LOYENS & LOEFF

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EU Tax Alert

- Commission publishes proposals on digital economy taxation
- New EU Mandatory Disclosure Rules for intermediaries applying to cross-border tax advice and circumvention of reporting obligations
- CJ precludes provision of an international agreement between Member States allowing for arbitral tribunal (*Achmea*)

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Highlights in this edition

Commission publishes proposals on digital economy taxation

On 21 March 2018, the Commission proposed two Council Directives addressing the taxation of the digital economy. The introduction of a digital services tax (DST) on revenues from certain digital services, as an interim solution, should affect about 100 large companies, mostly US-based. The corporate taxation of a significant digital presence (Digital PE) would be the comprehensive long-term solution and could have an impact on companies across a wider range of economic sectors, such as media & entertainment and IT services. The EU Commission hopes that the proposed rules will apply as from 1 January 2020.

Background

The EU Commission's proposals came after the OECD published an interim report on the tax challenges of the digitalising economy on 16 March 2018. The OECD is the preferred forum for those who wish to preserve a global level playing field, but reaching a consensus is difficult: interim measures (such as the DST) are contentious and some countries consider no action is needed pending the implementation of the BEPS recommendations. In particular, the US has expressed strong opposition against taxation of internet companies on a gross basis, as would be the case under the DST.

The preferred 'comprehensive' option: the Digital PE

The EU Commission's long-term option is also the focus of the OECD's ongoing work: both forums aim at adapting the permanent establishment concept to the digitalising economy. Certain digital services providers would be taxed in the countries where they have a significant digital footprint and generate value from technology, users' interactions and users' data. New rules to establish such taxable presence and new profit allocation rules would need to be introduced in domestic law and would also need to be implemented in tax treaties. The Digital PE option would not apply to companies resident in a non-EU country that has a tax treaty with the EU Member State where these companies have a significant digital presence; for that reason, the EU Commission issued a recommendation to amend these tax treaties. The Commission will also propose corresponding amendments to the CCCTB proposal. Please click here to read further details on the proposals for the Digital PE.

The 'interim' measure: the DST

The proposed DST is a 3% turnover tax that targets digital service providers with annual worldwide revenues exceeding EUR 750 million and revenues from the provision of digital services in the EU exceeding EUR 50 million. Digital services covered by the DST are (i) valorising user data by placing (online) ads targeting users of the digital interface, (ii) transmitting user data generated from their activities on digital interfaces, or (iii) making available a digital interface for users to supply amongst themselves goods and services (i.e., online marketplaces). The supply of IT solutions and digital products, as well as online retail activities and intragroup digital services would not be subject to the DST. Consequently, only a limited number of companies are likely to be affected. The EU Commission suggests (but does not propose) a binding provision to stop applying the DST to taxpayers that would be taxed under the comprehensive option, once implemented, i.e., taxpayers resident in the EU or in non-EU countries that do not have a tax treaty with the EU Member State of the Digital PE. By the same token, this means that the 'interim' DST will become a permanent tax for companies which are not subject to the Digital PE rules. Please click here for more information on what the DST would mean for your company.

Next steps

For the proposals to be accepted, EU Member States need to reach unanimity. This will be challenging for a number of reasons. For example, the proposed reforms would reallocate taxing rights from (often smaller) EU Member States that host the European headquarters of large digital economy companies to larger EU Member States with large user bases. Such headquarter countries generally seem to seek a solution that is globally supported.

The EU Commission and the EU Member States supporting the current initiatives hope for a swift approval process and a subsequent implementation in domestic law by 31 December 2019, such that the new rules would become effective as from 1 January 2020. However, the lack of global consensus observed by the OECD and the opposition expressed by the US could jeopardise this.

New EU Mandatory Disclosure Rules for intermediaries applying to cross-border tax advice and circumvention of reporting obligations

On 13 March 2018, the Council of the European Union reached political agreement on a Council Directive ('Directive') introducing mandatory disclosure rules for intermediaries such as lawyers, accountants and tax advisers. Intermediaries must report potentially aggressive tax planning arrangements with a cross-border dimension as well as arrangements designed to circumvent reporting requirements like CRS and UBO reporting. EU Member States' tax authorities will exchange the information automatically within the EU through a centralized database.

