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Free Gift, What Free Gift? Decrypting the CJEU VAT Judgment Deco Proteste – Editores (C-505/22)

Fabian Barth (VAT Manager Ernst & Young) · Friday, November 10th, 2023

Introduction

Two and a half years ago, the Kluwer International Tax Blog published a great contribution from Pawel Mikula titled “Are the Court of Justice of the European Union (CJEU)’s judgments on VAT too hard to understand?”. One could be forgiven for thinking that the recent judgment *Deco Proteste – Editores* (C?505/22) was the CJEU’s attempt to answer that question wholeheartedly in the affirmative.

While the decision is, in my view, substantially spot on as regards the legal conclusion, the judgment needs more clarity and contains statements that might be prone to misinterpretation. This post is my attempt at deciphering it. I will insofar (perhaps naively) assume that the CJEU intended to be consistent with precedent and was not seeking to depart from, or even overturn radically, anything it said in the past.

Issue Before the CJEU

The case referred to the CJEU by the Portuguese *Tribunal Arbitral Tributário* was not overly complex. The taxpayer sold subscriptions for a magazine. As is quite common in the business, they tried to incentivise new subscribers by providing them with a “gift” (i.e., a product free of charge) when signing up – specifically, this was a smartphone or a tablet. A new subscriber could keep the “gift” even if they left after the first month (so that they had paid only one month’s worth of subscription fees).

Under Article 16 of Directive 2006/112/EC (the VAT Directive), a provision of a good free of charge triggers a deemed supply, with the result that the supplier has to account for VAT on the value of the good (Article 74 of the VAT Directive). On the other hand, if a supply is made for consideration (Article 2(1)(a) of the VAT Directive), VAT is, in accordance with Article 73 of the VAT Directive, only due to the consideration actually received. The taxpayer in the case at hand had accounted for VAT only in proportion to the subscription fee received, not additionally on the value of the “gift”. In dispute was whether the “gift” was a supply under Article 16 so that additional VAT would be due thereon – a view the tax authorities naturally endorsed.

The CJEU ultimately found that there was no deemed “free” supply within Article 16 of the VAT Directive but that the supply of the gift was ancillary to the supply of the magazine, so VAT only had to be accounted for on the subscription fee. Furthermore, due to the designation of the “gift” as

ancillary, the reduced VAT rate for magazines also applied to it. This itself appears rather intuitive and not overly surprising. But, as I have indicated in the introduction, the CJEU's reasoning requires further dissection.

Determination of the Issue

The Missing Preliminary Issue

In the judgment, the CJEU dives straight into assessing whether the gift supply is an "ancillary supply" to the supply of the magazines under the subscription. To this end, the CJEU starts its analysis with a recaption of the principles concerning single versus multiple supplies. It also recalls its case?law on ancillary supplies:

"Second, an economic transaction constitutes a single supply where one or more elements are to be regarded as constituting the principal supply, while, by contrast, other elements are to be regarded as one or more ancillary supplies which share the tax treatment of the principal supply […]" (paragraph 22)

These statements themselves are not controversial and can be found almost *verbatim* in at least a dozen cases. Puzzling, however, is that this issue is raised right at the start of the judgment since its relationship to the question before the CJEU is not evident. The question asked by the national court, as summarised by the CJEU in paragraph 18, was essentially whether or not the "gift" was covered by the consideration paid by the subscriber for the main subscription. While it is true that the potential ancillary character of the gift formed part of the observations by the national court in the referral, the court itself formulated the issue in more general terms, asking whether the ostensible gift "falls within the concept of a 'supply of goods for consideration'" without reference to that being the case as an ancillary element to the main supply. The question summarised by the court could, therefore, in identical form, also arise in a context where it was clear that the gift was not ancillary, for example, because it had no relationship to the actual main supply. One unfortunate consequence of the judgment delving straight into the ancillary issue is that it could convey the impression that this alone was the relevant test for determining whether Article 16 of the VAT Directive applies. In other words, it *could* be read as if it was suggesting that the gift provided by Deco Proteste Editores would have *automatically* triggered Article 16 of the VAT Directive had it not been ancillary to the main supply.

