

VAT brief

Halifax ECJ decision endorses VAT planning in commercially driven transactions

In perhaps the most significant VAT case of recent years, the ECJ has ruled that legitimate VAT planning can be entered into where tax savings form part of wider commercial activities.

Issue 6

22 February 2006

Should you require further information, clarification on any of the above, or to discuss what this ruling means to you, please call your usual PwC contact or one of the following:

John Fay

email: john.fay@ie.pwc.com
Tel: +353 1 7048701

Caroline McDonnell

Email: caroline.mcdonnell@ie.pwc.com
Tel: +353 1 6626526

Jilly Riley

Email: jilly.riley@ie.pwc.com
Tel: +353 1 6626634

Colm Blaney

Email: colm.blaney@ie.pwc.com
Tel: +353 1 6626741

Sean Brodie

Email: sean.brodie@ie.pwc.com
Tel: +353 1 7048619

David Hughes

Email: david.hughes@ie.pwc.com
Tel: +353 1 6626194

Chris Timmins

Email: chris.timmins@ie.pwc.com
Tel: +353 1 6626768



The European Court of Justice (ECJ) has ruled in the Halifax and joined cases (21 February 2006) that supplies entered into solely for the purposes of gaining a tax advantage do qualify as supplies made in the course of economic activities; whilst the principle of abuse of Community law does apply to VAT, but only in limited circumstances.

Background

The fundamental issues being addressed by the ECJ in these cases were:

- Whether transactions entered into solely for the purposes of enabling input tax to be deducted qualify as 'supplies' in the course of an 'economic activity' ['the supply issue']; and

- Whether the doctrine of 'abuse of rights' operates to disallow the taxpayers right to deduct input tax ['the abuse issue'].

Findings of the ECJ

The supply issue

The ECJ has ruled that the terms 'economic activity', 'supply of goods' and 'supply of services' are objective in nature, and should be interpreted without reference to the purpose or results of the transactions in question.

Accordingly, the fact that economic activities are carried out, or supplies made, with the sole intention of gaining a VAT advantage, does not preclude such transactions from falling within the scope of VAT.

Indeed the Judgement states, 'Where the taxable person chooses one of two transactions, the 6th Directive does not require him to choose the one which involves paying the highest amount of VAT' and '... the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of a tax advantage'.

This element of the decision will come as little surprise to those following the debate particularly in light of the Advocate General's earlier Opinion in these cases, and the recent decision of the ECJ in Optigen and Others.

The abuse issue

The ECJ has affirmed the principle that Community law cannot be relied on for abusive means or for the purpose of wrongfully obtaining advantages provided for by community law, and that this principle does apply to VAT.

However, the ECJ has confirmed that this principle can only apply if the following two conditions are met:

1. Notwithstanding the fact that the formal conditions for securing the

particular advantage have been met, the granting of that advantage would be contrary to the purpose of the particular provisions.

2. It is apparent from objective factors that the essential aim of the transactions concerned is to obtain that advantage. In considering these factors, the substance and significance of the transactions concerned needs to be established. This evaluation may take account of factors such as the artificial nature of the transactions and the legal, economic and personal links between the parties.

Where the two above tests are satisfied, the transactions must be redefined or reconstituted, to establish the transaction which would have been carried out in the absence of the abusive transactions.

Additional elements

With regard to the prepayment arrangements implemented in the BUPA case, the ECJ has held that a payment on account cannot crystallise a tax point in respect of supplies of goods only identified in general terms, which the customer may choose from a list, and which he may unilaterally rescind at any time.

What does this mean for taxpayers?

Firstly, it should be borne in mind that each of the three cases referred were in respect of transactions which sought to crystallise an entitlement to deduction of input tax.

There are indications within the judgments that the concepts adopted would similarly apply to other types of VAT planning for example mitigating output tax, but the parameters are presently unclear. Indeed, whilst it is possible to more clearly identify the abusive effect of the transactions where input tax is being deducted by

businesses which engage in exempt activities, it is not easy to identify the abusive effect where the focus of the planning is on outputs alone.

Secondly, the ECJ has confirmed that VAT planning that has other commercial drivers may not be caught by the principle of abuse. Indeed, the ECJ has endorsed the fact that a taxpayer may choose to structure their business to limit their tax liabilities.

Thirdly, the ECJ has confirmed that a finding of abusive practice must not lead to a penalty but rather an obligation to repay all or part of the deductions of input VAT. It is ironic that s118 of the Finance Bill 2006 proposes to impose, in certain circumstances, a 10% surcharge where Revenue form an opinion that a transaction is a tax avoidance transaction.

The effect of the above can be summarized as follows:

- The ECJ recognises that businesses may choose to structure their commercial operations in a manner which results in the least VAT cost.
- Where Revenue has already challenged a business' VAT planning arrangements, advice should be sought as it is quite possible that further arguments are available to the business in defending its position.

What actions should businesses be taking?

- Those businesses that have been assessed or claims withheld should be carefully considering the validity of those assessments or refusals in light of this ruling.
- Going forward, businesses should feel confident about taking tax into account when planning where a genuine commercial rationale exists.

This document is intended only to provide a general guide to the subject matter. Professional advice should always be taken before acting on any information contained in this guide.

© 2006 PricewaterhouseCoopers. All rights reserved. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. PricewaterhouseCoopers, Wilton Place, Dublin 2 is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business.