The reporting obligation applies to intermediaries with residency, incorporation, professional registration or a permanent establishment in an EU Member State and only related to cross-border arrangements concerning at least one EU Member State. The Directive does not include a definition of aggressive tax planning. Instead, it includes a list of features, elements and examples of arrangements that should present a strong indication of aggressive tax planning or the undermining of reporting obligations. Covered intermediaries must disclose such arrangements within 30 days after making them available to their clients.

In certain cases, for instance when no intermediary is involved, when the intermediary does not have an EU presence or in the case of client-attorney privilege, the obligation to report lies with the client.

Member States must implement the Directive in their domestic laws ultimately on 31 December 2019 and apply it as from 1 July 2020. However, it will have retroactive effect for all reportable arrangements, the first step of which is implemented in the time frame between the entry into force of the Directive (likely June/July 2018 after formal approval by the Council) and 1 July 2020. This means that starting summer 2018, intermediaries and their clients should already be monitoring all tax advice provided with a cross-border dimension and all advice concerning reporting requirements to ensure that a future obligation to report can be properly fulfilled.

CJ precludes provision of an international agreement between Member States allowing for arbitral tribunal (*Achmea*)

On 6 March 2018, the CJ delivered its judgment in case *Slovak Republic v Achmea* (C-284/16). The case deals with Article 8 of the Bilateral Investment Treaty (BIT) concluded between the Netherlands and Slovak Republic which enables an investor from a Contracting Party to bring proceedings before an arbitral tribunal in the event of a dispute with the other Contracting Party.

As part of a reform of its health system, the Slovak Republic opened the Slovak market in 2014 to national operators and those of other Member States offering private sickness insurance services. Achmea, which is part of a Netherlands insurance group, set up a subsidiary in Slovakia through which if offered private sickness insurance services to the Slovak market. In 2006 the Slovak Republic partly reversed the liberalisation of the private sickness insurance market. As it considered that the legislative measures of the Slovak Republic had caused it damage, Achmea brought arbitration proceedings under Article 8 of the BIT. In those proceedings, the Slovak Republic submitted that, as a result of its accession to the EU, resource to an arbitral tribunal was incompatible with EU Law, in particular Articles 18, 267 and 344 TFEU.

The CJ started by recalling that, according to its case law, an international agreement cannot affect the allocation of powers fixed by the Treaties or, consequently, the autonomy of the EU legal system, observance of which is ensured by the Court. In order to ensure that the specific characteristics and the autonomy of the EU legal order are preserved, the Treaties have established a judicial system intended to ensure consistency and uniformity in the interpretation of EU law. In that context, in accordance with Article 19 TEU, it is for the national courts and tribunals and the CJ to ensure the full application of EU law in all Member States and to ensure judicial protection of the rights of individuals under that law. In particular, the judicial system as thus conceived has as its keystone the preliminary ruling procedure provided for in Article 267 TFEU, which, by setting up a dialogue between one court and another, specifically between the Court of Justice of the EU and the courts and tribunals of the Member States, has the object of securing uniform interpretation of EU law, thereby serving to ensure its consistency, its full effect and its autonomy as well as, ultimately, the particular nature of the law established by the Treaties.

The Court then went on to determine whether the disputes which the arbitral tribunal was called on to resolve referred to the interpretation of EU law. According to the CJ, Article 8 of the BIT allows that an arbitral tribunal may be called to interpret and apply EU law, in particular the provisions regarding the fundamental freedoms.

Subsequently the CJ analysed whether an arbitral tribunal such as referred to in Article 8 BIT is situated within the judicial system of the EU, and in particular whether it can be regarded as a court or tribunal of a Member State within the meaning of Article 267 TFEU. The consequence of a tribunal set up by Member States being situated within the EU judicial system is that its decisions are subject to mechanisms capable of ensuring the full effectiveness of the rules of the EU. In this regard, it concluded that the arbitral tribunal is not part of the judicial system of the Netherlands or Slovakia. It observed that it is precisely the exceptional nature of the tribunal's jurisdiction compared with that of the courts of those two Member States that is one of the principal reasons for the existence of Article 8 of the BIT. Therefore, it cannot in any event be classified as a court or tribunal 'of a Member State' within the meaning of Article 267 TFEU.

