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GUIDANCE NOTE

Conditions for eligibility of VAT under ESIF rules in the 2014-2020 programming period

DISCLAIMER:

This is a document prepared by the Commission services. It provides for technical guidance public authorities, practitioners, beneficiaries or potential beneficiaries, and other bodies involved in the monitoring, control or implementation of the ESI Funds, on how to interpret and apply the EU rules in this area. In order to facilitate the implementation of operational programmes and to encourage good practices, this document aims to provide its addressees with explanations and interpretations of the said rules as they will be applied by the Commission. However, this guidance note is without prejudice to the interpretation of the Court of Justice and the General Court or evolving Commission decision-making practice.

CONDITIONS FOR ELIGIBILITY OF VAT UNDER ESIF RULES IN THE 2014-2020 PROGRAMMING PERIOD

1. BACKGROUND

The treatment of Value Added Tax (VAT) in operations financed by the Structural Funds and the Cohesion Fund have been an issue of disagreement between the Commission and the Member States since the previous programming periods. The difficulties in interpretation of VAT provisions in rules applicable to the Structural Funds and the Cohesion Fund have been related to the notion of recoverability. Member States had challenged the Commission position that recoverability of VAT should not have been assessed in accordance with the possibility for the beneficiaries to deduct VAT paid on goods and services purchased on the sole basis of their taxable or not status in VAT law but based on rules specific to the Structural Funds and the Cohesion Fund. In 2012 the General Court (hereinafter 'the GC') issued two judgements[1] addressing the eligibility of VAT within the context of Structural Funds programmes. On the basis of this case law, eligibility of VAT under the ESIF rules in the 2014-2020 programming period should not be defined by strict reference to tax law but in accordance with general principles underpinning the notion of recoverable VAT in this specific context.

2. PURPOSE AND SCOPE OF THE NOTE

In the 2014-2020 programming period, eligibility of VAT is dealt with by Article 69(3)(c) of Regulation (EU) No 1303/2013, the Common Provisions Regulation setting out horizontal rules for all ESI Funds, hereinafter 'the CPR', which states that VAT shall not be eligible '*except where it is non-recoverable under national VAT legislation*'. This particular provision applies to all ESI Funds.

The purpose of this note is to explain the principles based on which the assessment of eligibility of VAT should be made and the related consequences. However, as different operations may present particularities, the final Commission position on recoverability of VAT has to be established on a case-by-case basis.

The principle of Article 69(3)(c) CPR is recalled in Article 37(11) CPR which refers to financial instruments within the meaning of the CPR (cf. Article 2(11)). However, this note does not cover financial instruments and thus does not analyse Article 37(11).[2]

3. PRINCIPLES OF INTERPRETATION OF ARTICLE 69(3)(C) CPR

Article 65(1) CPR provides that eligibility of expenditure should be determined based on national rules, except where specific rules, laid down in the CPR or in the Fund-specific acts, apply.

In line with Article 65(2) CPR, expenditure shall be eligible if it has been incurred by a beneficiary[3] and paid between the date of submission of the programme to the Commission or from 1 January 2014, whichever is earlier, and 31 December 2023. VAT that may be

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1 Case T-89/10 *Hungary v Commission* and Case T-407/10 *Hungary v Commission*.

2 For more information on the specific issue please refer to the '*Guidance for Member States on CPR eligibility Rules for ESI Funds for financial instruments*': http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=23196&no=4

3 Cf. definition in Article 2(10) CPR (and amendment agreed thereto by the co-legislators in the context of the revision of the Financial Regulation).

recoverable by a beneficiary cannot be considered as entailing a real cost for it. Consequently, the corresponding VAT expenses cannot be considered as eligible expenditure. Eligibility may be accepted only where VAT constitutes ultimately and genuinely an economic burden for the beneficiary.

Article 69(3)(c) CPR sets out that VAT shall not be eligible '*except where it is non-recoverable under national VAT legislation*'. Non-recoverable VAT is thus not excluded from eligibility for a contribution from the ESI Funds[4] as an exception to the general rule. It is up to Member States to define in their national eligibility rules whether or not non-recoverable VAT is eligible.

Reference is made to 'recoverability' of VAT, i.e. the possibility to recover. Thus, it is irrelevant whether the VAT is actually recovered or how much VAT has been effectively recovered. As long as the national law confers the right to recover for a given operation VAT, the latter should not be eligible.

