KPMG Meijburg & Co Tax Lawyers

VAT exemption not applicable on instruction to transfer money

On March 21, 2018, the Advocate General ('AG') at the Court of Justice of the European Union ('CJEU') issued his Opinion in the DPAS Limited case (C-5/17). The AG concluded that the VAT exemption for payments cannot be applied to a service provider that only instructs banks to transfer sums of money. The AG concluded that giving such instructions is a "*mere physical, technical or administrative service*" that is not covered by the VAT exemption for payments. According to the AG, such a service does not involve the execution of the transfer itself and thus does not directly result in the legal and financial changes which are characteristic for the VAT exempt transfer of money.

1. The case

The taxpayer ('DPAS') offers dentists practice-branded dental plans and manages these arrangements for the registered patients. As part of this arrangement, DPAS requests the patients' banks, by means of a direct debit mandate from the patients, to debit payments from the patients' accounts and to credit them to the DPAS trust account. After deducting a fee for its own services, DPAS requests its bank to transfer these amounts to the accounts of the dentists.

As of 2012, DPAS structured its services differently, with the aim of preventing the negative effects of the CJEU judgment in a case litigated by a competitor: AXA Denplan (CJEU, October 28, 2010, C-175/09). In those proceedings, the CJEU ruled that the services offered to dentists by AXA Denplan qualify as '*debt collection*' and are therefore subject to VAT. As of 2012, DPAS entered into a contractual relationship with not only the dentists (creditors) but also with the patients (debtors), although DPAS clearly communicated that nothing will effectively change. The purpose of this appears to be that DPAS took the position that the services to the debtors (patients) cannot be regarded as taxed debt collection.

The principal question addressed by the AG in his Opinion was whether the transfers – for which DPAS instructed the banks under the contract with the patient – are covered by the VAT exemption for payments. The alternative question essentially concerns whether such services indeed cannot be excluded from the exemption – as taxed debt collection – because, according to DPAS, they are performed for the debtor rather than the creditor.

2. Analysis of the AG's Opinion

The AG refers to earlier case law, in which it was established that a transfer is a transaction consisting of the execution of an order for the transfer of a sum of money from one bank account to another. The AG reiterates that the characteristic of such a transaction is that it results in changes to the legal and financial relations between parties. According to the AG, this means that there must be more than a mere physical, technical or administrative service. The AG further reiterates that the nature of the service is decisive and not the party providing the services.

The AG concludes that the services provided by DPAS should be categorized as *"mere physical, technical or administrative services"*. According to the AG, the activities of DPAS are limited to a preparatory step in the transfer process. Although DPAS does instruct the banks to make the transfers, it does not make the transfers itself. According to the AG, the legal and financial relationships are therefore not directly changed by DPAS. As such, the AG concludes that these services are not covered by the VAT exemption for payments. The AG notes here that while this conclusion is, on the one hand, at odds with (among others) the judgment of the CJEU in the abovementioned AXA Denplan case, on the other hand, it is in accordance with the judgment of the CJEU in the Bookit and NEC cases.

For completeness' sake the AG concludes that the restructuring of the contractual arrangements by DPAS in 2012 should be ignored for VAT purposes. Because DPAS clearly communicated that nothing would effectively change as a result of the restructuring, the AG concludes that the contractual restructuring does not reflect economic reality. Under these circumstances, economic reality is decisive for VAT purposes. Consequently, for VAT purposes the restructuring does not result in DPAS providing services to the patients (debtors) in addition to its services to dentists (creditors). This means that the AG did not address the question whether such services must be regarded as taxed services comprising 'debt collection' if these services are performed for the debtor (patient) instead of the creditor. The AG also points out that *were* the CJEU to rule that debt collection is provided, it does not matter whether the agreement designates the dentists (creditors) or the patients (debtors) as the formal recipients of the service. In his view, the economic reality of the service remains unchanged.

3. Practical consequences

The AG appears to place little value on the fact that payments are credited to a DPAS bank account and that DPAS passes these payments on. If the CJEU follows the AG's Opinion, then the consequences for the Dutch practice would appear to be that there would be an even more limited scope of the VAT exemption for payments. A strict interpretation of the Opinion would mean that only the parties that actually make the payment – and who thus bring about legal and financial changes – can apply this exemption. The other links in the payment chain then cannot apply the VAT exemption for payments.

Several parties that are not directly involved with the execution of the payment, but are currently applying the VAT exemption, will be affected by this. This does not necessarily have to have negative consequences in practice. Service providers in this sector that perform their services to customers entitled to a deduction (generally merchants) can benefit from this, because their own VAT deduction entitlement is thereby increased. It is expected that the implementation of the new EU Directive on payment services (Directive 2015/2366, 'PSD2') will lead to a number of new parties in this area.

Parties that offer their services directly to individual consumers or are paid by the banks are more likely to be negatively affected by this case. These could also include new parties that, under PSD2, are allowed to give instructions for payments (payment initiation service providers). As they do not execute the payments themselves, they should, in principle, charge non-deductible VAT to the consumer.

Whether the CJEU follows the AG's strict interpretation in this case remains to be seen. There are also two other cases concerning payment and transaction services pending before the CJEU. One of these cases concerns a service provider involved in the operation of cash dispensers (Cardpoint, C-42/18). The other case concerns a factoring situation (Paulo Consulting, C-692/17). These cases will presumably provide further guidance on the application of the exemption.

The tax advisors of Meijburg & Co's Indirect Tax Financial Services Group would be pleased to help you identify the potential implications of this Opinion and the CJEU judgment that follows. Please feel free to contact one of them or your regular contact at Meijburg & Co.

Meijburg & Co
March 2018