



Lund University

School of Economics and Management
Department of Business Law

Third Party Benefit and Implications for Input VAT Deduction

by

Gautam Agarwal

HARN60 Master Thesis

Master's Programme in European and International Tax Law

2021/2022

Spring semester 2022

Supervisor: Giorgio Beretta

Examiner: Sigrid Hemels

Author's contact information:
gautam.agarwal.7647@student.lu.se

+41 79 882 4958

Table of Contents

ABSTRACT	1
PREFACE	2
LIST OF ABBREVIATIONS	3
1. INTRODUCTION	4
1.1 BACKGROUND	4
1.2 AIM.....	5
1.3 METHOD AND MATERIAL.....	5
1.4 DELIMITATION.....	6
1.5 OUTLINE.....	6
2. THE PRINCIPLE OF FISCAL NEUTRALITY	7
3. THE RIGHT TO DEDUCTION.....	10
3.1 OVERVIEW.....	10
3.2 CONDITIONS REQUIRED FOR INPUT VAT DEDUCTION	10
4. CJEU'S RECENT CASE LAW RELATED TO FREE OF CHARGE SUPPLIES THAT BENEFIT THIRD PARTY	17
4.1 AES-3C MARITZA EAST 1	17
4.2 SVEDA.....	18
4.3 IBERDROLA.....	20
4.4 MITTELDEUTSCHE HARTSTEIN-INDUSTRIE.....	21
4.5 VOS AANNEMINGEN.....	22
5. ANALYSIS OF RELEVANT CASE LAW	25
6. CONCLUSION.....	31
BIBLIOGRAPHY	33

Abstract

The principle of fiscal neutrality is at the core of the EU VAT system. Neutrality in the EU VAT system comprises of two main elements, that is, equal treatment of taxable persons in the same situation and giving taxable persons the right to deduct input VAT for cost components. The right to deduction is an important element of the VAT system to achieve fiscal neutrality. Deductibility ensures that the burden falls on the final consumer and not on taxable persons, so business decisions are not influenced by VAT considerations. The main aim of this paper is to understand under what conditions input VAT for free of charge goods is deductible when it also benefits a third person. This paper also analyses if the CJEU's case law contributes to fiscal neutrality with regards to the right to deduction.

The right to deduction exists when there is a link between goods and services acquired and the taxable transactions undertaken by the taxable person. The application of the direct and immediate link has become much broader and less stringent over time. The CJEU considers the overall business activity rather than the strict application of the direct and immediate link.

According to settled case law, an entrepreneur can also deduct input VAT on costs that benefit a person other than the entrepreneur himself. However, the right to deduct input VAT for free of charge supplies that benefit third parties is not always straightforward and relevant case law highlights several factors that need to be considered. While a direct and immediate link must exist, case law shows it is enough that the link is between the expenditure and the overall economic activity of the taxable person. The primary purpose of the free of charge supplies should not be to benefit the third party and it should have a link to the taxable supplies of the taxable person. The benefit to the third party should be limited to what is necessary to accomplish the business activity, otherwise there is a risk for this provision being misused. Although not decisive in determining a taxable person's right to deduct input VAT, it should also not be possible to pass on the cost to the third person benefitting from the supply. The analysis of relevant case law in this paper shows that the decision of the CJEU to allow deductions based on the above conditions are necessary to achieve the objectives of fiscal neutrality.

Preface

This research is performed during the Master studies in European and International Tax Law at the School of Economics and Management, Department of Business Law of Lund University.

I would like to thank my supervisor, Giorgio Beretta, without whose guidance, feedback and support this thesis would not be possible.

My sincere gratitude to my classmates and professors for their support and making it possible for me to complete my studies remotely. It was a challenging year, and I am glad I have reached the finishing line.

List of abbreviations

AG	Advocate General
CJEU	Court of Justice of the European Union
EU	European Union
TFEU	Treaty on the Functioning of the European Union
VAT	Value Added Tax
VAT Directive	Council Directive 2006/112/EC
et seq	<i>et sequens</i> (and the following)

1. Introduction

1.1 Background

According to Article 168 of the VAT Directive, only goods and services used for taxed transactions of a taxable person are eligible for input VAT deduction.¹ This implies that there must be a direct link between goods and services acquired and the taxed output transactions carried out by a taxable person.² Free of charge goods are not subject to VAT and a business providing such goods is not a taxable person in relation to those supplies.³ Hence, input VAT related to the costs for producing free of charge goods are not deductible and would result in higher cost for the business.

Only costs related to the production of taxable supplies are within the scope of Article 168 of the VAT Directive. However, general costs of running the business are also in scope of Article 168 of the VAT Directive as these indirect costs facilitate in the production of taxable supplies. Thus, when businesses are solely involved in taxable supplies there is no distinction made between direct costs and general costs and all input VAT is deductible.

The distinction between direct costs and general costs becomes relevant when a business is involved in both taxable and exempt or non-taxable supplies. Costs that are directly related to taxable activities are deductible and direct costs related to exempt or non-taxable activities are not deductible. When a business carries out both taxable and exempt or non-taxable supplies, then the general costs are only deductible to the extent they relate to taxable activities.

While these rules may appear simple, they are not always straightforward. These rules have been subject to different interpretations by businesses and tax authorities and thus resulted in numerous cases dealing with the right to deduct. What makes this even more complex is that the CJEU has in recent cases indicated the possibility to deduct input VAT for activities that also benefit third parties engaging in free of charge supplies.

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1.

² B. Terra & J. Kajus, *Introduction to European VAT, Global Topics* (IBFD 2001), chapter 8.4.4.1.

³ *Ibid.*

In all these cases, the CJEU has given special importance to the principle of fiscal neutrality. In this paper we will focus on case law that have been central in shaping the principles of VAT deduction.

1.2 Aim

The main aim of this paper is to understand under what conditions input VAT for free of charge goods is deductible when it benefits a third person. To that effect, the paper analyses several CJEU case law on input VAT deduction on the purchase of goods and services, where a third party also benefits from these purchases. There has been a lot of research focusing on the importance of a direct link between an input and output transactions for VAT deductibility. Instead, no extensive research has been undertaken to analyse the impact on VAT deductibility when purchase of goods and services also benefits a third party. This paper aims to bridge this literature gap. Further, this paper also analyses if the CJEU's case law contributes to reaching fiscal neutrality with regard to the right to deduction.

1.3 Method and Material

Legal dogmatic approach is applied to achieve the aim of this paper. This method implies analysing the current law in force.⁴ A thorough legal study was performed considering primary and secondary legal sources in the EU. The main source of primary law for this paper is the TFEU. With regard to secondary law the key source was the VAT Directive. The case law of the CJEU comprised the supplementary source of law. The dogmatic approach is preferred as the aim of this paper is to analyse applicable law including case law of the CJEU.

The analysis is based on EU legislation, case law from the CJEU, AG Opinions, journal articles and scholarly literature.

⁴ S. Douma, *Legal Research in International and EU Tax Law* (Kluwer - Deventer 2014), p. 17.