The term '*non-recoverable under national VAT legislation*' in Article 69(3)(c) CPR is therefore to be understood to exclude all situations where a beneficiary may recover VAT. Otherwise, such situation may result for the beneficiary in unjustified double financial benefit.

The provision applicable to 2014-2020 programming period refers to recoverability *'under national VAT legislation'.*

As a preliminary remark, the public or private status of the beneficiary is not taken into account for the determination of eligibility of VAT in application of the provision of Article 69(3)(c) CPR.

The notion of recoverable VAT does not necessarily coincide with the notion of deductible VAT as defined in Title X of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[5], (hereinafter – 'the VAT Directive'). The notion of 'recoverable VAT' has not been purely transposed from the VAT Directive as synonymous of 'deductible VAT', but it is aimed to address certain specificities of the ESI Funds implementation. Thus, the wording of the provision of Article 69(3)(c) CPR does not suggest an assessment of eligibility of VAT solely in accordance with the taxable or not status under national VAT legislation excluding any other relevant considerations. Although it is indisputable that Member States have the competence to determine the tax status of a given beneficiary, in compliance with EU law, in the context of ESI Funds this status is not sufficient to assess the eligibility of VAT. The underpinning VAT recoverability/non-recoverability needs to be determined beyond the simple examination of the tax status of that beneficiary.

To determine whether VAT is recoverable in operations supported by the ESI Funds, it should be prior established whether or not VAT paid by a beneficiary on an operation is genuinely and definitively borne by that beneficiary as there may be situations where the economic burden of VAT paid is neutralised. In particular, where the beneficiary transfers the VAT burden to another entity, which is then allowed to exercise a right of deduction/refund to neutralise that burden, VAT should be considered as recoverable and therefore not eligible. This would be typically the case of revenue generating operations. In these operations, account should be taken of whether the operational phase of the project is subject to VAT.

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4 As defined in the first sub-paragraph of Article 1 CPR.

5 OJ L 347, 11.12.2006, p. 36.

4. RECOVERABILITY OF VAT IN REVENUE GENERATING OPERATIONS

In the context of revenue generating operations, supported by the ESI Funds, different case scenarios may be envisaged taking into account the taxable or non-taxable status of the beneficiary as well as whether or not the same body is responsible for the implementation and the utilisation of the operation.

Depending on the combination of the tax status of the beneficiary according to the national VAT rules with the charging or not of VAT on the revenues generated by the use of the operation, VAT may be considered non-recoverable and therefore eligible.

For the purpose of declaring VAT eligible, the Commission relies in principle on the Member State's assessment of the beneficiary's tax status.

4.1 THE BENEFICIARY IS A TAXABLE PERSON (AND PROVIDES GOODS OR SERVICES FOR CONSIDERATION) ACCORDING TO THE VAT DIRECTIVE

Articles 167 to 172 of the VAT Directive set out that, in so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person is entitled, in the Member State in which he carries out these transactions, to 'deduct' VAT or to obtain a 'refund' of VAT which he is liable to pay.

Article 9(1) of the VAT Directive defines 'taxable person' as *'any person who independently carries out an economic activity, whatever the purpose or results of that activity'*. Economic activity in the sense of the VAT legislation is to be understood as any business activity. Considering the objective character of the term 'economic activity', the fact that the activity in question consists of the performance of duties, which are conferred and regulated by law in the public interest, is irrelevant.

According to Article 13 of the VAT Directive, States, regional and local government authorities and other bodies governed by public law shall not, in principle, be considered taxable persons in respect of the activities or transactions in which they engage as public authorities[6], even where they collect dues, fees, contributions or payments in connection with these activities or transactions. This principle does apply when these authorities engage in activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition on the relevant market.

In cases, where a public entity is as taxable person, it has the right to require a deduction or a refund for VAT paid by it for taxable transactions in accordance with the national VAT law. In such a case, the VAT paid is naturally recoverable, as it does not constitute an economic burden for the public entity. Therefore, the VAT paid would not be eligible for reimbursement.

If a public entity and, *a contrario* - a private entity, is a taxable person for VAT purposes and is able to deduct tax for taxable transactions in compliance with the VAT directive, it is clear that the VAT is also recoverable and thus is not an eligible expenditure in relation to ESIF.

[6] The VAT Directive does not define the concept of public authority. According to case law, activities pursued by public authorities within the meaning of the first paragraph of Article 4(5) of the Sixth Directive are those engaged in by bodies governed by public law under the special legal regime applicable to them and do not include activities pursued by them under the same legal conditions as those that apply to private traders.