Consequently, having regard to all the characteristics of the arbitral tribunal mentioned in Article 8 of the BIT the CJ considered that, by concluding the BIT, the Member States parties to it established a mechanism for settling disputes between an investor and a Member State which could prevent those disputes from being resolved in a manner that ensures the full effectiveness of EU law, even though they might concern the interpretation or application of that law. Given that Article 8 of the BIT has an adverse effect on the autonomy of EU law, the CJ concluded that such provision is precluded by Articles 267 and 344 TFEU.

State Aid/WTO

Commission publishes State aid decision on Amazon

On 26 February 2018, the Commission published the non-confidential version of its October 2017 decision ordering Luxembourg to recover State aid from Amazon (the Decision). In the meantime, Luxembourg has challenged the Decision before the EU General Court. The publication of the Decision sheds further light on the Commission's reasoning, in particular as regards the key criteria of advantage and selectivity. Whereas an individual State aid decision does not have a direct impact on other taxpayers, businesses can now better assess their own State aid exposure in light of the Commission's reasoning.

Facts of the case
In the case at hand, a company fully taxable in Luxembourg (LuxOpCo) paid from May 2006 to June 2014, a royalty to a Luxembourg partnership (LuxSCS) for the use of certain intangibles (technology, marketing-related intangibles and customer data). At the time, the Luxembourg tax authorities had confirmed by means of a tax ruling that the royalty was in line with Luxembourg transfer pricing rules. The reasoning in the Decision is that this royalty exceeded the arm's length value, such that the tax base of LuxOpCo was unduly reduced.

Advantage – more uncertainty in transfer pricing?
State aid is defined as a measure granted by a State or through State resources, which distorts or threatens to distort competition and affects intra-EU trade by favouring certain undertakings or the production of certain goods. The Decision develops two lines of reasoning on the existence of an advantage. In the primary reasoning, the Decision provides an extensive functional analysis based on numerous documents obtained during the investigation, including ones from the US Tax Court case between Amazon and the IRS (see here the US Tax Court opinion of 23 March 2017). The Commission considers that LuxSCS did not have any function, risk or asset in relation to Amazon's European business, nor as to the development of the intangibles. Whereas Amazon claims those intangibles were essentially developed in the US, the Commission allocates functions, risks and assets to LuxOpCo.
Although both the Commission and the OECD prefer the CUP method under their respective guidance, the Commission subsequently dismisses the CUP method, rejecting the comparability of agreements that Amazon

considers sufficiently established by the US Tax Court to value a sub-set of the same intangibles in the US Tax Court case. Instead, the Commission asserts the transactional net margin method (TNMM) should apply, with LuxSCS as tested party making the less complex contributions as compared to LuxOpCo. It is remarkable that the Commission relies on and extensively refers to the 2017 OECD TP Guidelines, thus effectively enforcing non-binding guidance with retroactive effect. Based on its TNMM analysis, the Commission considers that the royalty paid by LuxOpCo should only cover the costs incurred by LuxSCS to develop and maintain the intangibles as well as a minor mark up on LuxSCS' related expenses.
In the alternative line of reasoning, the Commission points out what it considers methodological mistakes in the transfer pricing analysis. The Commission argues that LuxOpCo performed more than simply routine functions. It also questions the use of operating expenses rather than total costs as profit level indicator to benchmark the profitability of LuxOpCo under the TNMM, and also the introduction of a floor and a cap to LuxOpCo's remuneration.

Selectivity – comparison with all taxpayers or to group companies only?
On selectivity, the Decision applies three lines of reasoning. In its primary line, the Commission presumes selectivity, claiming that an individual measure (here, the advance tax confirmation of 2003) giving an advantage is automatically selective. This reading of the MOL case is yet to be confirmed by the EU Courts.
As an alternative line, the Decision applies the usual 3-step selectivity test: first defining the reference framework (i.e., the 'normal' application of the tax rules), second identifying if LuxOpCo is better treated than other undertakings in a similar legal and factual situation (within the same reference framework) and third, determining whether the difference in treatment (if any) is justified by the nature of the system.
The Decision, as in other recent tax State aid decisions, chooses the general corporate income tax system as reference framework, even though it questions the correct application of the Luxembourg transfer pricing rules in LuxOpCo's specific case. The Luxembourg transfer pricing rules are not questioned as such. The Decision compares LuxOpCo to any other corporate taxpayer, rather than to the sole group companies party to intragroup transactions and thus subject to transfer pricing rules. Because other taxpayers could not allegedly reduce their tax liability by paying an excessive royalty, the Commission considers that LuxOpCo received a selective advantage that is not justified by the nature of the tax system.
As a third line of reasoning, the Decision takes Luxembourg transfer pricing rules as reference framework, albeit without the related administrative practice. However, it barely develops any reasoning and instead, relies on the alleged existence of an advantage to conclude that the selectivity test is also met.

