18).

During an audit, the Romanian tax authorities found out that Terracult had incorrectly applied the VAT exemption for intra-Community supplies to its supplies to a German company called Almos Alfons Mosel Handels GmbH ('Almos'). Terracult was unable to provide evidence that the goods had left the territory of Romania. Therefore, the tax authorities in Romania imposed a VAT assessment on Terracult. Terracult issued corrective invoices in accordance with the tax assessment to Almos.

After that, Almos found out that its German VAT number had erroneously been mentioned on these corrective invoices and Almos requested Terracult to amend the invoices, this time stating the identification details of Almos' tax representative in Romania. In this regard, it should be noted that a local reverse charge mechanism applies to the supplies at hand (rapeseed) in Romania. Therefore, Terracult applied the reverse charge mechanism to the amended invoices and, thus, shifted the VAT liability to Almos' tax representative. As a result, Terracult requested a VAT refund for the VAT paid to the tax authorities following the tax audit (as, formally, this VAT was not due because of the application of the reverse charge).

According to the Romanian tax authorities, Terracult was not entitled to a VAT refund because the tax assessment had already become final following the tax audit. They

also took the position that the fact that, based on new information, the reverse charge mechanism should have been applied is irrelevant in this regard. The Romanian court thereupon requested a preliminary ruling.
The CJ ruled that Romania was acting contrary to EU law by not allowing Terracult to correct its invoices, simply because a tax assessment has already become final as a result of a tax inspection. In this light it is important to note that following the imposition of the tax assessment, it has become apparent that transactions to which the reverse charge mechanism applies have been carried out. It is irrelevant that the transactions were carried out during a period that has already been the subject of a tax audit. Nor is it important that an assessment has been imposed as a result of the audit, to which no objections have been raised.

CJ rules on adjustment of input VAT deduction (*HF*)

On 9 July 2020, the CJ delivered its judgment in case *HF v Finanzamt Bad Neuenahr-Ahrweiler* (C-374/19) on the adjustment of the input VAT deduction relating to the construction of a cafeteria annexed to a retirement home. HF operates a retirement home exempt from VAT. In 2003, HF constructed a cafeteria which was accessible to visitors through an outside entrance and to residents of the retirement home via the home's dining room. HF initially stated that it would use the cafeteria exclusively for taxable transactions as it was intended for use by external visitors and not by residents of the retirement home, who were supposed to remain in the home's dining room.

Following an audit, the tax authorities found out that HF no longer carried out VAT taxed transactions in the cafeteria from 2009 to 2012 and that HF had been removed from the commercial register in February 2013. During this period, the cafeteria's premises were used exclusively for VAT exempt transactions (i.e. the cafeteria was only visited by people from the retirement home).

As the cafeteria was no longer used at all for transactions giving rise to the right to deduct input VAT during this period, the tax authorities assessed HF for the amount of input VAT initially deducted on the construction of the cafeteria. HF disagreed, stating that the fact that the cafeteria was no longer used for VAT taxed activities should not lead to an adjustment of the deducted input VAT, because the cafeteria not being used should be understood to be the result of a bad investment.
Given that the cafeteria was no longer used to carry out any VAT taxed activities, the CJ ruled that HF's input VAT position needed to be amended, resulting in a payment from HF to the tax authorities. The CJ also clarified that this would not be different in the case the closing of the cafeteria to non-resident users is beyond HF's control. The usage of the cafeteria had shifted from mixed use for VAT taxed activities and VAT exempt activities to exclusive use for VAT exempt activities, thus giving rise to an adjustment of the input VAT position of HF.

CJ rules on concept of taxable person for VAT purposes (*UR*)

On 16 July 2020, the CJ delivered its judgment in the case *Cabinet de avocat UR* (C-424/19) concerning the concept of 'taxable person' for VAT purposes.

