The Impact of Discount and Rebate on VAT in EU

Name: Tianhua Yang
ANR: S813978
1st supervisor: Prof. Simon Cornielje
2nd supervisor: Gert Jan van Norden
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Chapter 1 Introduction

1.1. Motivation

After nearly ten years working as VAT specialist in different business sectors, I have experienced that many multinational companies in different industries consider VAT as important decision making element in setting up of group structures and business operation models. However, when legislators have designed VAT system, their initial aim was that VAT should be neutral and shall not influence the decision-making process of business. One of the areas which has influence is on the consequence of price reduction and its impact on VAT, especially pharmaceutical industries pertain a high discount in direct and indirect supply chain. One may wonder is there a real burden for business? or the burden is just a total separate supply chain and not burden at all?

EU VAT system is non-cascading transaction tax at all stages of supply chain, which is characterized as General tax on consumption of private consumers.\(^1\) The Neutrality principle in context of indirect taxation is that VAT should be borne by the final consumer, the tax payers in each stage and as part of the VAT supply chain should not bear VAT burden. From global GST and VAT systems, OECD has set in the VAT guidelines with the aim of elimination of VAT burden for tax payers and VAT rules should not be the primary influence on business decisions.

In my thesis, I would like to study the principles of neutrality, proportionality and equality to go through selective court cases on VAT rebate and discount, review legislations background and its essence in VAT within EU and examine by these principles in the selective court cases. What current EU VAT directive has proposed and do they solve the problem, if not why and what are the dilemma and recommendations.

1.2 Research question

In order to explain whether there are burden from VAT perspective levied to tax payers, I would like to start with the research question of my thesis:

What are influence of the principles of neutrality, proportionality and equality on discount and rebate in supply chain from VAT perspective?

In order to answer the research question, I would like to drill down the research question into sub

\(^1\) Value Added Tax in Cross Border Situation, Prof. Gert Jan van Norden, Prof. van Kersteren
research questions:

1. What are the characteristics of principle of VAT neutrality, proportionality and equality?
2. According to these principles, what outcomes are supposed to be for VAT on discount and rebate?
3. What are the problems with VAT on discount and rebate in practice?
4. What measures at EU level have been taken and do they solve the problems with VAT on rebate?

To answer these questions, I would like to analyze what are principle of neutrality, proportionality and equality in context of EU VAT law. Subsequently if we take these principles as benchmark, what are the outcomes of court cases supposed to be. If the results are not in line with practice, what are the consequences for tax payers? what EU council and commission have done to solve the problems? Will these measures solve the problems? Then finally I give my recommendation and conclusion.

1.3 Delimitation

In this paper, I will limit my scope only within the art 2, 30a, 73a and 79 of EU VAT directive. I will not examine other articles expressed in the VAT directive. Within the council directive on Voucher I would focus on multi-purpose voucher as well and not further discuss on single purpose voucher. The other principles embedded in EU law related to VAT are delimited in this paper due to the scope of research on area of discount and rebate.

1.4 Benchmark

Principle of neutrality will be my focus on as benchmark due to it is closely related to the research topic, principle of proportionality and equality are rather less weighted analyzed. These three principles are the benchmark in my paper to measure the outcome of court cases.

EC court cases as comparable parameters, selective Dutch and German domestic court cases are discussed because the rebate topic are closely related.
1.5 Outline of the paper

I will start first in Chapter 2 with the history and background of VAT law and the position of neutrality in the EU VAT law. Afterwards I will explain and outline what types of price reductions exist currently, what are the consequence due to the different types of reduction on VAT perspective. In Chapter 3 I will start to discuss on benchmark at OECD and EU level. What principles are both laid down and embedded in EU different layers of laws? What principles related to VAT are especially important? and what roles do they play? Focus on neutrality principle and less weight on principle of proportionality and equality. In chapter 4 I will start to examine selective court cases on rebate and discount, compare my benchmarks for what the outcomes should be with the decision of court on each case. In Chapter 5 I would like to give short review on what measures at EU level have taken and does new measure solve the problems on discount or rebate in VAT. In Chapter 6 I will finally give my recommendation and view the problem and dilemma. In the end Chapter 7 I will draw conclusion on this paper.

By analyzing the characteristics of principles of neutrality, proportionality and equality from legal and economic perspectives, from internal and external dimension, from the EU integration context to the long historic obstacles in harmonization, to the modern complex business operation models, there is not an easy solution but I hope to give a contribution to the VAT discount and rebate area through this thesis.
Chapter 2. VAT background and Price reduction

2.1. History and background

Hardly imagine almost 100 years ago the idea of VAT was already proposed by German industrialist in the period of the first world war. The idea has been further developed and introduced by French tax authorities soon after the liberation of second world war. Perhaps that is one of the reason as the originator of the system, France has one of most complicated VAT rules within EU. However, one thing is for sure, at the time of European Economic Community only consists of six member states, the first Council directives introduced VAT system and replace national turnover taxes, the preamble was already set: VAT should be levied at each stage of supply chain no matter the length of the chain, final consumer should bear the VAT burden, business in the middle of chain should not carry the VAT burden.

Today European Union has 27 Member States with 500 million citizens, we are confronted with VAT every day. EU legislators shoulder a tough job on legislate VAT directive which should be clear, effective, stimulate economy and keeping up with the development of the changing economies.

The world’s economy in 1950 the computer was not even there in the market when the then EC had already the preamble to achieve a common market and neutrality for VAT. VAT system with its success soon rolled over and implemented by today more than 160 countries in the world including all OECD countries.

VAT has become an increasingly important element in the EU’s tax and economic system, as it contributes to a non-distortive trade policy and respects the fundamental freedoms of the EU: the free movement of goods, capital, and persons. It is one of the most important revenue for member state’s governments.

