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Public Bodies and VAT Treatment in a Brief look at the Alternatives Solutions

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ABBREVIATIONS

Art.	Article
AG	Advocate General
Commission	Commission of the European Communities
EC	European Commission
ECJ	European Court of Justice
EU	European Union
Sixth Directive	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment.
MS	Member State
VAT	Value Added Tax
UK	United Kingdom
GST	Goods and Services Tax
RVD	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

1. Introduction

1.1. Background

An analysis of the VAT treatment of public bodies should begin from Article 13 of the European Union (Council Directive 2006/112/EC), which is the main provision of the VAT Directive, regarding bodies governed by public law. Undoubtedly, VAT is a general tax on consumption, applied indirectly through taxing supplies of goods or services for consideration at all stages of production and distribution.¹ The generality of that tax implies the inclusion of all economic activities, whatever might be the form of taxable persons involved in the provision of goods and services. It also entails a full right to deduct VAT on acquisitions by non-consumers.² Beyond its general character, the European VAT system excludes public bodies from the scope of the VAT. As a result, public bodies are taxed on their inputs as they will be charged VAT on purchases made, which are not deductible under EU VAT system.

According to the provisions of Art 13(1) RVD: ‘bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions’.³ Consequently, the activities or transactions performed by public bodies when acting as public authorities are outside the scope of VAT. Undoubtedly, no rule stands without exceptions and in the case of public bodies those are many and interesting. Accordingly, a public body is considered to generate taxable supplies in case:

1. They engage in activities as public authorities, but they are treated as taxable persons so as to avoid giving rise to considerable distortions of competition.⁴
2. They supply the goods or services listed in Annex (I) of VAT Directive, ‘provided that those activities are not carried out on such a small scale as to be negligible’.⁵
3. They generate intra community acquisitions above a specific threshold.⁶

As a result of being out of scope of VAT (based on Article 13 of RVD) public bodies are not eligible to deduct input VAT on their purchases because this advantage is preserved for taxable persons insofar they make taxable supplies. However, public bodies performing in their formal capacity are considered final consumers and must pay VAT on all their purchases.⁷ Ben Terra, Michel Aujean, Peter Jenkins and Satya Poddar, disagree with the current treatment of public bodies and believe that ‘[t]he traditional thinking with respect to services for which no explicit fee is charged is that the public bodies providing these services are themselves to be regarded as final consumers of the inputs necessary to make the supplies rather than as an intermediary/supplier in the distribution chain for these activities. If one moves away from this traditional line of thinking and treats a public body as an

¹Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of VAT, (2006) OJ L347/1 recasting Sixth Council Directive 77/388/EEC of 12 May 1977 on the harmonization of the laws of the Member States relating to turnover Taxes – Common system of VAT: uniform basis of assessment, (1977) OJ L145/01.

²Ben Terra- Julie Kajus, ‘A Guide to the European VAT Directives: The Recast VAT Directive’, vol. 1, IBFD, 2011.p274.

³Article 13(1), RVD, 2006/112/EC

⁴Article 13(1), Para 2, RVD, 2006/112/EC

⁵Article 13(1), Para 3, RVD, 2006/112/EC

⁶Article 2 (1) (b) (i) and 3(2) (a), RVD, 2006/112/EC

⁷ They are some exceptions in supplies to public bodies are whichever zero rated or exempt, such as supplies of warships and provisioning of and maintenance and other services to war ships (Article. 148(b)), gold for central banks (Article.152, RVD 2006/112), supplies under diplomatic provision (Article 151(a) RVD), and supplies within the context of NATO (Article 151(c) and (d), RVD).

intermediary/supplier for all of its activities regardless of whether a consideration was charged for them, a more logical and less distortional VAT system emerges'.⁸

In fact the common perception of final consumers is that they are mostly individuals, who purchase goods or services in order to consume them and not with the intention of selling them to other persons. On the other hand, when legal persons acquire goods or services, either in public or private sector, they have to be considered as inputs to the activities they are involved in. In order to determine the VAT treatment of public bodies in EU, it would first be essential to answer two basic questions:

1. Are transactions performed by public bodies regarded as 'taxable' or 'non-taxable'?
2. If they are considered taxable, are they considered 'VAT-exempt' or 'non-exempt'?

In practice, defining a public body's VAT liability is not an easy task for Member States. Nevertheless, the link between the first part (1) and second part (2), of Article 13 is not clear for Member States, and as a consequence they cannot exercise the option to consider an exempt activity listed as out of scope of VAT when this would lead to a considerable distortion of competition.⁹ Therefore, supplies generated by a public body may be outside the scope of VAT, or they may fall inside the scope because the public body is not performing as a public authority or its activities are subject to one of the exceptions.

As a consequence of current VAT treatment on public bodies, there is no regular interpretation of what is included in public activities. The European Court of Justice (ECJ) has ruled that the distinction between private and public activities can only be judged under national law and in accordance with the legal system applicable to public authorities.¹⁰ For example, in several cases dealing with road tolls, the Court judged that the activity of providing access to roads on payment of a toll carried out in an exclusive manner by traders administered by private law is subject to VAT, resulting indeed that road tolls in Ireland are taxed, in the UK and France partially taxed since as carried out by private traders, and in the Netherlands and Greece not taxed at all, if carried out by public bodies.¹¹

In addition, the Commission has recently initiated a study of the current provisions on public bodies and exemptions in the public interest. However, in view of the Commission the main problems of current treatment of public bodies are the following:¹²

- Lack of neutrality
- Lack of harmonization
- Complexity

While the European Commission has in the past emphasized the need to revise the framework of the current VAT treatment on public bodies, there still have been no changes made to the VAT Directive.

8 Michel Aujean, Peter Jenkins and Satya Poddar in "A new approach to public sector bodies", *International VAT Monitor* 4 (1999), pp.144-149. Ben Terra- Julie Kajus,(2011), p.392.

9 Rita de la Feria, *The EU -VAT Treatment of public sector Bodies: Slowly moving in the wrong directive*,(Oxford University Centre for Business Taxation, *Intertax*, Volume 37, Issue 3, 2009, Kluwer Law International BV, The Netherlands.pp.148-165.

10 Case C-231/87 CarpanetoPiacento, [1989] ECR 3233.

11 Cases C-358/97 Commission v. Ireland, C-260/98 Commission V. Greece, [200] ECR I-6355, C-408/97 Commission v. Netherlands, C-276/97 Commission v. France and Case C-359/97 Commission v. UK.

12 Commission Staff Working Document, *Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system* {COM (2010) 695 final}, p 24.

1.2. Purpose

The aim of this thesis is to examine the current VAT treatment of public bodies in the EU, as defined by the rules of the VAT Directive. This Thesis will examine and evaluate the current problems in interpretation of Art.13 of the VAT Directive and related rules and assess in specific whether the Court's interposition has been successful in dealing with problems arising from it, or whether more fundamental legislative reform is required.

A review of the case law reveals that problems still exist, despite the fact that the Court has delivered numerous rulings, thus providing Member States and taxable persons with guidance on how to interpret and apply provisions on public sector bodies. Accordingly, the consequences of the Court's findings will be analyzed in relation to different circumstances in which the public bodies are often involved. This Thesis will first attempt to define the status of public bodies under the VAT Directive. In order to answer this main research question, a series of questions should be considered and answered:

1. Are public sector bodies Taxable or Non-taxable persons?
2. Are public bodies' activities subject to VAT?
3. Are public sector bodies supplies taxed/ or VAT exempt?
4. Could public bodies deduct input VAT?

Finally this Thesis will focus on reform suggestions in order to examine the alternative solutions regarding the VAT treatment of public body's activities.

1.3. Method and material

In order to answer the aforementioned questions there will be used the traditional legal dogmatic method. As to the methods of interpretation, literal, contextual and purposive interpretation will be employed. This Thesis will base its analysis on the provisions of the VAT Directive and the case law of the ECJ. Towards this direction there will be examined and evaluated the links between articles (13), (9), 2(1) (b) (i), 3(2) (a) and (132) and Annex (I) of the VAT Directive. In addition, the European Commission's views on current problems of VAT treatment on public bodies in EU will be underlined. Furthermore, findings of the Court will be contrasted and compared with relative provisions of the VAT Directive. Moreover, other sources will be considered, largely scholars, articles and commentaries. Finally, the results of the interpretation will be analyzed from the law perspective in the light of the wide logic and principle of VAT Directive.

1.4. Delimitations

This Thesis focuses on the analysis of the current VAT treatment of public sector bodies based on EU VAT Directive. Furthermore, it discusses proposals of the Commission in the Green Paper on the future of VAT.¹³ Consequently, other legal instruments and solutions remain outside the scope of this Thesis. Finally, the scope of the Thesis is not to present an in-depth analysis of the VAT treatment of public bodies and the application of the public body rules in specific Member States. References to legislation of Member States will be made in order to exemplify and specify issues under discussion.

¹³Green Paper on the future of VAT, Towards a simpler more robust and efficient VAT system,COM(2010) 1455 final

1.5. Disposition

This thesis is divided into five parts. The introduction is followed by a section dedicated to a presentation of the provisions of the VAT Directive. Public bodies as taxable persons or non-taxable persons and the concept of public bodies, Acting as a public authority, Public bodies activities for consideration, public bodies activities as non-economic activities, non-negligible activities listed in Annex (I), Intra- Community acquisitions above the threshold and VAT treatment on public bodies when performing exempt supply in light of case law and ECJ rulings will be discussed in second part. Therefore, the analysis will be mainly based on the case law. The third part of Thesis focuses on the scope of the right to deduct input VAT incurred by public bodies' activities also the views of Commission on current problems with public bodies will be discussed. In fourth part, before the conclusion, two aspects of the alternative solutions will be discussed. First the idea of modifying the current VAT treatment of public bodies and second replacing the current VAT treatment with full taxation system will be analyzed. The thesis will be concluded with an assessment of the law as it stands with regards to alternative reforms advantages.