UR is a law firm established in Romania. UR requested to be removed from the register of taxable persons for VAT purposes with effect from 2002. Also, UR requested the Romanian tax authorities to reimburse the VAT amount paid by UR during the period 1 January 2010 to 31 December 2014, on the ground that UR had wrongly been entered in that register. In support of its appeal, UR relied on the authority of *res judicata* attaching to a judgment of 30 April 2018 which had become final, that held that a taxpayer such as UR which practises the profession of lawyer does not engage in any economic activity and, consequently, cannot be regarded as carrying out transactions for the supply of goods or services, as the contracts concluded with its clients are contracts for providing legal aid and not contracts for the provision of services. The appeal was rejected, and the Romanian court requested the CJ for a preliminary ruling.

For VAT purposes, a 'taxable person' is any person who, independently, carries out in any place any economic activity, whatever the purpose or result of that activity is. Any activity of producers, traders or persons supplying services, including the activities of the professions, shall be regarded as an 'economic activity'. Given that the profession of lawyer is a liberal profession, the CJ unsurprisingly ruled that a person practicing such a profession qualifies as a taxable person for VAT purposes. With regard to the principle of *res judicata*, the CJ first clarified that to ensure stability of the law and legal relations, as well as the sound administration of justice, it is important that judicial decisions which have become definitive after all rights of appeal have been exhausted or after expiry of the time limits provided for in that regard can no longer be called into question.

However, if the applicable domestic rules of procedure provide the possibility for a national court to go back on a decision having the authority of *res judicata* in order to render the situation compatible with national law, that possibility must prevail if those conditions are met, in accordance with the principles of equivalence and effectiveness, so that the situation at issue is brought back into line with EU law. Consequently, in the event that the referring court has the possibility, under the applicable procedural rules of Romanian law, of dismissing the action in the main proceedings, it is for that court to make use of that possibility and to ensure that EU law is given full effect and to disapply, on its own authority, the interpretation which it adopted in its judgment of 30 April 2018, because that interpretation is not compatible with EU law.

CJ rules on VAT deduction regarding construction costs (*Stichting Schoonzicht*)

On 17 September 2020, the CJ delivered its judgment in case *Stichting Schoonzicht* ('Schoonzicht') (C-791/18). Schoonzicht had built an apartment complex comprising seven residential apartments. Construction work began in 2013 and the complex was delivered to Schoonzicht in July 2014. As the apartment complex was intended for VAT taxable purposes, Schoonzicht deducted the entire VAT amount regarding the construction costs.

From 1 August 2014, Schoonzicht leased four of the seven apartments in the complex exempt from VAT. The other three apartments remained unoccupied in 2014.

Based on Netherlands VAT law, Schoonzicht was required to fully adjust the VAT deduction initially applied because first use of the apartments (VAT exempt lease) differed from the intended use (VAT taxed purposes). As a result, Schoonzicht had to remit the entire deducted VAT amount attributable to those four apartments to the tax authorities in a single step at the moment the apartments were first put into use.

In the Netherlands, there also exists a capital goods VAT revision scheme, in which the VAT deduction for immovable capital goods (like the apartments in this case) is revised for nine years following the year the goods are first put into use, each year for 1/9 of the total VAT amount charged to the taxable person. Schoonzicht took the position that this capital goods adjustment scheme applied, implying that the VAT deduction should only have been adjusted in parts instead of in one single step for the full amount. This would result in a cash-flow advantage for Schoonzicht.

The Netherlands Supreme Court requested the CJ for a preliminary ruling.

In short, the CJ ruled that the EU VAT Directive does not preclude the Netherlands VAT deduction adjustment scheme for the full amount in the case the intended use differs from the actual use at the moment of first use. The CJ clarified that the VAT exempt lease of the four apartments led to a change in the factors which must be taken into account in order to determine the amount of the initial VAT deduction. Because the actual use resulted in a VAT deduction being higher than that which Schoonzicht was entitled to deduct, the tax authorities must require Schoonzicht to adjust the initial deduction of VAT. Netherlands VAT law prescribes that taxable persons must make this adjustment in a single step for the full amount, which is not precluded by the EU VAT Directive according to the CJ.

