



Lund University

School of Economics and Management
Department of Business Law

**The VAT treatment of the payments on account
in distance selling in the light of Consumer Rights
Directive**

by

Linda Bengtsson

HARN60 Master Thesis

Master's Programme in European and International Tax Law

2014/2015

28 May 2015

Supervisor: Oskar Henkow

Examiner: Cécile Brokelind

Author's contact information:

[l_bengtson@hotmail.com]

[+46705153739]

Table of contents

Abstract

List of abbreviations

1. Introduction

- 1.1. Background
- 1.2. Purpose
- 1.3. Method and material
- 1.4. Delimitations

2. Legal background

- 2.1. Chargeability and chargeable event
- 2.2. Distance sale
- 2.3. Consumer Rights Directive

3. Payments on account versus deposits

- 3.1. Payments on account
- 3.2. Deposits
- 3.3. Case law
 - 3.4.1. Kennemer Golf
 - 3.4.2. BUPA
 - 3.4.3. Societe Thermal
 - 3.4.4. Le Rayon d'Or
- 3.4. Conclusions on payments on account versus deposits

4. Assessment of payments on account and Consumer Rights protection

- 4.1. Distance sale and Consumer Rights protection
- 4.2. Payments on account in the light of the Consumer Rights Directive
- 4.3. Contractually agreed deviations from initial obligations
- 4.4. Payments on account without taxable supply
- 4.5. Generalization of ECJ decisions
- 4.6. Conclusions on assessment of payments on account in distance sale

5. Reflections

Bibliography

Table of Cases

Abstract

Payments made prior to the delivery of the goods or services are either payments on account or deposits. ECJ has interpreted both concepts and concluded that VAT treatment must differ in both cases. In the cross-border business-to-consumer distance sale transactions consumers have the right to withdraw from the agreements for no reason. This rule is provoking and influencing both traditional contract law and the treatment of advance payments. The analysis in the thesis concentrates on how and if the consumer's right to withdraw from the distance sales agreements is influencing the application of the notion of payments on account and whether the rules of Consumer Rights protection legislation are influencing the VAT treatment of the transactions. In order to get a deeper knowledge of challenges with advance payments, a closer look is taken at how ECJ, VAT Committee and AG has interpreted the notion of prepayments particularly in connection with the interpretation in the area of distance sales and consumer rights.

List of abbreviations

AG	Advocate General
Art.	Article
ECJ	European Court of Justice
EU	European Union
OECD	Organization for Economic Co-operation and Development
OJ	Official Journal of the European Union
P.	Page
Para.	Paragraph
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
VAT	Value added tax

1. Introduction

1.1. Background

Free movement of goods and services is one of the fundamental principles of the internal market of the European Union. Articles 34-37 TFEU which are regulating free movement of goods are an important tool for achieving single market integration. Fundamental freedoms guarantee business people freedom of decision-making and consumer's freedom of choice between the greatest possible varieties of products¹. Consumers can select the cheapest and best products from the far greater range of goods on offer that results from increased competition². The development of technology and digitalization has under last decades introduced market with new means of doing business. E-commerce, cross-border shopping and distance sale are examples of result of digitalization of the modern business environment. However those new developments can constitute a temporary challenge in the area of distance sale as well as taxation.

Distance selling is sale of goods and services to the consumer in which the parties do not meet, - such as sale by mail order, telephone, digital TV, email, or the internet³. According to the definition, distance selling means that a supplier sells goods to private individuals or customers established in another Member State which does not apply VAT to their intra - Community acquisitions of goods⁴.

In the liberalized market popularity of distance sale is increasing. According to the statistical data, the share of turnover from e-sales is stable at 15% in the 2011-2013 period and showing steady increase to 18% year 2014⁵. With the increasing availability of distance trade, consumers can take advantage of the possibility to purchase goods from suppliers in other Member States as well as outside EU. Internet is accessible all over the world and it should be beneficial for trade between

¹ Klaus-Dieter Borchardt, "The ABC of European Union law", Luxembourg: Publications Office of the European Union, 2010, p. 22

² Ibid

³ Oxford dictionary of law, 7th edition, Clays Ltd, Great Britain, 2013, p 177

⁴ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 32

⁵ Konstantinos GIANNAKOURIS, Maria SMIHILY, "Share of turnover from e-commerce stable at 14% in 2009 and 2010", Eurostat, 2012 — Statistics in focus, (<http://ec.europa.eu/eurostat/documents/3433488/5584656/KS-SF-12-018-EN.PDF/29574eb8-7651-4921-bf10-85a477e83368?version=1.0>)

countries, suppliers and consumers. The question is whether the principle of neutrality, the core principle of taxation, is maintained in the case of distance selling?

Business decisions should be motivated by economic considerations and taxation should seek to be neutral and equitable between various forms of commerce and taxpayers in similar situations carrying out similar transactions, should be subject to similar levels of taxation⁶. Consumers buying goods and services in other MS with lower taxation and from the companies under threshold, not required to register in MS where final consumers are located, is paying VAT according to the principle of origin - in the MS where supplier is located and therefore benefiting from lower taxation. This can influence consumer's decision on where to purchase and therefore the principle of neutrality is not followed.

The VAT Directive⁷ is the most important legislative instrument in the area of value added tax. It is a systematization of the rules of common system of VAT in EU, which is applied to the consumption of most of the goods and services produced and distributed within the internal market.

A directive is binding on the Member States as regards the objective to be achieved but leaves it to the national authorities to decide on how the agreed Community objective is to be incorporated into their domestic legal systems⁸. The community legislation forms the base for further examinations of the questions related to payments on account and their application.

Advance payment is an integral part of distance sales transactions. Most of the cross-border transactions involving distance sale implies the obligation from the consumer to transfer the price agreed already at the moment the contract is concluded. According to the general definition of prepayment and article 65 of VAT Directive, a transfer of the payment before actual supply of the goods is to be considered as a prepayment. Such a payment is triggering the VAT consequences on the supplier as the chargeable event incurs at the moment the payment is received on the amount received.

⁶ Case C-174/11, Finanzamt Steglitz v Ines Zimmermann, 15 November 2012, para 48

⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006

⁸ Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal of the European Communities, C 83, 30 March 2012, Article 288.

VAT Directive is a legislative act regulating the issues of Value added Tax in EU and is a document that is a legal base for VAT law in each Member State of EU. VAT Directive is one of the many legislative acts influencing the functioning of the internal market. At the same time, the efficiency of the rules in the VAT Directive is influenced by other normative acts both in the area of taxation and other areas of law. One of those acts is Consumer Rights Directive⁹ which is primarily focused on consumer protection, but as all the areas that involves financial transactions, having impact on and consequences of chargeable event as well as chargeability of VAT.

The Consumer Rights Directive was adopted 2011 and replaced four other legislative documents governing consumer protection. The main goal of the directive was to simplify and update the applicable rules, remove inconsistencies and close the gaps in the rules protecting consumer rights.¹⁰ It laid down standard rules for the common aspects of distance and off-premises contracts, moving away from the minimum harmonization approach in the former directives whilst allowing Member States to maintain or adopt national rules in relation to certain aspects like imposing additional information requirements or extending the provisions of Directive to other areas than distance sale¹¹. Part of the rules governing consumer protection is related to the concept of withdrawal from the agreements concluded online between consumers and suppliers. As all the legal acts, Consumer Rights Directive, is forming part of Community legislation, and therefore influencing the rules set out in other legislative acts. As the payments made under conditions of distance sale are clearly qualifying to be payments on account, withdrawal rules protecting consumer rights, can jeopardize the application of prepayments laid down in the VAT Directive.

1.2. Purpose

The chargeable event, according to the EU VAT Directive, is when the goods and services are supplied or in the exceptional cases when the payment is on account before the actual delivery has taken place.¹² Article 65 in VAT Directive, which is representing the exemption to the general rule of chargeability of VAT, is constructed rather generally and therefore giving space for “grey zones” in the process of interpretation of this exemption. They render the outcome of a court case

⁹ Directive 2011/82/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, OJ L 304, 22.11.2011, p. 0064–0088.

¹⁰ Ibid, preamble, (2)

¹¹ Ibid, preamble (12), preamble (13)

¹² Ibid, Article 63, Article 65

unpredictable and hamper the much-desired systematization of the law. In other words: inconsistencies within the law threaten the coherence of the law as a system¹³. Consequently, such an unclear interpretation causes legal uncertainty for the taxpayers and tax administrations.

The purpose of Thesis is to assess the consistency of the case law of ECJ and application of Article 65 in itself and in relation to the Consumer Rights Directive. Taking into account growing activity in the area of distance sale and consumer rights, the correlation between well-established statements relating to the payments on account and the rather new priority of consumer rights will be scrutinized. The clarification of the notion of payments on account, and its VAT consequences in different business areas will be analyzed.

This Thesis aims to discuss relevant cases in order to give clarity and understanding of VAT treatment of payments on account by giving answers to the following questions:

“What is the nature of the payments made prior to the supply of goods?

“What is the impact of withdrawal rules in Consumer Rights Directive on VAT treatment of advance payments?”

1.3. Method

Legal dogmatic method in combination with different methods of interpretation will be used to analyze the case law of ECJ. Mostly the literal, purposive and contextual method will be used for the research of the subject.

In order to answer the legal questions raised, the main source of information used is secondary EU law as well as ECJ case law which will be analyzed to accurately evaluate consistency of the application of the notion of payments on account in general. Disputes related to the payments on account have been reviewed by the ECJ several times during past years with interesting discussions involved and a mixed outcome. Inconsistencies cannot be prevented as the law is a work of man and the situations are constantly changing, technique is developing and adoption of new laws is long process.

¹³ Marco B.M. Loos, “The Influence of European Consumer Law on General Contract Law and the Need for Spontaneous Harmonization”, *European Review of Private Law* 3-2007 [515-531] Kluwer Law International BV, Netherlands, p 516

According to EU legislation, there are three main bodies guarding the consistency of the interpretation of EU laws. First to be mentioned is the Court of Justice of the European Union whose role is to diminish the inconsistencies and show the way to legal certainty.¹⁴ Article 19 TFEU ensures that the interpretation and application of the Treaty law is observed. The second one is the VAT advisory Committee whose main task is to give a non-binding guidance to the uniform application of the provisions of VAT Directive.¹⁵ The third is Advocate General which is an institution unique to the European Court of Justice although it can be found in the legal orders of some of the Member States.¹⁶ Its sole function is to prepare and present publicly reasoned conclusions for the advice of the Court. Although technically not legally binding, its conclusions may strongly influence the development of Community law'.¹⁷ All three institutions have during the last decades interpreted the notion of payments on account, sometimes giving rather confusing messages to the taxpayers as well as to the tax administrators.