During the 2008 financial crisis, most of EU member states shifted from direct taxation to indirect taxation to increase government budgets.²

The OECD’s study on tax and economic growth also shows that among many common trends within taxation systems, many countries rather choose to cut down PIT and CIT rates to insure enterprise and foreign investments to stay in their countries, and increase VAT rates to collect budget because nationals are not easy to relocate as business.

² PwC shifting the balance 2014 https://www.pwc.com/gx/en/tax/assets/pwc-shifting-the-balance-v2.pdf
Although the harmonization of VAT within EU is largely achieved except some room left for countries to choose their own options in the domestic laws, however the VAT directive must keep up with the development of the rapidly changed economy. A supply chain is not as simple as decades ago; a business model is much more complicated with its grow.

2.2 Price reduction

Despite the fact of businesses develop its growing complex models, we could nevertheless classify price reduction into three categories simply by the time of discount:

1) Price reduction before supply- prompt payment
2) Price reduction at time of supply -discount
3) Price reduction after supply-rebate

What are the differences in VAT treatment among these three different categories? One would think if from neutrality point of view, it is just a question of before, at the time or after, therefore lead to the same VAT treatment for tax payers.

Let’s look at the 2006/112 EC EU VAT Directive, in art.79 regarding the taxable amount is laid down as such:

*The taxable shall not include: (a) price reductions by way of discount for early payment; (b) price discounts and rebates granted to the customer and obtained by him at the time of the supply; and (c) amounts received by a taxable person from the customer, as repayment of expenditure incurred in the name and on behalf of the customer, and entered a suspense account. Discounts will be offered at the time of the purchase, whereas rebates are reductions in price which are provided after the full payment has been made for the good or service purchased.*

2.2.1 Price reduction before supply

Price reduction before supply is usually called early payment or prompt payment. I think prepayment is part of supply which subsequently at the time of delivery marking the completeness of the whole deal, which obviously is kind of deposit and promises that customer would like to complete the contract as they have signed and closed. If VAT is due on prepaid part, then the remaining part taxable amount shall in proportion charged with VAT. Deposits encourage the parties

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3 EU VAT directive
to perform the contract. If a payment is made before the actual right is transferred/before it can be exercised, the payment qualifies as a VAT prepayment if all relevant information for VAT to become chargeable is known at the time of the payment.\textsuperscript{4} I will not further elaborate the VAT consequences in different situations in this category as obviously today there are a lot of discussion on this area, but I would rather concentrate on rebate and discount in my thesis.

### 2.2.2 Price reduction at time of supply

Strangely enough, when business grant discount to customer at the moment of supply and issuing of invoices, no one argue the taxable amount shall be reduced proportionally. No any dispute, no court cases but everyone thinks it is obvious that there is direct link between the supply and the discount granted, because the price reduction is granted immediately and simultaneously written on the invoices.

### 2.2.3 Price reduction after supply

Unfortunately, when the timeline stretches a bit longer, rebate is granted after selling of goods or services, business operate in a rather complex model, VAT treatment for the reduced price becomes less clear again.

In a lengthy supply chain from manufacturer to distributor, from wholesaler to retailer, perhaps more intermediaries in between and finally to consumer, if original supplier from the very beginning of the chain provide rebate to the very end consumer. Legislators, courts and business operators are getting into heavy discussion on whether the VAT are directly linked to the supply or disassociated from the supply chain, therefore VAT burden or extra VAT are levied for tax payers.

Rebate granted can be directly in the way of voucher or distribution chain in the way of monetary discount via cash or invoicing.

From the supplier’s remuneration point of view, voucher can be classified into three categories in terms of rebates:

(A) Scenarios where a business issues vouchers for remuneration or consideration

Single-Purpose Vouchers and Multi-Purpose Vouchers (to be discussed in chapter 6)

(B) Scenarios where a business issues vouchers for discount without remuneration

(C) Scenarios where a business A agrees with different businesses B on allowing holder of voucher discount by selling vouchers but without receiving any remuneration.

Form the supplier’s supply of goods or services point of view, voucher can also be classified with two categories:

1) Voucher as a prepayment for a future Supply

For such type of voucher, VAT becomes chargeable when payment is received. Such as Museum yearly card or train yearly discount card, they do not qualify as an instrument accepted as consideration for a supply of services by the entrance to the museum or the train but rather as a subscription or a right to unlimited admissions, rather by the decrease of the period during which the voucher is still valid.\(^5\)

2) Voucher of payment for the right to a supply

For this type of voucher, VAT is not chargeable when payment is received. Such voucher is a lump sum payment for the future supply of goods or services\(^6\). It cannot be considered as a VAT prepayment nor the transfer of a right. This means that the supply of a voucher can be the supply of a right to a supply, which is not subject to VAT.

Not intend to go in deep on the voucher classification and each category, but highlight here and I will focus on multi-purpose vouchers, rebate in distribution chain in my next chapters.

Indirect discount

The problem where legislator, tax authorities and tax payer having different view on is probably more due to the discount is direct or indirect discount. Indirect discount is a discount to a party which is not directly the recipient of the original supply of goods, it will still reduce the taxable amount.

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\(^5\) Jan Sanders The VAT Impact of Discounts to Parties outside the Traditional Distribution Chain

\(^6\) See the CJEU’s ruling in Case C-419/02, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs & Excise [2006] ECR I-1688.
Chapter 3 Benchmarks

Having briefly highlighted the types of price reduction and types of vouchers and their unequal treatment in the distribution chain. I would like to introduce in this chapter the benchmarks. Why do I think it is unequal treatment, what are the benchmarks I am measuring for extra burdens for taxpayers?

Obviously one can take different benchmarks in VAT or GST systems, I would like to highlight the OECD guidelines first and then focus on principles embedded in EU VAT system.

