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Highlights & Insights on European Taxation

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Year 2024, no. 11

TABLE OF CONTENTS

legislation. Court of Justice

(comments by **Svetlin Krastanov**) (*H&I* 2024/301)

– ***Drebers*** **(C-243/23)**. EU law precludes Belgian rules on extended adjustment period for immovable property in case of substantial

renovation. Court of Justice

(comments by **John Gruson & Nikhil Mediratta**) (*H&I* 2024/300)

– ***Makowit*** **(C-182/23)**. Expropriation of agricultural land subject to VAT. Farmer is taxable person. Court of Justice

(comments by **Emilia Sroka**) (*H&I* 2024/270)

– ***Inspecteur van de Belastingdienst Utrecht*** **(C-639/22 to C-644/22)**. VAT exemption for pension funds. Court of Justice

(comments by **Jeroen Bijl**) (*H&I* 2024/269)

CUSTOMS AND EXCISE

– ***Online services for Customs: NCTS, AES and PoUS***

(comments by **Piet Jan de Jonge**) (*H&I* 2024/280)

– ***Commission publishes the 2025 version of the Combined Nomenclature***

(comments by **Piet Jan de Jonge**) (*H&I* 2024/276)

MUTUAL AID

– ***Ordre des avocats du barreau de Luxembourg*** **(C-432/23)**. Protection of exchanges between lawyer and client in company law versus exchange of information on request in tax matters. Court of Justice

(comments by **Edwin Thomas**) (*H&I* 2024/294)

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FREE ARTICLE

– ***Makowit*** **(C-182/23)**. Expropriation of agricultural land subject to VAT. Farmer is taxable person. Court of Justice

(comments by **Emilia Sroka**) (*H&I* 2024/270)

The doubts raised by the Polish court concerned whether the transfer of ownership of agricultural land through expropriation, in exchange for compensation paid to a farmer who is a VAT-taxable person, should be subject to VAT, even though the farmer was not involved in any real estate transactions and had not taken any steps to facilitate such a transfer.

The ruling of the Court of Justice of the European Union (hereinafter: 'CJ') aligned largely with the position of the Polish tax authorities and the EU Commission. The Polish authorities argued that a farmer registered as a VAT-taxable person, who transfers ownership of agricultural land to the State Treasury through expropriation in exchange for compensation, due to the land being repurposed for non-agricultural use, should be considered to be acting as a VAT-taxable person for the purposes of that transaction (Written Comments of the Republic of Poland (RP) in case C-182/23, 28 July 2023, ref. DPUE.9313.168.2023.AJK(2)(AKS), obtained under the access to public information procedure, paragraph 31). The EU Commission adopted a similar position, indicating that the interpretation 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') leads to the conclusion that the disputed transaction should be subject to VAT. The fact that the taxable person's economic activity does not involve real estate transactions does not alter this conclusion (Written Comments of the EU Commission in case C-182/23, 12 July 2023, ref. sj.d(2023)7040197, obtained under the access to public information procedure, paragraphs 36 and 57).

Interestingly, in the EU Commission's view, it was not the interpretation of Article 9(1) of the VAT Directive, as pointed out by the referring court, that was relevant to resolving the dispute. This provision defines the concepts of the taxable person and economic activity, and the question of whether the farmer is a VAT-taxable person and whether he conducts an economic activity seemed uncontroversial to the EU Commission. Therefore, the EU Commission rightly suggested determining whether Article 2(1)(a) in conjunction with Article 14(2)(a) of the VAT Directive should be interpreted to mean that a transaction occurring under the factual circumstances of this case is subject to VAT. The CJ agreed with the Commission's position, stating that the referring court's question essentially seeks to interpret Article 2(1)(a) in conjunction with Article 14(2)(a) of the VAT Directive (paragraphs 22-24).

According to Article 2(1)(a) of the VAT Directive, a supply of goods for consideration within the territory of a Member State by a taxable person acting as such is subject to VAT. This provision establishes that for a transaction to be subject to VAT, two conditions must be fulfilled: first, there must be a supply of goods for consideration within the territory of a Member State; and second, the supply must be made by a taxable person acting as such.

