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Article

VAT Deduction: The Relevance of Being 'The Recipient' of a Supply and the Use of the Supply

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In this article, the author scrutinizes the current state of CJEU case law about VAT deduction on the purchase of goods and services by businesses, where third parties (also) benefit from these purchases. He also discusses case law about the VAT consequences of business funding transactions between two unrelated parties, where they have a financial interest in funding those transactions because they can lead to, for example, an increase of the turnover generated with their own taxed activities. The author comes to the conclusion that under the current provisions of the EU VAT Directive and CJEU case law, VAT deduction is not always allowed where, based on the principles of neutrality and economic reality, it should. He also offers a suggestion for adjusting the current rules in order to solve the issues that were highlighted in this article.

Keywords: EU VAT, Deduction, Benefit, Third-party-payments, Economic activities, Neutrality, Business promotions, Necessary costs

1 Introduction

Under the current EU VAT rules, businesses can deduct the VAT on costs that they incur, insofar as the goods or services they purchased are used for their taxed activities. Recent referrals to the CJEU suggest that if a business incurs costs that also benefit other parties, full VAT deduction could be called into question.

These referrals, which will be elaborated on in this article, seem to build on a case[1] where a private investor who purchased several parcels of land in a holiday village (owned by a municipality) in order to construct apartments for seasonal use, entered into a contract with the municipality for the reconstruction of a pump station that was owned by that municipality. Reconstructing the pump station was essential to the exploitation of the apartments in the holiday village. The CJEU decided that the business could deduct the VAT on the (re)construction services, even though the municipality also benefitted from those services. However, the CJEU also stated that if the reconstruction works relating to that pump station exceeded the needs created solely by the buildings constructed by the business, the existence of a direct and immediate link between that service and the taxed output transaction by the business would be partially broken and a right to deduct (input VAT on the costs) would thus have to be recognized in respect of the business only for the input VAT levied on the part of the costs incurred for the reconstruction of the pump station which was objectively necessary to allow that business to carry out its taxed transactions. This implies that incurring costs that also benefit other businesses can affect the deductibility of VAT on those costs.

This leads to two questions:

Should the (proportion of the) VAT that is not deductible under the above rationale, be deductible by the business that benefits from the supplies? And, in a similar sense, should businesses that incur costs relating to goods or services of which they are not 'the recipient' be allowed VAT deduction if these costs are directly linked to their own taxed output.

An example of the first question can be based the case described above: does the municipality in the Iberdrola-case have the right to deduct the VAT on the part of the costs incurred by the investor that it benefitted from?

An example of the second question would be: can a business that sells coffee pads, deduct the VAT included in a payment for (or contribution towards) a coffee machine that only uses those coffee pads, as manufactured and supplied by a third party to the purchaser of the coffee pads, to stimulate the sale of the coffee pads?

In this article, the following questions will be addressed.

- Should the fact that not only the purchaser of goods or services benefits from these purchases, affect his right to deduct the VAT on the costs of these purchases?
- If the answer to the above is 'yes', should the non-deductible part of the VAT be deductible by the party benefiting from those supplies (provided that he would be able to deduct that VAT if he were 'the formal recipient' of the supplies)?

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1 CJEU 14 Sept. 2017, case C-132/16, *Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' – Sofia v. 'Iberdrola Inmobiliaria Real Estate Investments' EOOD*, ECLI:EU:C:2017:683.

– If the answer to the above is 'yes', does it matter whether the costs incurred by 'the recipient' of the goods or services are reimbursed by these beneficiaries?
– Should a business be able to deduct VAT on the purchase by another person (the formal recipient), where (part of) that purchase is paid/funded by that business for his own taxed business purposes?

2 Reference/test

When answering the above questions, the existing CJEU case law that exist on the topic of deduction of VAT where others that 'the recipient' of the goods or services supplied benefit from those supplies will be scrutinized. For this purpose, these cases will be tested against the most basic principle of VAT: neutrality.

The right to deduct input VAT is a cornerstone of the EU VAT system.[2,3] It is meant 'to relieve the operator entirely of the burden of the VAT paid or payable in the course of all his economic activities'.[4] The right to deduct VAT ensures the neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT.[5]

Neutrality is used in the sense that taxable persons should not bear any net VAT and that VAT should not affect business decisions, distort competition nor cascade throughout the production chain.[6] As such, the right to deduct, which in practice arises at the time when the deductible tax becomes chargeable, thus forms a key part of the VAT mechanism and in principle cannot be limited.[7]

Also, under consistent CJEU VAT case law denotes that, neutrality must be interpreted as a prohibition of differences in treatment of two supplies of services which are identical or similar from the point of view of the consumer and which meet the same needs of the consumer.[8] This can also be interpreted as that VAT may not be a primary driver for business decisions.[9]

In this article, the principle of VAT neutrality will be used in both of its two senses, and will be applied to test to the case law and current practice, as well as to the suggested way forward.

It is relevant to note that when applying these tests, it should be kept in mind that Member States are not allowed to use the neutrality principle as a reason for applying rules that are not in the EU VAT Directive (yet), even if they are 'in the spirit of the EU VAT Directive'. Deviating from the (clear) rules of the EU VAT Directive is, in other words, not allowed to achieve greater neutrality (unless this is specifically allowed under a so-called 'stand-still provision').[10]

3 EU VAT Directive(s)

Under Article 1(2) of the EU VAT Directive,[11] the principle of the common system of EU VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged. On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components. It is clear that under this provision, VAT is considered deductible if incurred on the purchase cost components of the goods or services supplied.

