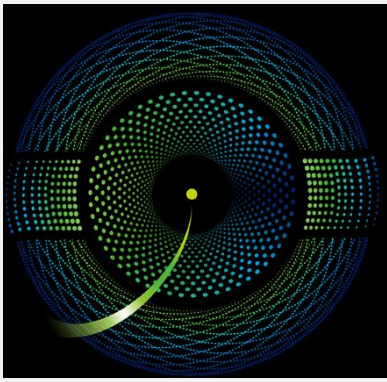

Indirect Tax I VAT

Alert December 2024

Weatherford Atlas GIP:

On 12 December 2024, the Court of Justice of the European Union (CJEU) ruled in case C-527/23 Weatherford Atlas GIP. It follows from this case that taxable persons should demonstrate the use – based on the benefit test concept known for direct taxation purposes - of purchases to be entitled to VAT deduction, even though tax authorities cannot deny VAT deduction based on the argument that the purchase is not necessary or appropriate. This case illustrates the correlation between Transfer Pricing ("TP") and VAT and underlines the principles of VAT deduction.

Introduction

Weatherford Atlas Gip ("Weatherford SA", established in Romania) received services from foreign group entities. It declared and reclaimed reverse charged VAT due on the services received. The Romanian Tax Authorities denied the deduction of input VAT, challenging the *need* to purchase the services and arguing that the services *benefited* multiple group companies and should be considered shareholder costs.

Shareholder costs is a TP concept. In just over a year time, four cases have been brough to the CJEU regarding the interaction between TP and VAT. We also refer to the "Background section" below.

Facts of the case

Weatherford SA is part of the Weatherford group, offering a range of services in the oil industry. These services are subject to VAT and as such the companies are in principle fully entitled to recover input VAT. After acquiring the shares in Foserca SA, the latter entity was merged into Weatherford SA. The business of Foserco SA is also fully subject to VAT. Considering the merger, Weatherford SA is the involved party and name of the case, though effectively it relates to the position of Foserco SA.

To facilitate its operations, Foserco SA relied on general administrative services from Weatherford Group companies, covering IT, human resources, marketing, financial and accounting optimization, finance, environmental protection and sales. These services were provided by EU group companies. As these companies were based outside Romania, no VAT was charged, though Foserco

SA self-assessed the VAT due based on the VAT reverse charge rule and reclaimed the reverse charged VAT as input VAT.

The Romanian tax authorities reviewed Foserco SA's income tax and VAT liabilities. This review resulted in a VAT assessment. The tax authorities took the view that the VAT relating to the intragroup services could not be deducted because no direct link between the services received and Foserco's taxable transactions was evidenced, and that those should have been considered shareholder costs, not to be charged to the subsidiaries. In particular the Romanian Tax Authorities challenged the need to purchase those services / how the services benefited Foserco SA and how they were used for its taxable activities.

The dispute of the case focuses on whether VAT deduction depends on evidencing the *benefit* and the *necessity* of the intragroup services received.

CJEU Judgment

The judgment of the CJEU at first sight looks positive for taxpayers. EU VAT law precludes denying VAT deduction, on the grounds that those services were simultaneously supplied to other companies and that their acquisition was not necessary or appropriate. It should be established that those services are used as output services by that taxable person for the purposes of its own taxable transactions. The considerations of the CJEU, however, provide further details when a VAT deduction limitation may apply.

Benefit / use test

The CJEU first refers to the principles of neutrality of the EU VAT system, on which basis taxable persons with VAT taxed activities are entitled to deduct VAT paid. This not only includes VAT on costs directly attributable to the activities, but also VAT on general costs being component of the price of the services rendered.

On the other hand, the CJEU emphasizes that no VAT deduction applies insofar the services are not used for the taxable person his own taxable activities, though for the activities of another person. The referring court should verify this, taking into account contracts and the economic and commercial reality. The CJEU explicitly states that for this assessment it is not relevant that the services are rendered to multiple group entities, provided that the share of costs received corresponds to the scope of services received. This need to test the share of costs appears an objective approach, whereas generally the remuneration for VAT purposes has a more subjective basis. The fact that multiple related parties are benefiting from the services appears to drive this approach. This is a recurrent topic analyzed from a TP perspective.

The taxable person needs to prove entitlement to (the level of) VAT deduction and the tax authorities may request documentation it considers relevant. Albeit this entitlement is linked to evidencing the use of the services received for the taxable person's own taxable activities, in the case no explicit reference is made to TP documentation. In our view, appropriate TP documentation (which elaborates on the relationship between the services received and the recipient's resources and business) may well support the VAT treatment in that the relation between the share of the cost (i.e. what cost basis should be allocable to the recipients, what should be retained by the head office as shareholder costs, what services can be directly charged to the recipient and what allocation keys are used for the indirect allocations to reflect the nature of the service and its need). The scope of the services received, as well as the benefit derived from receiving such services would typically be part of a comprehensive and appropriate TP documentation which should reflect the economic and commercial reality of the recipient as if it were a third independent party to the service provider that belongs to the same Group.