In the case of the first condition, it is necessary to refer to the wording of Article 14(2)(a) of the VAT Directive, which provides that the transfer, by order made by or in the name of a public authority or in pursuance of the law, of the ownership of property against payment of compensation shall be regarded as a supply of goods.

In interpreting this condition, the CJ similar to the EU Commission and the Polish authorities in their written comments, referred to the conclusions of the judgments in *Gmina Wroc?aw* (CJ 13 June 2018, C-665/16 *Minister Finansów v Gmina Wroc?aw*, ECLI:EU:C:2018:431 and CJ 25 February 2021, C-604/19 *Gmina Wroc?aw v Dyrektor Krajowej Informacji*

Skarbowej, ECLI:EU:C:2021:132).

Based on these judgments, the CJ first confirmed that Article 14(2)(a) of the VAT Directive constitutes *lex specialis* in relation to Article 14(1) of the VAT Directive, which defines 'supply of goods' as the transfer of the right to dispose of tangible property as owner (judgment, paragraph 28). Second, the CJ reiterated that for a transaction to qualify as a 'supply of goods' within the meaning of Article 14(2)(a) of the VAT Directive, three cumulative conditions must be fulfilled: (i) there has to be a transfer of a right to ownership, (ii) that transfer must be by order made by, or in the name of, a public authority or in pursuance of the law, and (iii) there must be payment of compensation (paragraph 29).

The CJ emphasized that, in this case, the first two conditions were clearly met (paragraph 30), the expropriation resulted in a change of ownership from the farmer to the State Treasury, and the transfer of ownership was based on a decision issued by the *voivode*, which is a public authority. However, there was some uncertainty regarding the fulfilment of the third condition. The Polish authorities indicated that, in connection with the expropriation, the *voivode* initiated proceedings to determine the compensation owed to the farmer for the land taken by the State Treasury and issued relevant decisions awarding compensation. Nonetheless, at the time of the prejudicial request, such compensation had not yet been paid. Thus, they concluded that the transfer of ownership by expropriation would qualify as a supply of goods only at the moment the compensation awarded to the farmer was paid (the Republic of Poland's (RP) Written Comments, paragraph 20). The CJ also noted that the transaction would be considered a 'supply of goods' only if the payment of the compensation 'has become effective', leaving this assessment to the referring court (paragraphs 31-32).

For Article 2(1)(a) of the VAT Directive to apply, in addition to the aforementioned condition that there must be a supply of goods for consideration, it is also necessary to fulfil the second condition, namely that the supply must be made by a taxable person acting as such. This particular condition appears to raise the greatest concerns for the referring court, due to the fact that the farmer was not engaged in any economic activity related to real estate transactions but was solely conducting agricultural activities.

It is worth noting that in the Polish practice of applying VAT provisions, administrative courts and tax authorities often treat the sale of real estate used in agricultural economic activity in a specific manner, often concluding that farmers engaging in such transactions are not acting as a VAT taxable person, given that their agricultural activity is not related to real estate trading (G. Kaptur, 'Podatnik VAT w obrocie nieruchomo?ciami VAT, cz. XXXV – wyrok Trybuna?u Sprawiedliwo?ci z 11.7.2024 r. (C-182/23, Makowit), cz. I', *Nieruchomo?ci* 9 (2024), p. 29).

In this context, it should be noted that according to the CJ's settled case law, the key issue in determining whether a transaction is subject to VAT is whether the property constitutes part of the taxable person's business or private assets. In *Armbrecht* (CJ 4 October 1995, C-291/92 *Finanzamt Uelzen and Dieter Armbrecht*, ECLI:EU:C:1995:304, paragraphs 17-18), the CJ noted that the distinction between private assets and assets used for economic activities depends on how the assets are used. It was held that a taxable person performing a transaction in a private capacity does not act as a taxable person and that a transaction performed by a taxable person in a private capacity is not, therefore, subject to VAT. This position was further developed in *Bakcsi* (CJ 8 March 2001, C-415/98 *Laszlo Bakcsi v Finanzamt Fürstenfeldbruck*, ECLI:EU:C:2001:136, paragraphs 37 and 40), where the CJ clarified that a taxable person who sells a business asset is