1.4 Delimitation

The chosen subject of this paper can be looked from many different perspectives. The analysis of this paper is focused on free of charge supplies that benefit other businesses. While free of charge supply also includes deemed supply of goods and services, it is not the focus of the paper. This paper specifically looks at the right to input VAT deductibility when cost of acquired goods and services benefits third parties, i.e., other businesses.

From the perspective of fiscal neutrality, the research analysed the right to deduct. While there are many other elements of fiscal neutrality, the focus of this paper is the right to deduct.

This paper covers case law published until 27 May 2022, ie, the date of this thesis's submission.

1.5 Outline

After this introduction section, fiscal neutrality in relation to VAT deductibility is discussed in section 2. Section 3 looks at the conditions necessary for input VAT deduction and introduces the concept of direct and immediate link. In section 4, VAT deductibility on costs that benefit a third person is discussed in light of the case law of CJEU. This section aims to determine the conditions necessary to deduct VAT on costs benefiting a person other than the entrepreneur himself. Section 5 concludes the paper.

2. The principle of Fiscal Neutrality

The principle of fiscal neutrality has several dimensions, although not all of them are equally important for the EU VAT system.⁵ Fiscal neutrality is not explicitly defined in EU primary law or secondary law but is a matter of interpretation.⁶ The origins of the principle of neutrality can be traced in the concept of equality which is the fundamental and guiding principle of EU law.⁷ The principle of neutrality in VAT relates to the concept of free competition where business decisions are not guided by VAT implications.⁸

In line with the TFEU, the Preamble of the VAT Directive sets out the principle of fiscal neutrality with the intention on equal treatment of taxable persons in the same situation and on promoting free competition.⁹ The VAT system achieves neutrality by the tax being applicable at all stages of production and ensuring the same tax burden applies to similar goods and services.¹⁰ The VAT system can be truly neutral, if input VAT does not form part of the cost of the business and thus does not influence economic decisions. The right to deduction of input VAT to achieve neutrality is outlined in Recital 30 of the Preamble of the VAT Directive. As reduced VAT rates can influence economic decisions and the functioning of the internal market they are against the principle of neutrality.¹¹

Article 1(2) of the VAT Directive highlights the general nature of the tax that is applicable on all consumption of goods and services. The VAT is calculated on the price of goods and services and is chargeable after deducting input VAT for the cost components.

⁵ P. Daniel, *Relations between the principle of neutrality and elements of value added tax structure*. Financial Internet Quarterly 17 (3) (2021), p. 56-63.

⁶ C. Amand, *VAT Neutrality: A Principle of EU Law or a Principle of the VAT System*, 2 World J. VAT/GST L. (2013), p.163.

⁷ Article 8 of the TFEU.

⁸ Article 113 of the TFEU.

⁹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1.

¹⁰ Recital 7 of the Preamble of the VAT Directive.

¹¹ Recital 34 of the Preamble of the VAT Directive.

Therefore, the concept of fiscal neutrality has many meanings, among which the most important for the EU VAT system is, equal treatment of taxable persons in the same situation and giving taxable persons the right to deduct input VAT for cost components.¹²

The first element of the principle of fiscal neutrality that is significant for the EU VAT system is the equal treatment of similar situations. Different treatment of similar transactions undermines the principle of fiscal neutrality as this might affect economic decisions. In *Commission v. France*, C-481/98, the EU Court held the principle of neutrality precludes treating similar goods, differently for VAT purposes.¹³ In *Kügler*, C-141/00, the CJEU held that the principle of fiscal neutrality precludes different treatment of economic operators carrying out the similar activities.¹⁴ Difference in treatment for the purpose of VAT of two similar services is an infringement of the principle of fiscal neutrality.¹⁵ In *Zimmermann*, C-174/11, the CJEU held that similar goods and services in competition with each other should not be treated differently for VAT purposes.¹⁶

The second significant element of the principle of fiscal neutrality for the EU VAT system and the focus of this paper is the right to deduct input VAT. The right to deduct means that the burden of VAT should fall on the ultimate consumer and not on (any intermediate) taxable persons. Taxable persons should wholly be relieved from the burden of input VAT and their right to deduction should not be limited if they carry out taxable activities. The right to deduct input VAT ensures neutrality of the VAT system and, hence, competition freedom in the internal market.¹⁷ As consumption takes place at the end of the supply chain the burden should fall only on the person consuming the goods or service. To ensure neutrality, all private consumption and supply of free goods and services where input VAT has been deducted should be subject to VAT. In *Hong Kong Trade*, C-89/81, the CJEU ruled that a business that habitually provides services free of charge cannot be regarded as a taxable person and hence not eligible to deduct input VAT.¹⁸ If input VAT on goods intended for private use has been deducted, VAT would be charged at the point of

¹² P. Daniel, *Relations between the principle of neutrality and elements of value added tax structure*. Financial Internet Quarterly 17 (3) (2021), p. 56-63.

¹³ CJEU, 3 May 2001, Case C-481/98 *Commission v. France*, para 22.

¹⁴ CJEU, 10 September 2002, Case C-141/00 *Kügler*, para 30.

¹⁵ CJEU, 10 November 2011, joined Cases C-259/10 and C-260/10 *Rank Group*, para 64.

¹⁶ CJEU, 15 November 2012, Case C-174/11 *Zimmermann*, para 48.

¹⁷ M. Varju, 'Case law note: *The Right to VAT Deduction and the ECJ: Towards Neutral and Efficient Taxation in the Single Market?*', 47, *Intertax*, Issue 3 (2019), p. 324-334.

¹⁸ CJEU, 1 April 1982, Case C-89/81, *Hong Kong Trade* para 13.

consumption.¹⁹ The other mechanism to charge VAT on free of charge supplies is to limit its deductibility.²⁰

In practice, however, the application of the principle of neutrality has several exceptions. Despite Recital 34 of the VAT Directive, the VAT rates are not harmonised leading to distortion of the internal market and influencing economic decisions. Different VAT rates in Member States leads to unequal treatment of similar goods which is against the principle of neutrality and the objectives of TFEU. The VAT system is meant to relieve the taxpayer of the burden of input VAT, but this is not always the case. Notably, for exempt supplies, there is no right to deduct input VAT. This increases the tax burden of the taxpayer. These exceptions to the main rule show that the principle of neutrality is not seamless.

¹⁹ Article 16 of the VAT Directive.

²⁰ Article 184 et seq. of the VAT Directive.

3. The Right to Deduction

3.1 Overview

VAT is payable on a net basis, that is output VAT on chargeable supplies minus input VAT. Article 168 of the VAT Directive outlines the conditions necessary for input VAT deduction. VAT is only paid on consumption, so the taxable person is relieved of the tax burden. According to Article 168 of the VAT Directive a taxable person shall be entitled to deduct input VAT “*in so far as the goods and services are used for the purposes of the taxed transactions of a taxable person*”. A person cannot deduct input VAT for transactions falling outside the scope of VAT including free of charge supplies. Deduction is also not permitted for supplies that are exempt and as discussed above is an infringement to the principle of neutrality.

Based on the above, it would seem that there are clear rules to calculate the amount that is deductible but in practice there is diversity in interpretation which leads to uncertainties.