3.1 OECD Guidelines

OECD International Guidelines have laid down several principles in VAT/GST field. Most important ones are Neutrality and Destination principles. Within Neutrality principles the guidelines address three dimensions and five categories: basic neutrality principles, neutrality principles in international trade, administration and compliance.

Under the OECD International VAT/GST Guidelines on Neutrality, various dimensions of the principle include “the absence of discrimination in a tax environment that is unbiased and impartial and the elimination of undue tax burdens and disproportionate or inappropriate compliance costs for businesses. Neutrality is one of the principles that helps to ensure the collection of the right amount of revenue by governments”.\(^7\) There are five guidelines set out in the document:

> First, the burden of value added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation; \(^8\)

> Secondly, businesses in similar situations carrying out similar transactions should be subject to similar levels of taxation; \(^9\)

> Thirdly, VAT rules should be framed in such a way that they are not the primary influence on business decisions; \(^10\)

> With respect to the level of taxation, foreign businesses should not be disadvantaged nor advantaged compared to domestic businesses in the jurisdiction where the tax may be due


\(^8\) Same as above, OECD guideline 2.1

\(^9\) Same as above, OECD guideline 2.2

\(^10\) Same as above, OECD guideline 2.3
or paid and furthermore, to ensure foreign businesses do not incur irrecoverable VAT, governments may choose from many approaches; 11

> Finally, where specific administrative requirements for foreign businesses are deemed necessary, they should not create a disproportionate or inappropriate compliance burden for the businesses. 12

The OECD guidelines have given quite clear guidance for member countries legislators, governments when setting up their VAT/GST rules, it is important to take into consideration that tax payers flow through the supply chain should not bear VAT burden and only final consumer bear the VAT burden. When it is necessary, specific sectors or certain nature of goods or services tax payers can bear the VAT burden but it should be specifically set out in domestic laws or provisions (which is not the scope of my thesis). In cross border situation, destination principle ensures that goods and services are taxed in the country where it is consumed, which is also in line with the objective of final consumer bearing VAT burden. From administration point of view, legislator should not go beyond its necessary to achieve its objective, reducing compliance burden and costs for tax payers, as after all tax payers flowing through the chain should not bear administration burden neither.

I am not intending to going further discussion and comment on the guideline itself, but trying to draw a framework of the benchmark for following chapter of court cases I am going to discuss. In each of court cases in Chapter 5, I would measure the outcome which are supposed to be per each principle. As we can see OECD and EU have similar principles and similar goals in order to achieve minimum burden for tax payers in VAT/GST area.

3.2 EU law

OECD guidelines are set out by OECD organization who does not have superior national power, as international tax law does not and having difficulty in giving direct sanction on member states. It is less powerful than EU law. 13

EU are governed by primary EU law, secondary EU law and directives, regulations. Principles as unwritten law play important role and functions in bringing the 27 member states national law together, balancing between the interests of member states and EU harmonization process.

11 Same as above, OECD guideline 2.4
12 Same as above, OECD guideline 2.5
13 Improving VAT/GST - Designing a Simple and Fraud-Proof Tax System, I ne Lejeune, Jeanine Daou
3.2.1 Sources of the principle in European VAT

National laws of member states are established much longer than Union law, national laws are more consistent with each other and they are the sources of EU VAT laws. It is not difficult to see that equality and neutrality principles can be traced back to all sources of national laws and regulations in various legislative levels. EU primary and secondary laws are both derived from these principles.

3.2.2. The legislative history

The First Council Directive was adopted with the aim of providing healthy competition among member states to establish common market. In order to achieve this, abolishment of customs duties between member states on import and export was based on neutrality principle. Within each Member State similar goods and services were to bear the same tax burden, whatever the length of the production and distribution chain as mentioned above section.

1) The First Directive enacted the economic vision of the common system of value added tax.
2) The Second Directive contained provisions on the structure of and the procedure for applying the VAT system.

In the Preamble of the Sixth VAT Directive, the neutrality of VAT was referred to the non-discrimination in taxation of the origin of goods and services for achieving fair competition and internal market. With further integration and harmonization of EU VAT system, principles are such important to ensure misinterpretation and disputes occurred among member states. The principles are also playing important role in adapting directives to the development of modern economy.

3.2.3. TFEU primary law provisions

In the European Union, the principle of equality is expressed in the treaties in terms of a general prohibition on discrimination. The treaty freedom of movement rights provide protection from discrimination on grounds of nationality not residence. The provisions of the Treaty on the Functioning of the European Union (TFEU) ensure an internal

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14 The Relationship Between the General Legal Principle of Equality and the Equal Treatment Principle in the Direct Tax Judgements of the Court of Justice of the European Union- Campbell, Eleanor
market without internal frontiers in free movement of goods, persons, services and capital. The internal market means only one customs union from non-EU countries enter EU countries, all goods shall be free moved without customs duties within the union. Article 113 of the TFEU has not only laid down the harmonization of indirect tax on common market, but also the objective of avoidance of internal distortion of competition. The harmonization is integrated with by principle of neutrality, proportionality and equality and many other principles which established upon.

3.2.4. Secondary Union law

From the Preambles of EU VAT Directive to the Sixth VAT Directive, neutrality principles are frequently mentioned, not only with the objective harmonization of VAT but also the avoidance of distortion of internal competition. Most importantly, VAT Directive also stipulates that a VAT system achieves the highest degree of simplicity when the tax is levied in all stages of production and distribution of goods and services.

When referring to the principle of neutrality, the EU court of Justice (ECJ) often derives it from article 1(2) of the VAT Directive, which stipulates that VAT is a general tax on consumption exactly proportional to the price of goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged. The VAT system ensuring the principle as expressed in article 1(2) to give taxable person a general right to deduct input VAT. The neutrality of tax, in this perspective, is closely linked to the legal character of VAT. However, when we look at the court cases to be analyzed in next chapter – whether it gives right to deduct input VAT, the decision of ECJ and national court are not in consistent.