2. Public sector bodies in the VAT Directive

2.1. Public bodies as taxable persons or non-taxable (Article 13 of VAT Directive)

According to the first paragraph of Article 13(1) of the RVD, wherever states, regional and local government authorities and other bodies governed by public law are involved in transactions or activities as public authorities, they are considered as non-taxable persons in respect of those, transactions or activities. As a consequence those activities will be considered to be outside the scope of VAT.¹⁴Rita de la Feria indicated that despite this seeming simplicity, the application of this provision does in fact give rise to many complexities, notably due to the fact that the words used are both unclear and open to different interpretations. She added, there are two key factors to the provision, namely the identity of the supplier, 'bodies governed by public law', and the method in which the supply is undertaken, 'transactions or activities in which they are engage as public authorities'.¹⁵

Advocate General Alber in case of *Porto* reiterated the ECJ's view¹⁶ that 'in so far as that provision makes such treatment of bodies governed by public law conditional upon their acting 'as public authorities', it excludes there from activities engaged in by them not as bodies governed by public law but as persons subject to private law. Consequently, the only criterion making it possible to distinguish with certainty between those two categories of activities is the legal regime applicable under national law'¹⁷. In addition, Advocate General Mischo referred to the ECJ's interpretation of the second subparagraph of Art.13(1) RVD as presented in Joined Cases 231/87 and 129/88 (para.24) according to which: 'the Member States are required to ensure that bodies governed by public law are treated as taxable persons in respect of activities in which they engage as public authorities where those activities may also be engaged in competition with them, by private individuals, in cases in which their

¹⁴It is important to note that the phrasing of the provision is mainly based in the civil law traditional difference between private and public law, something which is not introduce, at least with the same emphasis, on common law of Member States.

¹⁵Rita De La Feria, 'European Union Value Added Tax System and the Internal Market', Doctoral series, vol 16.2009.IBFD.p.157.

¹⁶See to that effect joined Cases 231/87 and 129/88 (cited in footnote 4, paragraph 15).

¹⁷Advocate General Alber referred to the court decision, in case of C-446/98;*Câmara Municipal does Porto*, [2000], ECR I-11435,para 32.

treatment as non-taxable persons could lead to significant distortions of competition, but they are not obliged to transpose that criterion literally into their national law or to lay down precise quantitative limits for such treatment¹⁸.

The second and the third subparagraphs of Article 13 of RVD are closely linked because they follow the same objective, namely the treatment of bodies ruled by public law as taxable persons. Those subparagraphs are consequently subject to the same logic, by which the Community legislature planned to limit the scope of the treatment of bodies ruled by public law as non-taxable persons¹⁹. As result, the second and third subparagraphs of Article 13 of the RVD are to be interpreted as a whole regarding the treatment of bodies ruled by public law as taxable persons.

In view of Ben Terra, Julie Kajus, Rita de la Feria, and Advocate General Mischo there are four exceptions to the main rule that bodies governed by public law will not be considered as taxable persons in regard of the activities or transactions in which they get involved as public authorities. It means that public bodies falling within the following four exceptions are considered as taxable persons²⁰:

1. Based on Article 13(1), second paragraph, Member States must ensure that public bodies are treated as taxable persons even in respect of activities in which they involve as public authorities, in circumstances in which their treatment might lead to significant distortions of competition.²¹
2. They should always be regarded as taxable persons in respect of the activities listed in Annex (I), unless fulfilled on such a small negligible scale.²² It should be interpreted as meaning that the MS are free to eliminate from the scope of such compulsory treatment the activities listed in Annex (I), since, they are carried out on a negligible scale.
3. Where the activities in question are intra-community acquisitions by public bodies (non-taxable legal persons), above a certain threshold are subject to VAT.
4. The final exception to the main rule (provided by Art. 13(2) looks to broaden its scope including exempt activities under Articles 132, 135, 136, 371, 374 to 377, and Article 378(2), Article 379(2), or Articles 380 to 390, engaged in by bodies governed by public law and regarded by Member States as activities in which those bodies engage as public authorities.

Therefore, the above information provided that legal persons governed by public law should be treated as taxable persons. Interestingly, the wording of Art.13 of the RVD seems to be unclear when referring to ‘activities or transactions engaged in as public authorities’,

18 Advocate General Mischo, referred to the court decision, in Case C-4/89, *Commune di CarpanetoPiacentino and Others*, [1990] ECR I-1869. Para 20.

19AG Maduro referred to the court decision in Case C-288/07, *Isle of Wight and Others*, [2008] ECR I-7203.

20Ben, Terra, Julie, Kajus, (2011), p392. Rita De La Feria, (2009), p.157. Opinion of Advocate General Mischo in Joint cases 231/87 and 129/88, *CarpanetoPiacentino and Rivergaro*, [1989] ECR 3233.

21 See ECJ judged in Case C-288/07, *Isle of Wight and Others*, [2008] ECR I-7203.p35.

22List of Annex I are as follows: 1. supply of new goods manufactured for sale; 2. passenger transport; 3. port and airport services; 4. transport of goods; 5. supply of water, gas, electricity and thermal energy, 6. running of staff shops, cooperatives and industrial canteens and similar institutions; 7. Activities of travel agencies; 8. Activities of commercial publicity bodies; 9. Warehousing; 10. activities carried out by radio and television bodies in so far as these are not exempt pursuant to Article 132(1) (q), 11. organization of (under the Sixth Directive referred to as the running of) trade fairs and exhibitions; 12. transactions in respect of agricultural products, carried out by agricultural intervention agencies pursuant to Regulations on the common organization of the market in those products; 13. Telecommunication services.

thus giving to the aforementioned provision a rather wide meaning and making it possible to include all activities under the main powers of the public authority (in the areas of justice or national security, general administration or even defense). As a result of this provision, the VAT status of the public bodies within its scope could change from ‘non-taxable’ to ‘taxable but tax-exempt’.

These rules are not only complicated, but could also lead to legal uncertainty. To specify, there is no clear scope definition so as to avoid diverging interpretations by the Member States, and the expressions: ‘significant distortion of competition’ and ‘on such a small scale’ do not present enough clarity for practical purposes.

The status of public bodies remains unclear, even in the light of decisions of European Court of Justice, since they are sometimes considered taxable persons and in some others non-taxable. For example, in case *Commission v. Netherlands*,²³ regarding the treatment for VAT purposes of notaries and bailiffs in the Netherlands (where independent officers perform their duties on behalf of their clients but without being public employees), the Court held that public bodies were taxable persons within Article 13(1) RVD of the Sixth Directive, since they independently carried out economic activities, and were not bodies governed by public law within Article 13(1) RVD.²⁴ This approach has been consistently repeated in the Court’s ruling of Tolls Cases²⁵ and the logic behind it seems to be the phenomenal nature of the system applicable to public sector bodies in general.

On the other hand, in case *Ayuntamiento de Sevilla*, the ECJ has ruled public bodies as non-taxable person, concluding that if public duties are delivered to an independent third party; those activities do not fall within the scope of the public sector bodies system.²⁶ It is obvious that the unclear nature of the phrase ‘activities or transactions in which they engage as public authorities’ has given rise to significant case-law and has been at the center of most ECJ judgments on the system applicable to public bodies.²⁷

In conclusion, based on the first paragraph of Article 13 of RVD, public bodies are excluded from the sphere of taxable persons. But the second and third subparagraphs of Article 13, reduce the scope of the exclusion in the cases where is a considerable distortion of competition caused or where the activity as such is supposed to result in distortion of competition (third paragraph), in those conditions, they are deemed as taxable persons.

23Case C-235/85, *Commission v. Netherlands*, [1987] ECR, 1471.

24Ben, Terra, Julie, Kajus, (2011), p394.

25A series of cases, regarding the VAT treatment of tolls paid as consideration for the use of roads, bridges and motorways. See cases C-260/98, *Commission v. Greece*, [2000] ECR I-6537. C-276/97, *Commission v. France*, [2000] ECR I-6251; C-359/97, *Commission v. United Kingdom*, [2000] ECR I-6355; C-358/97, *Commission v. Ireland*, [2000] ECR I-6301; C-408/97, *Commission v. Netherlands*, [2000] ECR I-6417.

26Case C-202/90, *Ayuntamiento de Sevilla*, [1991] ECR I-4247, in paras 19 and 20. This method has been repeated recently by the Court in case C-456/07, *Mihal*, on 21 May 2008; and again in case C-462/05, *Commission v. Portugal*, and Decision on 12 Jun. 2008, in paras 38-42.

27See Written Question 780/93 by Gary Titley to the Commission, VAT exemption for bodies ‘acting as public authorities’ as defined in the Sixth Council Directive on VAT, [1993] OJ C288/35.

2.2. Concept of public bodies

The public sector is a part of the government that deals with production, supply goods or services or allocation of income and wealth by and for the state or their citizens, whether national, or local municipal.²⁸ Public bodies for the purposes of VAT are indicated to in Article 13 of the VAT Directive as ‘states, regional local government authorities and other bodies governed by public law’.²⁹

In view of Joep J.P. Swinkels the VAT Directive does not define the concept of public bodies, but in first paragraph of Article 13 of the RVD, the use of the word ‘... and other bodies governed by public law’, results in the assumption that at least the municipal, regional and state government authorities are public bodies. Because the EU VAT regime is a harmonized system, the concept of public bodies must be the same in all Member States, which is impossible to happen in practice, since the form of government in the MS is far from similar.³⁰

The legal systems of the MS do not in all cases define administrative regions in the same way or acknowledge a difference between private (civil) and public law. For example, in the United Kingdom the phrase ‘bodies governed by public law’ would have no specific meaning. Moreover, ‘Germany is a federation and the position of the ‘Länder’ is totally different from that of the provinces in other Member States’.³¹

In order to understand the divergences among the MS regarding the VAT treatment of public bodies it would be useful to study the decisions of ECJ on toll cases. The Court of Justice ruled on road tolls cases delivering apparently conflicting decisions. The ECJ’s decisions on road tolls cases range from deeming activities or transactions as fully taxable, outside the scope of VAT, or partially taxable (if reduced rate is applicable).

