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Changes in the Spanish Use and Enjoyment Vat Rule as of 1 January 2023

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Article 59a of the VAT Directive (Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax) was implemented into the Spanish domestic legislation through Article 70(2) of the Spanish VAT Law (Law No. 37 of 28 December 1992 on value added tax). This article contains a particular place of supply rule, with very clear aims: prevent double taxation, non-taxation or distortion of competition. This special provision is known as the 'use and enjoyment' rule.

The interpretation and practical application that the Spanish tax authorities have made of this rule have changed over the years. In recent times, the Spanish tax authorities made an excessively broad interpretation of it that, in many cases, made it difficult to determine with certainty when to apply the rule and in what terms. With effect from 1 January 2023, the Spanish government has listened to a long-standing demand from Spanish companies and has finally decided to significantly restrict the application of this controversial rule.

In this article, which may be seen as a continuation of the article published in this blog on 22 June 2022, the author explains the Spanish use and enjoyment rule's changes.

1. The Spanish VAT use and enjoyment rule until 31 December 2022

The Spanish VAT use and enjoyment rule in force until 31 December 2022 established that specific services are considered to be supplied within the Spanish VAT territory and, consequently, subject to Spanish VAT when, following the place of supply rules, these services are deemed to be located outside the EU territory, the Canary Islands, Ceuta or Melilla, if their effective use or exploitation is carried out within the Spanish territory.

Until 31 December 2022, the services covered by this specific place of supply rule were those listed in Article 59 of the VAT Directive when their recipient is a taxable person for VAT (B2B). The rule also applied to the following services irrespective of whether the recipient was a taxable person for VAT or not (B2B and B2C)

- the hiring of means of transport;
- telecommunications, radio and television broadcasting and electronically supplied services.

How the assessment for the application of the use and enjoyment rule should be carried out was as

follows:

- It should be first determined the type of services and the status of the recipient of those services to decide whether or not they were among those to which this particular rule applied;
- it should be afterwards determined the place of taxation of these services;
- if they were deemed to take place in a third country or territory, the supplier must ascertain whether the service supplied was somehow used or enjoyed within the Spanish territory;
- in such a case, Spanish VAT must be charged.

2. The historical difficulty of determining when a service was used or enjoyed in the Spanish VAT territory

As the author pointed out in the previous article, **determining when a service was used or enjoyed in Spain has been a complicated task. In this respect, the Spanish VAT law did not establish a uniform criterion to be followed**, so each situation must be analyzed individually.

Indeed, the criterion applied by the Spanish tax authorities has not been uniform over the years, but rather the scope of application of the rule has varied, not to make the rule more restrictive and to provide a more straightforward interpretation, seeking legal certainty for VAT taxable persons, but rather the opposite. **We have seen a gradual expansion of the cases in which the use and enjoyment rule was understood to be applicable until it became a rule that was difficult to apply by service suppliers** and, even more worryingly, difficult to explain to their counterparty who ended up with an invoice where VAT was charged that in many cases would not be recovered.

We can say that the Spanish tax authorities' pioneer criterion for this rule to apply was that the service recipient must be the same person who actually used the service in the Spanish VAT territory. According to this former criterion, it was also necessary to find the underlying transaction for which the service is rendered. The use and enjoyment rule were applicable only if such an underlying transaction was subject to Spanish VAT. Also, a direct or substantial relationship between the service rendered and the underlying transaction was necessary.

This scenario implied a complicated process assessment which involved an effort from the VAT taxable persons and required them to have their transactions very well documented so that they could demonstrate in due course the application or non-application of the rule. However, despite all this, at least the process established a set of minimum criteria to be met, which gave a certain comfort to taxpayers.

However, as the author pointed out, **this criterion has not remained static but evolved towards a broader application adding more complexities to the process**. In the last rulings just before the 2023 changes were approved, the Spanish tax authorities no longer required a strong link between the service supplied and the underlying transaction for which the service was rendered.[1] Moreover, the rule is no longer applied only in cases where the services were effectively used in Spain by the direct recipient of those services. The rule could also be applied in cases where the services were effectively used or enjoyed in Spain by any other further recipient and regardless of whether these recipients of the services carried out transactions subject to VAT in Spain or not.

As can be seen, the Spanish tax authorities´ criterion evolved from a position in which a strong and direct relationship was required between the service provided and the underlying transaction to a much broader criterion in which the relationship no longer needed to be so direct and a mere weak link between the services supplied and any further transaction and further taxable person was

enough for this controversial rule to apply.

3. Some controversial aspects of the Spanish VAT use and enjoyment provision

The use and enjoyment rule, described in the VAT Directive, aims to avoid double taxation or non-taxation. Its application cannot be generalized as it is a particular provision. Indeed, this article is placed in section 3, named “particular provisions”, within Section 3 Chapter 3, Title V of the VAT Directive.

Precisely because a particular provision is just that, particular, it must be applied taking into account the objective circumstances of the case, and cannot be applied based on mere indications or ambiguous criteria. According to this, application of Article 59a of the VAT Directive and its equivalent articles in the domestic legislation of the different Member States must apply only in those cases where it is foreseen that a service will not be taxed for VAT or, on the contrary, will be double-taxed. Applying the use and enjoyment rule in any other circumstance would breach its purpose and not be aligned with EU legislation.