3.2.5 Principle in the hierarchy of sources of law

A place for the principle of neutrality in a hierarchy of EU law is very important position.

- Regulations, having direct effect without transposing to national tax law
- VAT Directive is a secondary source and an integral part of EU law, sharing the objectives and values as set in the primary EU law.

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15 http://www.europarl.europa.eu/ftu
Doctrine of supremacy of Union law, which takes precedence over the national laws of Member States.

Decisions, recommendations and preliminary rulings concerning the interpretation of the Treaties and the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union.

Principles have constitutional status and stay on the top of the pyramid of norm. The principles then have been transformed and adjusted to fit the unique features of the EU society. The gap between originally constituted unwritten sources of law and in EU law are filled by the principles.

VAT directive are not always written concrete and precise; they need to function in a uniform manner in all the Member States. That is why technical interpretation of the rules are very important.

I think the ultimate way to eliminate the unequal treatment in cross-border situation and no extra burden on taxpayers during the supply chain, only by principle of neutrality, proportionality and equality are not able to solve the problems, treaties alone are not possible to achieve relief of double taxations neither. The real harmonization of VAT among national laws within member states of EU is the only mean to achieve the goal completely. As long as secondary law needs to be transposed to national laws, options needs to be adopted by member states, neutrality will still be interpreted differently and leave space for discussion. This should be the task on the shoulder of the EU Commission and the Council.

3.3 VAT Neutrality Principle

3.3.1 Why Neutrality Principle is important?

From EU VAT law background point of view, the integration of different legal systems within EU is not simple process, member states have their own legal systems and principles, doctrines which founded long in their history. A VAT directive as creation of EU are inspired by the principles of member states with its own aim of integration and harmonization. Furthermore, the newly created Union laws are not always precise and consistent with each other in comparison to member states’ domestic laws. A directive still leaves options and spaces for member stated to transpose to their national law, and the result is not always the same as the meaning of directive. Principles are serving as a spin to filling the gaps and solve the discrepancies between the intention of law and the interpretation of law. VAT Neutrality is the most important aim for tax law concerns goods and
services levied on consumption. In discount and rebate area of VAT, neutrality principle is the important tool for court to judge whether the legal aim and outcome of VAT treatment are in line with each other.

3.3.2 Classification of VAT neutrality from different perspectives

Neutrality principle has been important analysis used by ECJ and national courts, as well as key consideration for legislation provision of the EU law. However, as the principle is not clearly written in the law, its status is still not very clear.

The ECJ is not consistent in its placing of the principle of neutrality in the hierarchy of sources of law. On the one hand it associates the principle of neutrality with the principle of equal treatment and on the other it denies the constitutional character of the principle of neutrality.

In design of VAT directive at European and VAT law in national levels, VAT principles are embedded in them and can be classified from the perspective of the origins, sources and destinations.

3.3.3 Origins of neutrality

VAT Neutrality is a comprehensive concept from diverse dimensions, it can be viewed from its impact on economy and norm dimension. As a principle of law, neutrality plays a significant role amongst the sources of law.

1) Economic dimension of neutrality

From economic dimension in both direct and indirect tax area the neutrality principle means tax should not interfere the business and economy. The market does itself to optimize the business process and allocation. Tax payer’s behavior should not be influenced by the choice of tax laws and regulations. Business decision should not be based on the tax incentives. The purpose of tax neutrality is to achieve an efficient market. Although tax neutrality cannot be fully achieved, but it at least was to striven to achieve.

In design of VAT directive and the VAT laws to be implemented at national’s level, neutrality principle are also transposed into the law in order to achieve economic goals and the tax policies designed.

2) Legal dimension of Neutrality

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16 The Principle of Neutrality in EU VAT in "Principles of Law” Marta Papis
17 The Principle of Neutrality in EU VAT in "Principles of Law” Marta Papis
When interpreting the law, Neutrality function as an obligation to be in line with the principle. Principles do not provide a result but they do provide a reason, giving arguments and guiding the interpretation of rules. Principles may also resolve clashes between rules. The correlation between legal rules and their underlying principles is a correlation between law and justice.¹⁸

3.3.4. External and Internal Neutrality

According to Terra and Kajus, VAT is not neutral as such. Neutrality can be explained in relation to various phenomena. Terra and Kajus divide the concept of neutrality into internal (relating to national aspects) and external neutrality (in cross border situation).

External neutrality achieved by VAT levied in the country where goods are exported to and the country where services are consumed, country of origin will not be subject to VAT, tax credit upon goods or services left the country. In addition to internal and external neutrality there are also distinction between intra-external neutrality on intra community neutrality within a common market and extra-external neutrality for transactions with non-EU market.

Internal neutrality, as VAT is taxed at each transaction level, it is difficult to measure the neutrality base on legal person level, therefore VAT rate is levied at each stage of goods and services for identical goods and services are the same.

When VAT is levied based on legal person, the length of production and distribution chain will not give impact on VAT burden. Terra has classified this as legally neutral, it is also competition neutral. Competition neutrality relates to the issue of horizontal and vertical integration of production and distribution. Neutrality of competition can be also seen in between member states and between different channels of product distribution services consumption.

3.3.5 Principle of Neutrality in EU VAT system

One of the fundamental principles when EU design the VAT system is VAT neutrality principle, which is mentioned in in the Preamble of the first Council Directive.

Before the first EU VAT directive came into force, many member states have the cumulative multi-stage tax systems. To harmonize VAT system and remain free competition in the meanwhile, little spaces left for member stated to adopt their own options. VAT rates is one of measures that free of choice by member states to achieve free competition within EU. However, no matter the length of supply chain, VAT should not result in tax burden for enterprises.