CJ rules on concept of taxable person (*XT*)

On 16 September 2020 the CJ issued its judgment in case *XT* (C-312/19). The case deals with the meaning of taxable person for VAT purposes. XT and another person ('partner') entered into a joint activity agreement for the construction of five residential properties in January 2010. In April 2010, XT and his partner decided to purchase a plot of land for the development of these properties. XT alone signed the purchase agreement. XT contributed 30% of the transaction price and the partner 70%.

After that the properties were developed and XT and his partner concluded an agreement terminating the partnership. It was agreed to grant the partner the right to the fourth and fifth buildings. The first, second and third buildings were allocated to XT. XT also undertook to make payment to his partner, this to compensate for the difference between their respective contributions and the difference between the shares of the joint assets falling to them.

In February 2013, XT and his partner signed a deed for the abovementioned division of assets, in which it was stipulated that XT transferred the fourth and fifth buildings to his partner. XT and his partner later decided that XT would sell the fifth building, for which he was entered in the land register as owner, and transferred the sum obtained to his partner. XT and his partner did not consider that the sales of the buildings to third parties constituted an economic activity subject to VAT. As a result, no VAT was charged to the purchasers, nor did XT and his partner deduct the input VAT paid in relation to the construction of the buildings. During a tax audit, the Lithuanian tax authorities took the position that XT acted as a taxable person, ordering him to pay the VAT amount due on those transactions, while at the same time, accepting deduction of input VAT charged by the project development company.

In short, the question put to the CJ by the referring court was whether the party liable for VAT should be XT or the partnership. Article 9(1) of EU VAT Directive states that a taxable person is 'any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity'. Based on settled case law, the CJ clarified that it should be assessed whether XT has carried out an economic activity in his own name, on his own behalf and under his own responsibility, and whether XT bears the economic risk associated with the carrying out of those activities. From the facts at hand, the CJ established that XT acted in the name of both parties to the agreement in relations with third parties, inter alia as regards the supplies at issue. XT did not mention the partner's identity or the partnership at issue, so that, according to the referring court, it is 'highly likely that the persons to whom the supplies were made were unaware that a partner existed'. As a result, the CJ ruled that XT had acted in his own name and on his own behalf, assuming by himself the economic risk associated with the taxable transactions at issue. The formal existence of an agreement such as that setting up the partnership at issue does not preclude independence of a person such as XT when carrying out the economic activity. This implies that XT should have charged VAT on the transfers of the newly developed buildings.

CJ rules on the right to deduct VAT (*Vos Aannemingen*)

On 1 October 2020, the CJ issued its judgment in case *Vos Aannemingen BVBA v Belgische Staat* C-405/19). This case concerns the question whether or not a VAT taxable person may claim input VAT deduction on costs incurred in relation to its own business activities, while these costs also directly benefit third parties.

Vos Aannemingen ('Vos') is a Belgian project developer active in the business of building and selling apartment complexes. These complexes are situated on land that belongs to third parties. Vos had deducted all VAT charged on costs incurred (advertising and administrative costs, and real estate agents' commission fees). These costs also benefitted the landowners.

During a tax audit, the Belgian tax authorities took the position that only the input VAT relating to the sale of the building complexes could be deducted by Vos. According to the authorities, the VAT charged on costs attributable to the land sales was not eligible for deduction because it directly benefitted the activities of the landowners and not Vos. After various national court rulings, each having a different outcome, the Belgian Court of Appeal requested the CJ for a preliminary ruling.

The CJ ruled that Vos is, in principle, entitled to a full VAT refund on the costs incurred because there exists a direct link between the expenditures and Vos' economic activities as a whole. The fact that third parties, like the landowners, also benefitted from the services is not a relevant aspect, provided that their benefit is considered ancillary to Vos' business purposes.

In previous case law from the CJ on this topic (e.g. *Iberdrola Inmobiliaria Real Estate Investments*, C-132/16), the expenditures qualified as general costs. In this case, the costs are directly attributable to particular output transactions. According to the CJ, this circumstance does not lead to a different outcome, provided that the costs maintain a direct link with Vos' taxable transactions. It is for the national court to determine whether that is true.

