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Highlights & Insights on European Taxation

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(comments by **Conceição Gamito** and **Nídia Rebelo**) (H&I 2023/176)

Introduction

The VAT treatment applicable to insurance companies' sales of parts from written-off motor vehicles has been the subject of a debate in Portugal in recent decades among academics, experts, the Portuguese Tax Authority and tax courts, and no consensus has yet been reached.

As a spoiler alert, we anticipate that the recently published judgment of the Court of Justice of the European Union (hereinafter: 'CJ') in *Generali Seguros, S.A.* (C-42/22) will not put an end to this long-running debate about the VAT framework for the resale of parts from written-off vehicles. In fact, we regard the questions not submitted to and therefore not analysed by the CJ as leaving more open than those resolved by the CJ's judgment.

General background

Under Portuguese insurance legislation (Article 13 of Decree-Law no. 44/2005 of 23 February), written-off vehicles are motor vehicles that, due to damage caused by accident seriously affecting their safety, become the property of an insurance company under the terms of an insurance contract.

Under the Portuguese compulsory motor vehicle insurance regime, the insured person ('the policyholder') and the insurance company may agree, in the event of an accident in which the vehicle covered is entirely written off, to transfer ownership of the parts of that written-off vehicle to the insurance company in exchange for a payment by the latter to the policyholder. To this end, the insurance company has to notify the policyholder of the payment it can make for these written-off parts. The policyholder then decides whether to accept this. If payment is made, the insurance company becomes the owner of the written-off vehicle, which it subsequently resells to a third party.

The sale of written-off vehicles was the subject of the case at hand, involving Generali Seguros S.A. and the Portuguese Tax Authority (hereinafter: 'PTA').

Generali Seguros S.A., an insurance company, purchased written-off vehicles damaged in accidents involving its policyholders. It subsequently resold these vehicles, without accounting for VAT on the sales, to third parties responsible for dismantling or destroying the vehicles. Following a tax audit for 2007, the PTA considered that the sales of written-off vehicles by Generali Seguros S.A. were subject to VAT as transfers of tangible property for consideration and were not eligible for any VAT exemption.

Generali Seguros S.A.'s position and legal arguments

Generali Seguros S.A. challenged the PTA's decision in an action brought before the Lisbon Tax Court, essentially arguing that the sale of written-off vehicles should be regarded as a transaction exempt from VAT insofar as it benefits from:

- the VAT exemption provided for in Article 9(28) of the Portuguese VAT Code (hereinafter: 'CIVA') (corresponding to Article 135(1)(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1) (hereinafter: the 'VAT Directive')), applicable to 'insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents'; and
- the VAT exemption provided for in Article 9(32) of CIVA (corresponding to Article 136(a) of the VAT Directive), applicable to 'transfers of goods which were used solely for an exempt activity, where those goods have not given rise to the right to deduction.'

In its judgment of 30 December 2017, the Lisbon Tax Court dismissed Generali Seguros S.A.'s action. The company subsequently appealed against that decision before the Supreme Administrative Court. Notably, the company argued before the Supreme Administrative Court that the VAT exemption should be applicable on the basis that resales of written-off vehicles by a company whose principal activity is insurance are connected with that activity and are inseparable from the normal activity of negotiating and paying compensation in the event of an accident, falling within the scope of that company's corporate purpose.

Questions referred for a preliminary ruling

In view of the diverging views on this topic, the Portuguese Supreme Administrative Court decided to stay the proceedings and to refer the following main questions to the CJ for a preliminary ruling:

– Must Article 135(1)(a) of the VAT Directive be interpreted as meaning that the concept of 'insurance and reinsurance transactions' includes, for the purposes of exemption from VAT, related or supplementary activities such as the purchase and sale of written-off vehicles?

– Must Article 136(a) of the VAT Directive be interpreted as meaning that written-off vehicles are regarded as being purchased and sold solely for an exempt activity, where those goods have not given rise to the right to deduction of VAT?

CJ's judgment

In reply to the first question, the CJ ruled that sales of written-off vehicles do not constitute

insurance transactions covered by the VAT exemption provided for in Article 135(1)(a) of the VAT Directive, notably because they take place under agreements separate from the insurance contracts covering the vehicles; these agreements are concluded between the insurance company and persons other than the insured person, and are not covered by an insurance relationship.