In case *Commission v. United Kingdom*,³² the European Commission took an action versus the UK, since the UK had failed to fulfill its requirements under the Sixth Directive by failing to subject tolls to VAT. The ECJ held that the UK should subject tolls to VAT as the activity was carried out by private traders. A similar judgment was reached in cases *Commission v. France*, and *Commission v. Ireland*, where the Court of Justice noted that the activity of delivering access to roads by payment of a toll was taken exclusively by traders ruled by private law and was, as a result, subject to VAT.³³

However, in two cases *Commission v. Netherlands* and *Commission v. Greece*, the ECJ ruled in a different manner. Accordingly, the Court found that the tolls were operated exclusively by bodies ruled by public law under Article 13 (1) of the RVD, and therefore those activities are outside the scope of VAT.³⁴

In addition, *Commission v. Portugal* case³⁵ dealing with the reduced rate of taxation, the ECJ ruled that since the requirements laid down in the first subparagraph of Article 13 (1) of the RVD, have been met in this case, the supply of services by the body governed by public law

²⁸See Ian Lienert, IMF working paper, ‘Where Does the Public Sector End and the Private Sector Begin?’ June 2009, p13.

²⁹See paragraph one of Article 13.

³⁰DrJoep J.P. Swinkels, ‘the Tax Liability of Public Bodies under EU VAT’, International VAT Monitor, September/October 2009, IBFD, p370.

³¹See Terra & Kajus, A Guide to the European VAT Directives, (online), part 3.1, Chapter 4.9.2.

³²Case C-359/97, *Commission v. United Kingdom*, [2000], ECR I-6355

³³ECJ judgment in Case C-276/97, *Commission v. France*, [2000], ECR I-6251, paragraph 49. And Case C-358/97, *Commission v. Ireland*, [2000], ECR I-6301, paragraph 78.

³⁴See ECJ judgment in Case C-408/97, *Commission v. Netherlands*, [2000], ECR I-6417, Paragraph 41. And Case C-260/98 *Commission v. Greece*, [2000] ECR, I-6537, paragraph 42.

³⁵Case C-276/98 *Commission v. Portugal* [2001], ECR I-01699

is not taxable. As a consequence of the decisions by ECJ in tolls cases, where the access to public roads, tunnels etc. is established free of charge, there are no VAT charges. In contrast, access to roads, tunnels or bridges on payment of a toll constitutes a supply of services for consideration within the meaning of Article 2 (1) (a) of the RVD, and an economic activity within the meaning of Article 9 (1) of the RVD. Consequently, if a road is run by a private contractor the activities fall within the scope of VAT and are liable to tax.

It seems that the decisions of ECJ in those related cases on access to road have a logic background. The economic activities do not fall within the scope of VAT according to Article 13 (1) first subparagraph of the RVD, if they should be attributed to a public body acting as a public authority. In practice, the VAT treatment of tolls within the EU varies significantly. While toll for highways in Italy, France and Spain ordinarily run by private companies or the payment for instance for a vignette in Bulgaria includes VAT, the toll for trucks in Germany does not include³⁶. These differences result from divergences in the interpretation of Article 13 of the VAT Directive.

It seems that it would be more appropriate for the VAT Directive to use the words ‘public bodies’ instead of the expression ‘bodies governed by public law’. In fact Art.13 of RVD exactly refers to ‘bodies’ mean that private persons are excluded for the purposes of that provision. The ECJ has interpreted the provision on several cases. It is clear from the case law that the conclusive criterion is whether the body is governed by public law or not.

In case of *Commission v. Netherlands*, the concept of public bodies does not include self-employed private persons, even if they practice public authorities, which means that, for instance, public bailiffs and notaries are not excluded from the VAT liability.³⁷ Also, in case *Ayuntamiento de Sevilla*, private individual tax collectors, who collect taxes for consideration on behalf and for the account of the government, are not public bodies.³⁸

In both cases, the ECJ concluded that a body is only will be a public body if it is part of the public administration. Oskar Henkow believes that ‘the reference made by the Court of Justice to public administration is thus referring to a narrower concept than in EU law in general. That concept does not cover limited liability companies, even if wholly owned by the state. The only difference between an organ of the state and a wholly owned company of the state is the legal status of the latter. The functions and control of the state may be the same. However, the condition that a body has to be a public body to come within the scope of the exclusion in Article 13(1) is a condition precisely relating to the legal form of the body involved’.³⁹

However, Dr. Joep J.P. Swinkels, believes that under different conditions, for instance for the application of the exemption for specific cultural services⁴⁰, a distinction between public bodies and private persons infringes the principle of equal treatment. Despite that infringement, that distinction should still be performed for the purposes of the particular system applicable to public bodies.⁴¹ Therefore, the question of whether certain activities form part of a body’s special duties as a public authority may diverge from one MS to the other, which means that the concept of bodies ruled by public law is cannot be considered as an autonomous concept of Community law.

36 Copenhagen Economic group, ‘VAT in the Public Sector and Exemptions in the Public Interest’, Final Report for Taxud /2011/DE/334 | 10 January, 2013. P142.

37 ECJ ruling in Case C-235/85, *Commission v. Netherlands*, [1987] ECR, 1471. Also decision in Case C-456/07, *Karol Mihal v. Daňovrad Košice V*, [2008] ECR I- 9, para 21.

38 ECJ ruling in Case C-202/90, *Ayuntamiento de Sevilla*, [1991] ECR I-4247.

39 Oscar Henkow, ‘The VAT/GST treatment of public Bodies’, *Kluwer Law International* 41 (February 1, 2013). Chapter 2, p.40.

40 See the judged of Court of Justice in Case C-144/00, *Hoffman*, [2003] ECR I-2921.

41 Dr. Joep J.P. Swinkels, (September/October 2009), p370.

2.3. Acting as a public authority

According to the first paragraph of Article 13 of the RVD, the concept of ‘acting as a public authority’ is used to determine the special rule under which public bodies are not considered as taxable persons for VAT purposes. In the first report on the implementation of the VAT system,⁴² the Commission noticed that it had been a deliberate choice to let the MS, define which activities involved in by public bodies within their territories established and carry out ‘as public authorities’. It seems that, in view of the important diversities between the MS, it was not possible to provide a Community definition. According to the Commission, that condition does not necessarily cause problems since, the Annex to the Directive⁴³ lists the activities in regard of which public bodies should be treated as taxable persons. Public bodies shall be excluded from the scope of the provision where they are acting under the same situations as those applied to private bodies.⁴⁴

In joined cases *CarparetoPiacentino and Rivergaro*⁴⁵ the ECJ judged that public bodies act as a public authority only if they carry out their activities under the special legal system applicable to them. In contrast, when they are acting under the same legal framework as that applied to private suppliers, public bodies cannot be considered as acting ‘as public authorities’. The Court added that, it is for the national government to define the activities that are carried out under the specific legal system applicable to public authorities and for the national courts to classify the activities in the light of that measure. This ruling has consistently been repeated by the Court in later judgments, for example in Case of *Commune di CarpanetoPiacento and Others*⁴⁶, and also in case *Ayuntamiento de Sevilla*⁴⁷. According to Dr. Joep J.P. Swinkels, the Member States’ discretionary powers in defining the VAT liability are not unlimited since Art. 13 of the RVD include additional provisions regarding the VAT position of public bodies. He also indicated to the case *Câmara Municipal do Porto*,⁴⁸ where the ECJ decided upon that issue, in regard of the provision, for consideration, to motorists of spaces for parking their vehicles. In fact, public bodies were deemed acting as public authorities if the pursuit of that activity includes the use of public powers, such as authorizing or limiting parking on a public highway⁴⁹.

In conclusion, the limitation to activities where bodies governed by public law engage as a public authority is not a limitation to public administration in the strict sense. The conclusive issue is whether the legal system applicable is that of public law or private law. When the activity engages the use of public power, the activity is performed under a public law system. But, when the activity is performed under the same legal situation with private entities, there cannot be justified an engagement of bodies governed by public law as a public authority.

42 First Report from the Commission to Council, on the application of the common system of value added tax of 14 September 1983, COM (8) 426.p30.

43 Annex (D) for the former Sixth Directive, and Annex (I) to the current VAT Directive.

44 Rita De la Feria, (2009), p150.

45 Joined cases 231/87 and 129/88, *CarparetoPiacentino and Rivergaro*, [1989] ECR 3233, para 15-16

46 Case C-4/89, *Commune di CarpanetoPiacento and Others*, [1990] ECR I-1869.

47 Case C-202/90, *Ayuntamiento de Sevilla*, [1991] ECR I-4247.

48 Case C-446/98, *Câmara Municipal do Porto*, [2000], ECR I-11435, para 22.

49 Dr. Joep J.P. Swinkels, (September/October 2009), p370.

2.4. Public bodies' activities for consideration

A distinguishing characteristic of public bodies' activities is that they are often difficult to be assessed. Activities of public bodies including redistribution of wealth or provision of public goods are indirectly paid through taxes.

As stated by case law of the ECJ, the scope of the word 'economic activity' is very wide and the word is objective in the sense that any activity is considered without respect to its purpose or results.⁵⁰ For example, in case C-246/08 *Commission of the European Communities v Finland* concerned public offices providing legal aid in return for a part contribution. Those offices were ruled as not carrying out an economic activity within the meaning of the VAT Directive, since the part payment performed by the recipient of the services depended only in part on the price of the services provided. The Commission complains considered the fact that Finland did not charge VAT on legal aid services when they were delivered by public offices in legal proceeding in return for a part contribution from the recipient. The Commission indicated that these provisions of services established economic activity and that there was a direct link between the payment and the services provided. The Court ruled that the legal aid services in question were not delivered by the public offices free of charge and therefore without any consideration, because the recipient of services were needed to make a payment to the public offices.

