



# Weekly VAT News

Week to 21 September 2020

Welcome to the latest edition of *EY VAT News*, which provides a roundup of indirect tax developments.

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If you would like to discuss any of the articles in more detail, please speak with your usual EY indirect tax contact, or one of the people below. If you have any feedback or comments on EY VAT News, please contact [Ian Pountney](#).

## EY Events

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### Brexit webcasts

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## COVID-19

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### EY Tax COVID-19 Stimulus Tracker - Stay up to date with COVID-19 stimulus responses

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## Court of Justice of the European Union

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### Judgment: Supplies by a 'partner' are independently pursued

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### Judgment: Construction work carried out 'free of charge' is linked to the taxpayers 'economic activity', in principle attributable VAT is recoverable

#### **C-528/19 F-AG**

On 16 September the CJEU released its decision in this German referral asking whether, where a taxable person carries out construction work on a municipal road on behalf of the city which is transferred to the city for no monetary consideration, is that taxable person, who has procured from other taxable persons services relating to the construction of the road, entitled to deduct attributable input tax pursuant to Article 17(2)(a) of the Sixth Directive?

F-AG is a public limited company and managing holding company. Its subsidiaries include A-GmbH which, in 2006, operated a limestone quarry. The Regional Council approved a new excavation of the quarry, subject to the condition that the development include the upgrading of a public road to be owned by the City.

The upgrading of the road in question was necessary for the purpose of carrying away the limestone extracted. The legal predecessor of A-GmbH undertook to bear all of the costs associated with the upgrading of the section of road. The agreement was also to apply to all legal successors of the parties to the agreement.

In 2006, A-GmbH commissioned its sister company B-GmbH, which is also a company controlled by F-AG, to upgrade the relevant section of road in accordance with the agreement with the City. The upgrade was completed in November 2006 and with regard to its 2006 VAT return, F-AG did not take into account the costs incurred by A-GmbH but sought to deduct, as input tax, the amounts of VAT attributable to the input services received from B-GmbH.

The tax authority considered that by the extension of the road, F-AG had made a 'free delivery' of works liable to VAT pursuant to national legislation. On appeal, the national Court partially found in favour of F-AG; it considered that the conditions under national legislation for the works to be taxable had not been met. However, VAT recovery is not permitted on the associated costs, since, according to the case-law of the national Court, a business which intends to use the services received exclusively and directly for a 'free supply' is not entitled to deduct attributable VAT.

The Court noted that it had essentially been asked three questions:

- Whether Article 17(2)(a) of the Sixth Directive must be interpreted as meaning that a taxable person is entitled to deduct input VAT paid for works for the extension of a municipal road carried out for the benefit of a municipality (first question)
- Whether, in the event that the first question is answered in the affirmative, the Sixth Directive must be interpreted as meaning that the authorisation to operate a quarry granted unilaterally by an authority of a Member State constitutes consideration received by a taxable person which carried out, without monetary consideration, works for the extension of a municipal road, with the result that those works constitute a transaction carried out for consideration, within the meaning of that directive (second question)
- Whether Article 5(6) of the Sixth Directive must be interpreted as meaning that works for the extension of a municipal road open to the public carried out, free of charge, by a taxable person for the benefit of a municipality constitute a transaction which must be treated as a supply of goods made for consideration, within the meaning of that provision (third question)

On the first question the Court noted that the right to deduct VAT laid down in Article 17(2)(a) is an integral part of the VAT scheme and in principle may not be limited. It is exercisable immediately in respect of all the taxes charged on input transactions. In so far as the taxable person, acting as such at the time when he acquires goods or receives services, uses those goods or services for the purposes of his taxed transactions, he is entitled to deduct the VAT paid or payable in respect of those goods or services.

The existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct is necessary, in principle, before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement. However, a taxable person also has a right to deduct, even where there is no direct and immediate link where the costs of the transactions in question are part of his general costs and are, as such, components of the price of

immediate link, where the costs of the transactions in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do have a direct and immediate link with the taxable person's economic activity as a whole.

The Court noted that without the works for the extension of the road in question, it would have been impossible to operate the limestone quarry. It follows that the works were essential in order for the operation of the limestone quarry to come to fruition and that, without those works, F-AG would not have been able to carry out its economic activity.

The fact that the public may also use the road free of charge is immaterial. The works were carried out not for the purposes of the municipality concerned or of public traffic but in order to adapt the municipal road in question to the heavy goods traffic generated by the operation of the limestone quarry by F-AG. The works can be linked to its economic activity as a taxable person, with the result that, subject to checks to be carried out by the referring court, that expenditure is not related to activities that are exempt or are outside the scope of VAT. It is for the referring court to determine whether the works were limited to what was necessary to ensure the operation of the limestone quarry by F-AG, if not an apportionment may be necessary.

On the second question, the Court noted that the referring Court stated that, in the light of EU law, it was not certain that F-AG carried out a supply for consideration for the benefit of the municipality concerned. However, it also has doubts as to whether it is possible to categorise the works in question as a supply made free of charge.

The Court considered that under Article 2(1) of the Sixth Directive, the supply of goods or services effected for consideration within the territory of a Member State by a taxable person acting as such is to be subject to VAT. In order for a transaction to be classified as a transaction for consideration as far as VAT is concerned, all that is required is that there should be a direct link between the supply of goods or the provision of services and the consideration actually received by the taxable person. Such a direct link is established where there is a legal relationship between the provider of the service and the recipient pursuant to which there is reciprocal performance, the remuneration received by the provider of the service constituting actual consideration for the service supplied to the recipient.

