

When gift is no gift 2/42/23



Manager, Tax, PwC Latvia
Matiss Auzins

It's usual for sellers (and service providers) to make offers such as "buy a product, get another one for free" or "each buyer gets a gift". For VAT purposes, sellers are not usually concerned about the concept of a gift as long as it's up to EUR 15, but they do become more careful if gifts exceed this threshold. The restriction on low-value gifts in the Latvian VAT Act is per individual and per year, placing a certain burden on the taxable person to identify the recipient and keep such a record. However, the Act's definition of a low-value gift contains a disclaimer that this does not apply to goods or services made available free of charge if their costs qualify as advertising or "representation" expenses. The State Revenue Service does not tend to evaluate the seller's advertising slogans literally but will assess a supply according to its economic substance. This article explores the latest ruling from the Court of Justice of the European Union (CJEU) on how to assess gifts for VAT purposes.

In its ruling C-505/22 of 5 October 2023, which examines the VAT treatment of a gift, the CJEU has primarily relied on the concept of a single supply.

A Portuguese-registered publisher of magazines that supplies them only to subscribers launched an advertising campaign to attract customers. The campaign stated that all new subscribers would receive a free tablet or smartphone worth less than EUR 50. The gift was mailed to subscribers together with the magazine after they had paid a monthly subscription, which was the same as later monthly payments. There was no minimum subscription period and the subscriber would keep the gift even if they cancelled their subscription. The magazines were invoiced with a reduced rate of VAT (Latvia has a reduced 5% rate on magazines) and the invoices made no reference to gifts.

Portuguese rules on the VAT treatment of gifts stated that VAT is chargeable on a free transfer of goods to employees or for non-business purposes in general if input tax has been deducted on those goods. An exception covers samples and low-value gifts worth up to EUR 50 per unit if their total value for the year does not exceed five thousandths of the previous year's revenue.

On a tax inspection, the Portuguese tax authority found that the threshold had been exceeded and charged VAT on the supplies of gifts at the standard rate. The tax authority rejected the company's claim that the transfer of gifts to new subscribers is a commercial offer, not an actual gift.

The dispute landed in the CJEU, whose task was to assess whether the gift given for a magazine subscription is part of the supply (subscription) or represents a supply distinct from the subscription supply and should be treated as a free transfer of goods under Article 16 of the VAT directive¹ (in the Latvian VAT Act these are clauses dealing with deemed taxable supplies for a consideration²).

In hearing the case, the CJEU pointed out the following principles:

- For VAT purposes, each supply usually qualifies as distinct and independent, but if one supply has two or more elements, the question is whether it qualifies as a single complex supply.
- An economic supply consisting of a single complex supply should not be divided artificially.
- A single complex supply exists if two or more elements or activities which the taxable person carries out for the customer are so closely linked that they objectively represent an indivisible

economic supply.

- Elements that are characteristic of the supply should be identified from the average consumer's standpoint.
- A single economic supply represents a single complex supply for VAT purposes if one or more elements make up the main service while one or more other elements qualify as ancillary services taxable in the same way as the main service.
- A service qualifies as ancillary if it's not the customer's goal in itself but rather the easiest way to receive the provider's main service.
- We need to consider the value of each economic transaction that goes into the service. The value of an ancillary service will usually be minimal.

The company had stated that giving a gift is part of its commercial strategy and that readers subscribe more actively if a subscription gift is added. So there is a clear link between the gift and the subscription.

The CJEU finds that the services are not inseparable because a gift is offered to new subscribers only, and there have been promotions with no gifts, yet the circumstances of the case indicate that an ancillary service (product) has been added to the main service. Giving gifts to new subscribers is an incentive to subscribe. This has no other purpose than to increase the number of subscribers and maximise profit. Giving a gift has been factored into the company's commercial calculations and allows it to substantially increase the number of subscribers each year. This means the gift is not the ultimate goal from the standpoint of an average consumer who agrees to pay the subscription for at least one month to receive the gift. In its analysis, the CJEU also considered the company's claim that the gift allows new subscribers to receive the publisher's services in optimal conditions, i.e. to read the digital version of magazines.

The CJEU finds that the magazine subscription represents the main service, while the tablet or smartphone worth less than EUR 50 given to new subscribers is an ancillary service, and both services together represent a single complex supply. Accordingly, the rules on the VAT treatment of free product transfers do not apply in this situation.

¹ If a taxable person uses for his own or his employees' private needs any goods that are part of his business assets, or supplies such goods free of charge or, in a broader sense, uses them for any purpose other than its business needs, then such use is treated as a supply for a consideration if the input VAT on the goods or their components was fully or partly deductible. However, if goods intended for business needs are used as samples or low-value gifts, this is not treated as a supply for a consideration.

² Section 6(1-2) of the VAT Act