Article 2 of the VAT Directive includes the essential requirement that goods or services must be supplied for consideration (i.e. for a certain payment). There is to be a direct link between the supply made and the consideration received in cash or non-cash⁵¹. If there is no link between a payment and activities made, the payment does not fall within the scope of VAT. As a result, when costs are paid, which are not linked to any supplies but paid as return for loss, or when donation or gifts are offered, or when a part of profit of a business is distributed as dividends, those payments do not constitute consideration within the meaning of the VAT Directive, because they are not linked to any supply.⁵²

However, the related supply should be made for consideration within the meaning of Article 2(1) (a) of the RVD. There is also necessary a legal relationship between the supplier and the recipient, according to which there is a reciprocal operation, the consideration received by the supplier of the service constituting the value actually given in return for the service supplied.⁵³ The word consideration also includes advantages granted by a third party (Article 73 of the RVD), as well as subsidies directly linked to the price of the supply.

In view of Copenhagen Economic group, in some sectors, such as cultural, education and broadcasting sectors, a service could be supplied without direct payment by the consumers. In such condition, if the government directly subsidizes those sectors, directly linked to the value of the service carried out, then there shall be a consideration. In addition, if the government normally subsidized the sectors, irrespectively of the service delivered, then there will be no consideration.⁵⁴

In conclusion, it is clear from the case law that the requirement of a direct link between supplies and consideration is very narrow. In addition there is a requirement of a contractual

⁵⁰For example: ECJ, decision on 26 June 2007, Case C-284/04, T-Mobile and Others, [2007] ECR I-5189.paragraph 35.and Case C-235/85, Commission v. Netherlands , [1987] ECR, 1471.paragraph8.

⁵¹ See case C-102/86 Apple & pear Development Council, also Terra &Kajus, A guide to the European VAT Directives (online) section 3.1. Chapter 2.7.

⁵²Oscar Henkow, (February 1, 2013).Chapter 3.p.58.

⁵³ ECJ, ruling on 3 March 1994, Case C-16/93,*R.J. Tolsma v. Inspecteur der Omzetbelasting Leeuwarden*, [1994] ECR I-0743. Paragraph 14.

⁵⁴ Copenhagen Economic Group, (10 January, 2013), P149.

relationship between the bodies and the actual linking of the consideration to the value of the services offered. Finally, there should be a direct link between the supply generated and the consideration received. If there is no link between activities performed and a payment, the payment does not fall within the scope of VAT.

2.5. Public bodies' activities as non- economic activities

Article 9 of the VAT Directive determines the concept of a taxable person as everyone who independently carries out any economic activities in any place, whatever the purpose of activity. This provision has been interpreted very broadly as to include all types of economic activities through all stages of business⁵⁵. In a number of cases the ECJ has dealt with different financial activities and whether they establish economic activities within the meaning of Article 9(1). Moreover Art. 9 RVD defines 'economic activity' as any activities of manufacturers, traders and natural persons supplying services. According to the ECJ, the scope of the phrase 'economic activity' is very extensive, and that phrase is objective in the sense that any activity is considered without respect to its purpose or results.⁵⁶ Nevertheless, the reception of payment for an activity alone is not enough to qualify an activity as economic in nature⁵⁷. It is also clear from case law that the sole holding of shares or other equities is not an economic activity.

In any situation, the ECJ has declared that the activity at issue should target the obtainment of income on a continuing basis⁵⁸. Moreover an 'economic activity', in relation to VAT, does not necessarily have to be a business activity intended to make a profit.⁵⁹

In two cases, *Hutchison 3G and others and T-Mobile Austria and others*, the ECJ has found that (contrary to the proposal of AG Kokott) public bodies activities of issuing 3G licenses do not constitute an economic activity for the purpose of Article 9 of the RVD.⁶⁰

In view of Dr. Joep J.P. Swinkels, in Article 13 of the RVD the word '...even where they collect dues, fees, contributions or payments in connection with those activities or transactions'⁶¹ might be interpreted as meaning that public bodies are not regarded to be acting as taxable persons, even though, their activities as public authorities are economic activities. He added that it is more believable that word actually adds nothing since; the entire system of charging VAT is limited to economic activities, in other word, goods and services supplied on a permanent base for consideration.⁶² Therefore, first it should be defined whether or not the activities of a public body are economic activities and, if they are, the second step is to decide whether or not the public body carried out those activities as a public authority.

In *Franz Götz*, case, the ECJ, before answering the questions set by the national court on the interpretation of Article 13, presented the issue whether the activity in question (milk production) constituted an economic activity falling within the scope of VAT. The Court found that this activity was not included in the transactions listed in the Annex (I), in regard

55 See Terra & Kajus, (2011), chapter 9, with reference to case law of the ECJ.

56 Case C-235/85, *Commission v. Netherlands*, [1987] ECR, 1471. paragraph 8.

57 Case C-284/04, *T-Mobile and Others*, [2007] ECR I-5189. paragraph 45. And Cases C-408/06, *Götz*, [2007] ECR I-11295. paragraph 21.

58 For example: ECJ, decision on 26 June 2007, Case C-284/04, *T-Mobile and Others*, [2007] ECR I-5189. paragraph 38.

59 Opinion of the Advocate General Ruiz- Jarabo Colomer for the case C-246/08 – *Commission v. Finland* – provided on 7 July 2009, paragraph 38.

60 Case C-369/04, *Hutchison 3G and Others*, [2007], ECR I-5247. and Case C-284/04, *T-Mobile and Others*, [2007] ECR I-5189

61 Refer to first paragraph of Article 13 of VAT Directive.

62 Dr. Joep J.P. Swinkels, (September/October 2009), p371.

of which public bodies should be treated as taxable persons⁶³. Furthermore, in case *Sevilla* the Court held that even activities that normally resemble part of the activities of the government, for example the collection of taxes, become economic activities if a community outsources them for consideration to an independent third party, thus making the exclusion from VAT not applicable.⁶⁴

Article 13(1) of the RVD governs situations where a public body is not making economic activities. Also Article 9 of the RVD includes the main provisions on the concept of taxable person declaring that a taxable person is anyone involved in economic activities. Therefore, it seems from the ECJ's case law⁶⁵ and from the formulation of the provision that public bodies should perform an economic activity.

2.6. Non negligible activities listed in Annex (I)

According to the third subparagraph of Article 13(1), where public bodies involve in the activities listed in Annex (I) to the RVD, they will be considered as taxable persons, except if such activities are carried out on a negligible scale. Compared to the main rule in the first paragraph of Article 13(1), the application of this exception appears to be dependent on the establishment of two cumulative factors: First, the activity at hand should fall within the scope of activities listed in Annex (I). Second, it should not be carried out on such a small scale as to be regarded negligible.⁶⁶

It seems that the notion behind Annex (I) in this provision is that the listed activities which were usually carried out by public bodies in many MS, are supposed to lead to distortions of competition. If those activities carried out on a negligible scale merely, it can be presumed that the distortion of competition would also merely be negligible.⁶⁷ Member States are free to consider bodies governed by public law, acting under the particular legal system applicable to them, as taxable persons in regard of the activities listed in Annex (I), although they are carried out only on a negligible scale⁶⁸. The ECJ never clarified the meaning of 'such a small scale as to be negligible', thus making that criterion hard to handle. Nevertheless, from the jurisprudence regarding the interpretation of the various activities listed in Annex (I) the following appears:⁶⁹

- The phrase 'telecommunications' in point (1), must be interpreted in its narrower sense and thus, does not include the allocation by the MS of regularity use rights to supply mobile communications services.⁷⁰
- Milk quotas sales points cannot be considered either as a 'transaction in regard of agricultural products', within the sense of point (7), or a 'staff shop', within the sense of point (12).⁷¹

63Cases C-408/06, Götz, [2007] ECR I-11295.paragaraph 22 and 37.

64Case C-202/90, Ayuntamiento de Sevilla, [1991] ECR I-4247.paragaraph 19 and 20.

65 See for instance, Case C-288/07, Isle of Wight and Others, [2008] ECR I-7203.29-30.

66Article 13(1), Para 3, RVD, 2006/112/EC. Also see Rita, (2009), p152.

67Case C-288/07, Isle of Wight and Others, (2008) ECR I-7203, at paragraph 75.

68Case C-4/89, Commune di CarpanetoPiacentino and Others, at paragraph 14.Joint cases 231/87 and 129/88, CarparetoPiacentino and Rivergaro, (1989) ECR 3233, at paragraph 27.

69Rita De la Feria, (2009),p153.See also, Christian Amand, 'VAT for Public Entities and Charities - Should the Sixth Directive Be Renegotiated', International VAT Monitor, November/December, 2006 IBFD.p436.

70 Opinion of the Advocate General Kokott, Cases C-284/04, *T-Mobile and Others*, [2007] ECR I-5189 and C-369/04, *Hutchison 3G and Others*, [2007] ECR I-5247,para 84.

71Cases C-408/06, Götz, [2007] ECR I-11295.Para. 33.

- The laying of a mains connection forms part of a supply of water, for the purposes of point 2.⁷²

From the Court's decisions on the cases mentioned above, it seems that in the absence of definitions of the activities listed in Annex (I), the ECJ will take into consideration, when interpreting those provisions, not only their phrasing, but also the context in which they were granted and the objectives followed by the rules⁷³. The Court will, therefore, involve in both teleological and historical interpretations when respecting the activities listed in Annex (I).

2.7. Intra- Community acquisitions above the threshold

Article 2(1)(b)(i) of the RVD, read in conjunction with Article 3(1)(b), (2)(a) and (b), and (3) of the VAT Directive, mean that intra-Community acquisitions by public bodies shall not be subject to VAT if they are below the threshold (EUR 10,000), unless the body chooses otherwise⁷⁴. However, when that threshold has been exceeded in the previous calendar year or generally exceeded, all intra- Community acquisitions shall be taxable. The ECJ has not yet, been called upon to interpret these provisions.