3.2 Conditions Required for Input VAT Deduction

The right to deduct input VAT is conditional on compliance with substantive and formal conditions.²¹ According to Article 168 of the VAT Directive there are three substantive components for input VAT deduction, that is: i) taxed transactions covered under Article 2(1) of the VAT Directive; ii) taxable persons covered under 9(1) of the VAT Directive; and iii) existence of a direct and immediate link between the input and output transactions. Possession of an invoice drawn up according to Articles 220-236 and 238-240 of the VAT Directive is considered a formal condition.²² If the substantive conditions are fulfilled, the right to deduction can be exercised even if the formal conditions are not fulfilled.²³ In this paper, the focus will be on the substantive conditions and not the formal conditions for input VAT deduction.

²¹ M. Merx, 'Case Law Trends: *Just a Formality! Substance over Form in EU VAT and the Right to Deduct Input VAT* [pre-publication]', 50, Intertax, Issue 6 (2022), p. 1-12.

²² Ibid.

²³ Ibid.

3.2.1 Taxed Transactions

According to Article 2(1) of the VAT Directive, the supply of goods and services by a taxable person for consideration is subject to VAT. This means that goods and services supplied free of charge is outside the scope of VAT. In *Hong Kong*, C-89/81, the services were provided without consideration and thus not regarded as a taxed transaction under the VAT Directive.²⁴ *Hong Kong*, C-89/81, deals with the question whether services habitually provided free of charge falls with the scope of VAT. Hong Kong Trade Development Council established in Amsterdam provides free advice and information about the possibility of trade between Hong Kong and the Netherlands. Hong Kong Trade Development Council deducted input VAT related to its activities in Amsterdam which was rejected by the tax authorities. The CJEU was asked to rule whether a person carrying out services free of charge can be a taxable person. The Court concluded that a person providing services free of charge is excluded from the scope of VAT as these services are not taxable transactions.²⁵

Another important element for a transaction to fall within the scope of VAT is that there should be a legal relationship between the person paying the money and the person receiving it. *Tolsma*, C-16/93, shows that the requirement of legal relationship is necessary for a transaction to be considered within the scope of VAT.²⁶ *Tolsma* was offered money by passers-by for playing music on the highway. The tax authorities considered this as a taxable transaction for which output VAT was due. He appealed and the CJEU ruled that as there was no legal relationship and there was no link between the consideration received and the music services provided. The services provided by *Tolsma* were not taxable transactions within the scope of VAT.²⁷ Thus, even if there is consideration involved in a particular transaction, the transaction might be outside the scope of VAT if it lacks a legal relationship.

The use of business assets for private purpose can amount to a taxable transaction if input VAT on those goods has been deducted.²⁸ Such transactions are considered deemed supply for consideration and output VAT will be due on such consumption. This rule ensures the neutral

²⁴ CJEU, 1 April 1982, Case 89/81 *Hong Kong*, para 11.

²⁵ *Id.*, para 13.

²⁶ CJEU, 3 March 1994, Case C-16/93, *Tolsma*.

²⁷ *Id.*, para 14.

²⁸ Article 16 and 26 of the VAT Directive.

character of the VAT system. If this rule was not in place it would lead to distortion of competition as a taxable person might buy goods in the name of his company to avoid paying VAT.

The private use of business assets by the taxable person or employees is not uncommon. As these are used for purposes other than business, they are taxable supplies for consideration. However, in several instances, the CJEU has ruled that use of business assets for private purpose or purpose other than the business or their disposal free of charge does not constitute deemed supply for consideration.

In *Fillibeck*, C-258/95, the CJEU was asked to decide whether free of charge transport to employees should be treated as a supply for purpose other than business and thus be subject to VAT.²⁹ *Fillibeck* runs a construction company and transports workers from their homes to different building sites free of charge. The tax authorities consider the transport should be subject to VAT. *Fillibeck* appeals and the case is referred to the CJEU for preliminary ruling.

The Court held that, as the employees do not make any payment, and there is no link between the wages received and the use of transport, it is not possible to regard part of the work performed as consideration for transport services.³⁰ The CJEU says that the purpose of VAT system is to ensure equality between taxable people and final consumers, thus non-taxation of business goods for private use should be prevented.³¹ According to the court, free of charge transport services to employees should normally be treated as supply of services for consideration. However, in circumstances where there is no suitable transportation the free of charge transport provided by the employer can be considered for purpose of the business. This personal benefit of the employees should however be ancillary to the purpose of the business.³²

3.2.2 Taxable Person

According to Article 9(1) of the VAT Directive, a taxable person is anyone who carries out an economic activity irrespective of its purpose. Economic activity is any activity of producers, traders or persons supplying services and includes mining and agricultural activities.³³ The

²⁹ CJEU, 16 October 1997, Case C-258/95, *Fillibeck*.

³⁰ *Id.*, para 16.

³¹ *Id.*, para 25.

³² *Id.*, para 30.

³³ Article 9(1), second indent of the VAT Directive.

exploitation of tangible and intangible property on a continuous basis for earning income is also regarded as economic activity.³⁴ Instead, a person that is bound by a contract of employment is not a taxable person.³⁵

The status of a taxable person is linked to taxable supplies. Thus, a person who habitually provides free of charge supplies cannot be considered a taxable person.³⁶ From the Tolsma case, C-16/93, we can conclude that a person providing non-taxable supplies is not a taxable person. A pure holding company is not considered a taxable person according to settled case law unless it is also involved in the management of acquired companies.³⁷ Charitable trusts are to be treated in the same way as a private holding company when it comes to holding and selling of shares in acquired companies.³⁸

If a person carries out economic activities on an occasional basis, then he cannot be considered a taxable person. However, the concept of continuous is not applied to the activity itself but to the income from that activity.³⁹ *Enkler*, C-230/94, deals with the question of occasional exploitation of tangible property.⁴⁰ *Enkler* bought a caravan deducted input VAT and accounted for small amount income during the two year it was hired out. The tax authorities questioned the deductibility of input VAT for the cost of the caravan as they did not consider her to be a taxable person. The tax authorities did not consider that hiring out of the caravan for a short period to be an economic activity. The CJEU ruled that hiring out of the caravan was an economic activity if it was done to obtain income on a continuous basis.⁴¹

To be considered a taxable person an economic activity must be carried out. However, an economic activity includes preparatory acts with the intention of making taxable supplies.⁴² This intention should be based on objective evidence that shows supplies are acquired to engage in taxable transactions. Input VAT on initial costs or preparation has immediate right to deduction.⁴³ Thus, a

³⁴ *Ibid.*

³⁵ Article 10 of the VAT Directive.

³⁶ CJEU, 1 April 1982, Case C-89/81 *Hong Kong*, para 13.

³⁷ CJEU, 20 June 1991, Case C-60/90 *Polysar*, para 14.

³⁸ CJEU, 20 June 1996, Case C-155/94 *Wellcome Trust*.

³⁹ B. Terra & J. Kajus, *Introduction to European VAT, Global Topics* (IBFD 2001), chapter 9.2.1.

⁴⁰ CJEU, 26 September 1996, Case C-230/94, *Enkler*.

