Kluwer International Tax Blog

The Contents of Highlights & Insights on European Taxation, Issue 8, 2023

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Highlights & Insights on European Taxation

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The journal offers extensive information on all recent developments in European Taxation in the area of direct taxation and state aid, VAT, customs and excises, and environmental taxes.

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Year 2023, no. 8

TABLE OF CONTENTS

GENERAL TOPICS

DIRECT TAXATION, CASE LAW

INDIRECT TAXATION, CASE LAW

– ***Finanzamt X*** **(C-516/21)**. VAT exemption. Permanently installed equipment and machinery in context of leasing an agricultural building. Court of Justice

(comments by **Andrea Parolini**) (H&I 2023/206)

– ***CEZAM*** **(C-418/22)**. Penalties for failure to comply with VAT obligations. Court of Justice

(comments by **Andrea Purpura**) (H&I 2023/205)

– ***Dyrektor Izby Administracji Skarbowej w Warszawie*** **(C-114/22)**. VAT deduction. Invalid transaction under national civil law. Court of Justice

(comments by **Pawel Mikula**) (H&I 2023/208)

FREE ARTICLE

– ***Finanzamt X*** **(C-516/21)**. VAT exemption. Permanently installed equipment and machinery in context of leasing an agricultural building. Court of Justice

(comments by **Andrea Parolini**) (H&I 2023/206)

Case C-516/21 (*Finanzamt X*) arose in Germany and deals with the application of the principle according to which ancillary supplies must be subject to the same VAT regime of the main supply in the specific context of Article 135 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter: the 'VAT Directive').

Before going into the details of the case, it is worth reminding that, as far as European VAT principles are concerned, there is no absolute rule for determining the extent of a supply from a VAT viewpoint and the VAT Directive does not make any specific provision regarding the conditions under which several related supplies should be treated as one comprehensive supply. To this end, according to the Court of Justice of the European Union (hereinafter: 'CJ'), all the circumstances in which the supply took place must be taken into consideration (see, *ex multis*, CJ 25 February 1999, C-349/96 *Card Protection Plan*, ECLI:EU:C:1999:93; CJ 29 March 2007, C-111/05 *Aktiebolaget NN*,ECLI:EU:C:2007:195; CJ 2 December 2010, C-276/09 *Everything Everywhere Ltd*, ECLI:EU:C:2010:730). This general rule makes the outcome of the VAT analyses uncertain and every decision highly casuistic or case-specific.

In fact, as a general principle, every supply must typically be regarded as distinct and independent for VAT purposes.

Where, however, a supply comprises several elements, the question arises as to whether it is to be regarded as consisting of a single supply or of several distinct and independent supplies, which must be assessed separately from a VAT viewpoint. According to the settled case law of the CJ, in certain circumstances, several formally distinct services (which could be supplied separately and thus give rise, in turn, to taxation or exemption) must be considered to be a single supply: 'when

they are not independent' (see CJ 21 February 2008, C-425/06 *Part Service*, ECLI:EU:C:2008:108, paragraph 51). The most common example always brought in academic literature refers to the packaging service, which is clearly not independent from the goods supplied.

Broadly speaking, there are two different reasons to treat a combination of transactions as a single supply for the purposes of VAT:

- one or more supplies constitute a principal supply, and the other supply or supplies constitute one or more ancillary supplies, which share the tax treatment of the principal supply. In particular, a supply has to be regarded as ancillary to a principal supply if: 'it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied' (see joined cases CJ 22 October 1998, C-308/96 and C-94/97 *Madgett and Baldwin*, ECLI:EU:C:1998:496).In a formula, it can be expressed as follows: principal supply A + ancillary supply B together follow the VAT treatment of A, or simply A + B = A;
- furthermore, there is a single supply where two or more elements or acts supplied by the taxable person to the customer (the latter being a: 'typical or average customer') are so closely linked that they form, objectively, from an economic point of view, a single, indivisible economic supply, which it would be artificial to split (see, *ex multis*, CJ 19 January 2012, C-117/11 *Purple Parking*,ECLI:EU:C:2012:29). In such a case, one also needs to determine the nature of the composite supply, i.e., a supply of goods or a supply or services given that there is no principal supply that dictates the treatment for VAT purposes. In a formula, this can be expressed as follows: transaction A + transaction B create a new transaction with its own characteristics, or simply A + B = C.

The application of such principles may come to play a role in different situations, such as those involving the application of different VAT rates, situations in which different rules on the place of supply may be applied, or in situations where the application of exemptions is at stake.

Case C-516/21 (*Finanzamt X*) deals with the latter situation.