This is, however, in my view, not what the CJEU meant to suggest. One test that can be applied to determine whether or not a "gift", as in *Deco Proteste*, was supplied for free is, in accordance with well-established principles, whether performance and payment occur under a legal relationship pursuant to which there is reciprocal performance. Perhaps the Judge Rapporteur would have been well?advised, for the sake of completeness, to start by reiterating (*mutatis mutandis* for goods) a statement he employed just half a year ago in *Gmina L* (C?616/21):

"According to settled case law, in order for such transactions to be 'for consideration' within the meaning of Article 2(1)(c) of Directive 2006/112, there must be a direct link between that supply of services, on the one hand, and the consideration actually received by the taxable person, on the other. Such a direct link is established where there is a direct link between the provider of the supply of services, on the one hand, and the recipient, on the other, a legal relationship in which there is reciprocal performance, the remuneration received by the provider of the transactions constituting the actual consideration for the service supplied to that recipient." (paragraph 25)

So, in my view, the real preliminary issue, at least for the question in the more general version as the CJEU itself stated it, was whether or not the "gift" was provided pursuant to the legal relationship under which the subscriber paid for the subscription. If that is answered in the affirmative (which, based on the referral, clearly would have to be the case), the "gift" is supplied in return for consideration and, therefore, not for free, depriving Article 16 *a priori* of applicability. Accordingly, the existence of the legal relationship itself would have already been sufficient to dispose of any notion of a "free supply", *whether or not* the gift was ancillary. Subsequently, it is necessary to ask whether the "gift" is ancillary to the magazine only to determine whether the tax rate of the latter also applies to the former or if, indeed, an allocation of the consideration is necessary.

While not being explicit, I think the fact that the gift formed part of the legal relationship pursuant to which the subscribers paid the subscription fee was a relevant consideration within the CJEU's reasoning. Indeed, it appears that the necessary direct link between the subscribers' payments and the provision of the "gift" was so evident to the CJEU that it did not require further scrutiny. Although it is (in the absence of an explicit analysis on the point) not with absolute confidence that I can say so, two pointers in the judgment strongly indicate that to the CJEU, in fact, it mattered that the "gift" was provided under the legal relationship pursuant to which the customer pays.

Firstly, at the end of paragraph 27, the CJEU finds as follows:

"The provision of such a gift therefore has no distinct purpose from the point of view of the average consumer, who agrees to pay at least one month's subscription in order to obtain the gift." (emphasis added)

If the customer "agrees to pay" "in order to" obtain something, there is reciprocity between the two, and hence a direct link so that the payment becomes the consideration for the supply.

Secondly, the value of the "gift" formed part of the determination of the subscription fee – a point made by the taxpayer (see paragraph 15) and accepted by the CJEU at paragraph 27:

"Moreover, it follows from the order for reference that the applicant in the main proceedings, in its commercial calculation, takes account of the fact that some subscribers will terminate their subscription after payment of the first monthly instalment, which allows them to keep the gift without being obliged to remain subscribers." (emphasis added)

If the gift influences the commercial calculation, and, by extension, the price, it follows that the fact that the subscribers pay for the gift reflects not only the legal but also the economic and commercial reality of the transaction.

These crucial points also distinguish the present case from *Kuwait Petroleum* (C?48/97), which *prima facie* appears to have similarities. In that case, fuel purchasers were given free vouchers if they purchased a certain quantity. The CJEU found this to be a free supply under what is now Article 16 of the VAT Directive. However, the value of the vouchers had no influence on the purchase price of the fuel (see paragraph 31 of that judgment) and was not part of the agreement according to which fuel was supplied (see paragraph 27), i.e., there was no reciprocity between fuel supply and payment, all the purchaser appeared legally entitled to was the fuel.

What remains unclear from *Deco Proteste Editores* is whether *Kuwait Petroleum* had been decided otherwise had the vouchers been ancillary to the supply of fuel. In that regard, one might debate

whether a supply without consideration, which, on a standalone basis, would trigger Article 16 of the VAT Directive, can be deprived of its character as a free supply when it is ancillary to a taxable supply. In other words, can a gift that does *not* form part of the legal relationship pursuant to which the main supply is made still be ancillary to it, and if it is, does it mean Article 16 is inapplicable? An argument against this might be that it better ensures the taxation of actual consumption when there is deemed consideration on the gift in addition to the actual consideration, and that the ancillary supply can, therefore, only share the VAT treatment of the main supply with regard to tax rate or exemption, but not with regard to the taxable amount. On the other hand, the judgment *Finanzamt X* (C?516/21), paragraph 34 *could* support the finding that the ancillary test is applied first, and that, if met, no further question around Article 16 of the VAT Directive arises. Crucially, however, in my view, the CJEU in *Deco Proteste Editores* did not mean to create authority for finding in favour of the latter. Even if a casual reading of the judgment might suggest so, it is, for the reasons given above, clear that the provision of the gift under the legal relationship was relevant to the outcome of the case and that the ancillary character of the gift *alone* was not *necessarily* determinative for the inapplicability of Article 16 of the VAT Directive.