⁴¹ *Id.*, para 22.

⁴² CJEU, 14 February 1985, Case C-268/83 *Rompelman*, para 25.

⁴³ *Id.*, para 23.

person carrying out preparatory activities linked with future taxable supplies is considered a taxable person.

3.2.3 *Direct and immediate link between input costs and taxable supplies*

Article 168 of the VAT Directive implies that for the right to deduction to exist there must be a link between goods and services acquired and the taxable transactions undertaken by the taxable person. In addition to Article 168 of the VAT Directive, Article 1(2) of the VAT Directive says that input VAT should be deducted for costs incurred for producing taxable transactions.

“On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components.”

Both these provisions of the VAT Directive presuppose a link between acquired goods and taxable supplies for the right of deduction to exist. When a taxable person carries out tax exempt activities, a direct and immediate link will not exist with the cost components, and input VAT will not be deductible. If a taxable person carries out both taxed and exempt activities, it becomes more difficult to determine if input VAT on certain indirect costs components is deductible and to what extent. In such an event, input VAT on indirect cost is deductible only to the extent acquired goods and services are linked to taxed transactions. This is where the importance of direct and immediate link comes in. As discussed above, if a person only carries out taxable supplies it would not be important to determine this link, and input VAT on both indirect and direct cost would be deductible. Most of the CJEU’s case law related to input VAT deductibility deals with this specific problem, that is deductibility of input VAT on indirect costs when a taxable person carries out both taxed and exempt activities.

Businesses may have both direct costs and indirect costs while supplying goods and services. A cost that is directly linked to the output transaction is a direct cost. Costs that are not directly linked to the output transaction is an indirect cost. Indirect costs are general in nature but equally crucial in the production of goods and services.

The direct link developed by the CJEU sets the limit between taxed transactions and the right to deduct.⁴⁴ Perhaps the first time the condition of direct and immediate link was tried at the CJEU's level was in *BLP*, C-4/94. In *BLP*, C-4/94, the CJEU applied the strict interpretation of the provision and ruled that only input VAT related to direct costs is deductible. The CJEU refused deduction of input VAT for services related to tax-exempt supplies. According to the CJEU, there should be a direct and immediate link between costs and taxable supplies and the aim of the taxable person was irrelevant.⁴⁵ Since *BLP*, C-4/94, this link has become more indirect and the CJEU has opened for input VAT deduction related to general costs of the business. In *Midland*, C-98/98, the CJEU ruled that while the expenditure in question is not part of the cost component of the particular transaction, it does form part of the general cost of the taxable person and is included in the price of the products.⁴⁶ Such general cost has a direct and immediate link to the taxable supplies of the taxable person.⁴⁷ *SKF*, C-29/08, deals with a similar question as *BLP*, C-4/94, although had a different outcome. In fact, the CJEU ruled that costs related to the sale of shares formed part of the general costs of the business and if incorporated in the price of SKF's products, the right to deduct input VAT should be allowed.⁴⁸

PPG Holding, C-26/12, is an example where a taxable person is allowed to deduct input VAT on the costs that benefit another entity. In *PPG Holding*, C-26/12, a pension fund is set up separate from the legal entity in accordance with local legislation. PPG Holding contracts with third party providers for administration and consultancy services provided to the pension fund. These costs are deducted by the group company but rejected by the tax authority. In this case, the CJEU ruled that, even though the pension fund and PPG Holding are separate entities, a direct and immediate link exists as the service costs form part of PPG Holding's products.⁴⁹

From the above cases, it can be derived that the application of direct and immediate link has become much broader and less stringent over time. As a matter of fact, for input VAT deduction,

⁴⁴ C. Amand, *What Does the EU VAT Actually Tax?*, 33 Intl. VAT Monitor 2, Journal Articles & Opinion Pieces (IBFD 2022).

⁴⁵ CJEU, 6 April 1995, Case C-4/94 *BLP Group*, para 19.

⁴⁶ CJEU, 8 June 2000, Case C-98/98 *Midland Bank*, para 31.

⁴⁷ *Ibid.*

⁴⁸ CJEU, 29 October 2009, Case C-29/08, *SKF*, para 73.

⁴⁹ CJEU, 18 July 2013, Case C-26/12 *PPG Holdings*, paras 25-26.

the CJEU now considers overall business activity rather than resorting to the strict application of the direct and immediate link.

4. CJEU's Recent Case Law Related to Free of Charge Supplies that Benefit Third Party

In this section, we analyse relevant case law on input VAT deduction on the purchase of goods and services, where a third party also benefits from these purchases.

4.1 AES-3C Maritza East 1

AES-3C Maritza East 1 relates to the deductibility of input VAT for clothing, protective gear, and transportation for hired staff working for the taxable person but employed by another entity.⁵⁰ In *AES*, it was perhaps the first time the CJEU opened for deduction of input VAT related to goods used by another business.

AES operates a power plant with the help of hired staff from another entity. The employment contracts are concluded by the other entity that also pays the staff their wages as agreed in the contract. *AES* pays the other entity remuneration for making staff available to work in the power plant. This remuneration includes salary and social security contributions for the staff concerned. The clothing, protective gear, and transportation are provided by *AES* directly to the staff working in the power station and are not included in the remuneration paid to the other entity. The local legislation requires that *AES* provides clothing and protective gear to staff that work in the power plant. The power plant was not served by public transport, hence *AES* decided to provide transport services for the staff concerned. *AES* engaged third parties to provide these services to the staff working at the power plant. The local tax authority rejected the right to deduct input VAT on the grounds that these goods and services were free of charge supplies to the staff. *AES* appeals and the national court referred the case to CJEU asking whether the taxable person has the right to input VAT deduction for these free of charge supplies.

⁵⁰ CJEU, 18 July 2013, Case C-124/12, *AES-3C Maritza East 1*.

The CJEU held that the existence of a direct and immediate link between a particular input transaction and a particular output transaction is necessary before the taxable person is entitled to deduct input VAT.⁵¹ However, the link between the output and the input transactions must be purely economic.⁵² The court goes on to say that by dissociating the legal relationship of AES with the staff working for its undertaking, and the expenses incurred by AES simplifies the identification of this economic link.⁵³ The CJEU draws similarities with *Fillibeck* considering that the costs incurred by AES can be regarded as the general costs of the business and thus has a direct link to the economic activities as a whole.⁵⁴ The Court says that the right of deduction as provided by Article 168(a) of the VAT Directive is an integral part of the VAT scheme and cannot be limited.⁵⁵ The VAT scheme is designed to relieve the trader of the burden of VAT payable for economic activities and this in turn ensures neutrality.⁵⁶ The Court considered like in *Fillibeck* that the benefit derived by the staff should only be secondary in nature compared to the needs of the business.⁵⁷ The EU Court concluded that if AES was to bear the input VAT on expenses in question without having a right to deduction, on the grounds that AES is not the employer, would be against the principle of neutrality of VAT.⁵⁸

4.2 Sveda

In *Sveda*, the question was whether the taxable person has the right to deduct input VAT for costs related to the supply of free of charge services, potentially leading to taxable supplies in the future.⁵⁹ This was a landmark judgment, which significantly broadened a taxable person's right to deduct in light of the principle of fiscal neutrality.