¹⁸ The Principle of Neutrality in EU VAT in "Principles of Law” Marta Papis
The first VAT directive in 11 April 1967, without modern technology and today’s complicated economy, the directive has set out based on that time’s common goal within six member states that:

- The VAT system involved the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transaction which take place in the production and distribution process before the stage at which tax is charged. The common system of VAT shall be applied up to and including the retail trade stage which also applies to the retail trade.\textsuperscript{19}

- The common system of VAT should, even if rates and exemptions are not fully harmonized, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain.\textsuperscript{20}

- The rates applied by Member States should be such as to enable, as general rule deduction of the VAT applied at the preceding stage.\textsuperscript{21}

The first Council directive was transposed to national laws, except for VAT rates and certain area which is up to member state’s own choice in adopting. To certain extent the VAT were harmonized within EC which is then EU, where the harmonized area shall also be subject to principles. The key principles are: neutrality above mentioned and the prohibition of abuse and the prohibition of abuse of EU law, the prohibition of any alternative general tax on turnover and tax at destination principle.

The neutrality principle in area of VAT means at all stages of production and distribution VAT will be levied in the same percentage on the output revenue and input costs occurred. In this sense, VAT neutrality principle is to achieve neutrality in competition, meaning within member states same type of goods and service are subject to the same VAT rates, no extra tax burden shall be borne by goods, no extra tax on tax itself, which leads to equalization in taxable amount.

VAT neutrality principle is not written in the text of the VAT Directive, therefore there is no constitutional status in its application. Unlike non-discrimination principle which can overrule secondary EU law, VAT neutrality principle cannot overrule the secondary EU law. There are certain exceptions laid down within the VAT directive for example exemption for public bodies and financial services which do not reach to VAT neutrality.

Just because VAT neutrality is unwritten text, the interpretation has led to different outcomes. In

some cases the ECJ has interpreted the neutrality principle in VAT as an equivalent or an application of the non-discrimination principle, but in other cases the ECJ has held that the two principles should be distinguished: “However, although infringement of the principle of fiscal neutrality may be envisaged only between competing traders, infringement of the general principle of equal treatment may be established, in matters relating to tax, by other kinds of discrimination which affect traders who are not necessarily in competition with each other, but who are nevertheless in a similar situation in other respects” and “it follows that the principle of equal treatment, in matters relating to tax, does not coincide with the principle of fiscal neutrality”. 22

3.4 Principle of Proportionality

Why it is important to address Proportionality principle?

Similar to VAT neutrality principle whose itself functions as important rule of reasoning for court and legislator to determine whether the aim of law and the practice in business are aligned, proportionality in VAT area is to prevent legislator overrule and taxes disproportionally; it is important measure to prevent VAT fraud and tax avoidance. Within rebate and discount area, VAT proportionality in my view addresses VAT taxable amount reduction if discount and rebate granted within the same supply chain.

The principle of proportionality in Lisbon Treaty of European Union Article 5:

The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality.

Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Competences not conferred upon the Union in the Treaties remain with the Member States.

The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. National Parliaments ensure compliance with the principle of subsidiarity in accordance with the procedure set out in that Protocol.

Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

22 Case C-480/10 European Commission v Kingdom of Sweden — Judgment of the Court (Fourth Chamber), 25 April 2013
Principle of proportionality in general requires that action undertaken must be proportionate to its objectives, in VAT it requires the right of deduction of input VAT must be in proportion to its taxable output payable. Member States must implement corresponding measures into their domestic law under the EU legislation framework. The measures should comply with the principle of proportionality, which must be suitable and do not go beyond what is necessary to attain the objectives. Therefore, the principle of proportionality in VAT means VAT occurred when discount and rebate are granted, VAT should be not levied as extra burden for tax payer during the supply chain but only taxed once at final consumer.

3.5 Principle of Equality

The principle of equality is ambiguous and embraces more than a single idea. These ideas, although overlapping, have a different scope. It has been formalized and enacted by provisions in the Treaty on European Union, the most significant of which are the provisions on the fundamental freedoms and article 18 of the TFEU which prohibits any discrimination on the grounds of nationality but without prejudice to any special provisions included in the Treaties. 23

Neutrality from concept of law as equality, the principle of equality of citizens before the law underpins the rule of law. 24 Nondiscrimination of EU citizens and comparable situation should be treated equally; this is based on the equality principle.

There is a difference between the principle of equal treatment and the principle of fiscal neutrality, which boils down to the question of whether economic operators that do not directly compete with each other are in a comparable situation. 25 This is so because fiscal neutrality is only applicable in this context of competition. Breach of the equal treatment principle can nonetheless arise if comparable situations are treated differently.

Equality in VAT are used by court often to compare similar situation on treatment. However, it is not key criteria in determining the VAT treatment by court, as today’s business model are hardly comparable with each other, even within same industry similar products or services, the discount and rebate are not granted in a straighforward way.

The general principle of equal treatment merely serves as a lex generalis in the field of VAT. 26

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23 The Principle of Neutrality in EU VAT in "Principles of Law" Marta Papis
24 Marta Papis[same as above]
25 AG Jääskinen,
26 Value added tax in cross border situation- Gert Jan van Norden.. Page 34
3.6 Conclusions

Principles are unwritten laws embedded in EU primary and secondary law. They are important tool to interpret EU laws and important rule of reasoning in determining the decisions for court of justice. In VAT areas, it is important concept for bringing different legal systems together to achieve a common VAT systems.

Principle of fiscal neutrality is the fundamental principle of the common system of VAT and VAT liability is to large extent based on this principle. VAT harmonization are achieved in majority area of VAT within EU, most important elements are taxable persons, taxable events, taxable transactions, calculation of taxable amount and deduction of input VAT. VAT Neutrality constitutes one of the objectives of harmonization. Although the reasoning of the ECJ is not always consistent and take the case-by-case approach, but the interpretation of the scope of taxability and deductibility by the ECJ was also inspired by the principle of neutrality.