The CJ considered that a link cannot be established between those sales and the insurance transactions that constitute the core of the insurance company's activities, precisely because the original owners of the vehicles are not obliged to transfer them to the insurance companies. Indeed, the original owners' decision is independent of those insurance contracts and is taken only after those contracts have been concluded, and the risk covered has materialised. The CJ also analysed whether sales of written-off vehicles and the insurance transactions carried out by insurance companies should qualify as unique composite transactions for VAT purposes and be subject to the same VAT treatment (i.e., a VAT exemption), but concluded that those sales and the insurance contracts relating to those vehicles were not sufficiently linked to justify that conclusion.

Regarding Article 136(a) VAT Directive, the CJ ruled that the fact that the written-off vehicles acquired by the insurance company resulted from accidents insured by the latter and were intended not for use in the company's insurance activities (which are exempt from VAT), but were intended to be resold to a third party, in an unaltered state and without having been used, was sufficient to establish that such written-off vehicles were not relevant in the context of these insurance activities, thus rejecting the application of that legal provision to insurance companies' sales of written-off vehicles.

Setting the scene of the Portuguese discussions

As mentioned above, this judgment answers the two questions put to the Court of Justice of the European Union (hereinafter: 'CJ'), confirming that sales of written-off vehicles by insurance companies do not benefit from the VAT exemption provided for insurance transactions, nor from the VAT exemption provided for goods used exclusively in a VAT-exempt activity, when such goods have not given rise to the right to deduct VAT.

In our opinion, no specific questions arise regarding the non-applicability of the VAT exemption provided for insurance transactions to insurance companies' sales of written-off vehicles. It is easy to agree that the CJ used sound and solid arguments to reach this conclusion.

In line with the CJ's conclusions, Portuguese academics and experts – namely Clotilde Celorico Palma (see *O tratamento em sede de IVA da transmissão de salvados automóveis pelas seguradoras*, in FISCALIDADE no. 11, p. 17-32), José Xavier de Basto (defended in a legal opinion, *Sobre o tratamento em IVA da venda dos «salvados» automóveis pelas companhias de seguros*, October 1998) and Maria Odete Oliveira (see *Anotação ao acórdão do STA de 19 de Fevereiro de 2003, proferido no recurso n.º 26435, AXA versus Fazenda pública (IVA. Venda de salvados pelas companhias de seguros. Isenção*, in AAVV, *Jurisprudência Fiscal Anotada*, op. cit., p. 91 et seq.) – had already expressed the view that Article 9(28) of the Portuguese VAT Code (hereinafter: 'CIVA') does not apply to such transactions.

José Xavier de Basto considers that such sales are not an 'inevitable consequence of the assessment of the insurance indemnity, but the product of an agreement on the execution of the insurance contract, so that the assessment of the indemnity may be carried out by the alternative procedure of payment in cash only (…).' According to this author, the acquisition of written-off vehicles would

still be a result of the typical activity of the insurance company, but its subsequent sale transcends the concept of an insurance transaction as it is 'too far downstream' of that activity to be considered part of it [*unless indicated otherwise, translations from Portuguese are free translations by the commenting authors*].

Clotilde Celorico Palma believes that Article 9(28) CIVA 'comprises only transactions of insurance and reinsurance, including related services performed by insurance brokers and insurance agents, and cannot cover any other transactions carried out as a complement to insurance activities, even if they fall fully within the purpose of the insurance company, that have no direct connection with those transactions.' Thus, sales of written-off vehicles have only an indirect connection with the insurance activities and, as such, should not be exempt from VAT under that legal provision.

Maria Odete Oliveira also rejects the application of the exemption provided for in Article 9(28) CIVA, based on a literal interpretation of the wording of the legal provision and rejecting any systematic interpretation. In her view, Article 9(28) CIVA refers only to 'insurance and reinsurance transactions' and, contrary to what would result from the Portuguese legislation regulating insurance activities, does not cover activities related or complementary to insurance or reinsurance, such as sales of written-off vehicles.

As regards the VAT exemption provided for goods used exclusively in a VAT-exempt activity and where those goods have not given rise to the right to deduction, the CJ's failure to provide a sound and robust analysis of its position means it has not made it reasonably clear why this exemption does not apply to sales of written-off vehicles by insurance companies.

This aspect gains special relevance if we take into account that the possibility of applying this exemption to these transactions has already been contemplated by some of the Portuguese authors mentioned earlier. Clotilde Celorico Palma (see above reference) and José Xavier de Basto (see above reference) are of the opinion that the VAT exemption provided for in Article 9(32) CIVA applies to sales of written-off vehicles by insurance companies. According to these authors, the two cumulative requirements provided for in the first part of Article 9(32) CIVA for the VAT exemption to apply are met because: (a) the written-off vehicles that become owned by insurance companies as a result of a contractual arrangement, in the execution of an insurance contract, are allocated exclusively to the insurance companies' insurance activities (in the same way as office furniture or computer equipment), and (b) no VAT incurred in the acquisition of the written-off vehicles has been recovered because the activity carried out by the insurance companies is exempt from VAT.