However, if the national court concludes that part of the services exclusively relates to the sale of the land, the direct link between the services and Vos' taxable transactions would be partially broken, which would result in a lower VAT deduction right for Vos. The fact that Vos has the possibility to on-charge the costs incurred to the landowners provides support to the conclusion that some costs relate to the landowners activities rather than those of Vos. However, in isolation, that element is not sufficient to determine the VAT deduction right. Instead, all the circumstances of the transaction should be taken into account.

CJ rules on scope of VAT exempt insurance transactions (*United Biscuits*)

On 8 October 2020, the CJ issued its judgment in case *United Biscuits (Pension Trustees) Limited and United Biscuits Pension Investments Limited v Commissioners for Her Majesty's Revenue and Customs* (C-235/19).

This case concerns the question whether investment management services supplied by a third-party fund manager to a pension fund trust company should be regarded as VAT exempt insurance transactions.

United Biscuits Pension Fund is a defined benefit pension scheme whose members are the employees of United Biscuits (UK). It is managed by the trustee United Biscuits (Pension Trustees). The trustee entered into a fund management agreement with a third party fund manager. The fund manager manages the investments of the pension scheme on behalf of the trust. According to the trust, these investment management services are exempt from VAT because they qualify as 'insurance services' under various local Insurance Directives. The British tax authorities did not agree with this view.

First, we note that the CJ, in the case *Wheels Common Investment Fund Trustees Ltd* (C-424/11), had already ruled that the VAT exemption for the management of collective investment vehicles does not apply to defined benefit pension schemes, because the employees (i.e., the participants) do not bear any investment risk.

Another way to treat the fund management services as VAT exempt, is by qualifying them as insurance services. In short, the CJ ruled that this, however, is not the case. The very essence of an insurance transaction lies in the fact that the insured protects himself against the risk of financial loss, which is uncertain but potentially significant, by means of a premium payment. Furthermore, insurance transactions necessarily imply the existence of a contractual relationship between the provider of the insurance service and the person whose risks are covered by the insurance. The request for a preliminary ruling clearly states that 'the investment managers do not contract with the applicants to provide any form of indemnification against the materialization of risk', so that the pension fund management services at issue do not entail any assumption of a risk by the investment managers for consideration. Further, the EU VAT Directive does not contain a provision which states that the term 'insurance services' has to be given the same meaning as in local Insurance Directive in the various EU Member States.

CJ rules on VAT exemption for closely related services to social work and social security (*Finanzamt D*)

On 8 October 2020, the CJ issued its judgment in case *Finanzamt D* (C-657/19). This case concerns the interpretation of the VAT exemption for service closely related to social work and social security.

E is a qualified nurse acting as an external advisor to the Medizinische Dienst der Krankenversicherung Niedersachsen ('MDK'). E provided advice on the care needs of patients in order to determine if those patients are entitled to care services at the expense of the health insurance fund. E considered her services exempt from VAT because they are closely related to social security. The German tax authorities disagreed because the services were provided to MDK instead of directly to the patients. In their view, this undermines the close link between E's services and the VAT exempt social security services. Further, the tax authorities also took the position that E is not recognized as a 'social institution' under German VAT law in the case the services do qualify as closely related to social work.

In the first place, the CJ clarified that the nature of a service determines its VAT consequences. If the nature of a service if closely related to social work and social security, the VAT consequences are not any different in the case the service is not directly provided to the patients. Therefore, E's services do qualify as closely related to social work and social security.

However, the application of the VAT exemption is also subject to the condition that the service supplier is recognized as a 'social institution' under national VAT law. In Germany, persons providing services as a subcontractor on behalf of the medical service (MDK) are not recognized as such. Only persons that directly perform services to the health insurance fund, like MDK, are recognized under German VAT law. This means that E's services are taxed with VAT, even though they are closely related to social security.