The fact patterns of the case are indeed simple and well described in the proceedings. From 2010 to 2014, Y leased turkey-rearing sheds with permanently installed equipment and machinery (i.e., an industrial spiral conveyor belt and a heating, ventilation and lighting system maintaining a temperature and brightness appropriate to the stage of growth of the animals concerned). Such goods were used to feed the turkeys and to guarantee the rearing conditions necessary for the turkeys to reach slaughter maturity and were specially adapted to the contractual use of the building as a building for rearing such poultry. Under the terms of the lease, Y received a single payment which was not split between the provision of the rearing sheds and that of the equipment and machinery. Y considered that the entirety of its leasing supply was exempt from VAT.

In the course of a scrutiny, the competent German tax office took the view that the leasing of the equipment and machinery at issue was not exempt and that the agreed one-off remuneration (including two components: 80 per cent attributable to the leasing of the real property and 20 per cent attributable to the equipment and machinery) had to be subject to VAT. That tax office issued amended tax notices for the years in dispute. Y brought an action against those notices.

The *Niedersächsisches Finanzgericht* (Finance Court, Lower Saxony, Germany), relying on the case law of both the CJ and the *Bundesfinanzhof* (Federal Finance Court, Germany), upheld the action brought by Y against those notices, taking the view that the supply was exempt in its

entirety. The competent German tax authorities appealed the decision before the German Federal Finance Court, which, in its turn, referred the case to the CJ.

The case is somewhat peculiar as the relationship between Article 135(1)(l) of the VAT Directive – which exempts from VAT the leasing and letting of immovable property – and Article 135(2)(c) of the same Directive – that excludes from the exemption the letting of permanently installed equipment and machinery – had never been directly faced by the CJ. The German Government considered Article 135(2)(c) of the VAT Directive as a kind of mandatory splitting provision because it excludes from the exemption the letting or leasing of operating equipment even if they are essential elements of an immovable property.

For this reason, the German Federal Finance Court asked the CJ whether Article 135(2)(c) VAT Directive covers only isolated supplies of leasing of equipment and machinery or also the leasing of such equipment and machinery together with an immovable property carried out by the same parties as if the latter provision would operate as a sort of mandatory splitting, such as the German Government pleaded during the procedure.

The CJ followed the analysis put forward by Advocate General (hereinafter: the 'AG') Pitruzzella (in his Opinion of 8 December 2022, ECLI:EU:C:2022:976) and concluded that Article 135(2)(c) VAT Directive does not operate as a mandatory splitting provision so that it does not apply where the letting or leasing of equipment and machinery constitutes only a supply which is ancillary to the principal supply of the letting or leasing of a building. To this end, both the AG and the CJ based their conclusions on the principles enshrined in CJ 19 December 2018, C-17/18 *Mailat*,ECLI:EU:C:2018:1038.

According to the CJ, such a conclusion would not be justified, even in light of the principle that exemptions must be strictly interpreted.

The CJ pointed out that, in the case at hand, the equipment was specifically adapted to the building and that the agreement was concluded between the same parties and provided for a single remuneration, circumstances that seem to suggest that the service constituted a single economic supply. However, the CJ left it to the referring court to determine which is the supply that is principal and the one that is ancillary.

To this end, one could wonder which are the criteria to be applied in identifying a single economic supply which is the main supply and which is the ancillary supply. To this end, several factors may be considered, and the result may vary depending on the factor applied.

One, for example, could be the value of the services (which, in its turn, would depend on the value of the assets). In the case at hand, if the value of the property is more relevant compared to the value of the equipment (as it seems to suggest the 80/20 splitting of the remuneration), one could argue that, in the eyes of the average consumer, the main supply is constituted by the attribution of the leasing right of the immovable property which, therefore, would be exempt from VAT.

It goes without saying that applying such principles could generate conflicts because, during a tax audit, the tax authorities and the taxpayer may have different opinions on the value to be attributed to the different elements forming a single service. However, such value, considered by itself, could also not be a decisive factor (as also stated by the CJ 29 March 2007, C-111/05 *Aktiebolaget NN*,ECLI:EU:C:2007:195). Indeed, factors having a subjective nature should be disregarded, given that their application might give rise to irrational results. This could be the case for a person who

chooses to lease a residential property because it includes a garden which has specific features (such as an equipped children's playground). In such a case, concluding that the person rented the equipped playground and not the property would have the effect of blurring the reasons for which a person decides to conclude a specific agreement with the nature of the service itself.

Andrea Parolini

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This entry was posted on Monday, August 28th, 2023 at 9:07 am and is filed under Customs and Excise, Direct taxation, EU law, Indirect taxation
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