Article 168 of the EU VAT Directive stipulates that:

> *In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled (…) to deduct (…) from the VAT which he is liable to pay: (…) the VAT due or paid (…) in respect of supplies to him* (emphasis by me, JB) *of goods or services, carried out or to be carried out by another taxable person.*

It is clear from this provision that, in order to be allowed VAT deduction, the goods or services must be supplied to the business that wants to deduct that VAT and therefore,

2. *See* e.g. the Opinion of Advocate-General Darmon of 24 June 1992 in case C-131/91, *'K' Line Air Service Europe BV v. Eulaerts NV and Belgian State*, ECLI:EU:C:1992:271, para. 35, the Opinion of Advocate-General Cosmas of 12 Feb. 1998 in case C-361/96, *Société générale des grandes sources d'eaux minérales françaises v. Bundesamt für Finanzen*, ECLI:EU:C:1998:56, para. 21 and the Opinion of Advocate-General Léger of 19 Sep. 2002 in case C-185/01, *Auto Lease Holland BV v. Bundesamt für Finanzen*, ECLI:EU:C:2002:515, para. 8.
3. Also *see* Marie Lamensch, *The Principle of 'Substance Over form' with Respect to the Exercise of the Right to Deduct Input VAT – A Critical Analysis of the Barlis Jurisprudence*, 6(2) World J. VAT/GST L. 129–137 (2017), DOI: 10.1080/20488432.2017.1407126, para. 1.
4. *See* e.g. CJEU 12 July 2012, case C-284/11, *EMS-Bulgaria Transport OOD v. Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' Plovdiv*, ECLI:EU:C:2012:458, para. 43 and the case-law cited, CJEU 21 June 2012, joined cases C-80/11 and C-142/11, *Mahagében Kft v. Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága (C-80/11) and Péter Dávid v. Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága (C-142/11)*, ECLI:EU:C:2012:373, para. 37–38 and the case-law cited and CJEU 8 May 2013, case C-271/12, *Petroma Transports SA and Others v. État belge*, ECLI:EU:C:2013:297, para. 22.
5. *Ibid.*
6. Van Doesum, Van Kesteren & Van Norden, *Fundamentals of EU VAT Law* 348 (Kluwer 2016).
7. *See* e.g. CJEU 8 May 2008, joined cases C-95/07 and C-96/07, *Ecotrade SpA v. Agenzia delle Entrate – Ufficio di Genova 3*, ECLI:EU:C:2008:267, para. 39 and the case-law cited, and CJEU (12 July 2012) and CJEU 22 Dec. 2010, case C-438/09, *Bogusław Juliusz Dankowski v. Dyrektor Izby Skarbowej w Łodzi*, ECLI:EU:C:2010:818, para. 24.
8. R. de la Feria, *VAT: A New Dawn for the Principle of Fiscal Neutrality?,* Oxford University Centre for Business Taxation 5–6 (2011). De la Feria refers tot his form of neutrality as 'VAT uniformity'.
9. *See* e.g. the OECD International VAT/GST Guidelines as completed on the third meeting of the OECD Global Forum on VAT on Nov. 5–6, 2015 in Paris, Guideline 2.3.
10. CJEU 5 Dec. 1989, case C-165/88, *ORO Amsterdam Beheer BV and Concerto BV v. Inspecteur der Omzetbelasting Amsterdam*, ECLI:EU:C:1989:608.
11. Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax, OJ L 347, (11 Dec. 2006), at 1–118, as last amended by Council Directive (EU) 2020/285 of 18 Feb. 2020, ST/14527/2019/INIT, OJ L 62, (2 Mar. 2020), at 13–23.

apparently, not to someone else. Also, these goods or services must be used for the purposes of the taxed transactions of that taxable person.

The first requirement is about the status of the business that wants to deduct VAT (he must be 'the recipient' of the goods or services), the second requirement is about the capacity of the business: it must acquire the goods for its taxed business activities, which means that, as a recipient, it should be acting in its capacity of a business that performs taxed activities.

The two questions that this article aims to answer, are not answered by these provisions.[12] Article 168 seems to imply that a business can deduct the VAT on costs if the costs relate to the purchase of goods or services that it uses for its own taxed activities, but does not make clear what should be done if other parties also benefit from these purchases. It is, however, clear that this provision does not allow VAT deduction if a business cannot be considered the recipient of the relevant goods or services. However, a business is considered the recipient of a good or service that it subsequently (partially or fully) provides for free to another (taxable or non-taxable) person.

4 CJEU CASE LAW

First of all, it is clear from CJEU case law that for determining who is 'the recipient' of a service,[13] the legal agreement regarding that supply is leading.[14] This can (only) be different where it is clear that 'economic reality' differs from that 'legal reality' or in case of 'abuse of law'.[15] With regard to the supply of goods, the recipient of the goods is the party to which the right to dispose of those goods as owner, is transferred.[16]

Relevant existing CJEU case law on deduction where the recipient is not the only party benefiting from a supply can be divided into three categories:

- case law about the taxation of having third parties enjoy a business' assets free of charge and the effect thereof on VAT deduction,
- case law about the deductibility of VAT on purchases that are also used by third parties where that use is not taxed (see the first bullet) and
- recent case law about the deductibility of VAT on purchase that are made on behalf of a third party, where it can be argued that the purchaser is acting as an agent.