2.8. VAT treatment on public bodies when performing exempt supplies (Article 132 of VAT Directive)

In order to determine the VAT treatment of public bodies' activities there must be established whether those activities are listed in any of the exemption provisions (Article 132 of the RVD), or whether they engage in activities that are subject to VAT. However, even if a public body is regarded as taxable person; it cannot in fact be obliged to pay VAT, if its activities fall within one of the tax exemptions provided in the VAT Directive. Having defined the taxable status of the specific public sector body, at present, it is unclear whether all exemptions might potentially apply to activities undertaken by public bodies, or purely the ones listed in Article 132 of the RVD.⁷⁵ These conditions refer specially to the public nature of the supplier, as there is no jurisprudential guidance on this matter.

The exemption activities which are undertaken by public bodies define in Article 132 of the RVD, as follows:⁷⁶

- (a): specific services supply by the public postal services;
- (b): hospital and medical care made by bodies governed by public law;
- (g): specific social security and welfare work by bodies governed by public law;
- (h): services linked to the protection of children and young person's by bodies governed by public law;
- (i): educational service, provided by bodies governed by public law;
- (n): certain cultural services and goods supplied by bodies governed by public law;
- (q): specific activities of public radio and television bodies.

⁷²Case C-442/05, *Zweckverband* [2008], ECR I-01817, para 44.

⁷³ Opinion of the Advocate General Kokott, Cases C-284/04, *T-Mobile and Others*, [2007] ECR I-5189 and C-369/04, *Hutchison 3G and Others*, [2007] ECR I-5247, para 84. also Case C-442/05, *Zweckverband* [2008], ECR I-01817. Para30.

⁷⁴ Rita De La Feria, (2009) P 159.

⁷⁵ Rita De La Feria, (2009), p.160.

⁷⁶ See Oscar Henkow, (February 1, 2013).Chapter 4, p.79. In particular, Article 132 of VAT Directive; define the activities which are exempt from VAT for public bodies as activities in which those bodies involve as public authorities.

Therefore, Article 132 provided an exemption list for certain activities of public interest, covering a wide area of activities. In view of Copenhagen Economic groups, some of these exemptions are linked to the identity of the supplier, while others relate to the requirement of the activity at issue. However, based on the identity of the supplier, some of the exemptions explicitly mention public bodies, although others refer to organizations with a formal establishing by the Member State. In addition, the 13th title of the VAT Directive presents for several stands sections, which are mainly the result of discussions between old and new Member States. Thus, these exemptions are not corresponding to the general VAT system.⁷⁷ The ECJ ruled that the application of the exempt section generally requires the MS to make an express legal provision stating that public bodies are non-taxable persons when they are performing exempt activities, rather than applying a mere administrative practice⁷⁸. In practice, the categorization of an activity as non-taxable or taxable but tax-exempt might be important for the supplier's right to deduct input VAT.

From the ECJ's case law regarding the interpretation of exemptions supplies and public bodies, four cases can be characterized as more relatively reported by the Court⁷⁹. In all of these cases the purpose was to include specific activities within the scope of the exemptions: in one of the cases, the activities of a public body itself remained at issue;⁸⁰ in all others, the public activities regarded were started by either an intermediate, or a subcontractor, on behalf of the public body. The Court's first method in these situations, as reflected in case, *Commission v. Germany*, was to reject the inclusion of the activities under consideration within the scope of the exemption, on the basis of a strict interpretation of the provisions.⁸¹ In more recent cases, namely *Stichting Kinderopvang Enschede and Horizon College*, the Court has adopted a more distinct method, rejecting the extension of the scope of the exemption, although permitting the exceptional inclusion of intermediate or subcontracted services, when specific conditions were fulfilled⁸². Different methods in considerable points appear from these judgments. In view of Rita de la Feria, it is equally apparent that outsourcing of activities by public bodies is now a common practice and that this practice increases the difficulties, in specific in terms of interpretation of the 'exemptions' provisions and the essential limitation to the right to deduction any VAT charged. Furthermore, irrespective of the legal situation adopted, in practice the decision as to whether the activities of public bodies are within the scope of VAT, or might be exempt, or outside the scope of VAT, will in the majority of the cases be concentrated in general on the interpretation of the exemptions listed in Art 132.⁸³

In both articles 13 and 132 of the RVD the activities of public bodies are structured. The services exempt under Article 132(1) seem that do not necessarily require the use of public power going outside those practical in commercial relationship.

At present, the interpretation and implementation of those exemptions seems difficult as it appears from the significant increase of ECJ's case law. In some cases the ECJ developed

77 Copenhagen Economic Group, (10 January, 2013), P63.

78 Case C-102/08, *Salix*, (2009) ECR I 4629, in paragraph 58.

79 See Cases: C-287/00, *Commission v. Germany*, [2002] ECR I-5811, about the interpretation of the exemption applicable to education services (Art. 132(1)(i)); C-415/04, *Stichting Kinderopvang Enschede*, [2006] ECR I-1385, about the interpretation of the exemptions applicable to welfare and social security, and protection of children (Art. 132(1)(g) and (h)); C-445/05, *Haderer*, [2007] I-4841 and C-434/05, *Horizon College*, [2007] I-4793, both concerning the interpretation of the exemption applicable to education services (Art. 132(1)(i)).

80 Case C-287/00, *Commission v. Germany*, [2002], ECR I-5811. Para 46.

81 Case C-107/84, *Commission v. Germany*, [1985], ECR 2655. para 20.

82 Case C-434/05, *Horizon College*, [2007], ECR I-4793. and Case C-415/04, *Stichting Kinderopvang Enschede*, [2006] ECR I-1385.

83 Rita De la Feria, (2009), p156.

two methods of interpretation in specific, which are applied for the interpretation of exemptions in the public interest. According to the first method exemptions are to be firmly interpreted and they are to establish an exception to the general principle of taxation that all services supplied for consideration by a taxable person.⁸⁴ Concerning this principle, it is important to consider that it might conflict with other principles, such as the uniformity and neutrality of the VAT system, which could require an exemption to be interpreted broadly in order to prevent unequal treatment of similar goods.⁸⁵

The Second method, based on the ECJ decisions, is that exemptions constitute independent concepts of Community law. Consequently, in the case of divergences between the languages versions of Member States the latter should be placed in the general context of the common system of VAT presented by the Sixth Directive⁸⁶. Therefore, the interpretation of exemptions must, despite the context and the purpose of the rules they belong to, must also take into consideration the intention of the legislator at the time when the rules were introduced.⁸⁷

In view of Oscar Henkow there are two exemptions in list of Article 132(1) containing no limitations, public postal services and public radio and TV bodies. It seems that the Union legislator might not have been concerned by the distortions that may arise regarding these two exemptions.⁸⁸

In view of Copenhagen Economic Group, similar to Article 13, the provisions open more windows for interpretations of Article 132 for public bodies. Also Article 133, beside Article 132 generated highly depends on particular national law, since the Member States have the freedom to identify private entities as tax-exempt and to select additional measures for the tax exemption.⁸⁹ Thus, it could occur that a public body, which operates in different MS, cannot be sure that its activities are treated as tax exempt or subject to VAT in all of the EU Member States.

The ECJ has not followed a stable strategy in interpreting the exemptions of public body laid down by Art.132 (1). One example of this would be the case of *Ms Bulthuis-Griffioen*, who run a day nursery service business in the Netherlands having no other differences with institutions presenting equivalent services, but for the fact that no VAT was charged. In the aforementioned case, the ECJ ruled that because of *Ms Bulthuis-Griffioen* was a natural person and not a 'body', she was not eligible for any exemption, on the base of the principle that exemptions should be interpreted in a limited manner.⁹⁰ In contrast, *Mrs. Jennifer and Mr. Mervin Gregg*, who organized an old people's home and, on the basis of case *Bulthuis-Griffioen*, asked for deduction of the VAT incurred as a result of the building of an extension of the construction were offered the benefit of the exemption⁹¹. In this second ruling, the ECJ

84 See Cases, C-453/93, *W. Bulthuis-Griffioen*, (1995) ECR I-2341, at paragraph. 19. and Case C-216/97, *Gregg*, [1999], ECR I-4947.para16.

85 See Case C-106/05, *LuP.* (2006) ECR I-5123, considering the interpretation of the exemption applicable to medical services (Art. 132(1) (b) of the VAT Directive).

86 C-141/00, *Kügler*, (2002) ECR I-6833, for interpretation of the exemptions related to medical services and also to social work and welfare (Art. 132(1) (b) and (g) of the VAT Directive).

87 See, European Commission (2006) 'Consultation Paper on Modernizing Value Added Tax Obligations for Financial Services and Insurances', page 10. Opinion of general advocate, delivered on 8 September 2005, Para 58; for Case C-169/04 *Abbey*, [2006], ECR I-04027. Case C-372/88 *Cricket St. Thomas* [1990] ECR I-1345, Para 19, Case C-2/95 *SDC* [1997] ECR I-3017.para 22 and Case C-384/98 *D* [2000] ECR I-6795. para16.

88 Oscar Henkow, (February 1, 2013), p.80.

89 Copenhagen Economic Group, (10 January, 2013), P64

90 ECJ judgment on 11 August 1995, Case C-453/93, *W. Bulthuis-Griffioen*, [1995] ECR I-2341.para16 and 24.

91 Case C-216/97, *Gregg*, [1999], ECR I-4947.para16 and 21.

gave priority, although in an indirect way and to a very limited degree, to the principle of tax neutrality over that of strict interpretation of exemptions. Remarkably, the ECJ has developed the same approach in other cases, such as in *Mathias Hoffmann*⁹² and *Fischer*⁹³. Advocate General Cosmas referred in his Opinion to the logic of the tax system and principle of tax neutrality by stating that it is not possible to support an interpretation according to which the sole activity of a natural person or persons without any organization would be to establish a body or organization within the meaning of Art. 132(1) (g) RVD⁹⁴. However, equal treatment between legal bodies and natural persons can be attained by an upgraded interpretation of the concept of ‘body’, expanding it to include a natural person. Remarkably, the condition of distortion of competition is stated in the second paragraph of Art13 of the RVD, as a situation under which public bodies are subject to VAT.