Potential actions to take
The Decision does not directly apply to other taxpayers or groups, whether in Luxembourg or in another Member State. The reasoning shows, however, that the Commission continues to use State aid rules as a tool to push forward tax reforms in the EU and address what is perceived as unfair tax competition.
As the Commission appears to insist on applying the 2017 OECD TP Guidelines with retroactive effect, companies engaged in intragroup transactions should make sure they have adequate transfer pricing documentation and review whether the allocation of functions, assets and risks correctly reflects economic substance. As part of a longer term transfer pricing strategy, restructuring could be opportune. Complying with the 2017 OECD TP Guidelines should minimize the State aid risk going forward.

Next steps
Several tax State aid cases are still in the formal investigation procedure stage: McDonald's and Engie in Luxembourg, Inter Ikea in the Netherlands, the Gibraltar tax ruling regime and the UK CFC financing exemption. Appeals with the EU General Court are pending in the Apple (Ireland), Starbucks (the Netherlands), Fiat (Luxembourg), Amazon (Luxembourg) and Belgian excess profit ruling scheme cases. The Commission continues to look into the tax practices of the EU Member States and is expected to open more investigations in the coming months.

CJ rules on export aid in the form of tax relief (*ZPT*)

On 28 February 2018, the CJ delivered its judgment in case *ZPT AD v Narodno sabranie na Republika Bulgaria and Others* (C-518/16). Export-related aid is excluded from the de minimis aid regulation, which roughly exempts aid up to EUR 200,000 per three fiscal years from the need of advance notification and approval by the European Commission. Bulgarian law stated that certain investment tax relief measures would not apply to assets used in activities related to exports, as to comply with the regulation. ZPT filed state liability charges as it was denied the relief because its asset was also used to produce goods for export.

The CJ pointed out in its judgment that the export aid exemption only applies to aid which is directly linked to stimulation export sales, the setting up of a distribution network or which relates to other export-related expenditure. Investment aid as such which is not related to export does not fall within that scope, even if the assets invested in facilitate the production of goods that are to be exported. It is now for the referring Bulgarian civil court to determine the consequences of this.

Direct Taxation

CJ rules on the personal scope of the Swiss-EU Agreement in the context of the French exit tax (*Picart*)

On 15 March 2018, the CJ issues its judgment in case *Christian Picart v Ministre des Finances et des Comptes publics* (C-355/16). The case deals with the exit tax charged as regards substantial holdings held by Mr Picart in French companies at the time of his transfer of residence to Switzerland as well as the additional assessments of income tax and social security contributions.

In 2002, Mr Picart transferred his residence from France to Switzerland. On the date of that transfer, he held significant shareholdings in a number of French companies. At the time of that transfer, Mr Picart declared an unrealised capital gain on the shares and, in order to benefit from suspension of payment of the tax payable on that capital gain, appointed a tax representative in France and provided a bank guarantee to ensure recovery of the debt to the French Treasury. In 2005, Mr Picart transferred the shares in question, thus bringing the suspension of the payment of that taxation to an end. Following an examination of his personal tax position, the French tax authorities re-assessed the amount of the capital gain declared and made Mr Picart liable for additional assessments to income tax and social security contributions, with penalties. Mr Picart filed a complaint with a view to obtaining a discharge from those assessments and penalties. In essence, he claimed that the French legislation was incompatible with the freedom of establishment guaranteed by the Swiss-EU Agreement on the Free Movement of Persons (AFMP) which allowed him to establish in Switzerland and to pursue in that State an economic activity as a self-employed person consisting in the management of his various direct or indirect shareholdings in a number of companies which he controlled in France.

Questions were brought to the CJ by the referring Court on whether the right of establishment as a self-employed person, within the meaning of the AFMP, has the same scope as the freedom of establishment which Article 49 TFEU has and, if it does have the same scope, whether account must be taken, for the purposes of its application, of the case law deriving from the judgment of 7 September 2006, *N* (C-470/04).