4.1 Case Law Related to Purchases that Also Benefit Another Party, Focusing on the VAT Consequences of the Supply of that 'Free Benefit'

There is a large volume of case law on businesses that purchase goods or services that they subsequently put at the disposal of third parties free of charge. This can be either a free supply of goods or a free service. The free supply of other services are covered by similar VAT rules.

Under the EU VAT Directive, the disposal free of charge of goods forming part of a taxable person's business assets, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.[17] Also, both the use of goods forming part of the assets of a business for purposes other than those of his business, where the VAT on such goods was wholly or partly deductible, and the supply of services carried out free of charge by a taxable person for purposes other than those of his business shall be treated as a supply of services for consideration.[18]

It is settled case law that businesses that perform activities that are covered by the above provisions are allowed VAT deduction for that reason, even though – at least for the supply of goods – to get to taxation requires VAT to be deducted.[19] However, for businesses that don't have a full VAT recovery right, this taxed use does not allow full VAT deduction but only partly (applying their 'pro rata' VAT deduction).[20] This means that businesses can deduct VAT *because* they perform these activities that are deemed to be taxed. The VAT status of the recipient of the supplies is irrelevant for the application of these provisions.[21] These provisions only apply where the free supplies of goods or services lead to private consumption, and not if these activities are outside the scope of VAT or non-economic activities.[22] Note that the application of business assets free of charge can always lead to taxation, whereas the free use of those

[12] In the same sense: André Mendes Moreira, *The Direct and Immediate Link with Specialised Services Contracts as a Measure for the Right to Deduct Input VAT and the Uncertainty in Europeans Tax Law*, 8(1–2) World J. VAT/GST L. 1–16 (2019), DOI: 10.1080/20488432.2019.1670027.

[13] Also *see* M. M. W. D. Merkx, *Haagse rechtsbetrekking versus Luxemburgse beschikkingsmacht*, WFR 2016/33 and M. M. W. D. Merkx, *Afnemer in de btw: wie is het?*, WFR 2012/1011.

[14] *See* e.g. CJEU 3 May 2012, case C-520/10, *Lebara Ltd v. Commissioners for Her Majesty's Revenue & Customs*, ECLI:EU:C:2012:264, and CJEU 20 June 2013, case C-653/11, *Her Majesty's Commissioners of Revenue and Customs v. Paul Newey*, ECLI:EU:C:2013:409.

[15] *See* e.g. CJEU 20 June 2013, case C-653/11, *Her Majesty's Commissioners of Revenue and Customs v. Paul Newey*, ECLI:EU:C:2013:409 and CJEU 21 Feb. 2006, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, ECLI:EU:C:2006:121.

[16] *See* Art. 14 of the EU VAT Directive and, e.g. CJEU 6 Feb. 2003, case C-185/01, *Auto Lease Holland BV v. Bundesamt für Finanzen*, ECLI:EU:C:2003:73 and CJEU 27 Mar. 2019, case C-201/18, *Mydibel SA v. État belge*, ECLI:EU:C:2019:254.

[17] Article 16 of the EU VAT Directive.

[18] Article 26 of the EU VAT Directive.

[19] CJEU 11 July 1991, case C-97/90, *Hansgeorg Lennartz v. Finanzamt München III*, ECLI:EU:C:1991:315, para. 26.

[20] CJEU 23 Apr. 2009, case C-460/07, *Sandra Puffer v. Unabhängiger Finanzsenat, Außenstelle Linz*, ECLI:EU:C:2009:254.

[21] CJEU 30 Sept. 2010, case C-581/08, *EMI Group Ltd v .The Commissioners for Her Majesty's Revenue and Customs*, ECLI:EU:C:2010:559, para. 22.

[22] CJEU 12 Feb. 2009, case C-515/07, *Vereniging Noordelijke Land- en Tuinbouw Organisatie v. Staatssecretaris van Financiën*, ECLI:EU:C:2009:88.

assets or the provision of other free supplies by a business only leads to taxation if performed '*for purposes other than those of his business*'.

Taxing these transactions has the same effect as (partially[23]) disallowing deduction on the purchase of the business assets or the services, since the taxable amount for these activities is the purchase price of the goods or of similar goods or, in the absence of a purchase price, the cost price, determined at the time when the application, disposal or retention takes place where it concerns the disposal of business assets free of charge,[24] and the full cost to the taxable person of providing the services in case of free services.[25] Remitting VAT on the purchase price has the same financial effect as not deducting the same VAT amount on the purchase (price).[26]

4.2 Case Law about the Deductibility of VAT on Purchases that are (Also) Used by Third Parties, Where that Use Is Not Taxed

The case law about purchases by a business where third parties also benefit, without taxing that benefit, is less uniform.