According to Articles 13 and 132 of the RVD and the case law of the ECJ, the supplies performed by public bodies might be exempt or taxed, depending on the status of the bodies and the activities which are engaged in. If a supply of a public body lies within the scope of VAT and involves transactions which are taxable, then VAT on supplies of goods and services will be charged. On the other hand if a supply of public body lies outside the scope of VAT or might be within the scope of VAT but exempt, then no VAT on supply of goods or services will be charged.

3. Right to deduct input VAT and current problems with public bodies

3.1. Could public bodies deduct input VAT?

The right of deduct input VAT is a key factor to ensure that the VAT system is neutral. Value Added Tax is neutral for most of businesses, since in accordance with the purpose that VAT must only be a burden on final consumption, they are qualified to deduct or receive a refund of VAT incurred in the process of supply goods or services (‘economic activities’). Nevertheless, for many public bodies, input VAT is not deductible since all or some of their activities do not fall within the scope of ‘economic activity’ or they are VAT exempt.

In order to define whether or not an activity gives the right to deduct input VAT, the first main criterion is to define whether or not it is an ‘economic activity’. Furthermore, economic activities are carried out for consideration and, more correctly, there should be a direct link between the activity and payment of a price, irrespective of the nature of that price and the person who paid it.⁹⁵ In this regard, the ECJ has ruled a clear example of that interdependence in case *Tolsma*.⁹⁶ According to the Court, the reception of donations by a musician who performs on the public highway cannot be considered as the consideration for the supply of services.

Public bodies would need to allocate their input VAT into three groups: those imputable to taxable supplies and so eligible for full input VAT deduction, those imputable to exempt supplies and qualifying only for partial or full input tax rebate and those not qualifying for any deduction or rebate at all.⁹⁷ As an outcome, the complicated allocation would still be necessary for public body. In case of public bodies with fully taxable output VAT, the

92 ECJ decision of 3 April 2003, Case C-144/00, *Hoffman*, [2003] ECR I-2921.para38.

93 ECJ decision of 11 June 1998 in *Karlheinz Fischer v. Finanzamt Donaueschingen*, Case C-283/95, [1998] ECR I-3369, Para. 27.

94 Opinion of AG in Case C-216/97, *Gregg*, [1999], ECR I-4947.para 29.

95 Christian Amand, (November/December, 2006), P 436.

96 Case C-16/93, *R.J. Tolsma v. Inspecteur der Omzetbelasting Leeuwarden*, [1994] ECR I-0743.para 16.

97 Michel Aujean, Peter Jenkins and SatyaPoddar,(1999), P 148.

taxable person's input VAT is fully deductible and where the output is outside the scope of VAT or fully exempt from VAT, there is no right to deduct input VAT⁹⁸. It seems that VAT exemptions do not concern whole sectors of activity, such as health care or education, but only certain transactions, normally without respect to the legal structure or purpose of the body that carries out those transactions. Consequently, it is a common scenario for public bodies to have only part of their activities exempt from VAT or outside the scope of VAT.

The underlying logic of treating public bodies involved in exempt activities as non-taxable persons might be that, in principle, it makes little difference whether a body is considered as a non-taxable person or its activities are exempt from VAT. In fact, under both conditions the body is not liable to account for VAT in connection with its activities and is not eligible to deduct related input VAT.⁹⁹ However, the deduction of input VAT is not possible in respect of expenses incurred by a non-taxable activity. Although, for specific kinds of tax-exempt activities (for example public activities like education, or health care) it is not possible to deduct input VAT, while for other tax-exempt activities e.g. intra-community supplies the deduction of input VAT is possible.

It could be argued, that the current treatment applicable to public sector bodies essentially infringes the principle of fiscal neutrality, as stipulated in Article 1 of the RVD, and interpreted by the ECJ. In case *WaterschapZeeuwsVlaanderen* concerning the right to deduct of public bodies, AG Jacobs mentioned that 'it is inherent in the existence of exceptions to the VAT system that they will interfere to some extent with the application of the principles of neutrality and of equality of treatment. Whatever the merits of the decision to treat public bodies as final consumers, it forms an integral part of the Directive. In that and in comparable situations, the treatment of taxable persons and persons excluded from the VAT system will inevitably be different'.¹⁰⁰

Regarding the general treatment of VAT in the deduction of input VAT for public bodies' activities, it could be supported that such a deduction is not regularly granted by the MS, where an activity is out of scope of VAT and treated as non-taxable or tax-exempt. However, if an activity of a public body falls within the scope of VAT, it will be given the right to deduction. Admittedly, any VAT payment is originally just a transfer back to the government itself, so if public body has fully the right to deduct input VAT; it seems that at least net cost of government will be increased.

3.2.View of Commission on current problems with public bodies

3.2.1. Neutrality

Definitely, the cornerstone of the VAT mechanism is the VAT Directive. Designed as a general tax on consumption precisely proportional to the price of goods and services, the European VAT System permits the deduction of the amount of VAT burden directly out of the different cost components of the distribution and production process before final consumption¹⁰¹. This method exists in order to guarantee the fiscal neutrality of the VAT. In other words, VAT must only be a burden on final consumption. The current provisions applicable to public bodies are not fiscally neutral in regard of both output and input. On the output level, Commission supported that, '[p]roblems of distortion of competition may

98 Under the conditions of Art. 17(3)(c) of the Sixth Directive, but with the exception of financial services

99 Dr.Joep J.P. Swinkels, (September/October 2009) P 372.

100Opinion of AG Jacobs inCase C-378/02, *WaterschapZeeuwsVlaanderen*, [2005] ECR I-4685, at Para. 38.

101See, the principle of fiscal neutrality, as set out in Article 1 of the VAT Directive.

occur because the same activity may be taxed if carried out by a private body but not taxed if carried out by a public body. In addition, as the status of the supplier determines whether the activity is taxable or non-taxable, this could give rise to distortions in a liberalized environment.¹⁰²

The distortion of competition could affect the output side through decreased competitiveness of private bodies regarding VAT-exempt bodies. The reason is that if an exempt public supplier and a non-exempt private supplier of a service compete in the same market, the public supplier will have the benefit of not charging VAT to its customers. However, the private supplier will require to add VAT to its price. Therefore, the public supplier will have a competitive advantage over the private supplier of the same service.

On the input side, the main input related distortions identified by the Commission are the following: self-supply bias, disincentive to investment, and cascade effect.¹⁰³

Copenhagen Economic Group explained the self-supply bias and disincentive to investment problems as follows: the inability to deduct input VAT creates more costs when a non-taxable public body outsources services to the private sector. Consequently, it avoids this extra cost by choosing to self-supply. It results that the current VAT condition encourages self-supplies, even if another possibility, for example contracting out or public private partnerships, could be more efficient; the increase of the VAT rates in a Member State enhances the aforementioned side-effect¹⁰⁴. In view of Rita de la Feria, cascade effect is one of the major input side effects of treating activities as exempt or outside the scope of VAT. In addition, Tax cascading will happen where the service supplied by the public body is an intermediate phase in the production, and thus, the VAT imposed until then becomes a hidden VAT as it cannot be deducted.¹⁰⁵ It is important to notice that cascade effects are not exactly related to the treatment of public bodies as non-taxable (Article 13), although, apply equally in relation to private and public bodies advantaging from tax exemptions such as Art 132 and Art 135.¹⁰⁶

Therefore, lack of neutrality in current treatment of VAT on public bodies causes two main problems: The first problem is the distortion of the competition between public and private bodies that result from output side. The second problem is the lack of right to deduct for public bodies that causes several problems like ‘reduced rates of investment’ or ‘no subcontracting’ which might be more efficiency performed by specialized suppliers of those activities and finally ‘cascade effect’ of exemption for supply to businesses.

102 Commission, Staff Working Document, Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system [COM (2010) 695 final].p24.

103 Commission, Staff Working Document, Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system [COM (2010) 695 final].p25.

104 Copenhagen Economic Group, (10 January, 2013), P 61.

105 Rita de la Feria, (2009), P 160.

106 Copenhagen Economic Group, (10 January, 2013), P 62.

3.2.2. Lack of harmonization

In view of Commission, the VAT Directive gives extensive discretion to Member States to describe concepts such as ‘public body’. As a consequence, there is no EU method to the activities that public bodies get involved in as ‘public authorities’.¹⁰⁷ From the perspective of harmonization, in its view relating to the Commission’s Proposal for a Directive an opinion to the elimination of the fiscal borders, the European Parliament proposed to remove the phrase ‘significant’.¹⁰⁸ The Commission comprised that proposal in its revised Proposal.¹⁰⁹ In view of Dr Joep J.P. Swinkels, in fact the Council’s rejection to delete the phrase ‘significant’ has not had much influence because the ECJ interprets distortions of competition widely: in its decision in case *Isle of Wight*.¹¹⁰ However, the ECJ declared that the phrase ‘significant’ is to be identified as meaning that the real or possible distortions of competition should be more than negligible.¹¹¹ In view of Copenhagen Economic Group, the comparison of the adoption of the VAT Directive concerning the public bodies among the MS has shown a large diversity in the implementation of EU provisions as well as the application of the national law. In addition, In this regard the main problem proved to be the different understanding of the words ‘public body’ and ‘public law’ between the Member States. Furthermore, to these interpretative diversities, a lack of harmonization is caused by the different stagnate clauses related only to some MS, and the rules of the VAT Directive, which leave the adoption at the decision of the respective MS, such as Art.133 of the RVD.¹¹² As a consequence, the same activity might, for instance, be considered to be non-taxable in one MS; however it would be treated as taxable in another Member States.

In fact, the lack of harmonization of VAT treatment for public bodies inside the EU is a result of the somewhat ambiguous phrasing of the VAT Directive, which allows significant initiative for interpretation by MS. Member States determine what is a public body, at what time it is acting as a public authority, if public bodies are not regarded as taxable persons, when there might be a considerable distortion of competition, and finally, when an economic activity is negligible or significant. Since there is more room left open for interpretation there can be noticed many differences in the VAT treatment of public activities between MS.