Non-binding Community acts such as AG opinions and VAT Committee guidelines and academic opinions are important source of information and gives additional view on the challenges raised before the ECJ. Those documents will be reviewed in connection with the analyses of the cases in order to get a wider view of the notion of payments on account.

1.4. Delimitations

The Thesis will focus on the analyses of the concept of payments made prior to the supply of the goods and services with the main emphasis on business-to-consumer cross-border distance sale of goods and consumer rights protection in the European Union. The thesis will analyze the challenges related to payments on account in the area of cross-border distance selling of goods. In order to obtain a full picture of the application of the notion of payments on account and the interpretation of the Article 65 of the VAT Directive, the case law related to the advance payments in the service sector will be analyzed and compared to the situation in distance selling of the goods.

¹⁴ Ibid

¹⁵ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, preamble, para 58, Article 398

¹⁶ Noreen Burrows, Rosa Greaves, "The Advocate General and EC Law", Published to Oxford Scholarship, Scholarship Online: DOI:10.1093/acprof:oso/9780199299003.001.0001, January 2009, Introduction - "Who is AG?", p.2

¹⁷ Ibid, Introduction, "Function to assist the Court", p.2,

The Thesis will not be focusing on other secondary issues related to the notion of payments on account, such as deductions, vouchers. Problems related to the places of supply will be mentioned only in order to clarify the specifics of the cross – border distance sale.

As the Community legislation in the area of VAT is harmonized and member states are obliged to introduce national legislation in line with the rules on VAT Directive, this thesis will not discuss and compare the VAT rules in different Member States.

2. Legal background

In order to discuss the challenges of application of the VAT rules of payments on account, the context of the legislation in the area of the chargeability and chargeable event of VAT, Distance Sale and Consumer Rights will be outlined in this chapter.

2.1. Chargeability and chargeable event

According to Art.1(2) of the 2006/112/EC, VAT is a “general tax on consumption”. Article 2.1 of the VAT Directive stated that the supply of goods and services is subject to VAT. When the goods are supplied, the right to dispose of tangible property in the capacity of owner has been transferred¹⁸. ECJ has stated that even if the legal ownership is not transferred, the right to dispose of tangible property as owner is deemed to be a supply of goods¹⁹. The supply of services, according to article 24, means any transaction that does not constitute a supply of goods.

As a general rule, according to Article 63 VAT Directive, the chargeable event for VAT purposes is considered to be the time when the goods or services are supplied²⁰. Consequently the VAT is due at the moment the goods are supplied or the service is completed. However, there are exceptions to this principle.

Prepayment or the payment on account is the exception to the general principle of chargeability. Prepayment is regulated in Article 65 – payment on account. The key

¹⁸ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 14

¹⁹ Case, C-320/88, *Staatssecretaris van Financiën v. Shipping and Forwarding Enterprise Safe BV*, 8 February 1990, [1990] ECR I-0285, para 9,

²⁰ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 63

message of the article is that in the case of payments made prior to the delivery of goods or services, the VAT becomes due at the moment when the advance payment is received and according to the amount that is actually received.²¹ According to the Article 90 of the VAT Directive the cancellation, refusal or total or partial non-payment or where the price is reduced after the supply takes place.²² In this case the taxable amount has to be reduced under the conditions laid down in the national legislation of the Member State.

Article 398 of the VAT Directive sets up Advisory VAT Committee whose main task in close cooperation between the Member States and the Commission is to work out the solution for consistent interpretation of the terms and conditions of the Directive.²³ To underline the importance of the issue, the question of the chargeability and chargeable event of the payments on account, has been raised during the VAT Committee meetings where the participants from all Member States have agreed over a number of guidelines explaining the article 65. The 99th VAT Committee²⁴ meeting decides that the payment made by a customer during the process of booking an airplane ticket shall be deemed to constitute a payment on account and VAT becomes chargeable at the moment when the airline receives the payment. Further, the Committee stated that even if the customer neither uses the service nor is cancelling the booking, the price paid and retained by the airline is considered to be consideration for the service provided and therefore VAT is to be charged. Although VAT committee's decisions have only advisory role, they have a big influence on the routine practice of VAT.²⁵

2. 2. Distance sale

Distance selling is sale of goods and services to the consumer in which the parties do not meet, - such as sale by mail order, telephone, digital TV, email, or the internet.²⁶ With the increasing availability and opportunity of the distance trade, consumers are taking advantage of the possibility to purchase goods from suppliers anywhere in the EU. Share of turnover from e-sales stable at 15 % in the 2011-2013

²¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 65

²² Ibid, Article 90

²³ Ibid, Preamble § 58

²⁴ VAT Committee Guidelines, Guidelines Resulting from the 99th meeting of 3 July 2013, TAXUD.c.1 (2013)3770682-778

²⁵ Ben Terra, Julie Kajus "Introduction to European VAT", IBFD, recast 2015, Chapter 21.3 VAT Committee, page 1233

²⁶ Oxford Dictionary of Law, Clays Ltd, Oxford, 2013, p 416

period and showing steady increase to 18 % year 2014.²⁷ Increased mobility of the people as well as the fast developing communication possibilities is encouraging consumers to purchase other Member States. Suppliers and consumers are able to benefit from free market concept in EU, without having the burden of complicated and costly legal procedures as well as uncertainties in the area of VAT.

Since the abolition of fiscal frontiers within the European Union, private consumers are free to purchase goods in other Member States than where they reside at the VAT applicable in the Member State of purchase.²⁸ VAT Directive states that intra community acquisition of goods for consideration within the territory of Member State are subject to VAT, with the exception to distance sale.²⁹ VAT directive includes special rules related to distance sale where, depending on the volumes of the transactions performed by the supplier through distance sales, the taxation might be in the Member State of residence of consumer or establishment of the purchaser.³⁰

In a liberalized market, the first question concerns the determination of the place of supply with respect to cross-border transactions.³¹ There are two main principles of the place of supply – the principle of origin and destination. The “origin principle” taxes goods where they are produced.³² Applying this principle can cause the difference in the tax burden for the goods produced domestically and those bought in Member States with lower VAT rate. This situation can create serious distortion in the market. The “destination principle” taxes goods where they are consumed³³, which maintains neutrality within the VAT system between Member States. The main difference between above mentioned principles is that the destination principle places companies operating in the same jurisdiction on an even footing but the origin principle places consumers of the same jurisdictions on an even footing. In EU for indirect taxes the country of destination has been accepted as the leading principle.³⁴ EU VAT model for the place of supply is based on approach by

²⁷ Konstantinos Giannakouris, Maria Smihily, “Share of turnover from e-commerce stable at 14% in 2009 and 2010”, Eurostat, European Commission, European Union, 2012

²⁸ Ben Terra, Julie Kajus ”Introduction to European VAT”, IBFD, recast 2015, Chapter 11.2.2 The supply of goods with transport, page 474

²⁹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 2.1.B (i)

³⁰ Ibid, article 33, Article 34

³¹ Ben Terra, Julie Kajus ”Introduction to European VAT”, IBFD, recast 2015, Chapter 11.2.2 The supply of goods with transport, page 482

³² Ibid, page 246

³³ Ibid

³⁴ Ibid

category, where the place of supply is determined by each category of supplies according to their nature and status of customers (business or consumers).³⁵

General rule for the supply of goods with transport is that where goods are dispatched or transported by supplier, customer or by a third person, the place of supply is deemed to be the place where goods are located when transportation to the customer begins, the country of origin.³⁶ Distance sale is a derogation from this general rule. Article 33 regulates the place of taxable transactions relating to the transactions between suppliers and final consumers who are residents in another Member State. Article provides that the place of supply of goods dispatched or transported by or on behalf of the supplier from a Member State other than that of arrival is the place where the goods are at the time when the dispatch or transports ends, in other words the country of destination.³⁷ Distance sales of new cars and of goods supplied after assembly or installation are excluded from this rule.

As a general rule, purchases by private persons are taxed in the country of purchase, unless the purchase is based on a distance sale.³⁸ In the case of the distance sale of goods to private persons, two important issues have to be taken into account. On the one hand, the place of taxable transaction is not always certain, but can be different from case to case depending on the volume of the transactions by the supplier to the other Member State.

On the other hand, the threshold according to the article 34 is an important factor determining the place of supply and consequently the place of taxation. VAT of the country of destination is applied if the threshold of 100 000 EUR, according to the article 34 is exceeded. However, Member States may limit the threshold for the distance sale in the country of origin to 35 000 EUR per supplier if there is a serious concern of the distortions of competition.³⁹ Member states that use the possibility to limit the threshold has to inform the competent public authorities in the Member State where the transport begins.⁴⁰ Suppliers, on the other hand, may opt for taxation

³⁵ OECD 2014, Consumption Tax Trends 2014, OECD publishing, <http://dx.doi.org/101787/ctt-2014-en>, p 27

³⁶ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 32

³⁷ Ben Terra, Julie Kajus "Introduction to European VAT", IBFD, recast 2015, Chapter 11.2.2 The supply of goods with transport, page 474

³⁸ Ibid

³⁹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, Article 34.2

⁴⁰ Ibid, Article 34.2.2

in the country of destination even if the threshold is not exceeded.⁴¹ VAT Committee has stated that Taxation at destination applies to those supplies of goods which give rise to the threshold being exceeded, any subsequent supplies during that year, and all supplies made to customers in that Member State during the calendar year following that in which the threshold has been exceeded.⁴²

The rules of the place of supply in the distance sale has no retroactive effect. If threshold is exceeded, the new place of supply rule, according to Article 33, is valid for the goods supplied after the limits of the threshold is exceeded. This is actual only in the case if the supplier has not opted for the taxation in the country of destination or if the threshold was not exceeded during the previous calendar year.⁴³ The thresholds and requirements for taxpayers to register in other Member States is certainly benefiting to the neutrality of the taxation, but at the same time the question can be raised if it is not contradicting to the main idea of distance sale.

