LOYENS LOEFF

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EU **Tax Alert**

- ECOFIN Council reaches agreement for exchange of information by digital platforms (*DAC7*)
- Commission concludes that Madeira Free Zone regime is in breach of State Aid rules
- 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
- CJ rules on recovery of input VAT on share acquisition costs for non-realized acquisitions (*Sonaecom SGPS SA*)

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Highlights in this edition

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Contents

Highlights in this edition

- ECOFIN Council reaches agreement for exchange of information by digital platforms (*DAC7*)
- Commission concludes that Madeira Free Zone regime is in breach of State Aid rules
- 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
- CJ rules on recovery of input VAT on share acquisition costs for non-realized acquisitions (*Sonaecom SGPS SA*)

Direct taxation

- Report on the implementation of ATAD
- Council Conclusions on Fair and Effective Taxation in Times of Recovery
- AG Hogan opines that Finnish legislation on taxation of distributions of income from UCITS is not in breach of EU law (*E*)
- AG Hogan opines on Portuguese legislation regarding taxation of capital gains on immovable property derived by non-residents (*MK*)

VAT

- CJ rules on VAT deduction regarding construction costs (*Stichting Schoonzicht*)
- CJ rules on VAT deduction on development of roads (Mitteldeutsche Hartstein-Industrie AG)
- CJ rules on concept of taxable person (*XT*)
- CJ rules on the right to deduct VAT (*Vos Aannemingen*)
- CJ rules on scope of VAT exempt insurance transactions (*United Biscuits*)
- CJ rules on VAT exemption for closely related services to social work and social security (*Finanzamt D*)
- CJ rules on conditions to reclaim the remitted VAT amount to tax authorities (*E. sp. z o.o. sp. K*)
- CJ rules on conditions for deduction of input VAT (*ITH Comercial Timişoara SRL*)
- CJ rules that German legislation on procedures related with VAT refunds are not in line with EU VAT Law (*Commission v Germany*)
- CJ rules on UK legislation concerning the cost-sharing exemption in relation to the VAT Group (*Kaplan International colleges UK*)
- CJ rules that Swedish legislation is not in line with VAT Directive (*Sögård Fastigheter AB*)

Highlights in this edition

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 (TIN) for certain income categories has been converted into a workable and pragmatic solution for the Netherlands.

The Netherlands can agree with the current DAC7 proposal. In this way, the proposal contributes to enable tax authorities to strengthen their enforcement capabilities in the area of taxation of income derived from digital platforms. It is now possible that some of the users of these digital platforms do not, incorrectly and/or incompletely declare the acquired income to the tax authorities. This creates a risk of erosion of the existing system of income taxation. The exchange of information ensures that the Member States become aware of this derived income. Furthermore, the changes to the operation of the existing directive have added value. Finally, a workable implementation period is proposed.

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.

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.

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.

Direct Taxation

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.

Council Conclusions on Fair and Effective Taxation in Times of Recovery

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AG Hogan opines that Finnish legislation on taxation of distributions of income from UCITS is not in breach of EU law (*E*)

On 19 November 2020, AG Hogan delivered his Opinion in case *E joined parties Veronsaajien oikeudenvalvontayksikkö* (C-480/19)

E is a natural person residing in Finland, who has invested in a sub-fund of a UCITS investment fund governed by Luxembourg law, from which the accrued income was distributed to the investors annually. E requested a preliminary decision from the Central Tax Committee to know whether, in substance, for the purposes of taxation in Finland, the income distributed by a Luxembourg SICAV should be taxed as capital income or as employment income. The Central Tax Committee found that income distributed by a SICAV governed by Luxembourg law is to be regarded as the payment of dividends in Finland and that, with regard to the taxation of E in Finland, that income is to be taxed, pursuant to Paragraph 33c(3) of the Income Tax Law, as employment income.

In essence, the Central Tax Committee considered that the fact that the SICAV at issue is a UCITS fund was not relevant in determining the applicable tax scheme. Rather, it considered that, in the light of the applicable tax provisions, the relevant criterion is the legal nature under Finnish law of the income distributed, which in turn depended on the legal form of the fund. According to the law applicable to its incorporation, SICAV governed by Luxembourg law have legal personality. Therefore, the income they distribute constitutes dividends and not shares in profits. Consequently, that income is to be considered as if it were distributed by any other undertaking constituted in accordance with statutes, whether or not they are investment funds. The Committee accordingly concluded that the profits distributed by such funds should not be treated differently to domestic funds because they will be taxed in the same way as if they were incorporated under Finnish law.