All in all, if I had advised the CJEU, I would have recommended that it spend two or three paragraphs on clarifying these considerations. It should have been made clear that because the payment of the subscription fee and the provision of the gift are mutually dependent on one another under a legal relationship (i.e., under the subscription agreement), there can be no supply for no consideration, and, hence, no application of Article 16 of the VAT Directive. This would have prevented any confusion around the degree of relevance of the ancillary character of the gift for the outcome of the case insofar as the existence of a free supply was concerned.

The fact that one is left to deduce these conditions from parts of the judgment that are easy to overlook is unfortunate.

The Ancillary-Supply Issue: An Ancillary Problem

Once the finding above has been made, it becomes necessary to analyse whether the “gift” is ancillary to the main supply of magazines. That matters because the two are, in Portugal, subject to different VAT rates.

The summary of the relevant legal principles in that regard, as it can be found in paragraphs 19 to 24 of the judgment, is not new and essentially beyond reproach.

Also, the fact that the CJEU found it a factor in favour of the ancillary character that the “gift” was a smartphone or tablet that could be used to read the magazines, hence a “means to better enjoy” the subscription, does not as such raise any eyebrows (although one might ask whether that is really the main point of the device, this is now water under the bridge).

Open to misinterpretation are, however, the references of the CJEU to the commercial position of the supplier. In paragraph 25, we are told:

“In this case, it is apparent from the information provided by the referring court, summarised in paragraphs 9 to 11 of the present judgment, that the provision of subscription gifts for all new subscriptions is an integral part of the commercial strategy of the applicant in the main proceedings. Furthermore, according to that court, [the number of subscribers] are considerably higher when accompanied by subscription gifts.” [The part in square brackets was replaced to correct a translation mistake in the official English translation of the judgment, FB].

Likewise, paragraph 27 focussed on the supplier's commercial position:

"The fact that the applicant in the main proceedings gives a subscription gift to new subscribers constitutes an incentive to subscribe. Its sole purpose is to increase the number of subscribers to the magazines published by that applicant and, consequently, to increase its profits."

At first glance, this might surprise. It is clear from the preceding case?law that the nature of a supply as ancillary must be assessed from the viewpoint of the average consumer. This is, under neutrality?considerations, as well?established as it is sensible. The preceding parts, however, could be interpreted as suggesting that the Court now also allows the supplier's perspective to be taken into account. There are numerous arguments why such a shift in case?law would be undesirable, but it is unnecessary to address them in the present context because I do not think that any such shift has occurred.

Firstly, the judgment in *Deco Proteste Editores* itself reiterates the necessity to focus on the perspective of the "average customer" in paragraph 23 and does not indicate any intention to depart from there. If such a departure was intended, one might reasonably expect it to be clear from the judgment.

Secondly, and more importantly, however, the sole reason why the CJEU considers the supplier's commercials seems to be that they enlighten what the "average" customer wants. In this context, it is helpful to remember that customers could technically terminate the subscription immediately after the first month while still keeping the gift. For such customers, the gift was likely not ancillary but rather the main reason why they signed up in the first place. Hence, to get comfortable that this was not the position of the "average" consumer, the CJEU examined the bigger picture and concluded that the fact that the arrangement makes commercial sense for the supplier proves that the majority of subscribers must remain subscribed for longer than just for receiving the gift. This is particularly clear from the end of paragraph 27:

"The fact remains that the subscription gift enables the applicant in the main proceedings to increase significantly the number of its subscribers each year. The provision of such a gift therefore has no distinct purpose from the point of view of the average consumer […]." (emphasis added)

The inclusion of the operator "therefore" leaves, in my mind, little doubt that the CJEU's thinking was as follows. The gift enables the applicant to increase its profits and subscribers. Hence, the average subscriber does not just sign up for the gift.

This is, however, an entirely reasonable factor to take into account when seeking to assess what the average consumer wants, and it cannot in any way undermine the principle that it is, in fact, that perspective that matters.

Conclusion

The CJEU was asked whether a "free" smartphone or tablet supplied as an incentive to subscribe to a magazine constituted a free supply, which triggers VAT under Article 16 of the VAT Directive. It found that the free "gift" was not supplied for free but that the customer paid for it by paying the subscription fee. Moreover, it found that the supply of the "gift" was ancillary to the supply of magazines and, therefore, followed the VAT treatment of the latter.

All of this makes sense. All of this is clear. However, the CJEU's reasoning in its judgment at

times lacked clarity. The preceding is, in my view, an interpretation that emerges if one reads the judgment very carefully and reconciles it best with precedent. No doubt, further case law will be necessary if one wants to be fully confident in these readings, and other interpretations are perfectly possible.

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This entry was posted on Friday, November 10th, 2023 at 12:05 pm and is filed under CJEU, Gift, VAT
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