



# COVID-19 Crisis and EU VAT

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## Foreword

Beyond its human toll, the COVID-19 pandemic caused unprecedented business and economic disruptions which, unsurprisingly, come with their own tax consequences. One such impacted tax area is VAT, a domain often shunned by direct tax professionals as overly esoteric but for the chosen few. In order to help our ORBITAX community navigate the potential VAT implications of the pandemic for businesses, I have turned to my former colleague and always friend Walter van der Corput for guidance on the EU VAT implications of the disruptions caused by the pandemic, and the hitherto neglected areas brought to the fore by its mitigation.

Walter is the contributor of the ORBITAX guidance on EU VAT for Non-EU Businesses {LINK}, and a leading world authority on VAT.

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## Introduction

On 30 January 2020, the World Health Organisation (WHO) declared the COVID-19 outbreak a public health emergency of international concern. On 11 March 2020, WHO declared the COVID-19 outbreak a pandemic. COVID-19 has caused infections in all 27 Member States and the United Kingdom <sup>1</sup>. As the number of infections increased alarmingly and due to the lack of means to deal with the COVID-19 outbreak, all Member States have declared a national state of emergency or at least proclaimed COVID measures, which have an adverse effect on economic activities.

Although the COVID-19 crisis has dramatic consequences for almost all businesses, the EU VAT rules, as laid down by the EU VAT Directive <sup>2</sup>, have not been amended. The only special measure at EU level is a temporary exemption from customs duties and VAT on the importation (from non-EU countries) of specific goods used for the purpose, or in the framework, of preventing and combating the virus <sup>3</sup>.

However, this temporary import exemption, which provisionally applies from 30 January 2020 until 31 July 2020, does not apply if the imported goods in question are destined for commercial purposes <sup>4</sup>.

In addition, individual Member States may grant specific temporary concessions, within (or even beyond) the options available to them under the provisions of the VAT Directive, such as

reduction of the VAT rates, application of a reduced VAT rate to the supply of specific medical goods and pharmaceuticals, exemption for the hiring out of medical personnel (nurses and doctors), deferment of the deadline for filing VAT returns, deferment of the deadline for remitting to the tax authorities any VAT due for the tax period. Discussion of such national measures and concessions is outside the scope of this article.

Discussing the VAT consequences of the COVID crisis in individual Member States is very complex because Member States have numerous options to determine when the VAT becomes payable, when the related VAT return must be filed and when the VAT due must be remitted to the tax authorities. Also the conditions under which Member States allow, in the case of cancellation or total or partial non-payment, suppliers of goods and services to recover the VAT that they have already remitted to the tax authorities are not subject to uniform rules and, consequently, the arrangements vary from Member State to Member State. The following overview of the VAT consequences of the COVID crisis is based on the provisions of EU VAT law, including relevant decisions of the Court of Justice of the European Union.

## **Cancellations of Contracts**

In the event of cancellation of a contract for the supply of goods or services, the supplier is entitled to reduce the taxable amount under conditions to be determined by the Member State in question. Cancellation of a contract for the supply of goods implies that ownership of the goods returns to the supplier. This reduction of the taxable amount is in particular relevant if the contract is cancelled after the supplier has become liable for remittance of the VAT to the tax authorities (e.g. if the supplier has already issued an invoice in relation to the transaction that is subsequently cancelled). If the supplier has already remitted the VAT to the tax authorities, the reduction of the taxable amount has the effect that the supplier can apply for a refund of the VAT on the cancelled transaction.

One of the common conditions for reducing the taxable amount is that the supplier issues a credit note, which enables him to recover from the tax authorities the amount of VAT for which he had already become liable or which he had already remitted to the tax authorities. The credit note also has the effect that the customer must repay to the tax authorities the VAT that he had already deducted.

Special conditions may apply to B2C contracts because suppliers are not required to issue VAT invoices in relation to B2C transactions.