The Becker-case[27] dealt with a business that had contracted and paid for the services of a law firm that defended the business' majority shareholder and managing director, Mr Becker, who was accused of bribery or aiding and abetting (for the benefit of the business). Mr Becker and the business were included in a VAT group (an 'Organschaft'). The lawyers addressed their invoices to the business, and Mr Becker, as controlling entity of the Organschaft, deducted the VAT charged on those invoices. The CJEU decided that the existence of a direct and immediate link between a given transaction and the taxable person's activity as a whole for the purposes of determining whether the goods and services were used by that person 'for the purposes of taxable transactions' depends on the objective content of the goods or services acquired by that taxable person. In this case, the supplies of lawyers' services, whose purpose is to avoid criminal penalties against natural persons, managing directors of a taxable undertaking, did not give that undertaking the right to deduct as input tax the VAT due on the services supplied. The CJEU founded its decision on the fact that the criminal proceedings were brought against Mr Becker solely in a personal capacity, and not against the business.[28] Also, even though the supplies would not have been performed by the lawyers at issue if the business had not exercised an activity which produced turnover and, consequently, which was taxable, there would be a causal link between the costs relating to those services and the business' economic activity as a whole, the CJEU found that that causal link cannot be considered to constitute the direct and immediate link that is required for VAT deduction.[29]

In the PPG-case,[30] a business had set up a pension fund for its employees. The pension fund was separate from the business. The business entered into contracts with suppliers of services relating to the administration of the pensions and the management of the assets of the pension fund. The costs associated with those contracts were paid by that business and not passed on to the pension fund. The CJEU held that '*in those circumstances, it may be considered that the exclusive reason for the acquisition of the input services lies in the taxable person's taxable activities, and that there is a direct and immediate link*'.[31] The CJEU decided that the business was entitled to deduct the VAT it had paid on services relating to the management and operation of the pension fund, provided that the existence of a direct and immediate link is apparent from all the circumstances of the transactions in question.[32] Some scholars point out that the CJEU seems inconsistent in applying the appropriate tests for the 'direct and immediate link' and that a 'consumption based test' cannot coexist with an 'economic based test'.[33] In its latter case law, as described below, the CJEU seems to make a choice for the 'economic based test'.[34]

The Sveda-case[35] dealt with a business whose activities consisted in the provision of accommodation, food and beverages, the organization of trade fairs, conferences and leisure activities, as well as the engineering and consultation associated with those activities. Sveda undertook to implement a project entitled 'Baltic mythology recreational (discovery) path' and to offer the public access to it free of charge. A national agency committed itself to assuming a share of up to 90% of the costs of implementing the project, with the remaining

[23] Insofar as the business assets are put at the disposal of a third party free or charge or the goods are used free of charge for other than business purpose, or the services are provided free of charge for other than business purposes.

[24] Article 74 of the EU VAT Directive.

[25] Article 75 of the EU VAT Directive.

[26] Unless the VAT is due in a different jurisdiction than the one where the VAT was deducted – if this is possible. This is, however, outside the scope of this article.

[27] CJEU 21 Feb. 2013, case C-104/12, *Finanzamt Köln-Nord v. Wolfram Becker*, ECLI:EU:C:2013:99.

[28] *Ibid.*, para. 30.

[29] *Ibid.*, para. 31.

[30] CJEU 18 July 2013, case C-26/12, *Fiscale eenheid PPG Holdings BV cs te Hoogezand v. Inspecteur van de Belastingdienst/Noord/kantoor Groningen*, ECLI:EU:C:2013:526.

[31] *Ibid.*, para. 26.

[32] *Ibid.*, para. 29.

[33] Dennis Ramsdahl Jensen & Henrik Stensgaard, *The Direct and Immediate Link Test Regarding Deduction of Input VAT: A Consumption-based Test Versus an Economic-based Test?*, 3(2) World J. VAT/GST L. 71–87 (2014), DOI: 10.5235/20488432.3.2.71.

[34] In the same sense: Oskar Henkow, *Sveda – The Increasing Obscurity of the Direct Link Test in EU VAT*, 5(1) World J. VAT/GST L. 48–54 (2016), DOI: 10.1080/20488432.2016.1155821, para. 3.

[35] CJEU 22 Oct. 2015, case C-126/14, *UAB 'Sveda' v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*, ECLI:EU:C:2015:712.

expenses to be covered by Sveda. Sveda deducted the VAT relating to the acquisition or production of certain capital goods as part of the construction work on the recreational path concerned. Doubts were raised as to whether there is a direct and immediate link between the input transactions and Sveda's planned economic activity as a whole, owing to the fact that the capital goods concerned are directly intended for use by the public free of charge. The CJEU holds that, given that the expenditure incurred by Sveda in creating that path can be linked to the economic activity planned by Sveda, that expenditure does not relate to activities that are outside the scope of VAT. Therefore, immediate use of capital goods free of charge does not, in circumstances such as those in the main proceedings, affect the existence of the direct and immediate link between input and output transactions or with the taxable person's economic activities as a whole and, consequently, that (free of charge) use has no effect on whether a right to deduct VAT exists.