The CJ started by assessing whether a situation such as that of Mr Picart comes within the scope *ratione personae* of the notion of 'self-employed persons', within the meaning of the AFMP, and, where relevant, whether that agreement contains provisions that Mr Picart may invoke in relation to his State of origin. According to the Court, the wording of Article 12(1) of Annex I to the AFMP, the right of establishment, within the meaning of that provision, is restricted to natural persons who are nationals of a Contracting Party and wish to become established in the territory of another Contracting Party in order to pursue a self-employed activity in that territory. Therefore, in order for that provision to apply, the person concerned must pursue his self-employed activity in the territory of a Contracting Party other than that of which he is a national. In the case of Mr Picart, a French national, does not intend to pursue his economic activity in the territory of the Swiss Confederation, but to maintain an activity in the territory of his State of origin. In addition, it follows from the wording of Article 13(1) of Annex I to the AFMP that the situation of a national of a Contracting Party who has his residence in the territory of another Contracting Party and who pursues a self-employed activity in the territory of the other Contracting Party, returning to his place of residence as a rule every day, or at least once a week, comes within the scope of that provision.

In this case, Mr Picart, unlike that self-employed couple, remains in the territory of his State of residence, namely the Swiss Confederation, from which he intends to pursue his economic activity in his State of origin, and that, contrary to what is provided for in Article 13(1) of Annex I to the AFMP, he does not undertake every day, or at least once a week, a journey from the place of his economic activity to his place of residence. Therefore, the CJ concluded that Mr Picart does not come within the scope *ratione personae* of the notion of 'self-employed person', within the meaning of the AFMP and, accordingly, he cannot rely on that agreement.

AG Kokott delivers several Opinions in Danish cases dealing with the concept of beneficial ownership in the context of the Parent-Subsidiary and Interest & Royalties Directives

On 1 March 2018, AG Kokott delivered Opinions in cases *N Luxembourg 1* (C-115/16), *T Danmark*, (C-116/16), *Y Denmark* (C-117/16), *X Denmark* (C-118/16), *C Danmark I* (C-119/16) and *Z Denmark* (C-299/16. Those Danish cases deal with the concept of beneficial ownership and abuse in the context of the application of the Parent-Subsidiary Directive and the Interest & Royalty Directive. They refer to tax disputes in Denmark taking into account tax administration's view that withholding tax was being avoided at source through the use of intermediate holding companies.

In cases C-115/16, C-118/16, C-119/16 and C-299/16, the questions referred to the meaning of beneficial ownership under the Interest & Royalties Directive and its interpretation, notably whether it has an autonomous EU law meaning or is to be interpreted in light of the OECD Commentaries. A question also arose as to the definition of abuse under EU law.
AG Kokott started by clarifying that an interest recipient is the person with a civil claim to the interest in his own name. Therefore, she stated that the beneficial owner within the meaning of Directive 2003/49 is the person entitled under civil law to demand payment of the interest. For the AG, Article 1(4) of the Directive confirms this. It states that an agent, trustee or authorised signatory cannot be treated as the beneficial owner. Such persons enforce the claim either *not in their own name* (agent or authorised signatory) or *not on their own account* (trustee). Conversely, according to the AG, it follows that an interest recipient who collects the interest in his own name and on his own account (i.e. for his own benefit) is also the beneficial owner. In accordance, AG Kokott concluded that a person simply acting as a trustee would not qualify as a beneficial owner within the meaning of the directive.
As regards the use of the OECD commentaries for the interpretation of the Directive, the AG considered that the concept of beneficial ownership must be interpreted under EU law autonomously from the OECD Model Tax Convention. For the AG, the commentaries on the OECD MTC cannot have a direct effect on the interpretation of an EU directive, even if the terms used are identical. In that sense, those commentaries simply reflect the opinion of the persons who worked on the OECD Model Tax Convention, not the views of a parliamentary legislature or indeed of the EU legislature.

The AG then went on to determine whether the arrangements at stake give rise to an abuse within the meaning of Article 5 of the Directive. As a preliminary remark, she clarified that abuse does not conflict with the concept of beneficial ownership. Subsequently, she reminded that the existence of abuse involves a wholly artificial arrangement which does not reflect economic reality. As regards the seeking of tax advantages, AG Kokott noted that apart from in the case of a wholly artificial arrangement that does not reflect economic reality, any person may rely on profit from tax advantages in force in a Member State. The freedom of establishment includes the choice of a Member State which, in the opinion of the undertaking concerned, offers the best tax situation. Furthermore, the AG recalled that the tax relief on dividends provided for under EU law is not contingent upon the origin or residence of the shareholder, which is immaterial for the purposes of the Parent-Subsidiary Directive and the Interest & Royalties Directive. Therefore, the fact that shareholders of an intermediate holding company are third-country residents is not in itself abusive. For the AG, the background to the arrangement deemed abusive is a decisive factor in an overall examination.