## **Cancellations of Events**

Where the organizer of an event is forced by the authorities to cancel a cultural, artistic, sporting, scientific, educational, entertainment or similar event, including fairs and exhibitions, the VAT

consequences are limited to the situation in which the visitors or participants have paid the admission fee in advance. If he does not repay the admission fee to the visitors or participants, the organizer of the event must still remit the VAT due on the cancelled service, and cannot reclaim that VAT from the tax authorities. The same applies where, instead of repaying the admission fee, the organizer of the cancelled event provides the visitors or participants with a voucher<sup>5</sup> for a future event. In the latter case, the use of the voucher by the visitors or participants does not have further VAT consequences.

If he repays the admission fee to the visitors or participants, the organizer of the event is entitled to reduce the taxable amount relating to the cancelled event, which means that the organizer can reclaim the VAT that he had already remitted to the tax authorities in relation to the cancelled event, under conditions to be determined by the Member State in question. Special conditions may apply where the visitors or participants are final consumers because organizers of events are not required to issue VAT invoices in relation to B2C transactions.

Whether or not he repays the admission fee to the visitors or participants, the organizer of the cancelled event does not have to repay any VAT he had deducted on expenses related to the cancelled event. Deduction of input VAT is of course only possible if admission to the event is not exempt from VAT. Hence, cancellation of zero-rated transactions, such as international flights, does not have any VAT consequences.

## **Late Payment by the Customer**

The fact that, in relation to supplies of goods or services, customers pay their suppliers later than agreed should not have any VAT consequences, even if the supplier charges a late-payment penalty to the customer. The supplier's obligation to remit VAT to the tax authorities and the customer's right to deduct the VAT charged to him on a valid invoice do not depend on payment of the invoice: the supplier becomes liable to remit the VAT to the tax authorities, regardless of whether or not he has received payment from the customer, and the customer can deduct the VAT at the time he receives the VAT invoice, regardless of whether or not he has already paid the supplier. The situation changes if late payment turns into non-payment.

## **Non-Payment by the Customer**

In the event of total non-payment by the customer of the price for supplies of goods or services, the supplier is entitled to reduce the taxable amount under conditions to be determined by the Member State in question.

The conditions under which Member States will allow the supplier to reduce the taxable amount in the case of non-payment vary from Member State to Member State because the tax authorities wish to ensure that the non-payment is a definitive situation and that they also have the possibility to reclaim from the customer the VAT that the customer has already deducted in relation to the unpaid

transaction. For example, specific Member States will require that the supplier is in possession of an acknowledgment, by the purchaser of the goods or services, of receipt of a correcting invoice or credit note. However, where it is impossible or excessively difficult for the supplier to obtain such acknowledgment of receipt within a reasonable period of time, he cannot be denied the opportunity of establishing, by other means, that he has taken all the steps necessary in the circumstances of the case to satisfy himself that the purchaser of the goods or services is in possession of the correcting invoice or credit note, and is aware of it, and that the transaction in question was in fact carried out in accordance with the conditions set out in the correcting invoice.

Member States are not allowed to make the reduction of the taxable amount in the event of total non-payment subject to the condition that insolvency proceedings have been unsuccessful when such proceedings may last longer than ten years. The mere circumstance that, at the time it becomes clear that the customer will never pay the supplier's invoice, the customer is no longer registered for VAT is not a sufficient reason for denying the supplier the right to recover the VAT included in the unpaid invoice. In other words, suppliers must, in practice, be able to recover the VAT relating to totally unpaid invoices within a reasonable period. The tax authorities will be reluctant to repay any VAT to the supplier because "non-payment" must be interpreted as meaning that the customer has not paid the invoice and will definitively not pay it in the future. Repayment of the VAT included in the unpaid invoice to the supplier implies that the tax authorities can reclaim the same amount from the customer, which is not always possible if the customer has gone bankrupt or is deregistered for VAT. In those circumstances, repaying VAT to the supplier is a loss for the tax authorities.

