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Indirect Tax Alert

European Court of Justice issues landmark ruling on VAT treatment of staff secondment

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Executive summary

In Case C-94/19 (*Italian Tax Authorities v. San Domenico Vetraria S.p.a.*) issued on 11 March 2020, the European Court of Justice (ECJ) ruled that the lending or secondment of staff of a parent company to its subsidiary is relevant for VAT purposes, even if it is carried out with the recharge of the cost of the assigned employees.

The decision may have a significant impact on a broad range of businesses that have in place intercompany agreements for the supply of staff by way of secondment and it could renew interest in Italian VAT grouping in order to eliminate the friction of unrecoverable VAT on intercompany transactions.

Detailed discussion

The case

As a result of a partial VAT inspection in relation to fiscal year 2004, the Italian Tax Authorities (ITA) audited the VAT treatment of a transaction by which an Italian parent company (Parent Company) seconded one of its directors to its Italian subsidiary (Subsidiary) to act as a manager of one of the Subsidiary's establishments.

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The Subsidiary received from its Parent Company invoices corresponding to the costs of the seconded manager. In reimbursing those costs, the Subsidiary applied VAT for the purpose of subsequently exercising the right to deduct.

The ITA recovered the VAT deducted by the Subsidiary, arguing that the reimbursement of those costs fell outside the scope of VAT because it did not relate to a supply of services between the Parent Company and the Subsidiary.

The Subsidiary challenged the tax assessment notice, but was unsuccessful at the first instance and on the second degree proceeding and appealed to the Italian Court of Cassation that then applied for a request for a preliminary ruling to the ECJ.

National law and case laws

Article 8(35) of Law No 67 of 11 March 1988 states that: "The lending or secondment of staff in respect of whom only the related cost is reimbursed shall not be regarded as relevant for the purposes of value added tax."

The Italian Court of Cassation[1] clarified that the special provision contained in Article 8(35) of Law No. 67/88 does not concern "a question of the basis of assessment; it is a question of whether or not the transaction is relevant; if there is a relevant operation, then, in accordance with the rules, the (entire) amount paid by the person hosting the seconded employee will be taxable."

Where the sum to be reimbursed is equal to the expenditure borne in respect of the seconded staff, the secondment, not being "relevant for VAT purposes," will not be subject to VAT. Conversely, where the remuneration to be paid is greater than the cost of the workers, not only the excess but the entire amount is subject to VAT. Likewise where the remuneration is lower than the cost, VAT is applicable on the entire remuneration.

Outcome of second-degree tax litigation proceeding and appeal before the Italian Court of Cassation

Based on the above interpretation, the local second-degree tax court held that Article 8(35) of Law No. 67 of 11 March 1988 applied and, lacking any evidence that the employee sent on secondment had received any extra payment or had carried out any duties different from those which he had performed within the Parent Company, the payments had merely constituted non-taxable reimbursements.

The Subsidiary brought an appeal to the Italian Court of Cassation against the second-degree judgment, alleging infringement or incorrect application of Article 8(35) of Law No 67/88.

Request for preliminary ruling to European Court of Justice and judgment C-94/19

The Court of Cassation referred the case to the ECJ and asked whether the national law provision which excludes a service such as the secondment of staff from the scope of VAT, when only the cost of the workers is reimbursed, is compatible with EU law and does not result in unequal treatment between the "secondment of staff" and the making available of labor, which is treated as a taxable supply.

The ECJ stated that Article 2, point 1, of the Sixth Directive must be interpreted as precluding national legislation under which the lending or secondment of staff of a parent company to its subsidiary, carried out for only the reimbursement of the related costs, is irrelevant for the purposes of VAT, provided that the amounts paid by the subsidiary to the parent company, on the one hand, and that employee lending or secondment on the other, are interdependent.

According to the ECJ, previous case law provides that there is a direct link between two services when they are mutually dependent on each other,[2] by which one is made only on condition that the other is also made, and vice versa.

In this regard, the ECJ stated that a supply of services is effected "for consideration" within the meaning of Article 2, point 1, of the Sixth Directive, and hence is VAT taxable, only if there is a legal relationship between the provider of the service and the recipient, pursuant to which there is reciprocal performance and remuneration received by the provider of the service constituting the value actually given in return for the service supplied to the recipient, thus creating a direct link between the service supplied and the consideration received.[3]

According to the ECJ, in the case at hand it appears that:

- The secondment was carried out on the basis of a legal contractual relationship between the Parent Company and the Subsidiary.
- In the context of that legal relationship, there was a reciprocal performance; namely the secondment of a director from the Parent Company to the Subsidiary on the one hand, and the payment by the Subsidiary to the Parent Company of the amounts invoiced, on the other.

- The payment by the Subsidiary of the amount invoiced by its Parent Company was a condition for the latter to second the director.
- The fact that the amount of the consideration is equal to, greater or less than, the costs incurred for the seconded worker is irrelevant[4] as it does not affect the direct link between the services supplied and the consideration received.

Based on the above, according to the ECJ, in order to assess whether the transaction at stake is VAT relevant, it is essential to ascertain if the payment made by the Subsidiary of the amount invoiced by the Parent Company was a condition for the latter to second the director and if the Subsidiary paid those amounts only in return for the secondment.[5]

Should the referring court ascertain this condition, then it would have to be held that there is a direct link between the secondment and the reimbursement of the costs of the director. Consequently, the secondment should have been subject to VAT, irrespective of whether the payment from the Subsidiary is equal to, higher or lower than the cost of the director.

Impact on businesses

A number of businesses should now assess their intercompany agreements on the supply of staff by way of secondment, as well as consider the opportunity to implement an Italian VAT group as a possible solution to avoid the application of VAT on the reimbursement of seconded workers' cost.

Furthermore, clarifications are expected by the Italian Legislature as well as by the Italian Tax Authorities as the ECJ decision will be implemented.

Endnotes

1. See judgments No. 23021/2011, 13118/2012, 14053/2012 and 4044/2015.
2. See judgments of 3 March 1994, *Tolsma*, C-16/93, paragraphs 13 to 20, and of 16 October 1997, *Fillibeck*, C-258/95, 23 November 1988, *Naturally Yours Cosmetics*, 230/87, paragraph 14, and of 2 June 1994, *Empire Stores*, C-33/93, paragraph 16.
3. See judgments of 22 June 2016, *Český rozhlas*, C-11/15, EU:C:2016:470, paragraphs 21 and 22 and the case-law cited; of 22 November 2018, *MEO – Serviços de Comunicações e Multimédia*, C-295/17, paragraph 39; and of 3 July 2019, *UniCredit Leasing*, C-242/18, paragraph 69.
4. See judgments of 20 January 2005, *Hotel Scandic Gåsabäck*, C-412/03, paragraph 22, and of 2 June 2016, *Lajvér*, C-263/15, paragraph 45.
5. See judgment of 11 March 2020, *San Domenico Vetraria SpA*, C-94/19, paragraph 27.

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