4.2 THE BENEFICIARY IS A NON-TAXABLE PERSON ACCORDING TO THE VAT DIRECTIVE

In cases where the beneficiary is a non-taxable person, it is not entitled to deduction of VAT paid based on its non-taxable status. This is a first but not sufficient step to qualify VAT as irrecoverable within the meaning of Article 69(3)(c) CPR. Further analysis is required to determine whether within an operation and, in the context of the national setup, the VAT would be neutralised or whether it would eventually constitute a genuine economic burden at the level of the beneficiary.

In the context of revenue generating projects, it should be prior assessed whether the operational phase of the project is subject to VAT.

Within the meaning of Article 61(1) CPR "net revenue" is defined as *'cash in-flows directly paid by users for the goods or services provided by the operation, such as charges borne directly by users for the use of infrastructure, sale or rent of land or buildings, or payments for services less any operating costs and replacement costs of short-life equipment incurred during the corresponding period'.*

In line with the above, for infrastructure investments, only revenues stemming from the direct use of the infrastructure are to be taken into account. In the relevant case law, related to the recoverability of VAT[7], the revenue to be taken into account resulted from tolls charged for the use of a motorway or from the fees charged for the access to the railway infrastructure. Where generated revenue cannot be directly attributed to a co-financed operation[8], this would not be taken into account.

Two cases may subsequently materialise:

First, the beneficiary in charge of the implementation of the operation is the same as the body operating it. It is not a taxable person and therefore it does not charge VAT on revenues from the operation of the project. In line with the interpretation of Article 69(3)(c) CPR, provided it is in accordance with EU and national tax law, VAT on construction will be considered as irrecoverable. Therefore, it would be considered as eligible to ESI Funds.

Second, the operational structure differentiates between the beneficiary in charge of the implementation of the operation and an operator, which is a taxable person and therefore charges VAT on the revenues from the utilisation.

Article 69(3)(c) CPR does not suggest that assessment of recoverability of VAT under the 2014-2020 programming period should be carried out outside the framework of the consolidated financial analysis in order to determine the financial support to the project.

In revenue generating projects, as defined in Chapter 4 of this guidance note, the implementation and utilisation phases constitute already an inseparable whole which should be examined together to calculate the Funds' contribution. This means that in determining the EU support the revenues generated by the use of the project should be taken into account, even if these revenues are received by a body different from the beneficiary (i.e. the operator) and could be passed on to the beneficiary.

Similar to major projects where a consolidated financial analysis must be carried out, if the body responsible for implementation is a different entity from the one that will operate the project, the same logic should be applied for the purpose of determining VAT recoverability i.e. separation between implementation and utilisation should be in principle excluded. In such cases the non-recoverability of VAT for the body implementing the project will not be

7 See footnote 1 of the Guidance note.

8 E.g. revenue generated by transport services provided on the co-financed infrastructure.

in itself enough to consider VAT eligible but will be examined in parallel with the question whether VAT is charged on outputs and could be passed on to the beneficiary.

Thus, where implementation and utilisation of an operation are separated, VAT paid by the beneficiary during the implementation phase of the project will be, in principle, considered recoverable through the means of the output VAT charged on revenues by the entity operating it. This, notwithstanding the arrangements chosen by the national authorities i.e. differentiation in the national setup between a beneficiary responsible for the implementation, non-taxable person and an operator, taxable person.

Finally, the Commission recalls that, according to a settled case law[9], the principle of prohibiting abusive practices also applies to the sphere of VAT. In the context of eligibility of VAT expenses, this principle has to be interpreted in a way to prevent that national, regional or local setup has been made with the exclusive purpose to render the VAT expenses eligible to EU co-financing.

4.3 THE BENEFICIARY HAS A MIXED STATUS (IT PERFORMS TAXED AND NON- TAXED ACTIVITIES) - PARTIAL VAT RECOVERY

In this configuration, two particular cases materialise where VAT may be considered as irrecoverable and therefore eligible for contribution from the ESI Funds: the case of VAT being a negligible percentage as compared to overall revenues (under Sub-section 4.3.1) as well as partial VAT eligibility based on the mixed status of the beneficiary (under Sub-section 4.3.2).

