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Dear Sir/Madam,

The CFE has issued an Opinion Statement on the VAT Treatment of Compensation Payments.

It is clear from the case law of the Court of Justice that not all compensation payments are subject to VAT. The difficulty is determining the demarcation line between cases that give rise to a liability and those that do not. The demarcation is not just potentially significant in determining whether a payment paid to a supplier is subject to VAT but also on the related question of whether a compensation payment made by a supplier should be considered to result in a reduction in the consideration for a supply.

The decisions in Case C222/81 *BAZ Bausystem AG v Finanzamt München für Körperschaften* and Case C-277/05 *Société Thermale d'Eugénie-les-Bains v Ministère de l'Économie*, *des Finances et de l'Industrie* make it clear that not all payments paid for compensatory reasons can be considered consideration for supplies. They also make it clear that there are two issues that need to be considered. The first is whether the taxable person can be considered to have rendered a supply. The second is whether there can be considered a sufficiently direct link between the payment and the alleged supply. Because of the harmonised basis of the tax, these issues cannot be purely determined by reference to concepts of national law, although they clearly form part of the context against which the issues need to be assessed.

Penalty and prepayment charges can in some cases be taxable if they are consideration for a supply. However, it is important to observe that in the facts of the cases considered by the CJEU concerning this issue there was clearly a supply, being the seat in the aircraft, access to the telephone networks or parking facilities. The Court also considered that the payments could be viewed as being consideration for those supplies, rather than purely compensatory. Therefore, different considerations may apply when these conditions are not satisfied. The fact sensitivity of these issues is also important to emphasise, because some tax authorities have sought to suggest that prepayments or cancellation payments, for example for a supply of goods, can be taxed even though no goods have been supplied.

In the generality of cases, the decision of C-107/13 *FIRIN OOD* also suggests that it cannot be correct to view a prepayment for the supply of goods as also resulting in a supply of services, since *FIRIN OOD* would then have had a right of recovery for that reason if its payment could be considered a payment for a supply of services. This conclusion is also consistent with the Court's reasoning in Case C-277/05 *Société thermale d'Eugénie-les-Bains v Ministère de l'Économie, des Finances et de l'Industrie*, where the Court considered that on the facts of that case it would be wrong to view the deposit as consideration for

a reservation service.

The *Apcoa* case makes it clear that some penalty payments may be consideration for a supply. However, we also do not consider that it would be correct to view all penalty payments as consideration. Each case will depend on its facts. However, it will clearly be significant if the payment does not impact on the quality of what is supplied to the customer and does not result in the customer obtaining any additional rights. With both compensatory and penalty payments, both these points will support the conclusion that there is an insufficiently direct and immediate link between the payment and any supply. For these reasons, the payment of a penalty when there is nothing corresponding to a supply should not give rise to a liability.

We also do not consider that all prepayments should be considered as consideration. In particular no charge should arise when it is not realistic to analyse the customer as receiving anything.

We invite you to read the statement and remain available for any queries you may have.

Kind regards,

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