The principle of fiscal neutrality, contrary to the principle of equality does not have a constitutional character and thereby the status of a primary source of law. Principle of equal treatment as written principle in TFEU implied for the comparable supplies of goods and services and comparable consumption. The question of whether in the field of VAT there is more than one principle of equal treatment: equal treatment as a primary source of law, and neutrality: equal treatment between supplies of goods and services in competition with each other, as a secondary source of law remains open.

Proportionality principle on one hand as a restriction the tax legislators not going beyond its necessary to burden tax payers; on the other hand, also to restrict tax payer’s evasion and abusing of the VAT system by deduct VAT beyond proportion of its taxable amount. In rebate and discount area, I would like to use this principle examine the VAT portion of discount and rebate in relation to the taxable amount in next chapter.

With the constant development of economy and business models, EU VAT laws and interpretation by ECJ also needs to keep in pace of such development. Principles with its initial aims to integrate VAT systems, to ensure VAT is taxed at private consumption and to release tax payers in each stage of supply chain from VAT burden, but ended up with inconsistent results. Is it the complexity of modern business models to be blame or is it the legislators to be blames? I would like to have further discussion on the outcome of selected court cases and the outcome by measuring with these principles.
Chapter 4 Examine Principles- Neutrality and Proportionality, Equality in practice

Principles as a norm and faith EU primary and secondary laws have established upon, by which to use for examining what the outcome of court cases should be. We will find the court is not always in consistent with its reasoning for comparable situation based on same principles.

The general principles of Union law recognized by the ECJ constitute a specific set of principles. In the process of interpretation, the ECJ has been inspired by the legal systems of the Member States.

According to the ECJ, the principle of neutrality is an emanation of the general principle of European law – the principle of equality. The principle of neutrality often connected with the principle of non-discrimination. The link between these two principles has been acknowledged by the ECJ in several cases. The Court has explicitly stated that the principle of fiscal neutrality was intended to reflect, in matters relating to VAT, the general principle of equal treatment, in the field of VAT, takes the form of the principle of fiscal neutrality.

Some of court rule that VAT neutrality does not necessary eliminate of double taxation. Neutrality for taxable persons in the view of court with meaning of taxable person for the economic activities performed with full right in deduction of input VAT. The decision on limitation of input VAT deduction leads to VAT burden for certain tax payers. I think such view of court is contradict to Neutrality principle.

VAT directive and Interpretation by the view of ECJ:

4.1 Granting of discounts by supplier of goods/services

Elida Gibbs – ECJ case C-317/97

Background: The litigation was related to the triangular relations between manufacturer, distributor and customer. Elida Gibbs (a manufacturer of personal hygiene products) sold its products to distributors and to retailers. To promote the retail sale to the end customers Elida Gibbs issued “money-off” and “money-back” vouchers. In particular, it was in dispute whether the VAT treatment of discount vouchers in case of interposition of performance levels (direct discounting through the vouchers from Elida Gibbs to the end customer) is to be treated in the same way as in
a direct supply chain.

Ruling: According to the judgment of 24th October 1996 by the court, there is a price reduction if the first entrepreneur makes a refund to one of the subsequent purchasers in the supply chain due to his own delivery. It is not decisive if the beneficiary customer maintains a direct relationship to the manufacturer or not. Thus, in case the manufacturer grants a price reduction by the way of either “money-off” or “money-back” vouchers, the manufacturer’s taxable amount (for his sale to the distributor) must be reduced by the same amount. On the other hand - in case that the customer is an entrepreneur who is fully or partially entitled to input VAT deduction – the customer’s right to input VAT deduction is reduced by the VAT amount which is contained in the discount amount.

Examine by Neutrality principle

No matter the length of supply chain, VAT should not result in tax burden for enterprises. In a triangular supply chain, voucher granted by manufacturer to customer in the end did give right for manufacturer as able to reduce VAT. This is in line with the result of result of the court.

From economic dimension that tax should not interfere the business and economy. If the triangular supply chain did not give manufacturer right to reduce VAT on discount, I would imagine the business operation model would be to large extent influenced by the way of vouchers to be granted, which is not the intention of business perhaps.

From legal dimension principle, do not provide a result but they do provide a reason, giving arguments and guiding the interpretation of rules. Before voucher directive proposed, court of justice does not have any existing VAT act and directive to reply on. The principle perfectly assisted the interpretation of indirect discount and achieved the aim of the directive.

Examine by Proportionality principle

Legislator does not go beyond its necessary to achieve its objective, goods /services sold for consideration when taxable amount reduced, VAT amount should be also accordingly reduced.

Having no contractual relationship with the final consumer but being the first link in a chain of transactions which ends with the final consumer, grants the consumer a reduction through retailers or by direct repayment of the value of the coupons.

The outcome is in line with the design of EU VAT law system, although the approach is different but the result in my view has not burden taxable persons in the lengthy supply chain. VAT is borne by final consumer and Elida Gibbs was able to reduce the taxable amount of the original supply.
4.2 Granting of discounts through intermediaries

Ibero Tours – ECJ case C-300/12

Background: Ibero Tours, a German travel agency provided taxable intermediary travel services to German end customers. Ibero Tours granted price discounts to the travel customers by reimbursement of paid amounts. These discounts have been financed by a part of the commission fee received from the tour operators. However, the customers paid the full travel price to the tour operators and the tour operators paid the commission fees to Ibero Tours independently of an eventual discount for the benefit of the travel customer. It was contentious between the responsible tax office and Ibero Tours if the principles stated in the “Elida Gibbs” –Jurisdiction are also applicable in case that the intermediary is granting discounts to the travel customer by refunding a part of the remuneration for the mediated turnover within a distribution chain.