Distance sale is becoming more and more popular and thereby allows enterprises to establish their presence in the market not only at the national level but also to extend their economic activities to other Member States. Making purchases online has become an integral part of the people's lifestyle. That includes also risks and uncertainties when it comes to products bought online both in terms of quality and appearance. In order to encourage distance sale and to compensate consumers for the risk of making purchases of the product that is maybe not in line with purchaser's expectations, the EU law is emphasizing the importance of protection of consumer's rights.

2.3. Consumer Rights Directive

The law governing the protection of the consumer rights in the area of distance sale is Consumer rights Directive.⁴⁴ Directive aims to harmonize the legislation within European Union and consolidate four existing directives in the area of consumer rights by simplifying and updating the applicable rules, removing inconsistencies and closing unwanted gaps in the rules.⁴⁵ It lays down standard rules for the

⁴¹ Ibid, Article 34.2.4

⁴² Guidelines resulting from the 64th meeting, of 20 March 2002, TAXUD/2352/02

⁴³ Council Implementing Regulation (EU) No 282/2011 of 15 March 2011, laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L 77/1 of 23 March 2011, Article 14

⁴⁴ Council Directive 2011/83/EU of 25 October 2011 "on consumer rights and protection", OJ L 304/64 of 22 November 2011

⁴⁵ Ibid, Preamble § 2

common aspects of distance and off-premises contracts, moving away from the minimum harmonization approach in the former Directives whilst allowing Member States to maintain or adopt national rules in relation to certain aspects.⁴⁶

The Directive lays down a number of wide-ranging rules and procedures in the area of consumer protection in the field of distance selling. The rules that are of a vested interest, allows consumer to withdraw from the agreements concluded. The rationale for the right to withdraw is that consumers need to inspect and try out the product before deciding upon the purchase.⁴⁷ Agreement is not complete until the consumer had the opportunity to inspect the product and decide not to withdraw.⁴⁸ Those rules are of special interest due to the fact that withdrawal from the contracts might influence the chargeability of VAT.

The essentials of withdrawal mechanism are regulated in the articles 9 to 16 of the directive. According to the general rule, the consumer shall have a period of 14 days to withdraw from a distance or off-premises contract, without giving any reason.⁴⁹ Certain categories of supplies such as reservations are made at hotels or concerning holiday cottages or cultural or sporting events, are excluded from the directive due to the fact that the supplier of the services, by the conclusion of the contract, implies the setting aside of capacity which, in the case of the right of withdrawal were exercised, the supplier may find difficult to fill.⁵⁰ The same relates to the passenger transport services.⁵¹

The trader has a duty to provide consumer with information regarding the right to withdraw.⁵² If the trader has not provided the consumer with the necessary information the withdrawal period is extended to additional period of 12 months from the end of the initial withdrawal period. The consumer exercises right to withdrawal without incurring any costs. However, supplementary costs, if the consumer has expressly opted for a type of delivery and direct cost of returning the goods shall be covered by the consumer.⁵³ This rule is not valid for the goods and

⁴⁶ Ibid

⁴⁷ Oren Bar-Gill, Omri Ben-Shahar, "Regulatory techniques in Consumer protection: a critique of European Consumer contract law", *Kluwer Law International, Common Market Law Review* 50: 109–126, 2013.

⁴⁸ Ibid

⁴⁹ Council Directive 2011/83/EU of 25 October 2011 "on consumer rights", OJ L 304/64 of 22 November 2011, Article 9.1

⁵⁰ Ibid, Preamble § 49

⁵¹ Ibid, Article 3 (k)

⁵² Ibid, Article 6 (1), h

⁵³ Ibid, Article 13.2, Article 14

services specially excluded from the scope of directive.⁵⁴ Withdrawal period starts from the day of the conclusion of the contract, in the case of service contracts or in the case of sales contracts, the day on which the consumer acquires physical possession of the goods.⁵⁵

3. Payments on account versus deposits

Treatment of the payments on account is regulated in the article 65 VAT Directive, which is describing exception to the general rule of chargeability of VAT in a case if the payments for the goods or services are made on account before the actual delivery is made. However, from the practical side the notion and the application is unclear and therefore the interpretation and uniform application is still a challenge.

The main focus of this chapter is on the interpretation of the notion of payments on account in comparison to deposits. In order to develop deeper understanding of the difference between those two concepts the cases BUPA and Societe Thermal will be analyzed. Further, the challenges in the area of lump sum payments as in the cases Kennener Golf, Le Rayon d'Or will be discussed.

3.1. Payments on account

In the European Union legislation there is no exact definition of prepayment and maybe because of that one can find many different terms like advance payments, pre-payments, payments on account to be often related to the notion of prepayments. According to Oxford Dictionary of law, prepayment or advance payment is payment for goods by the customer prior to receiving the goods.⁵⁶ Even though the definition seems to be straightforward, a question is often raised regarding prepayment for goods or certain services and chargeability of VAT.

As a general rule according to Article 63 VAT Directive, the chargeable event for VAT purposes is considered the time when the supply of goods or services are supplied. According to the settled case law, the supply of services against consideration is subject to VAT.⁵⁷ If the service is not provided, namely goods not

⁵⁴ Ibid, Article 16

⁵⁵ Ibid, Article 9.2

⁵⁶ Oxford Dictionary of Law, Oxford, 2013, p 416

⁵⁷ Case C-16/93, Tolsma R. J. v. Inspecteur der Omzetbelasting Leeuwarden, 3 March 1994, §14 [1994] ECR I-0743

delivered to the consumer, there is no reason to chargeable event of VAT. However the law has anticipated the exceptions to this rule by imposing the obligation to taxpayer to account for VAT already before the delivery which can be long before goods are on the way to the consumer. Such a situation is typical in the case of cross border distance sale. When concluding digital agreements consumers are almost always directly performing transfer of the consideration agreed which results in the payment on account and the chargeable event for the VAT.

The teleological interpretation of the VAT directives and regulation depends largely on the preambles and proposals of the legislator which set out the intention of the EU acts.⁵⁸ According to the Court of Justice every provision of Community law must be interpreted in the light of the provisions of Community law as a whole, regard being had to the objectives thereof.⁵⁹ In the Explanatory Memorandum to the Proposal for the Sixth VAT Directive ⁶⁰ the Commission observed that:

“When payments on account are received prior to the chargeable event, receipt of these amounts gives rise to a charge to tax, since the parties to the transaction in this way demonstrate their intention that all the financial consequences of the chargeable event should arise in advance.”⁶¹

The main argument for implementation of this rule was that for small businesses, the majority of whose transactions are with individuals, the rule relating to the receipt of the consideration avoids practical difficulties and the financing of the tax in advance by their customers.⁶² The aim mentioned in the proposal to the Directive has been recognized by ECJ in several cases.⁶³

As the payment on account is derogation from the general rule of the chargeability of VAT, it has to be interpreted strictly.⁶⁴ The payment on account can constitute

⁵⁸ Ben Terra, Julie Kajus ”Introduction to European VAT”, IBFD, recast 2015, Chapter 3.5. -The obligation to motivate regulations, directives and decisions, page 89

⁵⁹ Ibid, Chapter 6.3.5 - The teleological interpretation method, page 232

⁶⁰ Explanatory memorandum for the Six Directive, COM(73) 950, 20 June 1973

⁶¹ Ibid, Chargeable event and liability for tax, Article 11

⁶² Ibid

⁶³ Case C-549/11, Orfey Bulgaria v Bulgarian Tax authority, 19 December 2012, [2012] ECR I-0000, para 37

⁶⁴ Case C-419/02, BUPA, BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise, 21 February 2006, para 45 [2006] ECR I1685

both partial and the entire consideration for the transaction.⁶⁵ The prepayment may be paid in kind as long as the amount of such a payment is possible to express in monetary terms.⁶⁶ Goods and services in question must be precisely identified at the time the payment on account is made and neither of the parties are entitled to terminate the contract unilaterally at any time which would mean that it is not certain that taxable supply will be made.⁶⁷ If any realistic doubts exist in respect of the chargeable event and chargeability, Article 65 is not applicable.⁶⁸ Those doubts can be related to fictions and illegal transactions.

As stated above, the payments on account is a derogation of the general rule of chargeability of VAT falling within the scope of VAT. In order to have a broader view on financial transactions before the supply of goods and services, it is important to analyze the notion of deposit - transaction that might look similar to the payments on account, but has different role, function and position within the VAT rules.

3.2. Deposits

By definition, a deposit is a sum paid by one party to a contract to the other party as a guarantee that the first party will carry out the terms of the contract. The paying party will forfeit the sum in question if it does not carry out the terms, even if the sum is in excess of the other parties' loss. If the contract is completed without dispute, the deposit becomes a part of the payment.⁶⁹ The term 'deposit' refers to a specific legal concept that can vary from one jurisdiction to another.⁷⁰

Deposits mark the conclusion of a contract, since the payment of a deposit implies that the contract exists. Deposits encourage the parties to perform the contract, because otherwise the party who has paid it stands to lose the corresponding sum.⁷¹

⁶⁵ Case C-107/13, FIRIN OOD v Bulgarian Tax authority, Opinion of Advocate General, of 13 March 2014, para 22

⁶⁶ Case C-549/11, Bulgarian Tax authority v Orfey Balgaria EOOD, 19 December 2012, [2012] ECR I-0000, para 30

⁶⁷ Case C-419/02, BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise, 21 February 2006, para 48, [2006] ECR I1685

⁶⁸ Case C-107/13, FIRIN OOD v Bulgarian Tax authority, Opinion of Advocate General, of 13 March 2014, para 26

⁶⁹ Oxford Dictionary of Law, Oxford, 2013, p 165

⁷⁰ Jeroen Bijl, VAT, "Vouchers, Rights and Payments: The VAT Treatment of Vouchers", EC TAX REVIEW 2013-3, Kluwer Law International BV, The Netherlands, 2013

⁷¹ Ibid

Consequently, it is clear that the deposit is the sum of money held as security for the performance of the agreement, however, if the parties fulfill the obligations under the contract, the deposit is not returned and is a part of consideration agreed by the parties.⁷²

However, there are two kinds of deposits - those that can be applied to the amount charged for the goods or services supplied and deposits that are intended as security for the performance of an agreement between the parties.⁷³ Although at the time of transaction it may be difficult to determine, in some cases, whether a deposit fits in the first or second category.