It seems apparent that this case is different from the Becker-case and why that would warrant a different outcome. In the Becker-case, the CJEU found no link between the expenses used for the personal benefit of a shareholder/general manager of a business and the business' own economic activities. The Sveda-case could be compared to a large shop that purchases a plot of land on which it has a car park built that may be used by shoppers (and other people) free of charge. It is clear that the use of the car park is aimed at facilitating the taxed economic activities of the business. VAT on the costs should, therefore, be deductible. The free of charge use, in other words, is aimed at generating taxed turnover. This means that putting the mythology recreational path at the disposal of the general public free of charge is not a taxable transaction by Sveda under the provisions of the EU VAT Directive,[36] because this is clearly not done 'for other than business purposes'.[37] This means that a right to deduct input VAT exists, without an obligation to pay output tax on the actual use of the path. As the CJEU mentions, these costs are deemed to be included in the cost price of the activities that Sveda performs for consideration.[38]

In the Iberdrola-case,[39] a private investor, Iberdrola, purchased several parcels of land in a holiday village in order to construct buildings containing apartments for seasonal use. Iberdrola entered into a contract with the municipality on whose territory the future holiday village was to be located, for the reconstruction of a pump station that is to serve that holiday village. The pump station was owned by the municipality, and the municipality had obtained a permit to reconstruct that pump station to serve the holiday village. Iberdrola commissioned the works on the municipality's pump station from a third party company. Following completion of the works, the buildings which Iberdrola planned to construct in the holiday village could be connected to the pump station. Without the agreed reconstruction of the pump station, that connection would be impossible since the existing sewer system was insufficient. The CJEU held that the relevant circumstances were likely to demonstrate the existence of a direct and immediate link between the reconstruction service in respect of the pump station belonging to the municipality and a taxed output transaction by Iberdrola, since it appears that the service was supplied in order to allow Iberdrola to carry out the construction project at issue in the main proceedings. The fact that the municipality also benefitted from that service cannot justify the right to deduct corresponding to that service being denied to Iberdrola (provided that the existence of such a direct and immediate link is established).[40] Therefore, Iberdrola was allowed VAT deduction. However, the CJEU added that the referring court should examine whether that service was limited to that which was necessary to ensure the connection of the buildings to the pump station or whether that service went beyond that which was necessary for that purpose.[41] On other words, if the reconstruction works relating to that pump station exceeded the needs created solely by the buildings constructed by Iberdrola, the existence of a direct and immediate link between that service and the taxed output transaction by Iberdrola, consisting of the construction of those buildings, would be partially broken and a right to deduct would thus have to be recognized in respect of Iberdrola only for the input VAT levied on the part of the costs incurred for the reconstruction of the pump station which was objectively necessary to allow Iberdrola to carry out its taxed transactions.[42] This means that it should be ascertained whether purchasing goods or services that also benefit a third party constitutes providing (part of) that purchase for free to that third party, allowing full VAT recovery, but possibly leading to a VAT liability as a result of that transaction.

As the Iberdrola-case concerns the interpretation of Article 168 of the EU VAT Directive,[43] which (as mentioned in section 4) stipulates that:

> *In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person (emphasis by me, JB), the taxable person shall be entitled (…) to deduct (…) from the VAT which he is liable to pay: (…) the VAT due or paid (…) in*

[36] Article 26 of the EU VAT Directive.

[37] *See* Henkow *supra* n. 34, para. 5, where he states the following: '*So, the question is not whether a full right to deduct exists but whether, in a Sveda situation, there should or should not be a use for other purposes than the business present*'.

[38] CJEU in the Sveda-case, *supra* n. 35, para. 30.

[39] The Iberdrola-case, *supra* n. 1.

[40] *Ibid.*, paras 33–35.

[41] *Ibid.*, para. 37.

[42] *Ibid.*, para. 39.

[43] *Ibid.*, para. 20.

respect of supplies to him of goods or services, carried out or to be carried out by another taxable person

The CJEU seems to say that businesses cannot deduct VAT on costs that they do not use for the purpose of their own taxed transactions, but where only another party benefits from these costs. The case seems not to concern instances where a business incurs a possibly unnecessarily high amount of costs for its own business activities, because the CJEU is not to judge a taxable person's way of conducting its business, as long as there is no 'abuse of law'. This means that, in the author's view, a hairdresser cannot be denied VAT deduction on the purchase of, let's say, a set of diamond encrusted golden scissors, as long as he uses them for his taxable business. This is different where the 'excess' costs are not used for the purpose of the taxed transaction of the taxable person, but, for example, for the benefit of another party. As in the above Sveda-case, the services provided to Iberdrola leading to the pump station of the municipality being upgraded for free did not constitute a taxable service performed free of charge by Iberdrola to that municipality.[44]

From the above cases, it is clear that VAT on costs incurred by a business as a recipient of those services can be deducted, as long as those costs relate to a supply of goods and or services that the business uses in the furtherance of its own taxable activities. The fact that other parties (directly) benefit from these purchases as well, should not affect the recoverability of VAT on those costs, unless (part of) the costs are not attributable to the economic activities of the business, but where these costs were incurred for the (sole) benefit of another party.

4.3 Case Law about the Deductibility of VAT on Purchases that are Made on Behalf of a Third Party, Where It Can Be Argued that the Purchaser Is Acting as an 'Agent'

In this subsection a recent CJEU ruling is discussed, where the CJEU allowed VAT deduction on the purchase of a service made on behalf of a third party, because it could be argued that a provision from the EU VAT Directive applies that deems this to be a purchase of the service followed by a subsequent supply of the same service.