E claimed that treating the profits distributed by a SICAV as employment income, which are taxable according to a progressive system of taxation, would lead to higher taxation than that applicable to profits distributed by a Finnish investment fund, as that latter profit is treated as capital income. E maintained that this was contrary to the free movement of capital enshrined in Article 63 TFEU. The Korkein hallinto-oikeus (Finnish Supreme Administrative Court) requested a preliminary ruling. Advocate General Hogan concludes that Articles 63 and 65 TFEU do not preclude national legislation according to which income paid to a natural person residing in Finland by a collective investment undertaking having its registered office in another Member State of the European Union and having the statutory form within the meaning of UCITS, is to be taxed as a dividend and not a profit share. Those provisions neither preclude national legislation which rules out the application of mechanisms to reduce the effects of double taxation when such profits are

distributed by companies that have been taxed in another Member State at a rate lower than the rate provided for in that legislation, provided that that reduction mechanism is intended solely to correct this difference in the multi-stage taxation of those profits. Finally, those provisions do preclude the reclassification of dividends paid by such companies as income from employment, whereas that same legislation states that dividends constitute, in principle, capital income.

AG Hogan opines on Portuguese legislation regarding taxation of capital gains on immovable property derived by non-residents (*MK*)

On 19 November 2020, AG Hogan delivered his Opinion in case *MK v Autoridade Tributária e Aduaneira* (C-388/19). MK is a natural person, who filed a personal income tax return with the Portuguese tax authority for the financial year 2017. In this return, MK declared certain real estate income, and the value of the capital gain realized on the resale of a building located in Portugal. On the front of the relevant tax return in Table 8B, the applicant ticked box 4 (for 'non-resident'), box 6 (for 'resident in an EU country') and box 7 (electing to be subject to the tax regime applicable to non-residents) and rejected the option in box 9 (to be taxed in accordance with the general tax rates established in Article 68 of the Income Tax Code) and the option in box 10 (to be taxed under the legislation applicable to residents).

The tax authority issued a tax notice for an amount of EUR 24,654.22, calculated by applying the specific tax rate of 28% to 100% of the capital gains on the immovable property. The authority accordingly did not apply the 50% reduction of the taxable base which is applicable to resident taxable persons. MK challenged the legality of that notice before the national court, claiming that it was based on statutory provisions discriminating against nationals of other Member States who do not have tax resident status in Portugal. Accordingly, MK contended that this legislation constituted a restriction on the free movement of capital within the meaning of Article 63(1) TFEU.

The Tax Arbitration Tribunal (Centre for Administrative Arbitration) in Portugal decided to stay proceedings and to refer the question to the Court for a preliminary ruling. Advocate General Hogan concludes that Article 63 TFEU must be interpreted as not precluding national legislation which makes the taxation of capital gains derived from the sale of immovable property situated in a Member State by a resident of another Member State, subject to a different tax regime than the one applicable to residents, provided that that same legislation offers non-residents the possibility of opting for the tax regime applicable to residents. In those circumstances, the authorities of the Member State in question must ensure that the possibility of making such a choice has been brought to the attention of the non-residents in a clear, timely and intelligible manner and that the consequences attached to the fact that the whole of the income of the person concerned is not taxed in that State are neutralized. Compliance with the latter requirements is a matter for the national court to verify.

VAT

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 VAT deduction on development of roads (*Mitteldeutsche Hartstein-Industrie AG*)

On 16 September 2020, the CJ issues its judgment in case *Mitteldeutsche Hartstein-Industrie AG* (C-528/19). Mitteldeutsche Hartstein-Industrie AG ('AG') was authorized, by a Regional Council, to operate a limestone quarry. In order for the quarry to be operational, a municipal public road had to be redeveloped. The municipality and AG agreed that the road would be made available without restriction to AG so that the quarry could be operated, in return for which the latter would bear all costs relating to the development. AG deducted all input VAT regarding the development. During an audit, the German tax authorities took the position that AG had provided the municipality with free-of-charge work subject to VAT, meaning that AG should also have charged VAT to the municipality. The CJ delivered its judgment on 16 September 2020.

The CJ was first asked to clarify whether AG was entitled to deduct VAT on the development costs because the road legally belonged to the municipality. In line with earlier case law, the CJ ruled that a taxable person has the right to deduct the input VAT charged on expenses provided that, without those expenses, it would not have been able to carry out the economic activity. Further, the expenses incurred should not go beyond what is necessary. In the case of AG, the extension of the road made it possible to adapt it to the heavy goods traffic generated by the operation of the quarry. As a result, AG was entitled to deduct the input VAT charged in relation to the development of the road.