Sveda is a taxable person providing accommodation, food and beverages, the organisation of trade fairs, conferences, and leisure activities, as well as construction related to those activities. Sveda

⁵¹ Id., para 27.

⁵² Id., para 31.

⁵³ Id., para 38.

⁵⁴ Id., para 23.

⁵⁵ Id., para 25.

⁵⁶ Id., para 26.

⁵⁷ Id., para 33.

⁵⁸ Id., para 36.

⁵⁹ CJEU, 22 October 2015, Case C-126/14, *Sveda*.

agreed with a national authority to build a recreational path and offer it to the public free of charge. According to the agreements, the national authority would bear 90% of the cost and Sveda would bear 10% of the cost. Sveda deducted input VAT on the cost of acquisitions for the recreational path. The tax authorities refused deduction of input VAT saying that the goods and services acquired were used to provide free of charge goods and thus not within the scope of Article 168 of the VAT Directive. The national court referred the case to the CJEU asking whether the input VAT can be deductible when the goods and services acquired are used to provide free of charge goods but with the intention to attract visitors to buy taxable supplies.

AG Kokott concludes that Sveda should have the right to deduct even where there is no direct and immediate link between the input transaction and the output transaction if there is a direct and immediate link with expenditure incurred as part of his general costs. According to the AG, only when the ultimate purpose of the acquisitions is considered fiscal neutrality can be achieved.⁶⁰ In the case of Sveda the aim was to engage in an economic activity and provide taxable supplies. According to the judgement of the CJEU the right to deduction provided for in Article 168(a) of the VAT Directive is an integral part of the VAT scheme and cannot be limited, thus relieving the business entirely of the burden of VAT payable for economic activities.⁶¹ The EU Court considered Sveda's expenditure as investment costs borne to engage in economic activities, which should lead to immediate right to deduct VAT.⁶² The taxable person's capital expenditure was incurred solely for the purpose of engaging in economic activities and thus there was a direct and immediate link with the overall economic activity.⁶³ What was decisive in determining the direct and immediate link was the type of the expenditure and not amount of expenditure.⁶⁴

This case shows that input VAT related to a supply free of charge is deductible when the aim is to engage in economic activities to provide taxable goods and services.

⁶⁰ Opinion of Advocate General Kokott, case C-126/14, *Sveda*, para 31.

⁶¹ CJEU, 22 October 2015, Case C-126/14, *Sveda*, para 16.

⁶² *Id.*, para 20.

⁶³ *Id.*, para 22.

⁶⁴ M. Merckx, *Virtues and Fallacies of VAT: An Evaluation after 50 Years- Chapter 16: Supplies Below Cost Price or Free of Charge* (Wolters Kluwer 2021).

4.3 Iberdrola

In Iberdrola, the CJEU also looked at input VAT deductibility related to expenses that benefit a third party. The EU Court ruled that VAT can be deducted in respect of services provided free of charge relating to reconstruction of the pump station that benefitted the municipality⁶⁵.

Iberdrola Inmobiliaria Real Estate Investments (Iberdrola) purchased parcels of land in a holiday village to construct apartment buildings. Once completed, the buildings would generate property income. However, to connect the buildings to the wastewater pump station, the pump station had to be extensively reconstructed. Iberdrola entered into a contract with the municipality to reconstruct the water pump at its own expense. The reconstruction was performed by a third-party company and the input VAT on the construction costs were deducted. However, the input VAT deduction was denied by the tax authorities as the costs related to free of charge supplies. The case was subsequently referred to the CJEU.

The CJEU refers to its judgement in *Sveda* and held that if taxable person acquires goods and services for the purpose of taxed transactions, he should be entitled to deduct VAT payable.⁶⁶ As in *Sveda*, the CJEU considers the right to deduct an integral part of the VAT scheme, which as such cannot be limited.⁶⁷ The VAT deduction system is intended to relieve the trader from the burden of VAT payable and this right ensures neutral taxation of all economic activities.⁶⁸ The right to deduct exists if the costs of the services in question are part of a taxable person's general costs and part of the price of goods or services which that person supplies.⁶⁹ The existence of a direct link should be considered with the objective of the transaction in mind.⁷⁰ In this case the reconstruction was necessary to connect the building to the pump station and thus a prerequisite for the taxable person to carry out economic activities. The EU Court finds that there is a direct link with the reconstruction work and the economic activities of Iberdrola. The fact that the municipality also benefitted from the reconstruction does not justify that the right to deduction is denied.⁷¹ The CJEU however concluded with a cautionary word, noting that the service to the

⁶⁵ CJEU, 14 September 2017, Case C-132/16, *Iberdrola*.

⁶⁶ *Id.*, para 27.

⁶⁷ *Id.*, para 25.

⁶⁸ *Id.*, para 26.

⁶⁹ *Id.*, para 29.

⁷⁰ *Id.*, para 31.

⁷¹ *Id.*, para 35.

municipality should not go beyond what was required to serve the purpose of carrying out economic activities.⁷² If the service goes beyond what is needed to serve the purpose, then input should be deductible to the extent it allows the taxable person to carry out a taxable transaction.⁷³

4.4 Mitteldeutsche Hartstein-Industrie

In another recent case, the CJEU looked again at input VAT deductibility for expenses that benefit the trader and a third party. In *Mitteldeutsche Hartstein-Industrie AG*, the CJEU ruled that input VAT could be deductible even if the municipality benefited from free of charge services⁷⁴.

Mitteldeutsche Hartstein-Industrie AG was given permission to operate a limestone quarry on the condition that the road leading to the quarry was developed. The extension of the road was a precondition for the company to carry out taxable activities, that is extraction of limestone. The municipality agreed to the extension of this critical road provided the cost of the extension was borne by the company. The road would also be open to public without restriction. *Mitteldeutsche Hartstein-Industrie AG* deducted input VAT on the cost related to the construction of the municipal road. This deduction was rejected by the tax authorities and the case was referred to the CJEU.

Referring to *Sveda* and *Iberdrola*, the CJEU considered the right of deduction to be an integral part of the VAT scheme and is exercisable immediately in respect to input VAT transactions.⁷⁵ Again, referring to the above cases, the CJEU mentioned that the neutrality of the VAT system is maintained when a trader is relieved of all burden of input related taxable transactions.⁷⁶ As in *Sveda* and *Iberdrola*, the EU Court maintained that the right to deduction existed if there was a direct and immediate link to the general cost of the business as a whole and not necessarily to an output transaction.⁷⁷ The EU Court went on to say that without the extension of the municipal road it would be impossible to operate the limestone quarry, which is essential to carry out economic

⁷² Id., para 37.

⁷³ Id., para 39.

⁷⁴ CJEU, 16 September 2020, Case C-528/19, *Mitteldeutsche Hartstein-Industrie*.

⁷⁵ Id., para 23.

⁷⁶ Id., para 24.

