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GUIDANCE NOTE

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

CONDITIONS FOR ELIGIBILITY OF VAT UNDER ESI FUNDS 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 has been an issue of disagreement between the Commission and the Member States since the 2000-2006 programming period. The difficulties in interpretation of VAT provisions in rules applicable to the Structural Funds and the Cohesion Fund relate to the notion of recoverability, as referred to in Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 ('the CPR'). On the one hand, Member States have considered that eligibility of VAT is to be assessed in accordance with the right for the beneficiary to deduct VAT paid on goods and services purchased, based on its tax status. On the other hand, the Commission has constantly held that the recoverability of VAT is to be assessed based on the rules specific to the Structural Funds and the Cohesion Fund, including the tax status of the beneficiary. Member States had challenged this Commission's position. In 2012 the General Court ('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 ESI Funds 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) 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 is always 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).

[1] Judgement of the GC in case T-89/10 *Hungary v Commission* and judgement of the GC in case T-407/10 *Hungary v Commission*, both rendered on 12 September 2012.

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 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.

In Article 69(3) CPR, the legislator has explicitly excluded from ESI Funds[2] contribution certain costs. In particular, Article 69(3)(c) CPR sets out that VAT shall not be eligible '*except where it is non-recoverable under national VAT legislation*'. This provision should be read as limiting the ESI Funds contribution to situations where the VAT could not be recovered by whatever means and entails a genuine and definitive burden for the beneficiary[3]. VAT, which is abstractly recoverable, by whatever means, is considered as ineligible expenditure for the beneficiary, even if, de facto, the beneficiary does not itself recover the VAT.

Pursuant to the last amendment, introduced by Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012[4] (the Omnibus Regulation), 'beneficiary' is defined as a public or private body or a natural person, responsible for initiating or both initiating and implementing operations. In the context of State aid, the beneficiary is the body receiving the aid, except where the aid per undertaking is less than EUR 200 000, in which case the Member State concerned may decide that the beneficiary is the body granting the aid[5]. Where Member States make use of that option, the assessment of the VAT recoverability will need to extend to the body receiving the aid.

The provisions of Article 69(3)(c) cannot be interpreted as preventing Member States from establishing stricter national rules on VAT eligibility, which means that Member States may exclude eligibility of VAT.

The term of 'recoverability' of VAT has been interpreted by the General Court as the possibility to recover, in general. In line with the case-law[6], 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 VAT for a given operation and even though this right has not been exercised, the VAT will 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 VAT could be recovered. Certain situations may result for the beneficiary in unjustified double financial benefit.

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

3 See recitals 47-49 of the judgement of the GC in case T-89/10 and recitals 43-45 of the judgement of the GC in case T-407/10 referring to Article 11, paragraph 1 of Regulation 16/2003 of 6 January 2003 laying down special detailed rules for implementing Council Regulation (EC) No 1164/94 as regards eligibility of expenditure in the context of measures part-financed by the Cohesion Fund (OJ L 2, 7.1.2003, p. 7), repealed since.

4 JO L 193, 30.7.2018.

5 See Article 2(10)(a) CPR as last amended by the Omnibus Regulation.

6 See recital 51 of the judgement of the GC in case T-407/10.

In this context, 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. On the contrary, the tax status of the beneficiary has a direct effect on the VAT expenses incurred in an ESI Funds co-financed operations. If the beneficiary is a taxable person with regard to a given operation, VAT paid on that operation is ineligible as it is deductible, in the sense of the EU tax legislation. Changes in the national legal framework and the VAT status of a beneficiary during the implementation of an operation might however affect the eligibility of VAT, as it is at the moment of assessment of eligibility of VAT expenditure that the VAT status of the beneficiary and the possibility or VAT recovery will be assessed.

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[7], (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 ultimately established if VAT paid by a beneficiary on an operation is genuinely and definitively borne by that beneficiary. Indeed, there may be situations where the economic burden of VAT paid is nevertheless neutralised (through compensation schemes outside the VAT system). This is typically the case, where the beneficiary transfers the VAT burden to another entity, having the right to deduct/refund it and thus neutralise its economic burden (e.g. revenue generating operations where the operational phase of the project is subject to VAT). In such case, the VAT should be considered as recoverable and therefore not eligible.

4. RECOVERABILITY OF VAT IN OPERATIONS GENERATING REVENUE

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.

[7] OJ L 347, 11.12.2006, p. 36.

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[8], even where they collect dues, fees, contributions or payments in connection with these activities or transactions. This principle does not apply when these authorities engage in activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.

In cases, where a public entity is a 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 and it cannot represent an economic burden for the public entity. Therefore, the VAT paid would not be eligible for reimbursement.

If a public entity and, *a fortiori* - 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 ESI Funds.

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 non-recoverable 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*

[8] 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.

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[9], 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[10], this would not be taken into account.

In principle, VAT expenditure incurred in an operation that falls under one of the categories listed in paragraphs (7) and (8) of Article 61 CPR[11] have no impact on the VAT eligibility. The purpose of these provisions is solely to exempt the eligible expenditure of the listed operations from the deduction of net revenue. These provisions do not provide for any specific rules as regards the eligibility of the related VAT expenses. In the light of the specific structure of the operation, as long as the VAT is recoverable or the economic burden of the VAT is neutralised by other means, the VAT would be considered as ineligible[12].

In cases where the beneficiary is a non-taxable person, two scenarios 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 non-recoverable. 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. This is the reason why, in accordance with the case-law, for the purposes of assessing VAT eligibility in the revenue generating projects, the implementation and utilisation phases constitute 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

9 See footnote 1.
10 E.g. revenue generated by transport (or other) services provided on the co-financed infrastructure.
11 As last amended by the Omnibus Regulation.
12 E.g. VAT paid, compensated by State aid is considered as recoverable and therefore ineligible.

such cases the non-recoverability of VAT for the body implementing the project will not be 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 the revenues stemming from the direct use of the project, 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, which is a non-taxable person and an operator, which is a taxable person.

Finally, the Commission recalls that, according to a settled case law[13], 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, a particular case materialises where VAT may be considered as non-recoverable and therefore eligible for contribution from the ESI Funds: the case of partial VAT eligibility based on the mixed status of the beneficiary.

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 non-recoverable 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. This differentiated approach implies that the recoverability of the VAT is assessed separately, per activity, in accordance with the general principles laid down in this Guidance note.

5. VAT RECOVERABLE ACCORDING TO NATIONAL COMPENSATION SCHEMES[14]

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 be ultimately 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.

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13 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.*

14 The compensation schemes are not to be confused with the compensations for public services obligations.

Finally, the Commission considers that the principle of prohibiting abusive practices, in reference to the above-mentioned case law[15], should be interpreted as applying also to the sphere of the compensation schemes outside VAT legislation.

6. CONCLUSION

Article 69(3)(c) CPR establishes a general rule that VAT is ineligible to ESIF contribution. As an exception, this principle does not apply to situations where VAT cannot be recovered by whatever means and entails a genuine and definitive burden for the beneficiary.

The notion of recoverable VAT, which determines the eligibility of VAT for ESI Funds, cannot be interpreted simply in the light of the tax law. As operations may present particularities, the final Commission position on the eligibility 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, involving several activities, but only with regard to the activity, which in operation generates revenues that are subject to VAT. 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 Annex.

[15] See footnote 14, *supra.*

ANNEX

Steps for assessing the VAT eligibility under Article 69(3)(c) CPR