3.2.3. Complexity

In view of the Commission; the current VAT system for public bodies identifies three types of activities. They can be taxed, within the scope of VAT but exempt or outside the scope of VAT. As a result, from the perspective of complexity, the first problem is defining the VAT status of the supply not limited, which also makes defining the right of deduct of public bodies more complicated. The second problem is that exemptions in the public interest are also not very exactly determined. As a consequence, it is regularly hard to define the legal nature and the situations under which a body's activities may benefit from exemption. The third additional complexity is caused by the different options existing to the MS: the option in Art.13 (2) of the RVD to regard exempt activities as out of scope, and the option in Art. 133

107 Commission, Staff Working Document, Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system [COM (2010) 695 final],p25.

108 First Report of the Commission on the application of the common system of value added tax of 14 September 198, COM (8) 426.

109 Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive / 88/EEC with a view to the abolition of fiscal frontiers,OJ L 6 of 1 December 1991.

110 Case C-288/07, *Isle of Wight and Others*, [2008] ECR I-7203.

111 Dr.Joep J.P. Swinkels, (September/October 2009) P 373.

112 Copenhagen Economic Group, (10 January, 2013), P 23.

to grant specific exemptions listed in Art.132 (1) to bodies other than those governed by public law.¹¹³In view of Ingmar Beuth, one of the current issues of VAT treatment of public bodies is complexity which results in ‘difficulty determining the VAT status of the supply and the deductibility of input VAT, as activities of public bodies can be taxable (taxed or exempt) and non-taxable’.¹¹⁴ The current VAT regime which categorizes supplies by public bodies as non-taxable, taxable, outside the scope of VAT or exempt, is unavoidably complex and difficult to manage. It is not always simple to define which categories different supplies belong to and sophisticated rules are essential for allocating inputs to those categories and for claiming input VAT refunds under partial exemption approaches.

4. A Brief look at alternative solutions

In light of the foregoing discussion, this part will be devoted to the presentation of the possible reforms to the current VAT treatment of public bodies. In this regards the study will focus on two different solution categories without proceeding to a comparative analysis:

- (1) Modifying the current VAT treatment of public bodies and;
- (2) Replacing the current VAT treatment of public bodies.

In the first solution category, the study will look at what options exist to reduce current problems of the VAT treatment on public bodies without replacing the whole current system. Member States might alter the current treatment, opting for the Canadian system which applies a modified exemption system, or choosing refund system, which is also used worldwide, giving a lot of flexibility to MS. Additional possible reforms in this categories will be reducing the exemptions by expanding the scope of VAT for some activities that currently are exemptions in the MS. In the second category, this Thesis will discuss possible reforms that have been suggested in the literature to replace the current VAT treatment of the public sector bodies by a ‘full taxation’ model adopted in the modern GST systems such as New Zealand or Australia.

4.1. Modifying the current VAT treatment of public bodies

In this part the three possible alternatives will be analyzed, Canadian system, refund system and reduced exemptions.

4.1.1. Canadian system

The system applied in Canada is principally an exemption system: all supplies made by public sector bodies fall within the scope of the Canadian federal Goods and Services Tax (GST), and provincial system. However, many of the goods and services supplied by public bodies, charitable organizations and non-profit organizations as a whole are taxable; some supplies are exempt or zero-rated. In addition, taxes that those bodies incur to make taxable or zero-rated supplies are fully deductible, but input VAT related to exempt activities will not be deductible.¹¹⁵

113Commission, Staff Working Document, Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system [COM (2010) 695 final].p. 25

114See presentation of Ingmar Beuth, European Commission, in Academic Seminar on the VAT/GST treatment of public bodies.29 April 2013, Lund University.

115Pierre-Pascal Gendron, ‘Value-Added Tax Treatment of Public Sector Bodies and Non-Profit Organizations: A Developing Country Perspective’, July 14, 2005. ITP Paper 0514.p13.

In view of Rita de la Feria, the Canadian VAT system derives from the traditional systems by granting a rebate of the input VAT. The rebate arrangement establishes a feature of the Canadian system since its initiation, in recognition of the problems arising from exemptions. For example, in specific the compliance costs are supposed to be average, but in this system revenue effects are negative.¹¹⁶ Therefore, it seems that the Canadian system is well harmonized but still complex, and in some extent it is similar to some EU Member States that have rebate systems to compensate public bodies for input VAT paid to provide non-taxable or exempt supplies.¹¹⁷

4.1.2. Refund system

The idea of refund or compensation system is not new. Some MS namely Denmark, Sweden, Finland, the Netherlands and UK, have chosen financing the VAT costs of public bodies by the introduction of a refund mechanism but there are already functioning refund systems outside of the VAT Directive¹¹⁸. As mentioned above the Canadian rebate system is an example of this idea. Therefore, a refund system would solve the problem of public bodies with the input VAT and might rely on a practice in several Member States.

This system however is general and applies to exempt or non-taxable activities of local governments.¹¹⁹ In view of Rita de la Feria, regardless their potential advantages, this system also gives rise to problems, as results:¹²⁰

1. Exclusion or inclusion of exempt activities – in the Netherlands and UK, the refund is only provided for VAT costs relating to outside the scope activities, while in Denmark, Sweden and Finland the refund also operates in relation to exempt activities. Both possibilities have disadvantages: excluding exempt activities from the refund system indicates that in relation to these activities VAT considerations will continue to effect the choice between outsourcing and self-supplies; on the other side, the inclusion of exempt activities within the scope of the refund system will guide to an unequal treatment between public and private suppliers, as the majority exemptions will also apply to private suppliers.¹²¹
2. Inclusion or exclusion of non-national VAT – only in the Netherlands is refund given for non-national costs; this creates inequality between national and non-national suppliers, as the level playing field is only achieved in relation to national suppliers.
3. Inequality between MS – the existence of these systems in only some of the MS, results in inequality within the Community. In this framework private companies established in MS, which have a refund system in place, shall have a competitive advantage in comparison to private companies established in MS, which do not have such a system.

116Rita de la Feria,(2009), P 161.For more detail, See Pierre-Pascal Gendron, (July 14, 2005), pp1-42.

117Oscar Henkow, (February 1, 2013), P 170.

118Copenhagen Economic Group, (10 January, 2013), P 212.

119 For details on the more general refund scheme used in the Netherlands, see van Dijk, Harpert and Guido Lubbers, “The VAT Compensation Fund”, 11 *International VAT Monitor* 1 (2000), p6.

120Rita de la Feria, (2009), P 162.

121Norway operates a similar system for non-profit organizations, see O. Gjems-Onstad, ‘Refund of Input VAT to Norwegian NPOS’, *International VAT Monitor* 4 (2004): 244-246.

The Commission has so far treated them as falling outside the scope of the EU VAT system.¹²² However, consideration must be given to the recent ECJ legal system, namely *Heiser*,¹²³ which signifies the Court's willingness to expand the principles it has developed concerning state aid to the area of VAT.¹²⁴ It means that must be questioned whether these systems entail state aid.¹²⁵

Nevertheless, under a refund system there would still be a diverging VAT treatment causing possible distortions of competition and legal uncertainty. It seems that it would be hard to introduce a refund system outside the VAT Directive on an EU level, because according to Article 113 of the Treaty on the Functioning of the European Union ' [t]he Council shall [...] adopt provisions for the harmonization of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonization is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition' .¹²⁶

4.1.3. Reduced exemptions

This is a very general approach that, in principle, reducing exemptions might be attained by bringing goods and services currently outside the scope of VAT into the scope of the VAT, or by converting exempt goods and services into zero-rated or taxable. Pierre-Pascal Gendron, believed that 'one variant of this method is to tax explicit fees only: that would involve taxing goods and services for which the explicit fee represents the full consideration and is therefore equal to the market value of the supply. Also, this approach is appropriate in cases where no subsidies or grants are involved to finance part of the supplies. Good candidates include those goods and services that compete directly with those supplied by the private sector. This excludes most public goods and a fair number of quasi-public goods'.¹²⁷

A modification of the current exemption for certain activities of public bodies, would be useful if it could reduce some kind of problems like complexity, or distortion of competition between private and public bodies in common market. Generally, exemptions in VAT systems break the chain of tax and cause difficulties in exercising the right to deduct input VAT.

122 The consistency of these refund system with the RVD has been subject of a Parliamentary Question; former Commissioner Bolkestein replied on behalf of the Commission that such schemes do not conflict with the EU VAT system, see Common VAT System – Eighth Directive, Written Question P-2861/99, 7 Jan. 2000, [2000] OJ C225E/211.

123 Case C-172/03, *Heiser*, [2005] ECR I-1627, regarding Austria's transposition of the exemption applicable to medical services (Art. 132(1) (c) of the RVD).

124 See J. Swinkels, 'State aid and VAT', *International VAT Monitor* 5 (2005):pp. 311-316.

¹²⁵ See Henkow, (February 1 2013), Chapter 8.

¹²⁶ Article 113 (ex Article 93 TEC) of TFEU, Official Journal C 83 Volume 53 30 March 2010.

¹²⁷ Pierre-Pascal Gendron, (July 14, 2005), P 19.

4.2. Replacing the current VAT treatment of public bodies

4.2.1. Full taxation

In this section, the full taxation system adopted by the modern GST systems (e.g. Australian and New Zealand GST systems) will be discussed. The scope of these GST systems expands to public bodies. These systems are also described by the fact that they include fewer exemptions than the EU system. The most important change introduced with a full taxation system would be a basic alteration of the taxation of output supplies. All supplies within the public sector which are currently treated as tax-exempt (Art. 132 of the RVD) or non-taxable (Art. 13 of the RVD) in the future would be treated as non-exempt and taxable.

In view of M.Aujean, P.Jenkins, S.Poddar the full taxation model might be introduced in two fundamental modifications. First, all supplies of public bodies are taxed irrespective of whether a consideration is provided or not (e.g. on supplies of police, charities or fire brigades which are only receiving donations). Second, the output VAT is concerned to supplies only if an explicit consideration is charged¹²⁸.