We note that each EU Member State has a certain degree of VAT policy discretion when it comes down to the interpretation of the concept of 'social institutions'. It could very well be that the services at hand would be VAT exempt in other EU Member States. This depends on the policy choices made by the various Member States

CJ rules on conditions to reclaim the remitted VAT amount to tax authorities (*E. sp. z o.o. sp. K*)

On 15 October 2020, the CJ delivered its judgment, in case *E. sp. z o.o. sp. K* (C-335/19). This case concerns the question under which circumstances a VAT taxable person is entitled to reclaim the VAT amount remitted to a tax authority in case his customer does not pay the invoices issued.

E. sp. z o.o. ('E') provided tax consultancy services in Poland. One of E's customers did not pay the invoices relating to E's services. This debtor was registered as an active taxable person for VAT purposes on the date of provision of the services and at that time was not involved in any insolvency proceedings. Later, the debtor was in the state of liquidation and, therefore, E's invoices remained unpaid. E wished to reclaim the VAT amounts remitted to the tax authorities on these bad debt claims. According to Polish VAT law, a reclaim of VAT on bad debt claims is subject to the condition that the customer is not involved in insolvency proceedings or in liquidation both at the time of the provision of the service and on the day before the submission of the adjustment of the tax return. As a result, E would not be entitled to a VAT refund. The referring court asked the CJ to clarify whether such a national procedure is precluded by EU VAT law.

The CJ ruled that Poland is not allowed to require that the debtor is not involved in insolvency proceedings or in liquidation. Also, it is of no relevance whether that debtor is registered as a VAT taxable person or not. Therefore, E is entitled to reclaim the remitted VAT. This judgment demonstrates that the principle of fiscal neutrality is an important cornerstone of EU VAT and, more specifically, for the VAT rules relating to bad debts.

CJ rules on recovery of input VAT on share acquisition costs for non-realized acquisitions (*Sonaecom SGPS SA*)

On 12 November 2020, the CJ delivered its judgment in case *Sonaecom SGPS SA* (C-41/19). This case concerns the possibility to recover input VAT on share acquisition costs if ultimately, the acquisition does not take place.

Sonaecom SGPS S.A. ('Sonaecom') is a Portuguese holding company. Its business consists of acquiring, holding and managing of shareholdings. Sonaecom also provides strategic management and coordination services to telecom-companies.

Sonaecom intended to acquire the shares in telecom operator Cabovisão. To that end, Sonaecom purchased consultancy services in the form of a market study. Sonaecom also paid a commission fee to an investment bank to organize the placement of a private issue of bond loans. Sonaecom intended to use the capital to make investments in new 'triple play' technology. According to Sonaecom this investment in this 'triple play' technology-segment would take place by acquiring the shares in Cabovisão. Sonaecom intended to provide VAT taxed management services to Cabovisão after the acquisition.

In the end, the acquisition of the shares in the target did not materialize. After it became clear that the acquisition would not take place, Sonaecom decided to make the obtained capital available to its parent company by means of a loan. Sonaecom recovered the input VAT on the consultancy services as well as the commission fee, as it was of the view that those costs were linked to the services it rendered to its subsidiaries. The Portuguese Tax Authorities did not agree with the deduction of the input VAT.

The CJ ruled that Sonaecom can fully deduct the VAT on the consultancy services, as Sonaecom intended to perform VAT taxed activities to the subsidiary (Cabovisão) that was ultimately not acquired. The input VAT deduction is retained, even if the acquisition ultimately does not take place. With regard to the commission charged by the investment bank, the CJ emphasized that Sonaecom had planned to utilize the capital raised through the issue of the bonds for the acquisition of shares in the target. If a taxable person carries out an activity for which there is no input VAT deduction (e.g. granting of loan), rather than the initially intended VAT taxed activity, this actual use of the services has precedence over the original intention.

Consequently, Sonaecom cannot deduct the VAT on the commission fees paid.

CJ rules on conditions for deduction of input VAT (*ITH Comercial Timişoara SRL*)

On 12 November 2020, the CJ delivered its judgment in case *ITH Comercial Timişoara SRL* (C-734/19). ITH Comercial Timișoara SRL ('ITH') is a real estate developer. In 2006, ITH purchased a plot of land and several old buildings from an elevator manufacturer. ITH intended to realize an office tower and shopping center with the aim of renting these out. ITH also agreed with the elevator manufacturer that it would find and furnish a production space, which would be leased to that elevator manufacturer for a period of at least ten years.