⁷⁷ Id., para 27.

activity.⁷⁸ The court thus finds that there exists a direct and immediate link between the extension of the road and the overall economic activity. The fact that the road is used by the public is considered immaterial as the main purpose to the extension was to operate the limestone quarry.⁷⁹ As in *Iberdrola*, the EU Court adds that the deductibility of input VAT should be limited to the costs of the extension necessary to operate the limestone quarry.⁸⁰ Any input VAT deduction on costs that exceeds what is necessary to operate the limestone quarry would therefore not be deductible.⁸¹

4.5 Vos Aannemingen

In *Vos Aannemingen BVBA*, the CJEU, in line with earlier decisions of *Sveda*, *Iberdrola* and *Mitteldeutsche Hartstein-Industrie*, confirms that VAT is deductible even on expenses that benefit a person other than the taxable person seeking input VAT deduction. When expenses also benefit a third party VAT may be deductible firstly, when there is a direct and immediate link between that expenditure and the taxable person's economic activity, and secondly, the benefit to the third party is ancillary to the VAT payer's business purposes.⁸²

Vos Aannemingen sells apartment buildings that are constructed on land belonging to third parties. The shares in land corresponding to the apartments sold by Vos Aannemingen are sold by the landowners themselves. Vos Aannemingen incurs certain costs related to advertising, administration and real estate commission and deducts the input VAT in full. The tax authorities refused full deduction and observed that Vos could only deduct input VAT on the cost related to the construction of the buildings. The case was brought to the appeals court which shared the opinion of the tax authorities. According to the appeals court the costs incurred by Vos Aannemingen could be borne by the landowners themselves as the land and buildings could be sold separately. According to the appeals court, Vos Aannemingen could re-invoice the cost to the landowners. Vos Aannemingen appealed the decision, and the case was brought to the CJEU.

⁷⁸ Id., para 32.

⁷⁹ Id., para 37.

⁸⁰ Id., para 38.

⁸¹ Ibid.

⁸² CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*.

According to the CJEU, a prerequisite for input VAT to be deductible is that there should be an immediate and direct link to between the input transaction and output transaction or between the input transaction and the general costs of the business. Input VAT deduction is important to maintain the neutrality of the VAT system. The right to deduction may not be limited as it is an integral part of the VAT scheme. The CJEU considers the cost incurred by Vos Aannemingen for advertising, administration and real estate commission are for the entity's interest and the benefit to the landowners is secondary. The fact that third party also benefits from this expenditure does not justify the right to deduction being denied if that benefit is secondary to the purpose of the business.⁸³ The court goes on to say that if all or part of the costs relate to the sale of land then Vos Aannemingen should not be entitled to deduct input VAT on that part of the expenditure. Finally, the court also says that if part of the expenditure can be passed on to third parties, then it indicates that the costs relate to out transactions carried out by these third parties. However, this is not sufficient to determine the scope of deductibility and other factors must be considered.⁸⁴

⁸³ CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*, para 28.

⁸⁴ *Id.*, para 47.

Summary of the relevant case law

Case law	Issue	Ruling summary
AES-3C Maritza East 1, C-124/12	Deductibility of input VAT for clothing, protective gear, and transportation for hired staff working for the taxable person but employed by another entity.	<ul style="list-style-type: none"> i) Costs benefiting third party have a direct link to overall economic activities. ii) Benefit to third party is secondary in nature.
Sveda, Case C-126/14	Deductibility of input VAT for costs related to supply for free of charge services which could potentially result in taxable supplies in the future.	<ul style="list-style-type: none"> i) Costs related to non-taxable activity have a direct link to the economic activities.
Iberdrola, Case C-132/16	Input VAT deductibility for costs related to wastewater pump station that benefits a third party.	<ul style="list-style-type: none"> i) Expenditure benefiting third party is part of his general costs. ii) Expenditure benefiting third party should not go beyond what was required to serve the purpose.
Mitteldeutsche Hartstein-Industrie, Case C-528/19	Input VAT deductibility for expenses related to the construction of the road that benefits the municipality.	<ul style="list-style-type: none"> i) Costs benefiting third party has direct and immediate link to the general costs. ii) Costs benefiting third party should be limited to what is necessary to carry out business activities. iii) Third party benefit is immaterial.
Vos Aannemingen, Case C-405/19	Input VAT deductibility for expenses related to advertising, administration and real estate commission that benefit third parties.	<ul style="list-style-type: none"> i) Existence of direct link between the input transaction and general costs of the business. ii) Third party benefit is ancillary. iii) Limitation on deduction if expenditure can be passed on to third parties and costs relate to their output transactions.

5. Analysis of Relevant Case Law

From the above case law, it follows that a taxable person can deduct input VAT on costs that benefit a person other than the taxable person herself. However, these case law also highlight certain conditions that need to be met before any deduction can be allowed. Hereinafter, those conditions are analysed.

i) *Costs should have a direct link to the overall economic activity*

The point highlighted in all the above cases was that there should be a direct and immediate link between the costs and the economic activity of the entrepreneur. While this is in line with earlier case law, the CJEU has increasingly considered the overall business activity rather than a strict application of the direct link. There must not be a direct link between the input transactions and the output transactions if the costs are part of the general overheads and are linked to the overall economic activity of the entrepreneur. In *Sveda*, C-126/14, the court said that direct link to the output transaction is not required when “*the expenditure incurred is part of his general costs and are, as such, components of the price of the goods or services which he supplies*”.⁸⁵ It is sufficient that the expenditure has a direct link with the taxable person’s economic activity as a whole.⁸⁶

There are many examples of general costs that are not directly linked to an output transaction. Administration cost, management costs and maintenance costs are most common examples of free of charge services that are not directly linked to an output transaction but are nevertheless extremely important to carry out economic activities. All businesses engage in some type of free of charge services and if all these were to limit deduction it would infringe on the principle of neutrality which is an integral part of the VAT scheme⁸⁷. These free of charge services are sometimes provided to start an economic activity or to promote and develop the business. Thus, though not explicitly stated in the case law it would also imply that there should be a link between the taxed and free of charge supplies. If the free of charge service is not linked to the taxed supplies,

⁸⁵ CJEU, 22 October 2015, Case C-126/14, *Sveda*, para 28.

⁸⁶ *Ibid.*

⁸⁷ O. Henkow, *Sveda—The increasing obscurity of the direct link test in EU VAT*, World Journal of VAT/GST Law, 5:1 (2016), p. 48-54, DOI: 10.1080/20488432.2016.1155821.

it would indicate that the link between the costs for providing free of charge service and overall economic activity is broken and this would consequently limit input VAT deduction. The CJEU now follows an economic view and accepts deduction of VAT incurred on exempt supplies when these are related to the taxable activities.⁸⁸

There is a large amount of case law on taxable persons that purchase of goods and services that they put at the disposal of third parties free of charge.⁸⁹ Many businesses must carry out certain free of charge preparatory services with the intention of engaging in taxable supplies. These preparatory services are often related to the development of infrastructure that lie with the scope of public services. As the services performed are within the scope of a public authority these need to be put at the disposal of the competent authority free of charge. These services would not have been performed if there existed infrastructure to carry out taxable transactions. The decision of the CJEU is obviously based on the reasoning that these free of charge services are necessary to start taxable transactions and thus considered as general costs for the business.