If the deposit is not returned but considered to be a part of consideration, then the question arises what is the actual difference between deposits and payments on account? Both of these terms are related to the financial resources paid in advance for the goods or services. In the case of payments on account, the money paid by the consumer is the consideration agreed in the contract between the parties. But it can also be interpreted as a security since it is paid before the goods or services are supplied and because it secures the payment for the goods. In cross – border transactions, payment on account is an important part of the agreement, since the possibility for supplier to recover outstanding payments from the private persons in other Member States are usually rather difficult. In case if the agreement between the parties is withdrawn after the money is on account, the supplier is obliged to return the whole amount paid by the consumer.⁷⁴ In case of deposit, the money paid as a security for the fulfillment of the agreement is not returned but instead supplier is entitled to keep deposit.

The VAT consequences of the deposit is different from the ones in a case of payments on account. Deposit, seen as a penalty and not a part of consideration for the supply and therefore falling outside the scope of VAT transactions. The sums that are compensatory in their nature are not subject to VAT, but sums that are part of the consideration are taxable.⁷⁵

⁷² Oxford Dictionary of Law, Oxford, 2013, p 165

⁷³ Alan Schenk, Victor Thuronyi, Wei Cui, “Value Added Tax A Comparative Approach”, Cambridge University Press, 2015, Chapter 5 - Taxable Supplies and Tax Invoices
Chapter DOI: <http://dx.doi.org/10.1017/CBO9781107337671.006>, page 93

⁷⁴ Council Directive 2011/83/EU of 25 October 2011 ”on consumer rights and protection”, OJ L 304/64 of 22 November 2011, Article 9.1

⁷⁵ Alan Schenk, Victor Thuronyi, Wei Cui, “Value Added Tax A Comparative Approach”, Cambridge University Press, 2015, Chapter 5 - Taxable Supplies and Tax Invoices
Chapter DOI: <http://dx.doi.org/10.1017/CBO9781107337671.006>, page 94

It may be assumed that both the payments on account and deposits have the aim of concluding the agreement and encouraging the parties to perform the agreement. Both transactions mean that the consumer transfers financial resources to the supplier as a proof of intentions towards the agreement. However, there are two features that differ deposits from the payments on account. Firstly, in the case of payment on account, the supplier is obliged to return the full amount transferred by the consumer, but in the case or deposit, the amount is retained by the supplier as a penalty for the damages incurred to the supplier. Secondly, the VAT treatment of the transaction is different. In the case of payment on account, the chargeable event of the transaction is when the money is on account, but deposit is outside the scope of VAT.

3.3. Case law

3.3.1. Kennemer Golf ⁷⁶

Kennemer Golf was the first case that indirectly dealt with the lump sum payments and payments on account. From the fact in the case, Kennemer Golf and Country Club are the pursuit and promotion of the sport and games, in particular golf.⁷⁷ The members must pay the annual subscription fee as well as an admission fee.⁷⁸ The facilities could be used by its members, but also by non-members in return for the payment for the day subscription fee. Through such a setup Kennemer Golf earned large sums of money where one third is paid by the members as annual subscription fees.⁷⁹ Kennemer Golf believed that the services were VAT exempt and did not pay tax on those services. Tax authorities argued that the aim of the company was profit making and therefore the services should be taxed.

A dispute between the parties resulted in several questions addressed to the ECJ. One of the questions concerned was regarding interpretation of the meaning “annual subscription fees”, in particular if such fees of the members of sports association can constitute the consideration for the services provided even though the members do not use or do not regularly use the associations facilities.

⁷⁶ Case C-174/00, Kennemer Golf & Country Club v Staatssecretaris van Financiën, of 21 march 2002, [2002] STC 502

⁷⁷ Ibid, para 9

⁷⁸ Ibid, para 10

⁷⁹ Ibid, para 11

According to the settled case law, basis of the assessment of the VAT is everything that makes the consideration for the services provided and with the precondition that there is a direct link between the consideration and the services provided.⁸⁰

AG Jacobs in his opinion reasoned that the fact that the direct link is more obvious in the case payment of daily fees does not make it less obvious in the case of lump sum of annual membership. The club is there to provide certain services.⁸¹ The opportunity to use the services offered by the sports club is an important aspect and not the actual use of association's facilities. Following AG proposal for ruling, the court finds both the existence of a reciprocal performance as well as a direct link between the association and its members.⁸² The association has made available its services and the associated advantages to its members on the permanent basis and not by particular services provided by the member's request.⁸³

In other words, the opportunity to use services on the permanent basis is the main argument in the case. Even though neither the service was specified nor the uncertainty of the fact that the service will be delivered at all, was an obstacle for the court to declare that the lump sum paid by the association members was deemed to be the consideration for services and consequently taxed as a payment on account.

3.3.2. BUPA⁸⁴

BUPA is the landmark case of application of the article 65. This is the case where the challenge of prepayments is for the first time discussed on the scene of the European Court of Justice.

According to the facts in the case, BUPA is a UK company managing a large group of private hospitals which is involved in the supplies of drugs and prostheses to patients in its hospitals. Supplies were zero-rated for VAT purposes.⁸⁵ UK government announced its intention to change the existing legislation. In order to

⁸⁰ Ibid, para 39,

Case C-16/ 93, Tolsma v Inspecteur der Omzetbelasting, 3 March 1994, [1994] ECR I-0743, para 13

⁸¹ Case C-174/00, Kennemer Golf & Country Club v Staatssecretaris van Financiën Opinion of AG, 13 December 2001, para 32

⁸² Ibid, para 40

⁸³ Ibid

⁸⁴ Case C-419/02, BUPA Hospitals Ltd and Goldsbrough Developments Ltd v Commissioners of Customs & Excise, 21 February 2006, [2006] ECR I1685

⁸⁵ Ibid, para 15

benefit from a much more favorable VAT system, BUPA got involved in the prepayment arrangements ahead of the change of legislation.

Arrangements that concerned prepayments were between two companies within the group, for the future supply of the goods. Contracts stipulated that the contractual price has to be paid on the contract date, the products and the delivery scheme can be changed afterwards, the delivery of the products are subject to further instructions from the buyer and that both parties could terminate the agreement at any time and in this case the amount of money that is not used will be refunded by the seller.⁸⁶ Based on money received as a prepayment BUPA could claim relief for input VAT for the period when payment was made or when an invoice was issued, even if the delivery might take place in a later accounting period.⁸⁷ Commissioners refused to allow BUPA the deduction based on those prepayment arrangements.

The question to the ECJ was whether such payments are falling into the scope of the treatment of payments on account. The reasoning of the court is that since the payment on account is a derogation from the general rule of the chargeability of VAT, where the VAT becomes chargeable before supply of the goods, all relevant information concerning, future delivery or future performance must be known.⁸⁸

The court is following the AG opinion and stating that when the payment on account is made the goods or services must be precisely identified.⁸⁹ Additionally, AG emphasized that not only the unclear identification of the products, but also the possibility for either party to terminate the agreement unilaterally triggering the repayment of the prepayment is contradiction to the idea of the concept of payments on account.⁹⁰ In the case the court points out that the supplies are subject to VAT and not the prepayments and therefore payments on account for supplies of goods or services that have not yet been clearly identified cannot be subject to VAT.⁹¹

The court decided that the prepayment of the lump sums that are paid for the goods that are only generally identified, where the parties may change the terms and conditions of the agreement and even resile from the agreement recovering the

⁸⁶ Ibid, para 27

⁸⁷ Ibid, para 17

⁸⁸ Ibid, para 48

⁸⁹ Ibid

⁹⁰ Case C-419/02, BUPA Hospitals Ltd and Goldsbrough Developments Ltd v Commissioners of Customs & Excise, Opinion of AG, delivered on 7 April 2005, para 99

⁹¹ Case C-419/02, BUPA Hospitals Ltd and Goldsbrough Developments Ltd v Commissioners of Customs & Excise, 21 February 2006, para 50, [2006] ECR I1685

unused balance of the prepayments, do not fall within the scope of the article covering prepayments.⁹²

Conclusion from analyses of the case points out that the court is clearly identifying several conditions that are important for the article 65 to be applicable. The goods may not be generally identified and altered by the agreement between parties and none of the parties may unilaterally resile from the agreement. The question though remains on how those conditions should be applied in practical situations. The court is apparently not going into deeper discussion or explanations on whether it is important to meet all the above mentioned conditions in order to disregard the notion of payments on account or whether it is enough with only one of them to say that the article 65 cannot be used.

Another important aspect is that the facts in BUPA case shows clear intentions of the supplier to abuse VAT law, through the VAT optimisation scheme by transferring the lump sum of money and relying on the rules of the payments on account. Abuse of rights by fraudulent evasion of the law covers situations where the instruments entered into by the taxpayer are indeed real and can produce their effects, but were not motivated by any intention other than to avoid the tax that should have been triggered by the actual transaction.⁹³ In other words, question is whether abuse is the fourth condition, important for the application of the payments on account and whether the abuse in coherence with other above mentioned conditions is the base for the denial of the application of article 65?

Let us note that the Commission has stated that: “When payments on account are received prior to the chargeable event, receipt of these amounts gives rise to a charge to tax, since the parties to the transaction in this way demonstrate their intention that all the financial consequences of the chargeable event should arise in advance.” It is interesting that the wording in the memorandum is referring only to the financial consequences of the transaction, but not to the technical or practical consequences like the identification of the products or agreement on delivery terms. Supposing that the meaning of the phrase “financial consequences” is that the parties in question have agreed on the final amount of consideration to be paid in advance for the goods in question. In BUPA case the decision of ECJ is on the contrary, elaborating on the technicalities rather than the fact that the money is on account. Therefore indirectly showing that the receipt of the money is less important, thus contradicting the intentions of the legislator.

⁹² Ibid, para 51

⁹³ Laurent Leclercq, “Interacting Principles: The French Abuse of Law Concept and the EU Notion of Abusive Practices”, IBFD, Bulletin for International taxation, June 2007, page 236

3.3.3. Societe Thermal ⁹⁴

The case where ECJ, to the contrary of the suggestion of the AG, came to the conclusion that the payments made by customers should be seen as deposits instead of payments on account and therefore are not subject to VAT.