As part of this project, ITH acquired measuring activities and consulting services aimed at obtaining the building permit. ITH deducted the VAT amounts on those activities given its intention to apply VAT taxed leases. However, due to the economic crisis in 2008, the projects were delayed and eventually cancelled entirely. Because the projects never materialized, the Romanian tax authorities challenged the input VAT deduction of ITH in relation to these projects.

The CJ ruled that ITH was allowed to deduct input VAT for the originally planned investment projects and that it retain this deduction when these projects are discontinued due to circumstances beyond ITH's control. The deducted VAT amounts are not to be revised, provided that ITH still intended to use the procured goods and services for VAT taxed activities.

CJ rules on UK legislation concerning the cost- sharing exemption in relation to the VAT Group (*Kaplan International colleges UK*)

On 18 November 2020 the CJ issued its judgment in case *Kaplan International colleges UK Ltd v The Commissioners for Her Majesty's Revenue and Customs* (C-77/19).

The case Kaplan International colleges UK ('KIC') concerns the cost-sharing exemption in relation to the VAT Group as well as the cross-border application of this VAT exemption. KIC is the holding company of the Kaplan corporate group, which consists of nine subsidiary companies established in the UK, each running a higher education college. Eight of the international colleges are fully (100%) owned by KIC. KIC owns 45% of the remaining college. KIC and the eight 100%-subsidiaries form a VAT Group in the UK.
The VAT Group provides VAT exempt educational services. The 45% subsidiary is not a part of this VAT Group, because KIC does not possess a majority share.

All nine international colleges recruit their students by deploying recruitment agents from all over the world. They also make use of services from representative offices that provide the agents with promotion, marketing and training services. Prior to October 2014, the agents and the representative offices contracted directly with KIC. KIC had to report and, considering the use of the services for non-VAT-taxable activities, pay reverse charge UK VAT on these services. In October 2014, the nine international colleges established a so-called cost-sharing group in Hong Kong named Kaplan Partner Services Hong Kong Limited ('KPS'). All the individual international colleges were members of this group, KIC itself was not a member.

All KIC's contractual arrangements were transferred to KPS and, after this, the recruitment agents and local representative offices rendered their services directly to KPS. As Hong Kong does not levy VAT, this implied that the services could be procured free of VAT. With regard to the on-charge of the costs incurred by KPS to the international colleges, KIC argued that the VAT exemption for cost-sharing groups applied. Consequently, due to the establishment of the cost-sharing group in Hong Kong, the international colleges no longer paid any VAT on the services formerly provided to KIC. However, the UK tax authorities challenged the application of the cost-sharing exemption and the referring UK court requested the CJ for a preliminary ruling. In a fairly technical judgment, the CJ ruled that the cost-sharing exemption does not apply to services provided to members of a cost-sharing group if (some of) these members are in a VAT Group with other entities that are not a member of this cost-sharing group.

The reasoning behind the judgment is as follows. Services supplied by an independent group of persons (i.e., KPS) to members of a VAT group cannot be regarded as being supplied to those members individually but must be regarded as being supplied to the VAT group as a whole. This VAT Group also included KIC, which was not a member of the cost-sharing group in Hong Kong. The cost-sharing exemption in the EU VAT Directive only applies to supplies of services by independent groups of persons to their members. The cost-sharing exemption does not refer to supplies of services by an independent group of persons to a VAT group whose members are not all members of that independent group of persons. As a result, the cost-sharing exemption does not apply and the VAT Group must declare UK VAT under the reverse charge mechanism, which is not deductible given the use for its VAT exempt educational services.

The referring court also asked the CJ to clarify the territorial scope (i.e., cross-border application) of the cost-sharing exemption. Unfortunately, the CJ did not answer this question in its judgment because it had already concluded that the cost-sharing exemption was not applicable in this case.

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