

Is payment for early termination of contract subject to VAT? (2) (2/40/20)

This article completes what we wrote [last week](#).

The basis for the CJEU ruling

- The main condition that serves as a basis for the CJEU's assessment in each case is that VAT is chargeable only on a supply of goods and services the taxable person carries out for a consideration. A payment of money per se does not automatically create an obligation to pay VAT. If a transaction is to be taxable, there must be a legal relationship between the service provider and the customer that involves their reciprocal performance, and the fee received by the service provider must be the actual consideration for the service supplied individually to the customer. How the consideration is determined does not matter in the CJEU's eyes.
- The CJEU refers to its earlier rulings C-250/14 and C-289/14 of 23 December 2015 (Air France-KLM and Hop!Brit-Air). Those rulings state that once a passenger pays the ticket price and the airline confirms that a seat is booked for the passenger, the sale is complete and final. Accordingly, the price paid for the purchase of plane tickets on signing the service contract represents a consideration for the customer's right to receive the performance of obligations arising from the contract whether or not the customer exercises this right. The service provider has supplied the service as soon as the customer is given an opportunity to use the service, and it does not matter whether the customer has taken this opportunity or not.
- In the MEO case, the CJEU stated that the fee a customer has to pay for the early termination of a fixed-term contract allows MEO to gain the same income as if the customer had not terminated the contract, and both the service to be supplied and the fee payable during the fixed-term contract are already agreed when the contract is entered into, and this fee is payable regardless of how long the service is in fact used. On this basis, the CJEU finds that the fee a customer has to pay for early termination forms an integral part of the total service fee split into monthly payments. Like the Air France-KLM and Hop!Brit-Air case, the CJEU finds that MEO gives the customer the right to use the service and MEO performs its obligations and has supplied the service even if the customer does not wish to exercise this right or fails to do so through their fault. The fee payable on early termination is a fee for MEO's service whether or not the customer exercises the right to receive the service up to the end of the contract period.
- In the Vodafone case, although the fees received after the early termination of a fixed-term contract did not match the full value the service provider would have received over the remaining portion of the contract had it not been terminated, the CJEU finds that Vodafone's service, too, consists in enabling the customer to receive the service. Vodafone undertakes to supply services to customers according to their contracts and conditions, while the customers undertake to pay monthly fees stipulated in their contracts and to pay an agreed fee if the contracts are terminated for reasons within the customer's control. Accordingly, in the Vodafone case, the CJEU also found that the fee a customer has to pay on early termination is part of the monthly service fee. Paying compensation in this case has the same purpose as the monthly payment the customer would have made if they had not terminated their contract, considering that fixed-term contracts offered a discount compared to indefinite contracts. If customers default on their fixed-term contracts, the service is treated as supplied because the customers were given the opportunity to use the service. Accordingly, in the Vodafone case, the fee a customer has to pay for early termination through their fault was also

viewed by the CJEU as part of the consideration for the service, which is subject to VAT.

Conclusion

Fixed-term service contracts need careful evaluation because it is highly likely that within the meaning of the VAT Act, fees received by the service provider where a customer terminates a fixed-term contract for reasons within their control should in future be treated as a consideration for supplying services. This means that these fees are subject to VAT (depending on the contract conditions, VAT is either chargeable on top or treated as included in the fee). And a fee payable for terminating a fixed-term contract is treated as a consideration for the supply of services regardless of whether the fee matches the consideration that would be payable for supplying services during the remainder of the contract, or whether this fee is determined otherwise.

Although the CJEU has not dealt with this issue, the fee payable on the early termination of a fixed-term contract is likely to be treated as a consideration for services even where the contract does not stipulate the right to terminate it early but the parties have reached a separate agreement on this.

We are looking forward to some guidance from the State Revenue Service on this issue in order to explain the VAT treatment to taxable persons.