The consideration for a supply of goods may consist of a supply of services, and so constitute the taxable amount within the meaning of Article 11.A(1)(a), provided, however, that there is a direct link between the supply of goods and the supply of services and that the value of those services can be expressed in monetary terms. The same is true if a supply of services is performed in exchange for another supply of services, as long as the same conditions are satisfied. Also, barter contracts, under which the consideration is by definition in kind, and transactions for which the consideration is in money are, economically and commercially speaking, two identical situations.

The Court noted that there is a legal relationship and agreement between the municipality and F-AG. However, the agreement cannot

constitute a legal framework pursuant to which there is an exchange of reciprocal services, i.e. the extension of the road and the grant of the authorisation to operate the limestone quarry. The works in question were carried out on a road belonging to a municipality, whereas the authorisation to operate the limestone quarry was issued by the Regional Council. Also, the decision to grant the authorisation to operate that quarry was a unilateral decision taken by the Regional Council and a unilateral act by a public authority cannot, in principle, impose a legal relationship entailing reciprocal performance. Finally, the works in question did not give rise to the payment of any monetary consideration.

The Court considered that in the immediate case, no direct link can be established between the provision of the works to the municipality and the grant to F-AG of the authorisation to operate the limestone quarry, since that authorisation cannot be regarded as consideration for the works for the extension of that road.

Following (*Iberdrola Inmobiliaria Real Estate Investments (C- 132/16)*) The Court recognised a taxable person's right to deduct input VAT in respect of a supply of services which consisted of the construction or improvement of a property owned by a third party in the case where those services were used both by that taxable person and by that third party in the context of their economic activities, even though that third party enjoyed the results of those services free of charge.

In summary, the authorisation to operate a quarry granted unilaterally by an authority of a Member State does not constitute consideration received by a taxable person who carried out, without monetary consideration, works for the extension of a road belonging to a municipality, with the result that those works do not constitute a transaction carried out for 'consideration' within the meaning of the Sixth Directive.

Finally, considering the third question, the Court noted that the referring Court based its question on the premiss that in accordance with national law, the works in question constitute a supply of work to the municipality concerned, since the Federal Republic of Germany availed itself of the possibility, provided for in Article 5(5) of the Sixth Directive, of treating the handing-over of certain construction works as a supply of goods.

The Court noted that it will be for the referring Court to determine that, under German law, the supply in question constitute a supply of work. As regards Article 5(6), the Court recalled that the provision is intended to ensure equal treatment as between a taxable person who applies goods for his own private use or for that of his staff, on the one hand, and a final consumer who acquires goods of the same type, on the other. Thus, the taxation of the applications referred to in the first sentence of Article 5(6) of the Sixth Directive is designed to prevent situations in which final consumption is untaxed.

Since the works were delivered to the municipality, it is common ground that the case of consumption for private use or for that of business

Since the works were delivered to the municipality, it is common ground that the case of consumption for private use or for that of business staff is ruled out, as is that relating to the application for purposes other than those of the business, since those works were carried out for the purposes of F-AG. That last factor does not, however, preclude the application of Article 5(6), which from its very reading treats as a supply made for consideration, and therefore as subject to VAT, a taxable person's disposal, free of charge, of goods forming part of his business assets, where input VAT was deductible on those goods, it being in principle immaterial whether or not their disposal was for business purposes.

However, even though the road in question is open to public traffic, the actual end-use of that road should be taken into consideration. The works on the road benefit F-AG and have a direct and immediate link with its overall economic activity which gives rise to taxable transactions and. The costs of the input services received and linked to the works form part of the factors in the cost of the output transactions carried out by F-AG

Article 5(6) must be interpreted as meaning that works carried out, for the benefit of a municipality, for the extension of a municipal road open to the public but used, in connection with its economic activity, by the taxable person which carried out those works free of charge and by the public, do not constitute a transaction which must be treated as a supply of goods made for consideration within the meaning of that provision.

*Comments: This case demonstrates the potential complications that can arise in large construction projects particularly where a planning authority or municipality requires the developer to perform obligations - for example under a section 106 agreement. Whilst this case broadly supports the current approach in the UK from HMRC, given the potential VAT at stake, advice should be sought at the outset to ensure appropriate VAT accounting.*

For further information please contact **James Buckland**.

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**Judgment: Following a change in intention VAT should be adjusted in the first period and not in accordance with the Capital Goods Scheme longer period**



Opinion: Hiring of a means of transport to a 'non-taxable person' can include the authorisation of an employee to use a company car (including for private use) if the employee remunerates the employer for such authorisation

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Calendar update

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First-tier Tribunal

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Structuring a business to create tax efficiencies is acceptable provided the arrangements reflect commercial reality

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Hire of children's ice skates is a separate zero-rated supply

The supply and installation of conservatory roof insulation in the form of insulated roof panels is a standard-rated supply

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HMRC Material

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Update: Internal manual - VAT Registration, Transfers of going concerns (TOGCs): reallocation of VAT registration number (VAT 68 action): conditions of reallocation

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Digital Services Tax - Taxes (Interest Rate) (Amendment No. 2) Regulations 2020

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EY Global Tax Alerts

UK

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ME

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Ghana

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Malaysia

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Poland

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Turkey

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European Commission

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## EU State of the Union address - energy taxation and digital taxation

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