Rita de la Feria, Pierre-Pascal Gendron, Copenhagen Economic Group, believed that replacing the current EU system with full taxation model would offer several advantages like efficiency, reduction in distortions, possibility of right to deduct input VAT without an increase of administrative and compliance costs or a decrease in revenue.¹²⁹ As Ingmar Beuth presented in a recent seminar, the results of implementation of full taxation option are as follows:¹³⁰

- ‘Revenue gains up to 80,38 bn Euro
- Change of GDP in 27 of EU Member States: +0,34%
- Loss of public jobs which will be compensated by private job creations’

As Ingmar Beuth recently presented in the Seminar regarding the “VAT/GST treatment of public bodies” held on 29 April 2013 in Lund University, despite a lot of positive and less negative results of implementing the full taxation model, the negotiation with Member States has not reached a point of agreement, mainly because of political considerations.

4.2.2. Australian system

According to section 9-20 (g) of the Australian Goods and Services Tax (GST) Act an enterprise is an activity, or series of activities, done: (g) ‘by the Commonwealth, a State or a Territory, or by a body corporate, or corporation sole, established for a public purpose by or under a law of the Commonwealth, a State or a Territory; ...’¹³¹ Therefore, all activities carried on by public bodies (government entities and government related entities) are considered to be economic activities, and as a consequence fall within the scope of Australian GST. Also, according to Division 149-15 of the Australian GST law, all input GST related to the Government entity that is registered for GST purpose, it is deductible.¹³²

¹²⁸See M.Aujean, P.Jenkins, S.Poddar, (July/August 1999), P. 146 and 147. Also See, Pierre-Pascal Gendron, (July 2005), P. 33.

¹²⁹ Rita de la Feria, (2009), P. 163. Also See, Pierre-Pascal Gendron, (December 2005), PP. 521 – 522. Copenhagen Economic Group, (10 January, 2013), P.195.

¹³⁰ See presentation of Ingmar Beuth, European Commission, in Academic Seminar on the VAT/GST treatment of public bodies. 29 April 2013, Lund University.

¹³¹ See presentation of Professor Rebecca Millar, in Academic Seminar on the VAT/GST treatment of public bodies. 29 April 2013, Lund University.

¹³² GST Act, Division 149, also see presentation of Millar 2013.

Division of 9-15 (3) presents that a payment made by a related government entity to another related government entity, is not a provision for consideration. Furthermore, subsidies not sufficiently related to specific supply are not taxed.¹³³

In view of Oscar Henkow, in Australian system all transfers between governments entities are zero- rated, unless they entail consideration for exempt supplies in the event where input GST is not deductible to the extent that exempt supplies are made. However, where government supplies services, which are of social importance like health care and those supplies are in competition with private entities, they are zero-rated, and for both public and private entities a full credit is allowed, also no output is charged in this transaction.¹³⁴

It seems that GST in Australia applies to government entities and private entities in the same manner with equal treatment.

4.2.3. New Zealand system

The Goods and Services Tax (GST) was introduced in New Zealand in 1985. It is charged on all supplies and importation of goods and services by taxable persons. According to general rules in New Zealand GST Act, from October 2010, GST rates become 15 per cent, instead of 12.5 per cent used previous. The GST is calculated on the price of a supply and, paid for purchasing goods and services which are used for a taxable supply. A taxable supply is a supply that is subject to GST and is generated by a registered person in the way of carrying on an activity which engages or is intended to engage the supply of goods and services for a consideration.¹³⁵ The New Zealand GST system comes closer to a full taxation because there are only a few exemptions or zero-rated (e.g. for zero-rate: Transfer of going-concern or Exports) supplies. As from the GST rules appear, it is clear that the purpose was to introduce a broad-based, with low rate GST that was as neutral as possible.

In this system, public bodies are forced to register for GST purposes. Consequently, the supply of a public body is taxable if not exempt. The assessment base for the sales is normally calculated on the basis of revenue received from the Crown¹³⁶ or from the public in the form of levies, rates, fees and other charges. Therefore, the government renders deemed supplies and imposes a tax to itself.¹³⁷

The Australian and New Zealand GST system are considered as the best practice to replace the current treatment in the tax literature.¹³⁸ Under the aforementioned systems, distortions of competition (for example self-supply bias or unwillingness to investment) are removed as public bodies are enabled to deduct input GST. Furthermore, business consumers of public services do not have to suffer cascaded GST.¹³⁹ Oskar, Henkow, believes that the assessment of the New Zealand system shows that it would be difficult to switch that system into the EU context. However, eliminating exemptions and introducing zero-rates could not be politically possible, despite the clear advantages it may offer both in decreasing administrative burden

133See GSTR 2000/11 deals with the application of the Goods and Services Tax ('GST') to grants of financial assistance

134Oscar Henkow, (February 1, 2013).P.170.

135 See, Section. 5(2) New Zealand GST Act.

136 A Crown entity is an organization that forms part of New Zealand's Government funding that established under the Crown Entities Act 2004. (See Act part 1 section 7).

137 See Section 5(6) and (7) GST Act)... The GST Act include a number of definitions for the assessment base of the deemed supplies.

138M. Aujean/P. Jenkins/S. Poddar (1999), (1999): PP.144-149; Rita. De la Feria (2009), page 148; Ben, Terra, Julie, Kajus, Commentary – A Guide to the Recast VAT Directive, Online book, IBFD, 1 January 2013.Chapter 3.8.;OscarHenkow, (February 1, 2013).P.175.

139M. Aujean/P. Jenkins/S. Poddar (1999), PP. 144-149.; See presentation of Rita. De la Feria, in Academic Seminar on the VAT/GST treatment of public bodies.29 April 2013, Lund University.

and reducing economic distortions.¹⁴⁰ The most conceptual difficulty is the insistence on recognizing explicit consideration before a supply is seen to be made (there is no direct link between fee and benefit provided)¹⁴¹.

5. Conclusion

European VAT Directive is designed to be a common, indirect tax on consumption expenditure with as wide base as possible. Article 13 of the RVD, defines when state and local government are excluded from the scope of VAT Directive. It is clear from the case law¹⁴² and from the functioning of provision, that public bodies should perform an economic activity, therefore falling within the scope of Article 9. Current VAT treatment of public bodies shows that, supplies by public bodies are normally classified as taxable, non-taxable, and exempt. However, the exempt or nontaxable status of the supplies with different interpretation of MS used to define the taxable or nontaxable activities of public bodies have created problems with complex rules and given rise to economic distortions.

The ECJ's case law in relation to the EU VAT treatment of public bodies is broad and has been moderately successful in presenting guidelines, which have helped clarify the provision applicable to those bodies. But, it has not been able to resolve most of the essential problems of the current system, in specific those resulting from the limited recovery of input tax.

At the conceptual level, most of the current difficulty and confusion in the application of VAT to public bodies arises indeed from their exempt or outside-the-scope treatment.

The system is lacking harmonization among the MS because of different perceptions of MS for defining 'activities as a public authority' which are supposed to be non-taxable. This lack of harmonization becomes an obstacle to intra-Community trade. It must be considered that EU consists of 28 independent MS, each one of them having their own organization and their own legal systems. Consequently, it seems to be very hard to harmonize the rules on public body completely within the EU.

A more logical manner would be to deem all of their acquisitions as inputs of their supplies. Under the principle of neutrality, all of supplies must be taxable, regardless whether the supplies are made by public or private sectors. Public bodies should be enabled to full input tax refund for any VAT incurred on inputs taxable supplies. One of the main issues of current VAT treatment on public bodies is the definition of consideration for public bodies' supplies. In the current concepts of VAT Directive, consideration (taxable amount) includes any fees, charges, and subsidies directly linked to the supply. There are some views that it is better to include all subsidies and payment in the definition of consideration, with the purpose of simplifying administration and compliance. This thesis considered the possible reforms for current VAT treatment in two groups: first modifying the current treatment by for example refund system as Canadian system follows it or reduced the current exemptions. The second group indicated replacing the current treatment by full taxation of public bodies in the form of Australian and New Zealand systems. As commentators and tax literature mentioned, the best practice is the full taxation system. The full-taxation system, as described above, seems to best address the aims of economic neutrality, simplicity, and harmonization across the EU community. The New Zealand GST includes all the essential elements of this system and

140 Oscar Henkow, (February 1, 2013).P.176.

141 M. Aujean/P. Jenkins/S. Poddar (1999), PP. 144-149; Also Rita. De la Feria (2009), page 148.

142 For example, Case C-288/07, Isle of Wight and Others, [2008] ECR I-7203.pp.29-30.

confirms these benefits of the full taxation system. Therefore, in order to replace the current system by the full taxation model, Article 13 of the RVD needs to be eliminated. Public bodies are simply stated as one type of body which engages in economic activities. Theoretically, there seem to be very few issues involved in such a change, but in this way, public bodies are finally to be included completely within the scope of VAT.

Member States may be unwilling to apply VAT to public bodies at the full taxation system for political reasons. At present, they prefer to adopt a refund system like Denmark, Sweden, Finland, the Netherlands and UK, or they focus on modifying the current system by reducing the present exemptions in VAT Directive. The refund or reduced exemptions system would allow MS the flexibility of not applying the full taxation of VAT on the public bodies. Those options would have as a consequence the complex issue of defining the statuses of public bodies' activities as falling within the scope of VAT or outside the scope. In practice, it seems that there is a gap between the best optional (full taxation) model in theory and reality in order for MS to apply the full taxation to their public bodies.

It is clear that the problems, which increasingly arise from the current VAT treatment of public bodies, can only be eliminated through modifying the current system with radical legislative reforms at EU level. Finally, it should be noted that while the taxation option may seem the best option for a tax system that is being designed, the most difficult part in all tax reforms (replacing the current treatment) is moving from the current system to a new system, provided that fundamental reforms always generate winners and losers.

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