## **Partial Non-Payment by the Customer**

Where the customer does not pay the supplier's invoice in full, the same rules apply as in the case of non-payment, albeit that the amount of VAT that the supplier can reclaim from the tax authorities is reduced proportionally.

For example, if the invoice is for 120, i.e. 100 + 20 in VAT, and the customer pays only 75, the amount of 75 is presumed to include 12.50 ( $20/120 \times 75$ ) in VAT. Consequently, the supplier can only reclaim 7.50 ( $20 - 12.50$ ) from the tax authorities.

Also in the event of partial non-payment, before refunding any VAT to the supplier, the tax authorities may require documentary evidence that the customer will not pay the remaining part of the invoice at a later stage (see Non-Payment by the Customer).

## **Temporary Cessation of Business Activities**

Where, as a consequence of a "lockdown" proclaimed by the authorities, businesses are forced to temporarily scale down or interrupt their economic activities and, where the authorities pay those businesses a financial compensation for the negative consequences of the lockdown, any funds received

by the businesses in question are not treated as a consideration for supplies of goods or services. Consequently, the financial compensations received do not have any VAT consequences, i.e. businesses do not have to issue a VAT invoice and do not have to account for VAT in relation to compensations received.

The circumstance that, due to the COVID measures, businesses temporarily do not use their business assets for taxed purposes does not have a negative effect on their right to deduct VAT in relation to the business assets because the COVID measures are circumstances beyond their control.

## **Permanent Cessation of Business Activities**

Where the public COVID measures have the effect, directly or indirectly, that businesses go bankrupt, the VAT consequences are the same as those of bankruptcies in other circumstances.

In this context, one aspect deserves special attention. Where they cease an economic activity but continue to pay rent and charges on leased premises used for that activity (because the lease contains a non-termination clause), businesses are entitled to deduct the VAT on the amounts thus paid, even though the business premises are no longer used for taxed purposes, provided that there is a direct and immediate link between the payments made and the former commercial activity and that the absence of any fraudulent or abusive intent has been established.

## **Importation of “Anti-Corona Goods”**

As mentioned above, a temporary exemption from (customs duties and) VAT applies to the importation (from non-EU countries) of specific goods used for the purpose, or in the framework, of preventing and combating the virus ("anti-corona goods"), provided that the goods are imported for release for free circulation by, or on behalf of, designated State organizations and the goods are intended for distribution free of charge to persons affected by, or at risk from, the COVID-19 virus or involved in combating the COVID-19 outbreak, or where the goods are imported by, or on behalf of, disaster-relief agencies in order to meet their needs during the period they provide disaster relief to the persons affected by or at risk from COVID-19 or involved in combating the COVID-19 outbreak.

It should be noted that the import exemption does not require that the anti-corona goods are supplied by the non-EU supplier free of charge.

## **Intra-Community Acquisition of “Anti-Corona Goods”**

The intra-Community acquisition of goods is the taxable event that applies in the scenario in which businesses purchase goods from suppliers in another Member State.

Since Member States temporarily exempt the importation of designated medical goods used for the purposes of treating and preventing infections with the COVID virus if the goods are imported by, or on behalf of, designated medical institutions for the purpose of distributing them free of charge to persons affected by, or at risk from, the COVID-19 virus or involved in combating the COVID-19 outbreak, the intra-Community acquisition of the same designated goods acquired by the same designated medical institutions or disaster-relief agencies will also be exempt, under the same conditions and restrictions <sup>6</sup>.

It should be noted that the exemption for intra-Community acquisitions of anti-corona goods does not require that the anti-corona goods are supplied by the EU supplier free of charge.

## **Domestic Supplies of “Anti-Corona Goods”**

Although, under specific conditions, the importation of designated medical goods used for the purposes of treating and preventing infections with the COVID virus ("anti-corona goods") is exempt from VAT and also the intra-Community acquisition of the same goods is exempt from VAT, under the same restrictions, the VAT Directive does not contain any concessions for domestic supplies of "anti-corona goods", even if the goods are supplied to designated medical institutions for the purpose of distributing them free of charge to persons affected by, or at risk from, the COVID-19 virus or involved in combating the COVID-19 outbreak or to disaster-relief agencies.