Arguing the opposite, Maria Odete Oliveira (see above reference) believes that the conditions in Article 9(32) CIVA that have to be met for the VAT exemption to apply (i.e., the goods are used for an exempt activity and the acquisition of the goods by the taxable person was made with exclusion of the right to deduct VAT) are not met in the present case because: (a) 'it is not an exempt activity, but only exempt transactions. The exemption does not apply to insurance companies but only to insurance and reinsurance transactions carried out by them. The law does not state that all insurance and reinsurance activities are exempt, but only insurance and reinsurance transactions. The provision also does not cover related or complementary activities in general. Only those of insurance agents and brokers and not all but only those related to insurance and reinsurance transactions' and (b) the written-off vehicles should not qualify as goods connected with the insurance business because 'when we refer to goods connected with an exempt

activity, we are referring to goods that have been used in the business to carry out VAT-exempt transactions. Applying it in this context would mean starting not from the use of the asset to determine the regime for the subsequent sale, but reversing the relationship and taking the regime provided for the sale to qualify the previous use.'

It is also worth noting that the CJ has left out of the scope of its analysis the possibility of applying the second part of Article 9(32) CIVA (corresponding to Article 136(b) VAT Directive) to the sales of written-off vehicles. Under this provision, the VAT exemption also applies to transfers of goods in respect of which no VAT was deducted as a result of the application of an exclusion from the right to deduct VAT rules provided for in Article 21(1) CIVA (corresponding to Article 176 of the VAT Directive).

Given that this legal provision sees expenses incurred on purchasing or leasing a 'tourism vehicle' as one of the categories excluded from the right to deduct VAT, the question could have been raised as to whether Generali Seguros S.A. could apply this exemption to sales of written-off vehicles qualifying as 'tourism vehicles'.

Portuguese case law contains various judgments by the Supreme Administrative Court concerning the application of the VAT exemptions provided for in Article 9(28) and (32) CIVA to insurance companies' sales of written-off vehicles. In order to have a clear idea of how this matter has been addressed, non-unanimously, by Portuguese courts, it is relevant to highlight the first and also the most recent judgments by the Supreme Administrative Court on the subject.

In its judgment of 13 February 2003, case no. 26435, the Supreme Administrative Court ruled that 'the acquisition and subsequent sale of written-off vehicles by insurance companies under an insurance contract, being goods exclusively used in an exempt activity (insurance, reinsurance and related services), is covered by the exemption provided for in Article 9(29) and (33) CIVA [current Article 9(28) and (32) CIVA].'

Ten years later, the Supreme Administrative Court expressed a diametrically opposed position in its judgment of 23 January 2013, case no. 642/11, ruling that 'the sale of written-off vehicles by insurance companies does not fall within any of the exemption situations established by Article 9(29) and (33) CIVA [current Article 9(28) and (32) CIVA].' The court based its decision mainly on the opinions of the authors mentioned above, specifically Clotilde Celorico Palma, José Xavier de Basto and Maria Odete Oliveira, regarding the rejection of the application of the exemption provided for in Article 9(28) of the CIVA, and Maria Odete Oliveira regarding the rejection of the application of the exemption provided for in Article 9(32) CIVA.

More recently, the Portuguese South Central Administrative Court ruled along the same lines in its judgment of 24 June 2021, case no. 211/12.6BEFUN, referring to the latest decision of the Supreme Administrative Court in the above-mentioned case no. 642/11.

The Portuguese South Central Administrative Court rejected the application of the VAT exemption provided for in Article 9(28) CIVA on the grounds that: (a) the wording of the first part of Article 9(28) CIVA, by referring only to 'insurance and reinsurance transactions', covers only transactions included in the insurance companies' main activity, and thus excludes related or complementary activities, as in the case of the sale of written-off vehicles; and (b) in the second part of Article 9(28) CIVA, the exemption is extended to 'related services rendered by insurance brokers and insurance agents', referring to the activities included within the scope of insurance or reinsurance

activities and connected with the insurance sector, such as capitalisation transactions or mediation in the context of pension funds, and not the sale of written-off vehicles.