acting in a business capacity and therefore as a taxable person. It was highlighted that when a taxable person has chosen to incorporate, in full or in part, the capital item into his business assets, the fact that the taxable person was not authorised to deduct the VAT attaching to that item is irrelevant. The broad interpretation of economic activity and the principle that assets used for economic purposes in a business are subject to VAT, regardless of the specific details of the transaction, was also emphasized in *Polfarmex* (CJ 13 June 2018, C-421/17 *Szef Krajowej Administracji Skarbowej v Polfarmex Spó?ka Akcyjna w Kutnie*, ECLI:EU:C:2018:432). Here, the CJ held that even complex transactions, such as the transfer of real estate in return for the redemption of shares, can be treated as supplies of goods within the meaning of the VAT Directive. The Court stressed that the decisive factor is whether the property forms part of the taxable person's business assets used in economic activity, and not how the transaction was structured (*Polfarmex*, C-421/17, paragraph 42).

The case *Slaby & Ku?* (CJ 15 September 2011, C-180/10 and C-181/10, *Jaros?aw S?aby v Minister Finansów and Emilian Ku? and Halina Jeziorska-Ku? v Dyrektor Izby Skarbowej w Warszawie*, ECLI:EU:C:2011:589) also serves as a key point of reference. In that decision, the CJ emphasized that a natural person who carried out agricultural activity on land that was reclassified following a change to urban planning regulations, which took place for reasons beyond their control, must not be regarded as a VAT taxable person, unless that person takes active steps to market the property, deploying resources similar to those used by a producer, trader, or service provider in concluding those sales (*Slaby & Ku?*, C-180/10 and C-181/10, paragraphs 50-51).

In the case at hand, the Polish authorities highlighted that the fact that the expropriated land was used in the farmer's economic activity means that such property can no longer be considered part of the farmer's private assets. Therefore, it was argued that the transfer of ownership of such assets should be subject to VAT (RP's Written Comments, paragraphs 28-30).

The EU Commission took a similar stance, stating that the mere fact that the properties were used in an economic activity (agricultural) was sufficient to conclude that the farmer acted as a taxable person (EU Commission's Written Comments, paragraph 55). The EU Commission also stressed that, under Article 14(2)(a) of the VAT Directive, it is not required that the taxable person take active steps to sell the property, especially in the case of expropriation, which takes place by operation of law (EU Commission's Written Comments, paragraphs 53-54). The EU Commission further noted that the fact that the disputed land was used for economic activity at the time of expropriation distinguishes this case from *Slaby & Ku?* (C-180/10 and C-181/10), to which the referring court alluded when raising its doubts. In those cases, at the time of the disputed transactions, the individuals were no longer engaged in agricultural activities on the disputed land, and the debate before the CJ centered around whether their activity of selling the land could qualify as economic activity. Such a debate did not arise in the present case (EU Commission's Written Comments, paragraph 56).

The CJ concurred with the tax authorities and the EU Commission (paragraph 38). Importantly, the Court also added that expropriation does not require any active steps from the taxable person and requiring them would be contrary to the nature of expropriation and the effectiveness of Article 14(2)(a) VAT Directive (paragraph 39). Nevertheless, the CJ left some discretion to the national court, stating that if the referring court were to find that the transaction in question was carried out by the farmer as part of the management of assets not intended for agricultural activity, it should conclude that the farmer was not acting as a taxable person, and the transaction would not be subject to VAT (paragraph 40).

As rightly pointed out in the doctrine, in practice, determining whether a property is a part of the taxable person's business assets or private assets presents various challenges, particularly as the classification of the property may change over time. A taxable person may withdraw the property from the business assets, or property initially held as private assets may become part of the business assets (see Kaptur 2024, *op. cit.*, p. 32-33). It appears that this type of dilemma is closely linked to the specific facts of each case, and it is appropriate that the CJ rightly leaves the resolution of such uncertainties to the national court.

In conclusion, *Makowit* (C-182/23) fits into the CJ's established case law, which confirms a broad interpretation of economic activity and holds that properties used in such activities form part of the taxable person's business assets. This means that their sale is subject to VAT, even if the taxable person does not take active steps to sell the property. The ruling is particularly important as it clarifies that in the case of expropriation imposed by a public authority, the lack of active steps by the taxable person does not preclude VAT liability, provided the property was used in an economic activity.

Dr. Emilia Sroka

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