This situation is clearly discriminatory and undesirable but not necessarily unlawful.

## **Donation of “Anti-Corona Goods”**

The free-of-charge disposal by businesses of goods forming part of their business assets is in principle treated as a taxable supply of goods for consideration, where the VAT on those goods was wholly or partly deductible. Under those circumstances, the donating businesses must still account for VAT on the purchase price of the donated goods or of similar goods or, in the absence of a purchase price, on the cost price of the donated goods <sup>7</sup>. However, in view of the temporary VAT exemption on the importation of goods needed to combat the effects of the COVID-19 outbreak during 2020 (see footnotes 3 and 4), and the exemption for intra-Community acquisitions in the same circumstances, it is likely that Member States will also temporarily exempt the free-of-charge supply to designated medical institutions or to disaster-relief agencies of designated medical goods used for the purposes of treating and preventing infections with the COVID virus, the more since the transactions in question are of a non-commercial nature (free of charge).

## Footnotes

<sup>1</sup> On 31 January 2020, the United Kingdom formally ceased to be a Member State of the European Union; on the basis of a transitional arrangement, EU law continues to apply in the United Kingdom until 31 December 2020. For the purpose of this article, the United Kingdom is treated as being a "Member State".

<sup>2</sup> Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347 of 11 December 2006. Member States are required to adapt their national VAT Acts to the provisions of the VAT Directive.

<sup>3</sup> Commission Decision (EU) 2020/491 of 3 April 2020 on relief from import duties and VAT exemption on importation granted for goods needed to combat the effects of the COVID-19 outbreak during 2020, OJ L 103 of 3 April 2020 (<http://data.europa.eu/eli/dec/2020/491/oj>).

<sup>4</sup> The temporary import exemptions only apply where designated goods (such as COVID-19 test kits/instruments and apparatus used in diagnostic, protective garments and goods, disinfectants and sterilization products, oxygen therapy equipment and pulse oximeters, and other medical devices and medical consumables) are imported for release for free circulation by or on behalf of:

- designated State organizations and the goods are intended for distribution free of charge to persons affected by, or at risk from, the COVID-19 virus or involved in combating the COVID-19 outbreak, or
- disaster-relief agencies in order to meet their needs during the period they provide disaster-relief to the persons affected by, or at risk from, COVID-19 or involved in combating the COVID-19 outbreak.

Those conditions do not imply that the importation of the goods must be free of charge.

The VAT import exemption is based on Article 51 of Directive 2009/132, which provides that goods imported by State organizations or other charitable or philanthropic organizations approved by the competent authorities are exempt on admission where they are intended for distribution free of charge to victims of disasters affecting the territory of one or more Member States or to be made available free of charge to the victims of such disasters, while remaining the property of the organizations in question. The import exemption also applies to goods imported by disaster-relief agencies in order to meet their needs during the period of their activity. Granting of the exemption is subject to a Decision by the European Commission; in this case: Commission Decision (EU) 2020/491 (see footnote 3).

<sup>5</sup> Such a voucher is a "single-purpose voucher" within the meaning of Article 30a(2) of the VAT Directive, i.e. a voucher where the place of supply of the service to which the voucher relates, and the VAT due on



that service, are known at the time of issue of the voucher; under Article 30b(1) of the VAT Directive, the transfer (issue) of a single-purpose voucher is regarded as a supply of the service to which the voucher relates.

<sup>6</sup> Under Article 140(b) of the VAT Directive, intra-Community acquisitions of goods are exempt if the importation of the goods would in all circumstances be exempt. In the past, the European Court of Justice has not interpreted the phrase "in all circumstances" restrictively.

<sup>7</sup> See Articles 16 and 74 of Orbitax's EU VAT Directive.