Necessity of services test

It is not required for the VAT deduction right that the services received are necessary for Foserco SA. Such requirement does not align with the principle of

neutrality and the fact that the VAT system does not depend on the purpose or the result of economic activities.

VAT treatment of intergroup charges

The CJEU explicitly states that the referring court should verify whether the services acquired by Foserco SA are subject to VAT. This requires a direct link between the services received and the remuneration paid. This is a relevant consideration in our view, as whether or not a taxable service is recognized for VAT purposes is a recurring challenge when qualifying TP corrections for VAT purposes. Unfortunately, the CJEU does not give additional guidance for the time being. At the same time, there seems to be a clear interaction between this principle (not subject to VAT if there is no link between the services and the remuneration paid) and the benefit / use test (no VAT recovery insofar the share of costs incurred does not correspond to the scope of services).

Background – interaction between VAT and TP

VAT is an indirect tax based on EU and local VAT legislations and the purpose is to tax economic activities (supplies of services or goods against remuneration). In principle the taxable amount is the amount agreed between parties (subjective remuneration). Only in specific cases Member States may implement an Open Market Value (objective remuneration).

TP is part the direct taxation system. It is based on OECD guidelines, tax treaties and local legislation. The purpose of TP is determining the arm's length pricing of transactions between associated entities (objective remuneration) depending on their functionality and their actual conduit.

With regard to the costs of shareholder activities, from a TP perspective these should be borne by the shareholder. Therefore they should not be re-charged to group entities. However, the mere fact that services are provided to multiple group companies does not result in these being considered of a shareholder nature, rather, the nature of the activities are considered. In the Weatherford case, the nature of the services provided appear to be in line with support inter-group services that are often re-charged from a TP perspective for avoiding duplicating resources in all the jurisdictions were multinationals have presence (business efficiency reasons).

The VAT treatment of TP corrections, and the resulting impact on the cost of services provided, has been a topic of concern for quite some time. There is little guidance in current EU VAT legislation, guidelines and case law. The VAT Committee (an official advisory body) has discussed the topic in 2017 / 2018. The key conclusion was that TP adjustments may be in scope of VAT, if the payment can be allocated to individual transactions and there is a direct link between the considerations and the transaction. In many cases this is not an easy test.

Regardless of the challenges, the number of VAT disputes resulting from TP corrections have been relatively low for quite some time. One of the reasons is the cross border nature of the corrections and the fact that for many companies cross border services do not impact the balance of the VAT return. This is, however, different for companies that are not fully entitled to VAT deduction (i.e., within the financial services industry). Moreover, some of the cases recently referred to the CJEU illustrate that there may be a material impact if tax authorities do recognize the services rendered though challenge the VAT recovery based on benefit tests.

Looking at the case at hand, groups should ensure that their TP Documentation is comprehensive, that it not only clearly describes the nature of intra group services and the policy applied to ultimately determine an arm's length

remuneration for such services, but also that it identifies the costs incurred in shareholder activities retained at the head office level - not being charged to other entities of the group - and links the benefit of receiving the intra group services with the resources of the recipients, to demonstrate that neither costs associated with shareholder activities nor costs associated with duplicated activities or non beneficial activities, are charged to group entities. Having such support can go a long way in defending future challenges on the VAT treatment in relation to these same services.

The following cases regarding the interaction between VAT and TP are still pending at the CJEU.

- Arcomet Towercranes - C-726/23; Transaction net Margin Method, Romanian Tax Authorities requesting evidence on the reality and scope of the services rendered, as well as the benefit of the recipient and capacity of the provider to render the services.
- Högkullen AB - C-808/23; Open Market Value within VAT as implemented in Sweden. The Swedish Tax Authorities seek to include shareholder costs in remuneration for services rendered to a subsidiary.
- Stellantis Portugal - C-603/24; Supplied products with defects, is the agreed price for repair a service from the buyer to the supplier or a price correction for the original supply.

These upcoming cases should provide further clarification on the VAT treatment of pricing corrections.

Conclusion / How we can help

This case and the upcoming cases may trigger focus from tax authorities around Europe on this topic. The ruling illustrates the relevance of appropriate TP documentation on intra group charges to limit challenges on VAT deduction.

If you have any questions concerning the items in this alert, please contact your usual tax consultants or the below Deloitte contacts.

Get in touch with our experts below or find more on our VAT services via deloitte.nl.

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