In *Sveda*, C-126/14, *Iberdrola*, C-132/16, and *Mitteldeutsche Hartstein-Industrie*, C-528/19, the free of charge services were a prerequisite to start economic activity and thus could also be compared to start-up costs with the intention of carrying out taxable activities in the future. Input VAT on start-up costs according to settled case-law is deductible so these free of charge supplies should rightly be deductible.

ii) *The benefit to the third party should be secondary to the purpose of the business*

Once the direct and immediate link has been established, the second condition that must be fulfilled to deduct input VAT on costs that benefit a third party is, that the benefit to the third party should only be secondary compared to the purpose of the business. In *Fillibeck*, C-258/95, it was perhaps the first time the CJEU considered the concept of primary and secondary beneficiary of the free of charge services and its implication for input VAT deductibility. This was in relation to deemed supply as it related to employees of the taxable person. It was only later that this concept was also

⁸⁸ N. Wittcock, *Sales Promotion Techniques and VAT in the EU* 330 (Kluwer 2019) in J. Bijl, 'VAT Deduction: The Relevance of Being 'The Recipient' of a Supply and the Use of the Supply', 29, EC Tax Review, Issue 5, (2020), p. 227-235.

⁸⁹ J. Bijl, 'VAT Deduction: The Relevance of Being 'The Recipient' of a Supply and the Use of the Supply', 29, EC Tax Review, Issue 5, (2020), p. 227-235.

applied to third party business. In *AES-3C Maritza East 1*, C-124/12, the CJEU held that the personal benefit derived by employees “*must be regarded as being of only secondary importance compared to the needs of the business*”.⁹⁰ Also in *Mitteldeutsche Hartstein-Industrie*, C-528/19, the CJEU held that the primary purpose of the work performed should be for the benefit of the taxable person.⁹¹ According to the court, it would be in contrary to the principle of neutrality to make the taxable person bear the burden on VAT solely on the ground that a third party derives an ancillary benefit.⁹² For a benefit to qualify as ancillary, the benefit to the third party should flow from acquisition made for goods and services in the taxable person’s own interest.⁹³ If the primary purpose of the free of charge service is to benefit the third party, then the link between the cost and the overall economic activity of the business would be broken and the business would not be entitled to deduct input VAT.⁹⁴

It is clear from the above case law that the main purpose for the free of charge supplies was to promote the main economic activity of the business and not undertaken to benefit a third party. In *AES-3C Maritza East 1*, C-124/12, *Sveda*, C-126/14, *Iberdrola*, C-132/16, *Mitteldeutsche Hartstein-Industrie*, C-528/19, and *Vos Aannemingen*, C-405/19, the third party did benefit from the expenditure incurred by the business, but this was incidental and not the main purpose for incurring these costs.

If VAT was deductible on costs that mainly benefit the third party, it would be against the principle of fiscal neutrality.

iii) *Business reasonability test*

Deduction of input VAT on costs benefitting third party should be limited to what is necessary to carry out taxable activity. In *Iberdrola*, C-132/16, the CJEU mentions that the service benefitting the third party “*should be limited to what is necessary*” for the taxable person to carry out taxable output transactions.⁹⁵

⁹⁰ CJEU, 18 July 2013, Case C-124/12, *AES-3C Maritza East 1*, para 33.

⁹¹ CJEU, 16 September 2020, Case C-528/19, *Mitteldeutsche Hartstein-Industrie*, para 37.

⁹² CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*, para 29.

⁹³ *Id.*, para 30.

⁹⁴ *Id.*, para 39.

⁹⁵ CJEU, 14 September 2017, Case C-132/16, *Iberdrola*, para 37.

In *Iberdrola*, it was perhaps the first time the CJEU conditioned input VAT deduction on a service not exceeding what is necessary to carry out taxable activities. This subsequently became an important condition for input VAT deductibility in *Mitteldeutsche Hartstein-Industrie*, C-528/19, and *Vos Aannemingen*, C-405/19. In *Mitteldeutsche Hartstein-Industrie*, C-528/19, the CJEU mentions that the right to deduction exists only on the portion of the costs necessary to allow the taxable person to carry out economic activity.⁹⁶ If this work is limited to what is necessary to fulfil the purpose, the right to deduction should be recognised for all cost related to the free of charge supplies.⁹⁷ Similarly, in *Vos Aannemingen*, C-405/19, the CJEU ruled that the cost incurred should be for the purpose of the taxable person's taxable activity and not for the benefit of the third party.⁹⁸

If the service provided to third party exceeds what is necessary to carry out taxable activity, then the link between service and the taxed transaction is broken and the right to input VAT deduction would be limited⁹⁹.

Limiting input VAT deductibility to free of charge services necessary to carry out taxable transaction, is an important step in curtailing undesirable consequences. If there was no limit to how much input VAT could be deducted on free of charge services, there would be a risk that this provision would be misused to intentionally benefit certain third parties.

iv) *Costs of goods and services acquired relate to the third party's output transaction*

Based on the above discussion it is evident that a taxable person has the right to deduct when there is a direct and immediate link between an input transaction and output transactions. This link even exists when the costs at issue are part of the general overhead costs linked to the overall economic activity of the taxable person. Certain costs might not have a link to either the output transactions or to the overall economic activity of the taxable person but are instead attributable to the output transaction of the third party.

If the expenditure incurred is linked to the taxable supplies of the third party, the existence of a direct and immediate link between the expenditure and the taxable person's taxable transactions

⁹⁶ CJEU, 16 September 2020, Case C-528/19, *Mitteldeutsche Hartstein-Industrie*, para 38.

⁹⁷ *Ibid.*

⁹⁸ CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*, para 39.

⁹⁹ CJEU, 14 September 2017, Case C-132/16, *Iberdrola*, para 39.

would be broken.¹⁰⁰ If the given input transaction of the taxable person would be linked to the output transactions carried out by the third party, no right to deduct input VAT can arise.¹⁰¹

The above implies that the benefit to the third party is not ancillary but rather primary and would not fulfil the business purpose test highlighted in point two above. However, it might be necessary to consider all the circumstances as, this link to the output transactions of the third party does not necessarily mean that the main purpose was to benefit third parties.¹⁰² Even when the costs are attributable to output transactions of a third party, input VAT is deductible if there is a direct and immediate link with the taxable person's taxable transactions.¹⁰³

More importantly, it would imply that the taxable person went beyond what is necessary to carry out economic activity and would not fulfil the conditions of the business reasonability test. In such a situation it will be difficult to determine the extent of right to deduction. The taxable person's right to deduct would be limited to what was necessary to carry out the taxable transactions, and input VAT on the remaining cost would not be deductible.¹⁰⁴

v) *Possibility to pass on the cost of supply to third parties*

The possibility to pass on part of the cost to the third party supports the conclusion that the expenditure relates to the output transaction of the third party and not to the output transaction of the entrepreneur.¹⁰⁵ Hence no right to deduction would arise as the link between the input transaction and the output transaction is broken.¹⁰⁶

This condition is however not in itself decisive in determining a taxable person's right to deduct input VAT and all circumstances in which the transaction occurred should be considered.¹⁰⁷ It may be possible to pass on part of the cost to third parties for reasons other than business and thus this condition cannot be seen in isolation to determine VAT deductibility. However, the possibility to

¹⁰⁰ CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*, para 39.