According to the facts in the case, Société thermal, a company established in France, which is engaged in the operation of thermal establishments, including the provision of hotel and restaurant facilities. It collects, by way of deposits, sums paid in advance by clients of those establishments when reserving rooms. ⁹⁵ Those sums are either deducted from the amount to be paid for the accommodation later or retained by the company in cases where clients cancel their reservations. ⁹⁶ The tax authority considered that VAT should have been applied to such a payments.

ECJ was asked whether a sum paid as a deposit by a client to a hotelier should be regarded as consideration for the supply of a reservation service, which is subject to VAT, or as fixed compensation for cancellation, which is not subject to VAT if the client exercises the cancellation option available to him and that sum is retained by the hotelier.⁹⁷

Study in the case starts with the identification of the direct link. The ECJ has repeatedly stated that only if there is a direct link between the service rendered and the consideration received, the sums paid constituting genuine consideration for an identifiable service supplied in the context of a legal relationship in which performance is reciprocal.⁹⁸ Surprisingly enough, in the present case ECJ do not find the existence of such a direct link. The court finds that the deposit is not an essential, but more optional element of a contract for accommodation and therefore it is not enough to constitute the direct link.⁹⁹ This statement can be opposed, by examining the usual practice. If the supplier is requiring the deposit as a security or the proof for the concluded agreement, the consumer has no possibility to avoid transferring the amount of deposit since it is often the precondition from supplier.

⁹⁴ Case C-277/05, Société thermale d'Eugénie-les-Bains v. Ministère de l'Économie, des Finances et de l'Industrie, 18 July 2007, [2007] ECR I-6415

⁹⁵ Ibid, para 10

⁹⁶ Ibid

⁹⁷ Ibid, para 15

⁹⁸ Ibid, para 19

⁹⁹ Ibid, para 21

Contrary to the ECJ, AG in his opinion has clearly identified direct link between deposit paid by the customer and the reservation made by the hotel. According to AG, the customer is not paying the deposit without receiving an undertaking in return. The hotel is making a reservation thereby making the room available for the customer at the certain date and in return the customer is paying certain sum of money that will be retained in the event of cancellation. This line of reasoning is showing the reciprocal link between reservation service and payment made by the customer.¹⁰⁰

AG is discussing the difference of the qualification of the deposit in two possible situations. First, when the service in question is performed and the sum paid by the customer as a deposit is reduced from the payment for the service. In this case AG suggests that money paid in advance by the customer, should be considered as a payment on account. Secondly, in the case of cancellation, where the main service is not used, the sum paid by the customer should be considered as a consideration for the separate service - reservation. Consequently, in both cases, according to the opinion of the AG, the VAT should be chargeable on such deposits.

ECJ denied that the reservation can be seen as a separate, independent and identifiable service since the amount of the deposit is applied towards the price of reserved room.¹⁰¹ ECJ stated that the deposits mark the conclusion of the contract, encourages parties to fulfil the contract and the amount paid by the customer must be seen as a fixed compensation in case the customer is using the cancellation option. The court is concluding that neither the payment of the deposit, nor the retention of that deposit is covered by the rules of VAT Directive.¹⁰²

The obligation to make a reservation arises from the contract for accommodation itself and not from the payment of a deposit, there is no direct connection between the service rendered and the consideration received. The deposit shall not be regarded as a “payment on account” subject to VAT, but intended to offset the consequences of the non-performance of the contract.¹⁰³

The confusion in the case is related to the direct link which, according to the ECJ, was missing in the case. Is the existence of the contract and the encouragement to

¹⁰⁰ Case C-277/05, *Société thermale d'Eugénie-les-Bains v. Ministère de l'Économie, des Finances et de l'Industrie*, Opinion of AG, 13 September 2006, para 15

¹⁰¹ Case C-277/05, *Société thermale d'Eugénie-les-Bains v. Ministère de l'Économie, des Finances et de l'Industrie*, 18 July 2007, para 26, [2007] ECR I-6415

¹⁰² *Ibid*, para 35

¹⁰³ *Ibid*

perform the contract provisions not enough evidence of the existence of the direct link between advance payment and the service provided? If ECJ argues that legal link does not depend on the payment of deposit, one can turn the argument and ask if the payment of deposit would exist without the legal and direct link between parties.

Another interesting thing is that ECJ is not even discussing the possible link between the money, paid by the customers in the case of reservation of the hotel room and the payments on account. The duty of the ECJ is to give preliminary rulings, at the request of courts of the Member States, on the interpretation of Union law.¹⁰⁴ In BUPA case the court has clearly stated that in order to provide a useful reply to the court which has referred to it a question for a preliminary ruling, the Court may be required to take into consideration rules of Community law to which the national court did not refer in its question.¹⁰⁵ Seems like in the case *Societe Thermal* the ECJ is just following the questions asked by the national court without giving a wider look at the challenges at hand. Conclusion is that in the case the ECJ defined conditions to be met for the advance payments to be treated as a deposits. Deposits are, according to decision in the case, marking the conclusion of a contract, to encourage the fulfilment of that contract and to providing fixed compensation if the contract is fulfilled as agreed. As, according to ECJ, the hotel is not making any supply of identifiable service to the customer, no VAT should be charged on this advance payment.

The ruling influences the VAT treatment of forfeited deposits, generating as a result of cancellation of the service by the customer. The decision in the case can influence not only hotel services but also relates to the supply of other services and goods. Money retained by a supplier when a customer makes a cancellation and a supply does not take place, should be treated as falling outside the scope of VAT since it is regarded as penalty and not a payment for the taxable supply.

¹⁰⁴ Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal of the European Communities, C83, 30 March 2012, Article 19.3, Article 267.

¹⁰⁵ Case C-419/02, *BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise*, Opinion of AG, delivered on 7 April 2005, para 42

3.3.4. Le Rayon d'Or ¹⁰⁶

RCHE is also providing health care and according to the agreement with State authorities, receives a global lump-sum payment in respect to those services.¹⁰⁷ Le Rayon d'Or, the company which operates RCHE, received a subsidy paid by a national sickness insurance fund. This subsidy was paid as a lump sum, which according to Rayon d'Or, fell outside the scope of VAT. The arguments presented before the court was that the services to the residents was neither defined in advance nor personalized and that the residents receiving care was not even aware of the price of the services.¹⁰⁸ On the other hand, the tax authorities stated that the services, just like in *Kennemer Golf*, do not have to be personalized, but must have a potential to be personalized.

The question was asked to the ECJ if the healthcare lump-sum payment falls into the scope of VAT.¹⁰⁹ In the case of the legal relationship and reciprocal performance between the sums paid by the health care organization and the service provider the court finds that involvement of the third person in the supplier – customer relationship does not influence the direct link.¹¹⁰ In regards to the lump sum payments, the court finds that neither the fact that the services are not defined in advance nor personalized is not affecting the existence of the direct link between the supply of services made and the consideration received. The court is also adding that the amount of such a consideration is determined in advance on the basis of well-established criteria.¹¹¹

The question on what is the interpretation of the phrase “well-established criteria” is still open. From one side, in the case of subsidy paid by a national sickness insurance fund the consideration can be the amount decided by the State authorities on the governmental level and applies to all residents receiving similar services. If the decision in the case would be applied to similar situations in the private sector, the question is whether the phrase “well-established criteria” can be related to the prices applied in the other cases, with other customers or during longer period of time.

¹⁰⁶ Case C-151/13, *Le Rayon d'Or SARL v Ministre de l'Économie et des Finances Le Rayon d'Or*, 27 March 2014, EU:C:2014:185

¹⁰⁷ *Ibid*, para 15

¹⁰⁸ *Ibid*, para 22

¹⁰⁹ *Ibid*, para 27

¹¹⁰ *Ibid*, para 37

¹¹¹ *Ibid*

When deciding the case in *Le Rayon d'Or* the court is referring to the decision in *Kennemer Golf* by stating that the payment made in advance for unspecified services is falling in the scope of VAT. One might argue that if all the payments on account for unspecified services would not be the subject to VAT, practically any service provided on basis of all-inclusive charges would escape VAT.¹¹² The difference in those two cases is that in case of *Le Rayon d'Or* the service provided is in fact used by the customers. The service provider is receiving the consideration for each person placed in the elderly home which are using the services according to individual needs. In *Kennemer Golf* the customers are free to choose not to use any services at all.

3. 4. Conclusions on payments on account versus deposits

There are two types of transactions resulting in the money being paid by consumer to supplier before the supply of goods or services. The first is the payment on account and the second is deposit. ECJ has discussed both notions from the different perspectives and in different areas of business. Several conclusions can be drawn from the case law analyzed above.

First, in the case of *BUPA*, the ECJ has defined conditions which should be met in order for Article 65 to become applicable. The goods must be clearly identified, goods may not be altered by the agreement between parties and none of the parties may unilaterally resile from the agreement. The question still remains unanswered if all the above stated conditions should be met in order to disregard the notion of payments on account or if it is enough with only one of them to say that the article 65 cannot be applied.

Second, the ECJ in its judgments is using a generalized phrase like “uncertain deliveries” that can lead to further misunderstandings and give too much room for subjective interpretation by the national courts and authorities. Another example is “well-established criteria” that even though is well established, but as it shows from the practice of the ECJ, can be difficult to apply and should be evaluated on a case by case basis.

Third, the border between the notion of payments on account and deposits is unclear, inconsistent and can vary between different business areas. The payment for the booking of a hotel room is considered as a deposit and therefore not subject

¹¹² Case C-174/00, *Kennemer Golf & Country Club v Staatssecretaris van Financiën*, 21 march 2002, [2002] STC 502, para 41

to VAT while payment for the airline ticket, according to the decision of the VAT Committee, is considered to be a supply of service even if the service itself is not consumed by the customer while the payment is retained by the supplier. The pending case of *Air France v KLM*¹¹³ is not yet finalized and its impact on the issue is as yet uncertain.

Fourth, the ECJ has defined the basic condition for the applicability of the notion of prepayments - goods and services should be precisely specified in order to be considered payments on account. Application of the statement is not entirely consistent. In the case *Le Rayon d'Or and Kennemer Golf* the court decided that if the service provider is supplying services that are unspecified and available permanently to its customers is the subject to VAT. This derogation can possibly be justified by different areas of business, with specific conditions, where such generalized statements are difficult to apply.

Last, but not least, the consistent interpretation of the notion of payments on account is still a challenge for ECJ.