Finally, the AG went on to analyse whether the arrangement circumvented the purpose of the tax law which had been circumvented (in the case of taxation in Denmark). In that regard, AG Kokott noted that Denmark was not deprived of taxes on the profits of the operational companies. The interposition of the holding companies ultimately avoided that at source on the interest payments in Denmark. However, tax at source actually taxes the recipient of the income. It is simply a particular taxation technique, rather than a type of tax, intended essentially to secure (minimum) taxation of the income recipient. According to the AG, in cross-border cases in particular, proper taxation of the recipient's income is not always ensured. As a rule, the recipient's State of residence will rarely be aware of his income from abroad, unless functioning data exchange systems exist between the tax authorities (as they do now in the EU). Therefore, for the AG, two requirements must be fulfilled for an arrangement to qualify as abusive circumvention of this objective of the law (to ensure the income recipient is taxed). First, in the case of direct disbursement, tax must be chargeable in Denmark. Second, there must be a risk that the income will not be caught in the actual State of receipt and thus will not be taxed. If, therefore, one reason for choosing a particular business structure is to pay income via a third country in order to prevent their States of residence from obtaining information on their income, then that overall arrangement should, in the AG's opinion, qualify as abuse of law. In turn, any such complaint of abuse might be invalidated if the relevant tax information is provided to the investors' States of residence.

In cases C-116/16, C-117/16, the AG dealt essentially with identical questions as referred to above, but in the context of the Parent-Subsidiary Directive. In this regard, it is relevant to highlight the discussion about the need of beneficial owner of dividends payments. The AG noted that the approach adopted in the Parent-Subsidiary Directive differs from that of the Interest and Royalties Directive deliberately avoiding the use of the term beneficial owner. In fact, by prohibiting Member States from imposing withholding tax on the profits distributed by a resident subsidiary to its non-resident parent company, Article 5(1) of the Parent-Subsidiary Directive limits the powers of the Member States to tax profits distributed by companies that are resident in their territory to companies resident in another Member State. Therefore, Member States cannot unilaterally adopt restrictive measures and make the entitlement to exemption from withholding tax provided for in Article 5(1) contingent upon other requirements. In other words, the entitlement to exemption from withholding tax does not depend on the owners of the parent company being resident or on the dividends payer disclosing how the dividends recipient will use the dividends.

VAT

CJ rules that VAT treatment of second supply in chain transactions cannot depend solely on VAT classification of first supply (*Kreuzmayr*)

On 21 February 2018, the CJ delivered its judgment in the case *Kreuzmayr GmbH* ('Kreuzmayr', C-628/16). BP Marketing GmbH ('BP Marketing') is established and registered as VAT taxable person in Germany. BP Marketing supplied goods to BIDI Ltd. ('BIDI'). BIDI is registered as VAT taxable person in Austria and provided BP Marketing with its Austrian VAT number. BP Marketing and BIDI agreed that BIDI would take care of the transport of the goods from Germany to Austria. BIDI resold the goods to Kreuzmayr and they agreed that Kreuzmayr would carry out the transport from Germany to Austria. BP Marketing regarded its supply to BIDI as an intra-Community supply. BIDI regarded its supply to Kreuzmayr as a local supply in Austria and charged Kreuzmayr with Austrian VAT. Kreuzmayr paid this VAT to BIDI and deducted this Austrian VAT in its Austrian VAT return. Then, BP Marketing found out that Kreuzmayr had transported the goods to Austria and had communicated that information to the German tax authorities. The German tax authorities, therefore, considered the supply by BP Marketing as a local supply in Germany and requested BP Marketing to remit the German VAT due. Following an audit, the Austrian tax authorities observed that BIDI had neither declared nor paid the VAT that it had charged to Kreuzmayr. BIDI justified its course of action by claiming that its supply to Kreuzmayr qualified as an intra-Community supply and, therefore, was not subject to VAT. Therefore, the Austrian tax authorities took the view that Kreuzmayr was not entitled to deduct the Austrian VAT that was charged by BIDI and they cancelled Kreuzmayr's input VAT deduction right.

