Employee incentive programmes: tax aspects 1/50/22

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There are various programmes out there aimed at increasing a company's sales by raising the productivity of its employees joining the programme, by increasing customer loyalty etc. Cross-border programmes are also implemented in Latvia, and their tax issues are very topical as well as complicated. This article explores employee incentive programmes in the light of a recent VAT ruling from the Court of Justice of the European Union (CJEU).

The essence of the case

The case heard by the CJEU (ruling C-607/20 of 17 November 2022) has the following facts and circumstances:

- GEAES is a UK-registered company within the General Electric group (the "GE group"). The case relates to the period when the UK was an EU member state.
- The GE group had launched a staff recognition programme. This provided for awarding cash bonuses, gift vouchers or recognition certificates depending on performance. Staff nominations for prizes had a set of criteria but the score was based on recommendations from colleagues only.
- A voucher given as a prize enabled employees to select a retailer through a certain website and exchange their voucher for goods.
- The website was maintained by a company that initially purchased vouchers from retailers then sold those to General Electric (US), which sold them through another US company on to all group companies, including GEAES.
- GEAES paid reverse-charge VAT on the vouchers and deducted input tax. When the vouchers were given to the employees free of charge, VAT was not applied. GEAES believed that the voucher awards to employees are primarily related to the company's business and that the employee benefit is only secondary. This approach was based on an analogy with the CJEU's assessment in earlier cases dealing with transport or meals provided to employees in certain circumstances.
- The tax authority charged VAT on GEAES's voucher awards to employees as so-called "personal consumption".

The Advocate General has stated that it is possible in the actual circumstances that GEAES was not liable to charge VAT on the purchase of vouchers at all because the retailer also charged VAT when exchanging goods for the voucher. The CJEU has made some useful comments on the content of the personal consumption rule.

The personal consumption rule found in article 26 of the VAT directive (the first and the second part) provides that a supply of services for consideration includes the case where a taxable person uses for his own or his employees' private needs some goods forming part of his business assets or – in a broader sense – for purposes other than his business needs if VAT on those goods was fully or partially deductible.

In the VAT Act, this rule matches section 6(1) while the personal consumption rule in its second subsection applies to services.

So the CJEU assessed the phrase “goods being used for the taxable person’s own or his employees’ private needs or – in a broader sense – for purposes other than the taxable person’s business needs”.

The CJEU noted the purpose of this rule: to ensure equal treatment between a taxable person who uses goods or services for his own or his employees’ private needs, on the one hand, and a final consumer who acquires goods or services of the same type, on the other. If a taxable person who has deducted VAT on the purchase of goods uses his company’s goods without charging VAT for his own or his employees’ private needs, he is in a privileged position compared to an ordinary consumer who always has to pay VAT on goods.

So, if a company’s assets are used free of charge or gifted, the taxable person is automatically treated as a final consumer and he is liable to charge VAT. Yet this rule provides that a supply of services free of charge may still be treated as one that was not made for private needs if it was made for the taxable person’s business needs.

The CJEU stated that it is important to assess the substance and purpose of this programme. In this case the purpose was to improve staff performance and thus increase the company’s profitability. Having assessed the usability of goods received in exchange for the voucher, the CJEU finds they satisfy the employee’s private needs. Yet GEAES does not decide about awarding vouchers, and it does not know and is unable to influence what goods the employee will acquire. Also, the employees have no certainty or reliable criteria they could strive to achieve for a prize.

So, even though the CJEU asked the national court to clarify the situation, the CJEU stated that giving a free voucher to an employee primarily benefits the company through the prospect of increasing sales thanks to higher staff motivation. The employee’s private benefit is only secondary. Accordingly, such activity falls outside the scope of article 26(1)(b) of the VAT directive, i.e. GEAES was not liable to charge VAT on the free vouchers.

We find this CJEU ruling to be very interesting. There is no knowing how the national court will assess and decide this case. And there is no telling whether the ruling would have been different had the retailer not charged VAT on the goods exchanged for the voucher.

It’s even more difficult to predict how this situation will be assessed in Latvia. We believe that in order to exempt gifts given under such a programme, firstly, there must be evidence that there is a link between the gift to the employee and the taxable person’s business, and secondly, it must be possible to verify that the gift has indeed made an impact on the taxable person’s business. Gifts that incentivise staff, just like free meals or transport to work and back, are primarily given as a private benefit unless it can be established that the supply of services employees free of charge is necessary because of some special circumstances.