In the Amărăşti-case,[45] the CJEU was asked to rule on whether a business that had availed itself of the services of a land-registration company for the purposes of the first registration of land – that it wished to purchase – in the Land Register, which was an act that the local legislation required the seller of the land to do. The costs linked to the first registration of that land in the Land Register, which the parties to the contract valued by common accord at EUR 750 per hectare, were not re-invoiced to the vendor. The promises to sell the land stated that Amărăşti was to pay the vendor the full price of the land, which did not include the value of the land-registration operations.[46] Amărăşti had deducted the VAT on those costs in full. The local tax authorities argued that Amărăşti had performed a service on to the vendor, the cost of which should be borne by the vendor. The CJEU looks into the question whether Amărăşti, in the context of a bilateral promise for the sale of immovable property not registered in the Land Register, the purchaser – a taxable person – who, as Amărăşti contractually undertook to do with regard to the vendor in that promise, carries out the necessary steps for the first registration of the immovable property concerned in that register by having recourse to the services provided by third parties who are taxable persons, is deemed to have supplied the services in question himself or herself to the vendor, within the meaning of Article 28 of the EU VAT Directive, even though the parties to the contract agreed that the sale price of that property does not include the value of the land-registration operations. What the CJEU basically has to answer, is the question whether in this case Amărăşti acted in its own name but on behalf of the seller of the land, thereby being deemed to have received and supplied those services itself.[47] The CJEU ruled that VAT in this case Amărăşti acted in its own name but for the account of another entity, and that therefore Amărăşti was deemed to purchase and then supply the underlying services. The CJEU seems to argue that a taxable person can also act 'on behalf of another person' in the sense of that provision (as a result of which he is deemed to have received and supplied the service) where he does so for no consideration.[48] This 'deemed' transaction would allow VAT deduction, according to the CJEU.[49]

It is unclear how a business can perform a service free of charge, as the CJEU finds in the Amărăşti-case, and still be allowed full recovery of the VAT on the costs relating to that service. Article 26 of the EU VAT Directive would lead to a free of charge service being taxed, but only if that service is performed for other than business purposes. In this case, Amărăşti incurred the costs for business purposes and performed its 'deemed' supply to the vendor for business purposes as well. Therefore, taxation cannot be achieved through a combination of Articles 28 and 26 of the EU VAT Directive. Is it, then, sufficient that Amărăşti incurred the costs for its own economic activities, even though the vendor benefitted from Amărăşti's purchases and the CJEU

[44] *Ibid.*, paras 22–23.

[45] CJEU 19 Dec. 2019, caseC-707/18, *Amărăşti Land Investment SRL v. Direcţia Generală Regională a Finanţelor Publice Timişoara and Administraţia Judeţeană a Finanţelor Publice Timiş*, ECLI:EU:C:2019:1136.

[46] *Ibid.*, para. 20.

[47] *Ibid.*, para. 36.

[48] *Ibid.*, para. 42.

[49] *Ibid.*, paras 44–46.

holds that Amărăşti performed a service to that vendor? It can be argued that the fact that Amărăşti purchased the services for its own taxed economic activities should have sufficed to allow it VAT deduction. As in the Iberdrola-case above, the fact that the services were also to the benefit of another party does not affect that right to deduct the VAT on those costs. Or is it now possible to argue that if Iberdrola would have purchased services that exceeded its own needs, that it acted in its own name but on behalf of the municipality, therefore allowing Iberdrola full VAT recovery anyway? This seems not to be the case. In the author's view, the Amărăşti-case should only be applied to situations where a business agrees to undertake activities that, by law, someone else should have performed. This business is therefore deemed to act in its own name but on behalf of someone else. However, this is not completely clear form the wording of the ruling in the Amărăşti-case. The neutrality principles described in section 3 would require the VAT on the costs incurred by Amărăşti to be fully recoverable, because the purchased services were all used for fully taxable transactions.

4.4 Pending Cases/references to the CJEU on VAT Deduction

Courts from Belgium and Germany referred preliminary questions to the CJEU that resemble the Iberdrola-case. In the Vos Aannemingen-case,[50] two parties jointly sell immovable property: the owner of the land and the business that built a building on that land. The latter agrees to contract the real estate agents to help sell the properties and the public notaries that are involved in the sales. The VAT on these costs is fully deducted by that business. The Belgian tax authorities argue that part of these costs should be borne by the owner of the land, and that the business that built the properties can only deduct the VAT insofar as it is related to the sale of the building, and not for the sale of the land.

In the Mitteldeutsche Hartstein-Industrie-case,[51] a German company (MHI) wants to operate a quarry agrees with a German municipality that it is allowed to do so. As part of the agreement, MHI will have to upgrade a public road, owned by that municipality, so that it can operate the quarry. However, since it is a public road, all other traffic will be allowed on it as well, free of charge. The German Tax Authorities argue that MHI has no right to deduct the VAT on the costs of upgrading the road.

Based on the above case law of the CJEU, the businesses incurring the costs in both cases should have at least a partial right to VAT deduction. A full deduction right should only be disallowed if it can be established that part of the costs were not made for the economic activities of the business incurring the costs, but solely for the benefit of someone else, as suggested in the Iberdrola-case. Prima facie, it seems that the Vos Aannemingen case would lend itself to a partial VAT recovery restriction under the 'Iberdrola-rule' better than the Mitteldeutsche Hartstein-Industrie-case, although full VAT recovery can be argued in both cases.