With regard to deposits, that do not trigger the VAT to become chargeable on receipt of the payment, no VAT will become chargeable if these amounts are never applied as (partial) payments for a taxable transaction.¹¹⁴ Since the notion of deposit is not covered by the harmonized VAT legislation, it is likely that the interpretation and application of the concept is different in different Member States. The question is whether the VAT becomes chargeable upon receiving of the money, according to the rules of payments on account, since there is an uncertainty around the outcome of the transaction as such. In the case the supplier is retaining the whole amount of deposit until the service is supplied, it can in any case be seen as a payment on account but with the chargeability according to general rules of VAT.

4. Assessment of payments on account in distance sale

Payment on account is an integral part of distance sales transactions. Most of the cross-border transactions involving distance sale implies the obligation for the consumer to transfer the price agreed already at the moment the contract is concluded and goods or services are ordered. According to article 65 of VAT Directive a transfer of the payment before actual supply of the goods is considered

¹¹³ Case C-250/14, *Air France – KLM*, pending

¹¹⁴ Jeroen Bijl, VAT, “Vouchers, Rights and Payments: The VAT Treatment of Vouchers”, EC TAX REVIEW 2013–3, Kluwer Law International BV, Netherlands, 2013

as a payment on account. Such a payment is triggering the VAT consequences on the supplier as the chargeable event incurs at the moment the payment is received on the amount agreed even though the taxable supply is planned only sometime in the future.

4.1. Distance sale and Consumer Rights protection

During many years the consumer protection has not been given high priority in EU. Consumer protection was partly secured through different directives¹¹⁵, but the main legislative power lay in the Member states, which had to adapt laws in the area of consumer protection. Through the development of the internet and liberalizing of the internal market, business-to-consumer sales activities has increased. Different legislation in different Member states has given rise to increasing conflicts between consumers and suppliers. The case *Gysbrechts*¹¹⁶ is an interesting example of how ECJ is handling the problem of Consumer rights and cross-border transactions and giving a high priority to the challenges at hand.

The case was brought to the ECJ at the time of minimum harmonization in the area of distance sale and consumer protection, but a number of interesting statements were made during the process of the litigation.

From the facts in the case, Santurel is a company which specializes in the wholesale and retail sale of food supplements. Most of the sales are made on-line by means of the company's Internet site, and goods ordered are then sent to the purchasers by post.¹¹⁷ Santurel brought an action against one of its customers, Mr Delahaye, who resided in France because of the failure to pay the price of a number of products which had been delivered to him. The company failed to provide the information to the consumer on the rights of withdrawal according to the law in consumer protection.¹¹⁸ On the website of Santurel it is stated that in respect of goods delivered in Belgium, the price may be paid within a week after delivery. In respect of other countries, the only acceptable means of payment is credit card. In all cases, when a payment is to be made by credit card, the customer must state on the order

¹¹⁵ Directive 1999/44/EC of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, Directive 97/7/EC on the protection of consumers in respect of distance contracts, of 20 May 1997

¹¹⁶ Case C-205/07, *Lodewijk Gysbrechts, Santurel Inter BVBA*, 16 December 2008, [2008] ECR I-9947

¹¹⁷ *Ibid*, para 8

¹¹⁸ *Ibid*, para 11

form the number and validity period of the card.¹¹⁹ Since at the time of the events in the case, the legislation in the area of consumer protection was not harmonized in EU, according to the article 80 of the Belgian law on consumer protection no deposit or any form of payment may be required from the consumer before the end of the withdrawal period of seven working days”.¹²⁰ The aim of the article is to eliminate the possibility that the difficulties inherent in recovery of sums already paid may discourage the consumer from exercising that right.¹²¹

The Belgian authorities interpret the provision at issue in the main proceedings as meaning that, on the conclusion of a distance contract, the supplier cannot require that the consumer provide his payment card number, even though the supplier undertakes not to use it to collect payment before expiry of the period concerned.¹²² ECJ examines if the national rule does not go beyond what is necessary to attain the proposed objective – protection of the consumer rights and at the same time not restricting intra – community trade.¹²³

ECJ underlined that among the features of distance selling contracts is the fact that there is often a gap between the performances by each party of his contractual obligations. Thus, the consumer may be induced to pay for the goods before he has received them or, on the contrary, the supplier may be led to deliver the goods without having received the agreed amount for them. That gap exposes the contracting parties to a specific risk of non-performance.¹²⁴

Maybe due to the principle of the weakest party, the ECJ held the line of reasoning of Advocate General and agreed that the prohibition on requiring prepayment was regarded as justified by the mandatory requirement of consumer protection which is given high priority in the case and classified as an “overriding requirement of public interest”.¹²⁵ Contrary to the opinion of the AG, ECJ found that the prohibition on requiring the credit card number was taken as disproportionate, because the misuse of the credit card is effectively eliminated by the prohibition to collect the price before the expiry of the seven-day withdrawal period.¹²⁶

¹¹⁹ Ibid, para 12

¹²⁰ Ibid, para 6

¹²¹ Ibid, para 24

¹²² Ibid, para 30

¹²³ Ibid, para 54

¹²⁴ Ibid

¹²⁵ Ibid, para 45, 56

¹²⁶ Ibid, para 62, Wulf-Henning Roth, “Case law”, *Common Market Law Review* 47: 509–520, *Kluwer Law International* 2010, page 513

The consequence of the judgment of ECJ is that the supplier, in this case and according to the national rules of Belgium, has to deliver goods without receiving the consideration until a week after the supply of the goods. One might argue that the supplier has a certain security in the form of the credit card details, but consumer's ability to pay at the point of the payment is not certain at all. Another question is related to supplier's initial costs that might not be proportionate. Firstly, supplier has to pay for the production or purchase and delivery of the goods. Secondly, VAT consequences of such a transaction will incur in line with the general rule of the chargeability of the VAT – at the moment when the goods and services are supplied.¹²⁷

4.2. Payments on account in the light of the Consumer Rights Directive

The option placed before the consumer to examine the goods without obliging him to purchase them, should be deemed beneficial to both parties - supplier and consumer - as an extra flexibility, or even a variation of another service in a way, thus enhancing its overall attractiveness. Once discovered and promoted, and in line with the development of the online offer, distance sale is here to stay; however, not without a certain degree of uncertainty with it. In order to stimulate distance trade and to protect consumer from unexpected surprises when receiving product bought online, the consumer has been given two options vis-à-vis contractual obligations at hand. First, the right to withdraw, in accordance with the terms and conditions of the Consumer Rights Directive. Second possibility for the consumer to enjoy the flexibility in distance sale transactions by means of changing the subject of the agreement or withdrawing in accordance to the contract between the parties.

Most of the cross-border transactions involving distance sale implies the obligation to the consumer to transfer the price agreed already at the moment the contract is concluded which can be long before the products are received. According to the Article 65 of the EU VAT Directive, transfer of the payment before actual supply of the goods is considered as a payment on account. Such a payment is triggering the VAT consequences on the supplier as the chargeable event incurs at the moment the payment is received on the amount received.

The ECJ and the AG in the case BUPA suggests certain conditions to be met in order for the goods to be considered as payment on account. Firstly, the goods may

¹²⁷ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, article 63

not be generically indicated in where buyer may choose in the future one or more items, or none at all. Secondly, the buyer should not be able to terminate agreement unilaterally at any time. Thirdly, the buyer should not be able to recover unused balance of the payment made prior to the delivery of the products. Further, the court stated that if those conditions are not met, the transaction does not suffice to characterize that prepayment as a payment ‘on account’ within the meaning of the article 65 of VAT Directive. In the case BUPA, the ECJ refused to apply the provision of the payments on account *inter alia* because the customer had rights to cancel the agreement unilaterally which meant that the existence of the taxable transaction is not certain. ECJ has also said that Article 65 of the VAT Directive cannot apply where, at the time of the payment on account, it is uncertain whether the chargeable event will take place.¹²⁸

If the statements in BUPA case are applied in a cross – border distance sale case, it is obvious that consumer is fulfilling the first condition - the goods or services are identified since consumers are choosing the products before payment is completed. In order to examine the appearance in question, consumers have possibility to see the product electronically as well as read the description offered by the supplier.

Confusion is the phrase “unused balance”. In the ordinary situation of distance sale, the products purchased are delivered to the consumer and therefore the chargeable event has occurred. There is no unused balance at that point of time. If consumer decides to use the withdrawal rights that can be done only after the supply of the product then the money paid for the products is returned, but it can hardly be seen as “unused balance”.

Finally, consumer has the right to withdraw from the agreement for the period of minimum 14 days from the moment the goods are delivered or up to 12 months in the case if the supplier has not provided consumer with all necessary information required in the Consumer Rights Directive. No doubts that such a rather long period of withdrawal is creating uncertainty for both parties as the final purchase will materialize even though the chargeable event has already taken place.

Other, possible confusion is the existence of legal link. The existence of contractual relations between the parties and certainty that the contract is a definite document that parties can rely on. “The contract is a legally binding agreement that arises as a result of offer and acceptance. Some contracts, although valid, may be liable to be set aside by one of the parties, on such grounds as misinterpretation or the

¹²⁸ Case C-107/13, FIRIN OOD v Bulgarian Tax authority, Opinion of AG, 19 December 2013, EU:C:2014:151, para 24

exercise of undue influence”.¹²⁹ According to the principles of consumer rights protection, the consumer has a right to withdraw from the agreement for no reason, just because he or she have changed their mind. In this case there is no question of misunderstanding or undue influence but only unilateral decision to ignore the agreement. From the VAT perspective, at the time when the consumer has a possibility to use the withdrawal rights, the supply of the goods has already taken place. Consequently, from the time the payment on account is made and up until the moment the goods are supplied, consumer has neither the rights to change the agreement nor withdraw. From the contractual point of view the agreement is uncertain, but from the viewpoint of VAT it is doubtful whether the legal link can be questioned.

4.3. Contractually agreed deviations from initial obligations

In the growing world of electronic purchases and tough competition between companies, flexibility has been one of the most important feature of suppliers. As certain categories of purchases are excluded from the scope of the Consumer Rights directive, the terms and conditions of the transaction are governed by the agreement between the parties. Agreements may be concluded where one of involved parties, often consumer, has the right to introduce changes in the agreement, namely, change it's the subject at any time. This is a usual practice in different business sectors, especially airline, hotel etc and, if the ECJ conclusions were followed, this makes initial purchase uncertain. Consumer purchasing airline tickets or booking the hotel room often has the possibility to change the route, time, date or room booked previously.