Kreuzmayr challenged the decision of the tax authorities. The case eventually ended up before the Federal Finance Court of Austria. This court decided to stay the proceedings and to refer to the CJ for a preliminary ruling. By its questions, the referring court essentially wished to ascertain whether the first supply should be considered to be the intra-Community supply. Furthermore, the referring court questions whether the person ultimately acquiring the goods, who wrongly claimed a VAT deduction right, may nonetheless deduct the VAT paid on the basis of the invoices provided by the intermediary operator who had incorrectly classified its supply as a local supply.

According to the CJ, it is in this respect necessary to determine when the second transfer of the right to dispose of the goods as owner, to the person finally acquiring the goods, has taken place. In a situation where the second transfer of the right to dispose of the goods as owner took place before the intra-Community transport occurs, the intra-Community supply cannot be ascribed to the first supply. Furthermore, the CJ ruled that the right to deduct input VAT can be exercised only in respect of VAT actually due and cannot be extended to overpaid input VAT. According to the CJ, the right to deduct input VAT does not extend to VAT which is due exclusively because it is mentioned on an invoice.

CJ rules on reduction of deductible amount (*T-2*)

On 22 February 2018, the CJ delivered its judgment in the case *T-2, družba za ustvarjanje, razvoj in trženje elektronskih komunikacij in opreme, d.o.o.* ('T-2', C-396/16). T-2 is a company established in Slovenia which supplies electronic communications equipment and services. T-2was the subject of a procedure for reaching an arrangement with creditors, which is a special procedure designed to alleviate the liabilities of insolvent debtors. Pursuant to that arrangement, T-2 was required to pay its creditors an amount corresponding to 44% of its debts, without interest, within a period of nine years from the date on which the decision became final. At the request of the tax authorities, T-2 drew up a list of its suppliers' invoices which it had failed to pay which came within the terms of the arrangement with the creditors and on the basis of which it had deducted input VAT. On the basis of those invoices, the tax authorities decided that T-2 must adjust its deduction of input VAT by an amount corresponding to the reduction of its debts resulting from the arrangement with creditors, that is to say, a reduction of 56% of the VAT initially deducted.

T-2 brought a complaint against that decision before the Ministry of Finance. The Ministry dismissed the complaint. Then, T-2 brought an appeal against that decision before the Slovenian Administrative Court, which dismissed the appeal. Finally, T-2 brought an appeal on a point of law against that judgment before the Supreme Court of Slovenia. The Supreme Court decided to stay the proceedings and to refer to the CJ for a preliminary ruling. By its questions, the referring court essentially wishes to ascertain whether tax authorities are entitled to demand a reduction in the deduction of VAT made by a taxable person that has benefitted from a reduction in its liabilities to its creditors in the context of a procedure for reaching an arrangement with creditors.

The CJ ruled that the EU VAT Directive requires EU Member States to reduce the taxable amount and consequently the amount of VAT payable by the taxable person whenever a part or all of the consideration has not been received by the taxable person. However, according to the CJ, it is clear from the order for reference that the decision approving the arrangement with creditors prevents creditors from seeking full payment of their claims and that, from an economic point of view, that decision leads to a reduction of the debtor's obligations towards its creditors, and not just to a default. Consequently, it does not appear that the reduction of a debtor's obligations resulting from the final approval of an arrangement with creditors constitutes a case of a transaction remaining totally or partially unpaid. However, according to the CJ, that is a matter for the referring court to determine. If it turns out that it constitutes a case of a transaction remaining totally or partly unpaid, the deductible amount has to be adjusted.

CJ rules that the sole ground that additional formal requirements have not been met does not justify the refusal of a VAT exemption (*Piénkowski*)

On 28 February 2018, the CJ delivered its judgment in the case *Stanislaw Piénkowski* ('Piénkowski', C-307/16). Mr. Piénkowski is a trader whose supplies are subject to VAT. He is engaged in the business of selling telecommunications equipment to travellers resident outside the EU. The goods therefore leave the EU once they are in the customers' possession. Based on the VAT exemption for goods carried in the personal luggage of travellers, Mr. Piénkowski made VAT refunds to the travellers or applied the VAT zero rate on his supplies. Polish law provides for additional conditions for the application of aforementioned VAT zero rate, such as a minimum amount of turnover or the obligation to conclude an agreement with a person authorized to refund VAT to travellers.