As mentioned above, the neutrality principles described in section 3 would require the VAT on the costs incurred by both Vos Aannemingen and MHI to be fully recoverable, because the purchased services were all used for fully taxable transactions. Based on the Amărăşti-case, it could possibly be argued that Vos Aannemingen incurred the costs in its own name but (also) on behalf of the sellers of the land, allowing Vos Aannemingen full VAT deduction.

5 Answering the remaining questions

In section 2, the following questions were asked that needed answering:

- Should the fact that not only the purchaser of goods or services benefits from these purchases, affect his right to deduct the VAT on the costs of these purchases?
- If the answer to the above is 'yes', should the non-deductible part of the VAT be deductible by the party benefiting from those supplies (provided that he would be able to deduct that VAT if he were 'the formal recipient' of the supplies)?
- If the answer to the above is 'yes', does it matter whether the costs incurred by 'the recipient' of the goods or services are reimbursed by these beneficiaries?
- Should a business be able to deduct VAT on the purchase by another person (the formal recipient), where (part of) that purchase is paid/funded by that business for his own taxed business purposes?

Based on the above CJEU case law, the first question can be answered with 'no, unless the costs are made solely for the benefit of a third party and do not relate to the economic activities of the business incurring the costs itself'. The answer to the other three questions cannot be found in the case law as described above.

The second question is: should the non-deductible part of the VAT be deductible by the party benefiting from the supplies, provided that he would be allowed VAT deduction of he were the 'formal recipient' of those supplies?

Given the fact that, under consistent CJEU case law and under the principle of neutrality,[52] VAT should not be a burden to business in a chain of transactions

[50] Request for a preliminary ruling lodged on 24 May 2019 in case C-405/19, *Vos Aannemingen BVBA v. Belgische Staat*.

[51] Request for a preliminary ruling lodged on 10 July 2019 in case C-528/19, *Mitteldeutsche Hartstein-Industrie*.

[52] *See* e.g. A. J. van Doesum, H. W. M. van Kesteren & G. J. van Norden, *Fundamentals of EU VAT Law*, 37 (Alphen aan den Rijn: Kluwer Law International 2006) and J. B. O. Bijl, *The EU VAT Treatment of Vouchers in the Light of Promotional Activities (Fiscale Monografieën* (No. 157) (diss. Tilburg)), 23 (Deventer: Wolters Kluwer 2019).

involving taxable businesses, the answer to that question is 'yes'. VAT should not be a burden by it being not fully deductible, if this VAT is incurred on costs that are solely used for the taxed activities of businesses. Wittock agrees, where she states that:

> *the CJEU follows a more economic approach and accepts that taxable persons may also deduct the VAT incurred on "free supplies" when these are made in support of a taxed activity. In accordance, where free additional value is supplied as a sales promotion technique and is made in support of a taxed activity, a sales promotor's VAT position should not be impacted. (…). Where a company (…) make(s) expenditure for (…) for business purposes, VAT should be deductible.*[53]

For substantiation of this view, the (also) refers to the case law described in this article.

Clearly, the formal requirements for VAT deduction under the current EU VAT rules are not met in this case, since the party that would want to deduct the part of the VAT on the costs attributable to its own taxed activities is not considered 'the recipient' of those supplies.

Un the UK, the Tax Authorities allow VAT deduction by the recipient of a free supply that is deemed taxable under Article 16 or Article 26 of the EU VAT Directive, if that recipient would be allowed VAT deduction if he would have made the initial purchase himself.[54] This scheme does, however, require taxation at the level of the supplier in order to get to deduction at the level of the recipient, and the deemed taxed supply would allow full deduction at the level of the supplier in the first place. Be that as it may, this scheme does demonstrate that at least one EU Member State disregards formal requirements and allows VAT deduction that results in avoiding non-deductible VAT being paid on transactions between fully taxable businesses.

The next question that needs to be answered is: does it matter whether the costs on which part of the VAT was not deductible under Iberdrola, are recharged to the entity benefiting from these costs. This should not be necessary in a fully neutral principle-based VAT system.

Whether or not costs are recharged may be relevant for determining who should be entitled the VAT recovery. From an economic standpoint, only the party that actually bares the cost of VAT should be allowed to deduct it (assuming the relevant substantial requirements are met). Therefore, if a business incurs costs that also benefit a third party, this third party should only be allowed VAT deduction on the part of the costs that it benefits from, if he also bears those costs. This implies that in that case, the original recipient of the service should be allowed full VAT recovery, assuming that it can be argued that the full amount of the costs were incurred for performing his own taxable activities.

Recharging costs could be considered purchasing a good or a service and then supplying (part of) that same good or service to the entity that also benefited from it. The Amărăşti-case, as described earlier, definitely provides grounds for this view. If the CJEU is of the view that in certain cases, a business is even deemed to have performed a transaction in its own name but on behalf of someone else without an actual consideration for the supply made to that 'someone else', this can definitely be upheld for situations where the intermediary business charges a consideration for the use of part of the supply made to him. Further support can be found in other CJEU case law, where the court held that services supplied indirectly to a third party, and invoiced to a middle party who in turn invoices them to the third party, is considered to be two supplies of the same service.[55]

If recharging the service can be considered the supply of that service, the recharging entity, by definition, performs a taxable transaction. The VAT on costs attributable to that taxable transaction should be fully deductible. This means that even though VAT should always be fully deductible by the businesses that use supplies for their taxed activities, this is already the case under the current rules, if (part of) the goods or services are recharged to the actual beneficiary of the underlying supply and that recharge can be considered consideration for a taxed supply.