Where within the same operation involving several activities (for example motorway construction as well as gas stations), the revenues generated from one activity (for instance toll collection) are not subject to VAT while revenue generated from another activity (for example the lease of areas used by bodies providing road services such as gas stations or rest areas) are subject to VAT, an approach may be considered whereby the amount of VAT limited to the amount of the real economic burden of VAT paid by the beneficiary may be considered to be irrecoverable under both VAT and ESI Funds and therefore eligible. In the example above, out of the total amount of VAT paid on the construction of the whole operation (construction of motorway, rest areas or gas stations), only VAT paid on construction costs of rest areas and gas stations may be considered as recoverable and therefore ineligible as it may be offset with VAT received from the lease of such areas.

5. VAT RECOVERABLE ACCORDING TO NATIONAL COMPENSATION SCHEMES

Some Member States compensate public entities (for instance local authorities) for the VAT which they pay on their purchases. Where this is the case, VAT will be considered non-eligible given that the economic burden caused by the VAT will ultimately be neutralised for the beneficiary. Therefore the beneficiary could not claim the VAT recovery a second time. In principle, the Commission relies on the Member State's assessment as to the existence or not of compensation schemes outside VAT legislation that could cover VAT expenses in a given operation.

[9] See, in particular Judgement of the Court of Justice of 21 February 2006 in Case C-255/02 *Halifax;* judgement of the Court of Justice of 21 February 2008 in case C-425/06, 2e ch., *Part Service Srl;* judgement of the Court of Justice of 22 May 2008, in case 162/07, 3e ch., *Ampliscientica Srl.*

Finally, the Commission considers that the principle of prohibiting abusive practices, in reference to the above-mentioned case law[10], should be interpreted as applying also to the sphere of the compensation schemes outside VAT legislation.

6. CONCLUSION

The provision of Article 69(3)(c) CPR excludes all situations where a beneficiary may recover VAT by whatever means. On the contrary, whenever VAT constitutes a genuine and definitive burden for the beneficiary, it should be considered as unrecoverable.

The notion of recoverable VAT, which determines the eligibility of VAT for ESI Funds, is to be assessed beyond the simple application of tax law. As operations may present particularities, the final Commission position on recoverability of VAT will be established on a case-by-case basis. In its assessment, the Commission will take account of the revenue generating character of the operation and the possibility to recovering VAT, including through -compensation schemes at national, regional or local levels.

Institutional or contractual constructions, within or outside VAT legislation, set up with the exclusive purpose to render VAT expenses eligible to ESI Funds contribution may constitute abusive practise and thus may be prohibited according to settled case law.

Based on the above considerations, VAT will not be eligible because it is recoverable in the following situations:

- The beneficiary by virtue of its status as a taxable person, has the right to require a deduction or a refund for VAT paid by it in accordance with the applicable national VAT law.

- In the context of revenue generating operations, where the project design differentiates between the beneficiary, having the status of non-taxable person and the operator, having the status of taxable person, charging VAT on revenues stemming from the direct use of the project after completion.

- In the context of revenue generating projects, where within the same operation involving several activities the revenues generated from part of the activity operated are not subject to VAT while revenues related to another activity are subject to VAT, an approach may be considered whereby partial eligibility of VAT may be considered, i.e. the amount of VAT limited to the amount of the real economic burden of VAT paid by the beneficiary may be considered irrecoverable and therefore eligible.

- The project is implemented and operated by a beneficiary non-taxable person but a national, regional or local compensation scheme compensates for the VAT paid on implementation. In this regard, the Commission will in principle rely on information provided by Member States as to the existence or not of compensation schemes outside VAT legislation that could cover VAT expenses.

A schematic presentation of different scenarios, based on determining factors with conclusion on the eligibility of VAT is included in the Table.

[10] See footnote 10, *supra.*

Tax status of the beneficiary, legal entity responsible for the implementation (VAT) directive	Project operation (operator)	Compensation schemes outside VAT system	VAT irrecoverable, thus eligible to contribution from ESI Funds
Taxable person	Same as beneficiary: VAT on operation	Irrelevant	No
Non-taxable person	Same as beneficiary: no VAT on operation[11]	Yes	No
Non-taxable person	Same as beneficiary: no VAT on operation	No	Yes
Non-taxable person	Other public body (non-taxable): no VAT on operation	No	Yes
Non-taxable person	Other public or private body (taxable):VAT on operation (cf. Section 4.2)	No	No
Mixed taxable person	Mixed taxable person: taxed and non-taxed activities	No	Eligible VAT relates to the amount of the real economic burden of the beneficiary

Table 1. The different cases on assessment of recoverability of VAT for ESI Funds operations based on the applicable rules in 2014-2020 programming periods.

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[11] I.e. VAT cannot be recovered in the operational phase of the project when the latter is split between construction and utilisation phases.