The Polish tax authorities found that the level of Mr. Piénkowski's turnover meant that he was not permitted to make VAT refunds to travellers personally or to apply a VAT zero rate and Mr. Piénkowski's had not concluded an agreement with a person authorized to refund VAT to travallers. Mr. Piénkowski who considered that threshold to be an 'administrative barrier' to the application of the preferential VAT zero rate, appealed on a point of law to the Polish Supreme Administrative Court, submitting that certain Polish VAT provisions were incompatible with the provisions of the EU VAT Directive and with the principles of proportionality and fiscal neutrality. The Polish Supreme Administrative Court decided to stay the proceedings and to refer to the CJ for a preliminary ruling. By its question the referring court asked whether the EU VAT Directive precludes national legislation which provides that a VAT taxable person may apply a VAT exemption (implemented in Poland and other EU Member States as a VAT zero rate) to the export of goods by travellers only if his turnover reached a certain threshold during the preceding tax year, or if he has concluded an agreement with a person authorized to refund VAT to travellers.

According to the CJ, it is clear from the EU VAT Directive that there is no obligation imposed on VAT taxable persons to have attained a certain turnover during the preceding financial year, or to have concluded an agreement with a person authorized to refund VAT, in order for the VAT export exemption to apply. The EU VAT Directive provides for EU Member States to impose additional conditions for the purposes for ensuring the correct and straightforward application of VAT exemptions and of preventing any possible evasion, avoidance or abuse, but only as they shall deem necessary. However, the CJ ruled that in circumstances where the conditions for export exemption are satisfied, no liability to pay VAT arises in respect of such supplies. In those circumstances, there is no longer, in principle, any risk of tax evasion or loss of VAT which could justify the transaction concerned being taxed. Therefore, the Polish legislation is not necessary in order to attain the objective of preventing tax avoidance and evasion.

CJ rules on VAT deduction right after the time limit for exercising that right has been expired (*Volkswagen*)

On 21 March 2018, the CJ delivered its judgment in the case *Volkswagen AG* ('Volkswagen', C-533/16). Between 2004 and 2010, Volkswagen received goods from certain suppliers without VAT being included in the relevant invoices. The suppliers and Volkswagen had wrongly assumed that the transactions in question constituted financial compensation and, as such, were not subject to VAT. When, in 2010, they realized their mistake, the suppliers charged the VAT to Volkswagen and issued the relevant invoice stating the amount of VAT payable. The suppliers also filed a supplementary VAT return and paid the VAT to the tax authorities. Volkswagen sought to deduct the input VAT but the tax authorities allowed the application only in respect of some of the periods claimed, rejecting it in the case of the other periods on the basis that the time limit for exercising the right (five years) had already elapsed.

The decision of the tax authorities was confirmed by Finance Directorate of the Slovak Republic. Volkswagen challenged that decision before the Regional Court, which dismissed the action. Then, Volkswagen appealed against that judgment. The case ended up before the Supreme Court of the Slovak Republic. The Supreme Court decided to stay the proceedings and to refer to the CJ for a preliminary ruling. By its question, the referring court asked whether it is permissible under EU law to refuse granting a taxable person a refund of input VAT on the grounds that the time limit for exercising that right has expired, in a situation where it was thought, wrongly, that the supply of goods was not subject to VAT and the subsequent adjustment took place several years later with the taxable person paying the VAT at that time and then claiming it back as input VAT.

According to the CJ, the right to deduct input VAT arises at the same time as the VAT becomes chargeable. However, that right can only be exercised if the taxable person holds an invoice showing that the goods have been supplied. Nevertheless, the VAT Directive provides that EU Member States can authorize a taxable person to exercise the right to deduct input VAT at another moment than the moment on which the VAT has become chargeable. However, this right is then subject to conditions and procedures determined by that EU Member State. A temporal limit is such a condition. The CJ ruled that since Volkswagen was not in possession of the invoices and was not aware that the VAT was due, Volkswagen obviously could not claim the right to deduct VAT which had not been previously paid. Therefore, the right can only be exercised once the taxable person is aware that the transactions are subject to VAT and if that person has acted in good faith.

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