Ruling: The ECJ has decided in this case that the discounts which an intermediary grant towards the travel customer do not result in a reduction in the taxable amount neither in the relationship between the travel intermediary and the tour operator nor in relationship between tour operator and customer. Consequently, the payments of Ibero Tours do not fall within the scope of the “Elida Gibbs” –Jurisdiction, as the tour operator was not the first link in the supply chain. However, there was no supply chain, as the tour operator provided its services directly to the end customer and Ibero Tours acted only as an intermediary of that one transaction. Its (intermediary) service is separate from the service provided by the tour operator. Furthermore, Ibero Tours was obliged to pay the agreed price to the tour operators regardless of any discount granted to the travel customer.

Examine by neutrality principle similar above mentioned characteristics and dimension of Neutrality principle. Perhaps business operation model will largely be influenced by adopting other models, it seems to be same triangular supply chain as Elida Gibb case, but if we consider it as same supply chain, the result should give same VAT reduction for intermediary. However, it seems that neutrality principle itself is not sufficient to explain and solve the problem. The court has concluded there is no direct link between original supply from tour operator to consumer and the discount granted between intermediary and tour supplier. A fixed amount of remuneration by intermediary its service on selling a tour is here considered to be outside of the single supply chain, does it mean if the contract is modified with allocation to individual tour and the sum remain unchanged, would the judge view it then differently?

Examine by the proportionality principle, I feel the decision goes beyond its necessary to achieve
its objective. There is no tax avoidance or evasion, VAT discount granted is directly linked to the supply I would argue. If tour operators do not sell tours to final consumers, there would not be discount granted to intermediary at first place and most importantly the discount granted is on an individual selling of tours base. The same supply chain VAT is partly levied twice on the same transaction I would argue, and this is against the aim of EU VAT first directive and OECD guideline. EU VAT directive art.175 proportional deduction has not achieved in this type of supply neither. Examine principle of equality, I find the difference in treatment between two cases in terms of triangular supply chain, the supplier(manufacturer) granted discount to customer in first case, but the intermediary granted discount to customer in second case, does it suggest contractual terms modification and discount method changed slightly among three of them, it shall then lead to different treatment?

4.3 Granting of discounts through foreign entrepreneurs

Background: A manufacturer of processors resident in the UK, supplied goods to a middleman resident in Germany. The manufacturer carried out zero-rated intra-Community supplies. The middleman declared intra-Community acquisitions in Germany and locally sold the goods to his customer with German VAT. The customer deducted the VAT charged in the invoices issued by the middleman as input VAT. Subsequently the manufacturer granted price reductions directly to the (end) customer. The tax office responsible for the customer regarded the price reductions granted by the manufacturer as an amendment of the taxable base with the consequence that the customer had to correct its input VAT deduction.

Decision: The court was requested to clarify if the granting of discounts from the manufacturer to the customer result in an amendment of the reclaimable input VAT amount at the level of the customer. The court ruled that the customer is not obliged to correct the input VAT. The German VAT Law is in first instance focusing on the legal relationship between the middleman and the customer. The customer is not required to correct input VAT due to the fact that the taxable base for the turnover from the middleman to the customer had not changed. The value, which the customer paid to the middleman had not been changed due to the rebates granted by the manufacturer. BFH decided that if the first supplier in a supply chain directly grants a price reduction to the last recipient – here manufacturer directly to customer – generally, the taxable base for the transaction of the manufacturer is changed. The transaction carried out by the manufacturer qualified as a zero-rated intra-Community supply from the UK to Germany. Therefore, the taxable base for a zero-
rated intra-Community supply has changed. However, a precondition for the correction of the input VAT deduction is that the taxable base for a turnover has changed for which VAT is due to the customer.

Examine VAT neutrality principle, the question is whether the current application of the VAT system reflects the objectives announced in the first Council directive regarding the Neutrality principle. As part of the European Commission’s consultation on the future of the VAT system in the EU (VAT Green Paper), it appears that “the fragmentation of the common EU VAT system into 27 national VAT systems is the main obstacle to efficient intra-EU trade and thus prevents citizens from reaping the benefits of a genuine single market.

- The first EU VAT directive aim at remove cross border trade VAT barrier.
- VAT external neutrality- VAT levied at destination of consumption.
- VAT internal neutrality, no matter the lengthy of supply chain, VAT levied on each stage of chain are no VAT born by taxable person in between.

Examine VAT proportionality principle, court seems inspired by Ibento case, considering the taxable amount between middle man and customer remain unchanged regardless of discount. The crucial criteria again here is the contractual terms set up between intermediary and customer or supplier instead of upstream in Ibento case but here is downstream.

### 4.4 Obliged discounts granted by supplier to public intermediary body

**Rheinland-Pfalz decided k1251-14**

Background: A producer of pharmaceutical products resident in Germany. It distributes medicines to pharmacies and their distributors. According to German Social Insurance Code, the pharmacies have to grant statutory health insurance companies discount on the sales price of medicines. The producer is obliged to reimburse the discount to the pharmacies and distributors. The court BFH (ruling of 28th May 2009) and the tax authorities assume that this leads to a reduction in taxable amount of goods sold. SGB code also requires the producers to grant discount to private health insurance companies on prescription of these medicines. As the medicine cost are fully or partially paid by these private health insurance companies. The private health insurances claimed the discounts from the producers through a central drug discount settlement company known as ZESAR. Both the BMF and the Lower Tax court of Berlin Brandenburg denied the reduction in consideration, stating that discounts may only lead to a reduction of the assessment basis within the
supply chain.

Decision: The lower court of Rhineland-Palatinate affirmed the reduction in consideration in the present case. According to the lower tax court, is in opinion that there is a reduction in consideration because the producer may not retain the full amount of the consideration received to dispose it freely, but is obliged to pay for the discount when the insured claim the costs from their private health insurance companies. It further states that the repayment is in direct connection with the supply provided before and therefore constitutes a price reduction. The lower Tax Court permitted the appeal before the BFH.