As the ECJ has stated, article 65 cannot apply where, at the time of the payment on account, it is uncertain whether the chargeable event will take place.¹³⁰ The question then becomes actual in which situations does the article 65 apply? Apparently it applies to the transactions where, after supplier has confirmed an order, all the details of the transaction are definitive. The customer is not able to unilaterally change either the goods or services nor the delivery terms. According to the decisions in BUPA such a unilateral change is considered to create uncertainty as to the taxable supply and therefore article 65 cannot be applied. Consequently, the transaction has to be treated according to the general rule of chargeability of VAT – when the service is delivered or alternatively considered to be deposit which is falling outside the scope of VAT.

¹²⁹ Oxford Dictionary of Law, Oxford, 2013, p 130

¹³⁰ Case C-107/13, FIRIN OOD v Bulgarian Tax authority, 13 March 2014, para 39

Seems like the VAT Committee by taking the decision in its 99th meeting¹³¹ is not taking into account the statements of ECJ, by stating that the possibility for the customer to cancel the ticket, or to change the date or the route of the travel is not influencing the transactions status as a “payment on account”. This statement is important also from the perspective of distance sale and consumer right to withdraw, since applied to the cross-border business-to-consumer transactions, can be related to the notion of payments on account. The question is if this VAT Committee’s decision, which as a rule is not legally binding, should be considered as a turning point in the way of seeing payments on account in general or it is just a guideline that will be neglected when deciding, for example, Air France-KLM case which is still pending ECJ ruling.

4.4. Payments on account without taxable supply

Discussion in this section is related to the business areas in the services sector, but since the focus is on the application of payments on account, it can be applied also to the distance sale of goods. In the earlier ECJ judgment in *Societe Thermal*, the court decided that, where a hotelier retains the deposit after a guest has cancelled his reservation, the sum retained by the hotelier is compensation for his loss suffered as a result of the guest’s default, which has no direct connection with any supply of services by the hotelier and, as such, is not subject to VAT.¹³²

If consumer is not using the service that it has paid for and not demanding refund, the supplier retains the consideration paid by consumer and treats it as a deposit. This can be compared to the situation in distance sale where, for example, consumer is paying for the product that will be delivered in the future, but finally never picks it up from the postal office. Product is then returned to the supplier which makes the factual situation similar to the one in *Societe Thermal*. In this case, if following the decision in *Societe Thermal*, all the conditions for qualifying for the deposit are met – payment marks the conclusion of the contract, it encourages the fulfilment of the contract and the consumer is often losing the money transferred in the case of not using the service. Consumer cannot exercise the withdrawal rights before the physical possession of the goods is acquired, in this case there is no change of the owner because there is no supply of goods. If, following the ECJ decision in the

¹³¹ VAT Committee Guidelines, Guidelines Resulting from the 99th meeting of 3 July 2013, TAXUD.c.1 (2013)3770682–778

¹³² Hans-Martin Grambeck, “B2C Supplies of Electronic Services from 1 January 2015 from a German Perspective”, IBFD, International VAT monitor July/August 2013

case, payment made by consumer should be treated as a deposit and no VAT should be charged. Or maybe it is the possibility for the consumer to have a physical possession of the goods, similarly to the case Kennemer Golf that is enough in order to say that the delivery of the goods has taken place.

Maybe as a reflection to the increasing number of cases and uncertainty regarding the application of the payments on account and the chargeability of the VAT in different business sectors, during the 99th VAT Committee meeting the question was raised regarding treatment of the purchase of airplane tickets.¹³³ Does the purchase of an airline ticket constitute the payment on account according to article 65? The VAT Committee unanimously agrees that the payment made by a customer during the process of booking an airplane ticket shall be deemed to constitute a payment on account and VAT becomes chargeable at the moment when the airline receives the payment. The possibility for the customer to cancel the ticket, or to change the date or the route of the travel is not influencing this condition. Further the Committee stated that even if the customer neither uses the service nor is cancelling the booking, the price paid and retained by the airline is considered to be consideration for the service provided and therefore VAT is to be charged.

If, applying guidelines of the VAT Committee to the cross-border distance sale, payment done during the transaction is considered to be payment on account. VAT becomes chargeable on receipt of the payment and on the amount received. Does it mean that prepayment is deemed to be the supply of the service? The ECJ has stated in the BUPA case that the supply of goods and services is the reason for a chargeable event and not the payment on account.

It will be interesting to follow the pending cases of Air France – KLM¹³⁴ and Brit Air¹³⁵ where one of the questions raised is if the issue of the ticket may be treated as the effective performance of the transport service and that the sums retained by an airline company where the holder of an air ticket has not used his ticket, which is no longer valid, are subject to VAT? The question is still open if the ECJ is going to follow the VAT Committee guidelines, or maybe follow the pattern as in Societe Thermal finding no direct link between the payment made in advance and the service to be delivered.

¹³³ VAT Committee Guidelines, Guidelines Resulting from the 99th meeting of 3 July 2013, TAXUD.c.1 (2013)3770682–778

¹³⁴ Case C-250/14, Air France – KLM, pending

¹³⁵ Case C-289/14, Brit Air, pending

4.5. Generalization of the ECJ decisions

The BUPA case may be considered as a landmark case for the interpretation of the notion of the payments on account mainly because this is the only case where the ECJ is directly discussing and deciding upon the interpretation of the notion of payments on. The statements in the case have been used as a base for the interpretation of the notion of payments on account in different cases before ECJ¹³⁶ as well as in the national courts.

ECJ task according to the article 267 TFEU is to give the preliminary rulings and to interpret both treaties of EU as well as acts of the institutions, bodies, offices or agencies of the Union.¹³⁷ Aim of the ECJ decisions is to interpret legal norms according to the factual circumstances in the case before the ECJ and to provide the national court with the binding interpretation of the law applicable. Ideally decisions of the ECJ should be like a rule-like formula that is so clear that national courts and other institutions applying them would have no doubts on how and in which situations they should be applied.

The question lays in the level of generality, the problem to what extent courts have a discretion or freedom of maneuver as to the level of generality they decide upon.¹³⁸ Where a rule-like formula in a legal provision can be applied to resolve a case problem, the level of generality issue does not arise at all.¹³⁹ In the question for the preliminary ruling the exact report of all the circumstances in the case has to be described and the concrete question asked in relation to facts reported.¹⁴⁰ The base for the decision of the ECJ consists of two components – the facts of the case and the rules of the law that should be applicable in the case. Those two components builds the actual legal issue/situation. The aim of the decision is to provide information to the national court on how to interpret the legal rules in the factual situation at hand. Earlier decisions can be used in the case at hand leading to the

¹³⁶ Case C-107/13, FIRIN OOD v Bulgarian tax authority, 13 March 2014, para 35, para 36, Case C-549/11, Orfey Balgaria v Bulgarian tax authority, 19 December 2012, para 27, para 28

¹³⁷ Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal of the European Communities, C 83, 30 March 2012, pp. 1 – 403.

¹³⁸ Gerard Conway, “The Limits of Legal Reasoning and the European Court of Justice”, Book DOI: <http://dx.doi.org/10.1017/CBO9780511735929>, Chapter 6 - Levels of generality and originalist interpretation in the legal reasoning of the ECJ, (retrieved 20150512), page 245

¹³⁹ Ibid, page 246

¹⁴⁰ Rules of Procedure of the Court of Justice, OJ L 265, of 25 September 2012, amended on 18 June 2013, OJ L 173, Article 94

wrong outcome of the case giving misleading signals to the national courts and taxpayers.

4.6. Conclusions on assessment of payments on account in distance sale

Payments for the goods before the delivery is an integral part of cross-border distance sale transactions. In order to encourage consumers to purchase goods online in other Member States, special, harmonized legislation protecting consumers has been introduced in EU.

From the assessment and discussion above, several conclusions can be drawn. First, when purchasing online, consumers are concluding online agreement with suppliers. Agreement, according to the general rules of contract law, may not be rendered void. However, the situation is different in the cross-border distance sale transactions where consumers have right to withdraw. Uncertainty remains on when the agreement in distance sale actually becomes definite.

Secondly, in certain categories of transactions consumer may withdraw from the agreements without any reason according to the rules of the Consumer Rights protection. For other businesses, falling outside the scope of consumer protection directive and in order to increase the competitiveness, suppliers are more and more often choosing to include the possibility for the consumers to change the initially concluded agreement. The possibility to introduce significant changes in the purchase agreements has led to misunderstandings on how to treat the payments from the VAT perspective.

Thirdly, the question regarding the actual supply of goods and services and its role/effect of the chargeability of VAT is unclear. The basic rule when the goods are supplied is when the right to dispose of tangible property as owner has been transferred.¹⁴¹ ECJ has stated that even if the legal ownership is not transferred, the right to dispose of tangible property as owner is deemed to be a supply of goods. The question is still open if the possibility for the consumer to dispose of tangible property is enough to say that the supply has taken place. VAT Committee has gone even further by deciding that the fact that the consumer is deliberately not making use of the purchased services does not influence the existence of the payment on account. If this reasoning is applied to the distance sale of goods, then the VAT consequences incurs already at the time the payment is done according to the article 65 of the VAT Directive.

¹⁴¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006, article 14

Fourthly, the ECJ has given an interpretation on both payments on account and deposits. In its decisions the ECJ has stated conditions that have to be met in order for the transaction to qualify for either payments on account or deposits. However, those conditions cannot be used as a rule-like formula, but should be applied on case by case basis which complicates the application of the ECJ statements.

5. Concluding remarks

The notion of payments on account has been introduced in the EU VAT Directive already from the introduction of the first Directive. The intention of the prepayments in EU VAT Directive was mainly geared towards medium and small enterprises with the reference to the possible cash flow questions. Most of the sales was within the same Member State and distance sale did not exist at that time.