The problem with the Spanish tax authorities’ application of this rule was the broad extension of its scope of application. This broad application of this particular provision is particularly serious in cases where the Spanish tax authorities decided to apply the rule even in cases where not the recipient of the service but any other subsequent operator could make such use or enjoyment. This clearly left taxable persons in a situation of uncertainty and did not comply with many of the fundamental rationales underlying the functioning of the common VAT system, such as the following:

- The rules governing the place of supply must be applied to each individual transaction. Any further transaction following the initial one should be analyzed separately with their own place of supply rules. This is precisely what the Spanish tax authorities were not doing by re-assessing the place of supply of a given service according to what happens with another service supplied further down the supply chain. It is worth noting that the CJEU warned that the use and enjoyment rule does not require an account to be taken of transactions carried out after the first supply of services.[2]
- As mentioned in the previous article, the starting point of this problem is the generalised application to all types of services of the CJEU´s decision in the *Athesia Druck* (C-1/08) The criterion outlined by the CJEU in this case should apply similar cases to the one dealt with by the court (advertising services). Using a broad interpretation of a certain and particular court case without clear guidance may be inaccurate.

The adverse effects of this application of the use and enjoyment rule by the Spanish administration over the years have been numerous. For example, Spanish companies have often been obliged to charge VAT to their non-EU customers based on ambiguous criteria. This made non-EU companies, which found it difficult (and impossible in many cases) to recover the VAT, reluctant to do business with Spanish companies. In cases where the recipient companies agreed to receive an invoice with Spanish VAT, they postponed the payment until the input VAT was refunded to them. Since these are companies from third countries, these refunds were not often possible, generating a severe problem for Spanish companies that had to pay the VAT to the Spanish tax authorities even though it had not been paid to them by their customers, without the possibility of recovering it in any way. **Ultimately, all of the above resulted in losing**

competitiveness for Spanish businesses.

4. The new use and enjoyment rule from 1 January 2023. A more restrictive application but part of the problem remains unsolved

The Spanish government has finally decided to modify the use and enjoyment rule with effect on 1 January 2023 through the General State Budget Law for 2023. If it has done so, it means that it has effectively understood that the interpretation that was being made of the rule was erroneous. In fact, the law passed by the Spanish government itself states that the reason for modifying this rule is '*harmonise VAT legislation with EU legislation as regards the place of supply of certain services*'.

The Spanish government admits that the use and enjoyment rule, as it has been applied in Spain, has shown that it limits the competitiveness of Spanish companies and that the application made so far cannot be justified as an anti-fraud measure.

The rule is modified, with effect on 1 January 2023, as follows:

- The rule will apply to B2B supplies in sectors that do not generate the right to deduct input VAT, such as the financial and insurance activities
- The rule also applies to the B2B and B2C supplies of services consisting of leasing of means of transport; and
- The rule will also apply to supplies of intangible services (those listed in Article 59 of the VAT Directive) when provided to final consumers (B2C) not established or domiciled in the EU territory.

As can be seen, **the use and enjoyment rule has been significantly reduced and no longer applies to the vast majority of B2B services**. This is undoubtedly a welcome change that will be very well received by Spanish taxable persons. However, in those cases where the rule applies, the problem has not yet been wholly solved because **it will still be necessary to determine when a service is used or enjoyed in the Spanish territory** and, as we have seen, there is no clear criterion, not even a guideline to follow.

The author considers that it would be a reasonable solution to consider that a service is understood to be used and enjoyed in Spain only when the direct recipient of the service carries out transactions subject to VAT in Spain on the occasion of the acquisition of that service in the case of B2B transactions. In the case of B2C transactions, the author considers that the service should be understood to be used and enjoyed in Spain only when consumed in the Spanish territory by the person acquiring it. **Extending the rule beyond the first acquirer of the service does not seem reasonable and, as we have seen above, is difficult to reconcile with EU law**.

The changes approved by the Spanish government have effects as of 1 January 2023, which means that the previous interpretation remains in force in earlier years that can still be audited by the Spanish tax authorities. Therefore, until the statute of limitation period expires (four years in Spain), uncertainty remains for VAT taxable persons unless we consider the statement made by the Spanish government that the rule is being changed to align the Spanish VAT law with EU VAT legislation, allows us to understand that it could have a retroactive effect. If this were the case, it would undoubtedly close much of the uncertainty around the Spanish interpretation of this rule.

5. Conclusions

The Spanish government has finally modified the use and enjoyment rule with effects from 1 January 2023. The application of the rule has been dramatically restricted.

In the words of the Spanish legislator, the rule has been amended to '*harmonise VAT legislation with EU legislation as regards the place of supply of certain services*'.

Although part of the problem has been solved by limiting the application of the rule to very specific cases, there are still doubts about what should be considered as 'using or enjoying' a service. The Spanish lawmaker still does not offer a guideline to follow.

The author proposes that whichever criterion is followed should refer exclusively to the potential use and enjoyment made by the initial purchaser of the service. Moreover, unless the application of the rule can be considered to have a retroactive effect to align with EU law, uncertainty exists until the exercises open to inspection are fully time-barred.

[1] Among others, ruling V0931-22 (29.04.2022); V0904-22 (28.04.2022); V0912-22 (28.04.2022); V0883-22 (26.04.2022); V0094-22 (21.01.2022) etc.

[2] CJEU´s judgment in case *Design Concept* (C-438/01). In particular, paragraphs 26 and 28 of the judgment.

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