In brief, the answer to the third question is: it shouldn't matter whether costs are recharged, but under the current rules, it does.

The next question is: should a business be allowed VAT recovery where, in the interest of his own (taxable) business, it makes a 'third party payment' by (partly) funding a supply made by another business (and not being part of the production and distribution chain for that goods) to a third party.

The example of this situation, as given in section 1 of this article, was a business that sells coffee pads, and that want to deduct the VAT included in a payment for (or contribution towards) a coffee machine that can only use those coffee pads, as manufactured and supplied by a third party to the purchaser of the coffee machine, to stimulate its own sales of coffee pads.

The business selling the coffee pads is not the purchaser or the 'recipient' of the coffee machine. However, it is willing to pay (part of) the consideration for the supply of the coffee machine because it is aimed at increasing its own taxable sales of coffee pads. It is, therefore, an expense made in its capacity of a taxable

[53] Nathalie Wittock, *Sales Promotion Techniques and VAT in the EU* 330 (Kluwer 2019).

[54] Business promotions (VAT Notice 700/7), Find out how to account for VAT schemes on business gifts, samples and promotional schemes, published 28 May 2012, from: HM Revenue & Customs, para. 2.4, to be found on, https://www.gov.uk/guidance/business-promotions-and-vat-notice-7007 (accessed 9 July 2020).

[55] CJEU 15 Mar. 2001, case C-108/00, *Syndicat des Producteurs Indépendants (SPI) v. Ministère de l'Économie, des Finances et de l'Industrie*, ECLI:EU:C:2001:173.

business. As in the previous cases, the business selling the coffee pads benefits from the supply of the coffee machine, and he pays for (part of) that supply.

The CJEU has decided in the Ibero Tours-case[56] that a business that partly pays for the supply made by a business to an end consumer, because this will increase his taxed turnover, is not allowed to decrease the taxable amount for his own supplies with the amount paid 'as a discount for the underlying supply'. Such lowering of his VAT taxable amount would, financially, have had the same effect as a deduction of the VAT included in his payment for that supply. The business selling televisions from the example is, therefore, not allowed to lower the taxable amount for the supply of a television by the amount paid for the furniture.

Since the business selling the coffee pads is not the recipient of the coffee machine, it cannot deduct the VAT due on the supply of that machine either. This would have been different if the coffee machine would have been supplied to him, and if he had then included the coffee machine in the sale of a certain amount of coffee pads. Provided that part of the consideration could therefore be allocated to the supply of the coffee machine, the business would have had a full recovery right. Even if he would have sold the coffee machine at a discount, i.e. at a the retail price less the amount of the payment that he would have made in the original scheme, full VAT recovery would still be allowed. Economically and financially, the two scenarios are the same. For VAT purposes, however, they lead to different outcomes. This difference is not in line with neutrality. In a principle-based VAT system, the supplier of the coffee pods should be allowed to deduct the VAT included in his ('third party') payment towards the coffee machine.[57] However, the current provisions within the EU VAT Directive and CJEU case law don't allow this.

In order to solve the issues described above, the author would suggest an adjustment to the EU VAT Directive, allowing businesses that make payments in the furtherance of their taxed activities to deduct the VAT in those payments much more broadly than they are currently allowed.[58] Also, where multiple businesses benefit from a single supply to one of those businesses, but where that supply is used solely for the taxed activities of all businesses involved, no VAT recovery restriction should apply. This would mean either allowing full VAT deduction by the recipient of the service, or allowing all entities paying for the supplies to deduct the VAT included in their payments.[59] The Dutch Ministry of Finance currently allows such 'joint deduction' in very specific cases where businesses share the use of a business asset is purchased by one of them or where services are procured by one of the parties or performed by one of the parties and used by all parties involved, and where the parties have agreed upfront to bear a fixed part of these 'costs for joint account' that should be distributed between the parties without adding any mark-up.[60] Allowing deduction of VAT paid by businesses in the furtherance of their taxed economic activities could be achieved by including a provision in the EU VAT Directive where such businesses are deemed to be the recipients of the relevant supplies they (co-)fund. These suggestions are in line with economic reality, and they are in line with the mechanism and purpose of the EU VAT system.

[56] CJEU 16 Jan. 2014, case C-300/12, *Finanzamt Düsseldorf-Mitte v. Ibero Tours GmbH*, ECLI:EU:C:2014:8.

[57] In the same sense, *see* Wittock, *supra* n. 53, at 331.

[58] In the same sense, *see* Bijl, *supra* n. 52, at 164 and Wittock, *supra* n. 53, at 332.

[59] The author refers to this as 'joint payment, shared deduction' in Bijl, *supra* n. 52, at 164.

[60] Decree of 25 Nov. 2011, Nr. BLKB 2011/641M, Aftrek van omzetbelasting, Staatscourant 2011, 21834, para. 6.3.3.