Additionally, it rejected the application of the VAT exemption provided for in the first part of Article 9(32) CIVA on the grounds that: (i) the acquisition of written-off vehicles does not result from execution of the insurance contract because, in the event of an accident, the insurance company is subject to the obligation to pay an indemnity, but this does not necessarily imply the acquisition of written-off vehicles; (ii) the purchase and sale of written-off vehicles, despite being complementary to the insurance activities, is merely an eventual activity that can be carried out by other entities; (iii) the legal provision refers to an exempt 'activity' and not to an exempt 'transaction', as in the case of the purchase and sale of written-off vehicles; (iv) even if the purchase of written-off vehicles were to result from clauses in the insurance contract, only the purchase could possibly benefit from the VAT exemption, and then only if it is understood that there is no underlying price, but rather the payment of an insurance premium; (v) where the party transferring ownership of the written-off vehicles is a private individual, outside the scope of VAT under Article 1 CIVA, the condition that it is a good that has not been subject to the right to deduct is missing.

Lastly, the Administrative Court rejected the application of the VAT exemption provided for in the second part of Article 9(32) CIVA by referring to the above opinion of Maria Odete Oliveira, according to which: (a) 'being the supply of the written-off vehicles outside the scope of VAT, it cannot properly be said that the insurance company acquired them without exercising the right to deduct VAT. This right of deduction is of input VAT (VAT borne on acquisitions). If there was no input VAT, it is not possible to talk of exercising or not exercising the respective right to deduct'; (b) 'extending the scope of the exemption provided for in Article 9(32) CIVA in the sense defended in the Supreme Administrative Court's decision of 13 February 2003 in case no. 26435 would imply accepting that whenever any taxpayer, given that the provision is generically applicable, acquires any good from a private individual, he would be in a position to exempt its subsequent transfer. However, in the most common case of the sale of second-hand goods, where goods are acquired from private individuals with the intention of re-introducing them into the market, a special provision was needed to cover such situations, which were not exempt from VAT in this way. The issue was the object of a specific directive (Council Directive 94/5/EC of 14 February 1994, or the 7th VAT Directive), transposed into Portuguese law under Decree-Law 199/96 of 18 October 1996. Under the regime deriving from the directive, in situations where the person insured is a private individual or taxable person who has not deducted input VAT on the purchase of the vehicle, the margin scheme applies to the sale by the insurance company because this is also a situation of second-hand goods acquired for sale'; and (c) 'in the particular case of the acquisition/sale of written-off vehicles, the extension of the scope of the exemption would raise the question as to whether it would also extend to the other connected or complementary activities provided for in Article 8(1) of Decree-Law 94-B/98 (2nd part) [regulating the conditions for access to and exercise of insurance and reinsurance activities in the territory of the European Community] as it can also be argued that they occur following or as a result of payment of the insurance premium and within the framework of insurance contracts, understood in the broadest sense.'

A particularly relevant point that was not raised at the CJ, and that was consequently not addressed in its judgment, was the possibility of using the VAT margin scheme applicable, for example, to the resale of second-hand goods, implemented in Portugal and regulated by Decree-Law no. 199/96 of 18 October.

The PTA provided guidance on its position in this respect in Circular Letter no. 30153/2013 of 16 October, stating that this margin scheme applied to insurance companies that had previously purchased written-off vehicles from private individuals or taxable persons who did not recover any input VAT on such vehicles. If this scheme were to be applied in such situations, VAT would be due only on the margin, i.e., on the difference between the sale and purchase prices of the written-off vehicle (in line with the CJ's interpretation in *Bawaria Motors* (CJ 19 July 2012, C-160/11 *Bawaria Motors*, ECLI:EU:C:2012:492).

Although less advantageous than the VAT exemptions provided for in Article 9(28) and (32) CIVA, the margin regime is undoubtedly a more attractive option than subjecting the resale transaction to the general VAT rules, particularly if account is taken of the very low margins applied by insurance companies when reselling written-off vehicles.

In the same circular letter, the PTA stated that, other than in these situations (i.e., where insurance companies purchased the written-off vehicles from policyholders who had recovered input VAT on those vehicles), insurance companies' sales of written-off vehicles were transactions complementary to insurance activities and subject to VAT, meaning that VAT should be assessed on such transactions by application of the general VAT rules (i.e., Article 3(1) CIVA). In practical terms, this would result in insurance companies having to account for VAT on those sales and being able to deduct the VAT incurred on the purchase of written-off vehicles from policyholders.

Although not requested by the Portuguese Supreme Administrative Court to rule on this, we believe it would have been very useful for the CJ to have ruled on the possible application of the margin scheme. All the more so because taxable persons tend to rely on the PTA's circular letters to guide their behaviour in these matters. What certainly is and will remain the case in Portugal is that the margin scheme will continue to be applied by insurance companies that previously purchased written-off vehicles from private individuals or taxable persons who did not recover any input VAT on such vehicles.

Conceição Gamito and Nídia Rebelo

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