Due to the development and accessibility of internet, popularity of cross-border online purchases is increasing. Distance sale rules were added to the VAT Directive due to the specifics of the transaction and in order to maintain the neutrality of the taxation. The aim of the Consumer rights protection legislation is to encourage the cross-border distance sale. Today the Consumer Rights Directive and VAT Directive are providing the maximum harmonization in the area of consumer protection and distance sale. Following the rules of consumer protection, which according to ECJ, is given high priority and classified as an “overriding requirement of public interest”, the consumer has always the right to withdraw from the agreements for no reason. In the businesses that are not covered by the Consumer rights protection, parties often agree upon rights to withdraw or to change the contractual obligations.

In spite of the fast development of internet and new methods of doing business, EU VAT legislation regarding the notion of payments on account has not been changed. In order to minimize the gaps between legislation and changing business environment, ECJ has interpreted Article 65 in a number of cases that is directly or indirectly related to payments made before the delivery of the goods and services. Nevertheless, it is obvious that the interpretation of the notion is not entirely consistent mainly due to the fast changing development of the business environment, especially concerning abuse and avoidance.

What is the nature of the payments made prior to the supply of goods? Payment on account is payment for goods by the customer prior to receiving the goods. The legal ground of application can be found in the Article 65 of the EU VAT

legislation. In BUPA case ECJ came to the important statements regarding application of the article 65 in general. ECJ has defined conditions that should be met for the transaction to be qualified to be called payment on account. The goods may not be generically indicated, the buyer should not be able to terminate agreement unilaterally at any time and recover unused balance of the payment made prior to the delivery of the products. However, in practice, the application of those conditions is still unclear and complicated.

Deposit is the concept that is legally and technically close to payments on account. There are two types of deposits – the one returned when supply is made and the second which one is set off against the final price paid by the consumer. Deposits are, according to decision in the case, marking the conclusion of a contract, to encourage the fulfilment of that contract and to providing fixed compensation if the contract is fulfilled as agreed. Forfeit deposit is seen as a penalty and not a part of consideration for the supply and therefore falling outside the scope of VAT transactions.

What is the impact of withdrawal rules in Consumer Rights Directive on VAT treatment of advance payments? Payments that are made prior to the delivery of goods can be classified as payments on account or deposits. VAT treatment of the transaction as well as consumer right to withdraw and to recover such a payment differs in both cases.

The attempts to consider the advance payments as a deposit may present a certain difficulty. From VAT point of view and according to ECJ in *Societe Thermal*, transactions in distance sale can fulfill the conditions to qualify as deposit. However, *leges speciales* - consumer rights protection is giving consumer the right to receive back all the amount paid for the goods. This is where the challenge begins, since according to the definition, deposit is a security and should be either returned to the consumer or counted as a payment for the goods purchased. If the advance payment is considered a deposit, there is no VAT consequence until the goods are supplied and the amount of deposit included in the final payment. However, the consumer can still use the withdrawal rights and recover the amount paid which would contradict the legal consequences of deposit.

It is crucial to also compare the advance payment as a payment on account. The special rule of the chargeable event states that in the case of payments made prior to the delivery of goods or services, the VAT becomes due the moment the advance payment is received and according to the amount that is actually received. This is in line with the factual situation in distance sale. If in accordance with the reasoning of the ECJ statements in BUPA, consumer is paying in advance for an identified

product, which has to be delivered in a certain time frame. If, comparing facts in the BUPA case with those in the situation in distance sale, there are, however, considerable differences between them. Firstly, according to withdrawal rights in Consumer Rights Directive, consumer has always unlimited power to unilaterally resile from the agreements for no reason, but only after the delivery of the product. Secondly, in distance sale consumer has right to recover full payment in regard to goods the supply of which has already taken place. Thirdly, the fact that in BUPA case the factual situation was artificially created with the aim to abuse VAT rules, there is a serious reason to doubt that the situation can be comparable to the one in distance sale. Those facts make the situation in BUPA case different from the one in the cross-border distance sales.

Consequently, withdrawal rights are technically and legally provoking the application of the rules of traditional contract law, the interpretation of the notion of payments on account and deposits. However, the right to withdraw, in practice, is apparently not influencing the application of Article 65 in cross-border distance sale transactions. VAT Committee has made a decision related to the application of Article 65 to the provision of the services in airline industry stating that the possibility for the consumer to change the subject of the agreement or not to use the service at all, is not influencing the transactions status as a “payment on account”. This decision is challenging the ECJ decisions and partly also the message of the VAT Directive that the supply of goods is a reason of VAT. If VAT Committee’s decision can be implemented and applied to the transactions in distance sale in general, then it can be a stable legal base for the payment made by consumer to be treated as a payment on account.

Bibliography

Legislation and other sources of law excluding case law

1. Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11 November 2006
2. 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, OJ L 145, 13 June 1977, pp. 1–40
3. Council Implementing Regulation (EU) No 282/2011 of 15 March 2011, laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L 77/1 of 23 March 2011
4. Explanatory memorandum for the Six Directive, COM (73) 950, 20 June 1973
5. Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal of the European Communities, C 83, 30 March 2012
6. Directive 2011/82/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, OJ L 304, 22.11.2011, p. 0064–0088
7. VAT Committee Guidelines, Guidelines resulting from the 64th meeting, of 20 March 2002, TAXUD/2352/02
8. VAT Committee Guidelines, Guidelines Resulting from the 99th meeting of 3 July 2013, TAXUD.c.1 (2013)3770682–778
9. Rules of Procedure of the Court of Justice, OJ L 265, of 25 September 2012, amended on 18 June 2013, OJ L 173

Books

1. B. Terra, J. Kajus, A Guide to the European VAT Directives, “Introduction to European VAT”, published IBFD 2015, (retrieved 20150315)

2. Oxford dictionary of law, 7th edition, Clays Ltd, Great Britain, 2013
3. Noreen Burrows, Rosa Greaves “The Advocate General and EC Law”, Published to Oxford Scholarship, Book DOI:10.1093/acprof:oso/9780199299003.001.0001, January 2009, (retrieved 20150512)
4. Ruth Sefton-Green , “Mistake, Fraud and Duties to Inform in European Contract Law”, Book DOI: <http://dx.doi.org/10.1017/CBO9780511495052>, Online ISBN: 9780511495052, (retrieved 20150512)
5. Gerard Conway, “The Limits of Legal Reasoning and the European Court of Justice”, Book DOI: <http://dx.doi.org/10.1017/CBO9780511735929>, Online ISBN: 9780511735929, (retrieved 20150512)

Articles and other materials

1. Klaus-Dieter Borchardt, “The ABC of European Union law”, Luxembourg: Publications Office of the European Union, 2010
2. Konstantinos GIANNAKOURIS, Maria SMIHILY, “Share of turnover from e-commerce stable at 14% in 2009 and 2010”, Eurostat, 2012 — Statistics in focus, (<http://ec.europa.eu/eurostat/documents/3433488/5584656/KS-SF-12-018-EN.PDF/29574eb8-7651-4921-bf10-85a477e83368?version=1.0>) (retrieved 20150512),
3. Marco B.M. Loos, “The Influence of European Consumer Law on General Contract Law and the Need for Spontaneous Harmonization”, European Review of Private Law 3-2007 [515-531] Kluwer Law International BV, Netherlands
4. OECD 2014, Consumption Tax Trends 2014, OECD publishing, <http://dx.doi.org/101787/ctt-2014-en>, (retrieved 20150512)
5. Oren Bar-Gill, Omri Ben-Shahar,” Regulatory techniques in Consumer protection: a critique of European Consumer contract law”, Kluwer Law International, Common Market Law Review 50: 109–126, 2013
6. Jeroen Bijl, VAT, “Vouchers, Rights and Payments: The VAT Treatment of Vouchers”, EC TAX REVIEW 2013–3, Kluwer Law International BV, Netherlands, 2013

7. Alan Schenk, Victor Thuronyi, Wei Cui, “Value Added Tax A Comparative Approach”, Cambridge University Press, 2015,
Book DOI: <http://dx.doi.org/10.1017/CBO9781107337671.006>
8. Laurent Leclercq, “Interacting Principles: The French Abuse of Law Concept and the EU Notion of Abusive Practices”, IBFD, Bulletin for International taxation, June 2007
9. Wulf-Henning Roth, “Case law”, Common Market Law Review 47: 509–520, Kluwer Law International, 2010
10. Hans-Martin Grambeck, “B2C Supplies of Electronic Services from 1 January 2015 from a German Perspective”, IBFD, International VAT monitor July/August 2013

Table of cases

1. Case C-320/88, *Staatssecretaris van Financiën v. Shipping and Forwarding Enterprise Safe BV*, February 1990, [1990] ECR I-02858
2. Case C-16/93, *Tolsma R. J. v. Inspecteur der Omzetbelasting Leeuwarden*, 3 March 1994, [1994] ECR I-0743
3. Case C-549/11, *Orfey Bulgaria v Bulgarian Tax authority*, 19 December 2012, [2012] ECR I-0000
4. Case C-419/02, *BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise*, 21 February 2006, [2006] ECR I1685
5. Case C-419/02, *BUPA Hospitals Ltd and Goldsborough Developments Ltd v Commissioners of Customs & Excise*, Opinion of AG, 7 April 2005
6. Case C-107/13, *FIRIN OOD v Bulgarian Tax authority*, 13 March 2014, EU:C:2014:151
7. Case C-107/13, *FIRIN OOD v Bulgarian Tax authority*, Opinion of Advocate General, 13 March 2014
8. Case C-174/00, *Kennemer Golf & Country Club v Staatssecretaris van Financiën*, 21 March 2002, [2002] STC 502

9. Case C-174/00, *Kennemer Golf & Country Club v Staatssecretaris van Financiën*, Opinion of AG, 13 December 2001
10. Case C-277/05, *Société thermale d'Eugénie-les-Bains v. Ministère de l'Économie, des Finances et de l'Industrie*, 18 July 2007, [2007] ECR I-6415
11. Case C-277/05, *Société thermale d'Eugénie-les-Bains v. Ministère de l'Économie, des Finances et de l'Industrie*, Opinion of AG, 13 September 2006
12. Case C-151/13, *Le Rayon d'Or, SARL v Ministre de l'Économie et des Finances Le Rayon d'Or*, 27 March 2014, EU:C:2014:185
13. Case C-205/07, *Lodewijk Gysbrechts, Santurel Inter BVBA*, 16 December 2008, [2008] ECR I-9947
14. Case C-250/14, *Air France – KLM*, pending
15. Case C-289/14, *Brit Air*, pending