The second question put to the CJ was whether the authorization to operate the quarry granted unilaterally by an authority of a Member State constitutes consideration (in kind) received by AG given that AG carried out (without monetary consideration) redevelopment works to a municipal road. The CJ ruled this was not the case. First the developmental works were carried out on a road belonging to a municipality, whereas the authorization to operate the limestone quarry was issued by the Regional Council. Second, the decision to grant the authorization to operate that quarry was a unilateral decision taken by the Regional Council. From settled case law, it follows that a unilateral act by a public authority, in principle, cannot impose a legal relationship entailing reciprocal performance.

The third question answered by the CJ was whether or not the developmental works for the benefit of a municipality, free of charge, constitute free-of-charge work subject to VAT based on the VAT rules for fictitious supplies of goods. The CJ ruled that was also not the case, because the costs were incurred by AG in relation to its own economic activity. The fact that the municipality also benefitted from the redevelopment is not a relevant aspect. In short, AG was entitled to deduct the input VAT in relation to the development costs without also having to charge VAT to the municipality.

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 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 that German legislation on procedures related with VAT refunds are not in line with EU VAT Law (*Commission v Germany*)

On 18 November 2020, the CJ issued its judgment in case *Commission v Germany* (C-371/19).
This case concerns an infringement procedure launched by the European Commission against Germany.
The European Commission argues that Germany has failed to comply with its obligations under Council Directive 2008/9, which regulates the procedures regarding VAT refunds to taxable persons not established in the Member State of refund but established in another EU Member State. A formal requirement under this Directive 2008/9 is that the refund request is filed ultimately on 30 September of the calendar year following the refund period. Germany has systematically refused VAT refund requests that were submitted before 30 September, if a request is not accompanied with all required information (e.g. copies of the invoices or import declarations). In such cases, the German tax authorities did not ask the applicant to submit additional information and/or documents supporting the VAT refund claim. As a result, many applicants lost their right to a VAT refund.

The CJ ruled that this German practice is not compatible with EU VAT law. The principle of neutrality requires that VAT taxable persons are entitled to a VAT refund when the material conditions for VAT deduction are met (i.e., the goods and services, on which foreign VAT was due, are used for activities that give rise to VAT deduction) and the request is filed prior to 30 September. If such a refund

request does not contain all relevant information in order for it to be processed, the tax authorities are required to ask the applicant to supplement their initial request, e.g. by providing the invoices which the refund request relates to. If this action is not taken, the tax authorities are also not allowed to reject a request for a VAT refund.

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.

CJ rules that Swedish legislation is not in line with VAT Directive (*Sögård Fastigheter AB*)

On 26 November 2020, the CJ issued its judgment in case *Sögård Fastigheter AB* (C-787/18).

Sögård Fastigheter AB ('AB') acquired two properties with the aim of renting them out. AB and its tenant opted for a VAT taxed lease. The seller of the property had previously also leased the property taxed with VAT and, as a result, deducted input VAT on refurbishment costs incurred. The Swedish VAT Act contains a provision that waives the requirement for input VAT revision when the supply of capital goods is VAT exempt and the purchaser is a taxable person using the capital goods solely for VAT

taxed transactions. Because these conditions were met, the seller did not revise the input VAT recovered on the refurbishment costs.

At a later moment, AB sold the two properties to private individuals, who used these properties for activities that were out-of-scope of VAT. Because of this subsequent transfer, which was exempt from VAT and that resulted in the properties no longer being used for VAT taxed activities, the Swedish tax authorities argued that AB should have revised the input VAT deducted by the previous owner. The supreme court of Sweden asked the CJ to clarify if it is compatible with EU law to assess AB for the input VAT revision relating to expenses incurred by the previous owner. The Swedish court also asked to emphasize if the outcome of this case would be different if the transfer of the properties to AB would qualify as a so-called 'transfer of a going concern', as a result of which AB is deemed to take over the seller's VAT position relating to the properties.

The CJ ruled that the Swedish rules are not in line with the VAT Directive by requiring a buyer to pay the revision VAT relating to the previous seller's expenses when it itself transfers the properties VAT exempt. The input VAT revision cannot be due by a taxable person other than the taxable person who applied the deduction. Further, the CJ considered the questions on a TOGC hypothetical and therefore, did not answer these.

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