¹⁰¹ *Id.*, para 38.

¹⁰² *Id.*, para 43.

¹⁰³ *Ibid.*

¹⁰⁴ *Id.*, para 40.

¹⁰⁵ *Id.*, para 46.

¹⁰⁶ *Id.*, para 45.

¹⁰⁷ *Id.*, para 47.

pass on the cost to a third party does constitute one of the elements, along with all the other circumstances in determining the taxable person's right to deduct input VAT.¹⁰⁸

As we see these conditions for VAT deductibility are interrelated and should thus not be seen in isolation of the other conditions.

¹⁰⁸ Id., para 48.

6. Conclusion

Article 168 of the VAT Directive implies that input VAT on all costs including general costs is deductible if they are used for the purpose of taxable supplies. As general costs enable production and distribution of taxable supply of goods and services, they are within the scope of Article 168 of the VAT Directive. It can thus be said that the requirement of direct and immediate link between the general or indirect costs and the taxable transaction of the business has always existed, and it is not that the CJEU has broadened its view to include indirect costs. All businesses have indirect costs to support in the production and distribution of taxable supplies and if the deduction of input VAT on these costs were to be restricted, it would infringe the principle of fiscal neutrality.

The problem of VAT deductibility arises mainly when a taxable person carries out both taxed and exempt transactions. Here it is important to determine to what extent input VAT on indirect or general costs relate to taxable supplies. This determination is not easy as has led to different interpretations and numerous case law. What is however evident from the case law discussed above is that the CJEU considers overall business activity in its application of direct and immediate link.

The right to deduct input VAT for free of charge supplies that benefit third parties is not always straightforward as several factors need to be considered. Case law shows that there does not need to be a direct link between the input and output transactions of the taxable person for input to be deductible. It is enough that there is a direct and immediate link between the expenditure and the overall economic activity of the taxable person. However, the benefit of the service to the third party should be secondary and the service should not exceed what is necessary to carry out economic activity. Also, the ability to pass on the expenditure to the third party would give an indication that the costs do not relate to the output transaction of the taxable person but instead relates to the output transaction of the third party.

When deducting input VAT on free of charge services that also benefits a third-party it is important to consider all the above conditions. Considering the above factors however does not guarantee that the right to deduction exists and it might be necessary to consider all the circumstances in

which the transaction occurred.¹⁰⁹ Nevertheless, what is clear from the decisions of the CJEU is that it considers the economic reality of the transactions and accepts input VAT deduction on free of charge supplies if it supports taxable activities in some way.

¹⁰⁹ CJEU, 1 October 2020, Case C-405/19, *Vos Aannemingen*.

Bibliography

EU legislation

Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax [2006] OJ L 347/1

Treaty on the Functioning of the European Union [2012] OJ C 326/47 (consolidated version)

Case-law

The Court of Justice of the European Union

Judgment of 1 April 1982, Case 89/81 *Hong Kong*, EU:C:1982:121

Judgment of 14 February 1985, Case C-268/83 *Rompelman*, EU:C:1985:74

Judgement of 20 June 1991, Case C-60/90 *Polysar*, EU:C:1991:268

Judgment of 3 March 1994, Case C-16/93 *Tolsma*, EU:C:1994:80

Judgment of 6 April 1995, Case C-4/94 *BLP Group*, EU:C:1995:107

Judgment of 20 June 1996, Case C-155/94 *Wellcome Trust*, EU:C:1996:243

Judgement of 26 September 1996, Case C-230/94, *Enkler*, ECLI:EU:C:1996:352.

Judgement of 16 October 1997, Case C-258/95, *Fillibeck*, ECLI:EU:C:1997:491.

Judgment of 8 June 2000, Case C-98/98 *Midland Bank*, EU:C:2000:300

Judgment of 3 May 2001, Case C-481/98 *Commission v. France*, EU:C:2001:237

Judgement of 10 September 2002, Case C-141/00 *Kügler*, EU:C:2002:473

Judgment of 29 October 2009, Case C-29/08 *SKF*, EU:C:2009:665

Judgment of 10 November 2011, joined Cases C-259/10 and C-260/10 *Rank Group*, EU:C:2011:719

Judgment of 15 November 2012, Case C-174/11 *Zimmermann*, EU:C:2012:716

Judgment of 18 July 2013, Case C-26/12 *PPG Holdings*, EU:C:2013:526

Judgment of 18 July 2013, Case C-124/12 *AES-3C Maritza East I*, EU:C:2013:488

Judgment of 22 October 2015, Case C-126/14 *Sveda*, EU:C:2015:712

Judgement of 14 September 2017, Case C-132/16, *Iberdrola*, ECLI:EU:C:2017:683.

Judgement of 16 September 2020, Case C-528/19, *Mitteldeutsche Hartstein-Industrie*, ECLI:EU:C:2020:712.

Judgement of 1 October 2020, Case C-405/19, *Vos Aannemingen*, ECLI:EU:C:2020:785.

Opinions of Advocate General

Opinion of 22 April 2015, case C-126/14, *Sveda*, EU:C:2015:254

Literature

Christian Amand, *VAT Neutrality: A Principle of EU Law or a Principle of the VAT System*, 2 World J. VAT/GST L., 2013

Christian Amand, *What Does the EU VAT Actually Tax?*, 33 Intl. VAT Monitor 2, Journal Articles & Opinion Pieces, IBFD 2022

Jeroen Bijl, *'VAT Deduction: The Relevance of Being 'The Recipient' of a Supply and the Use of the Supply'*, 29, EC Tax Review, Issue 5, 2020

Sjoerd Douma, *Legal Research in International and EU Tax Law*, Kluwer - Deventer 2014

Oskar Henkow, *'Sveda – The increasing obscurity of the direct link test in EU VAT'*, World Journal of VAT/GST Law, vol. 5 issue 1, 2016

Madeleine Merckx, *Virtues and Fallacies of VAT: An Evaluation after 50 Years- Chapter 16: Supplies Below Cost Price or Free of Charge*, Wolters Kluwer 2021

Madeleine Merckx, *'Case Law Trends: Just a Formality!: Substance over Form in EU VAT and the Right to Deduct Input VAT [pre-publication]'*, 50, Intertax, Issue 6, 2022

Daniel Pawal, *Relations between the principle of neutrality and elements of value added tax structure*, Financial Internet Quarterly 17 (3), 2021

Ben Terra & Julie Kajus, *Introduction to European VAT, Global Topics*, IBFD 2021

Marton Varju, *'Case law note: The Right to VAT Deduction and the ECJ: Towards Neutral and Efficient Taxation in the Single Market?'*47, Intertax, Issue 3, 2019

Nathalie Wittock, *Sales Promotion Techniques and VAT in the EU* 330, Kluwer 2019 in Jeroen Bijl, *'VAT Deduction: The Relevance of Being 'The Recipient' of a Supply and the Use of the Supply'*, 29, EC Tax Review, Issue 5, 2020