In opposite to this case, the German court took completely different view and decision on comparable situation.

4.5 Obliged discounts granted by supplier to private intermediary body

Case C-462/16 Finanzamt Bingen- Alzey v. Boehringer Ingelheim Pharma GmbH & Co. KG(BI)

Background: This is a recent case from 17 August 2016, Boehringer Ingelheim(BI), a Pharmaceutical company producing drugs and supplying its medicines through wholesalers to pharmacies. These pharmacies provide the medicines to mandatory Health insurance. The medicines are delivered to the sickness funds and Made available to them to their insured persons. The pharmacies provide the Sickness funds discount on the drug price.

The dispute in the main proceedings relates solely to the treatment of Discounts granted to private health insurers. BI has granted such discounts and subsequently included in VAT return and reduced the taxable amount.

Decision:

On one hand, drugs supplied to statutory health insurances by pharmacies, when pharmacies grant a discount to health insurer, pharmaceutical company needs to reimburse discount to the pharmacies according to German SGB Code. In such case discount is treated with reduction in consideration by tax authorities.

On the other hand, pharmacies supply drugs to privately insured people, the company of private insurance itself is not the recipient of drugs, but reimburse the cost for patient. In such case, the pharmaceutical company must grant the privately insured company discount on the drug price. Tax authorities do not accept the discount as reduction in consideration for VAT.
The court has taken below analysis

According to Art 73 and Article 90 (1) of the VAT Directive in case of cancellation, termination, cancellation or full or partial non-payment or in case of price reduction after the transaction has been completed. The taxable amount is accordingly reduced under the conditions to be determined by Member States.

According to German National VAT law art 17. Section 1, paragraph 1: If the taxable amount for a taxable transaction within the meaning of section (1) number 1 has changed, the entrepreneur, who executed this transaction, must adjust the amount of tax owed on this. (§ 17, paragraph 1, first sentence, UStG).

The court has further reviewed court cases based on Elida Gibbs case( although final consumer has no direct contractual relationship with manufacturer, but the consumer and manufacturer are in the same supply chain, manufacturer can reduce the taxable amount for the discount granted to final consumer. ) and Ibero Tours case(that Travel agency act on its own initiative and own expense, there is no direct link between the amount agency charged to the consumer and the discount tour operator granted, what no matter what price sold to the end customer, the discount will be granted anyway. Therefore no direct link between taxable amount and the discount granted.

In this case, the court has the view that the taxable amount remains unchanged when a pharmaceutical company transfers to voluntary payment to the statutory sickness funds which is different than to finance insurance premiums and done only for the future reimbursement. The VAT will be reduced on the discount only when there is a direct link contractual relationship between the company and the third party (insurance company). As the private sector health insurers, does not link in the supply chain between the manufacturer and the final consumer.

Insurer being public body or private company, the VAT treatment in discount is different. There is clearly a VAT burden on the pharmaceutical company, this is incompatible with the general principle of equal treatment. I think these discounts are comparable similar situations.

a) Principle of equality and tax neutrality

Similar situations are not different and different situations are not equal.

The court viewed that principle of equal treatment requires the fact is subject to objective justification. Principle of equality in tax matters does not coincide with the principle of taxation Neutrality.
In addition to the principle of fiscal neutrality judge has also referred Zimmerman and Travel4you, Marks & Spencer cases. This principle may require that VAT law regardless of the legal form of the companies are applied equally, discrimination based on legal form may violate principle of equality.

b) Comparability of situations

The discounts granted to private health insurers and discounts in the framework of the statutory health insurance is aimed at the same purpose. The on Private health insurers grant discounts in the context of Apply the legal health insurance scheme with equivalent effect in other forms of protection of illness. The intention is that the Pharmaceutical companies in both cases contribute equally to reduce the cost for both organs.

c) No objective justification for unequal treatment

The court viewed that the objective difference between both discounts does not justify A different treatment for the VAT treatment.

(1) The difference is limited to the technical modalities of the discounts and has to do with the fact that the legal health insurance bodies are differently regulated by social legislation.

(2) In view of the Court ‘s existing case law on differences in Treatment based on the legal form, this difference may be an unequal tax treatment.

The application of that case law does not prevent the Court from applying unequal treatment. Suppliers or service providers can have differences treatment even though the recipient of service have the same effect or benefit.

Decision of court

Although the decision from the court has referred Elida and Iberto Tour based on the reasoning that direct link between taxable amount and the discount is essential, further supplier and final consumer should be in the same supplier chain. Although principle of equality and principle of neutrality are examined, comparability of the situation are examined. However in my opinion the argument are vague, in economic reality manufacturer would bear more VAT burden. This is not to encourage private insurer sector, neither free of competition among insurance sector internally within the same member state.

From principle of equality point of view, I would think the comparable situation is to be found with Rheinland-Pfalz decided k1251-14 case. Both from VAT treatment perspective for comparable goods and services and method of discount and from legal perspective for public body should not
enjoy more benefit than private business. I think unequal treatment is found here to be discriminated between granting discount to public intermediary and private intermediary.

From principle of neutrality and proportionality point of view, OECD guideline, in addition to above mentioned argument to other cases earlier in this chapter, I would think this is to suggest when a shorter supply chain only containing two parties the VAT on discount would have been reduced, if the supplier is manufacturer and sells medicine directly to final consumer then there would have been a direct link. with the global business model growing the complexity, segmentation of supply chain and increasing of the lengthy of supply chain resulting confusing decision and legislation maker eventually lost its original intention.

4.6 Direct Link

Why it is important to examine Direct link?

Link, the term itself is defined in dictionary as ‘single element of chain’, relationship and connection between two objects. If we add direct with link together, we can interpret as direct chain or direct relationship and connection between two objects, people and situation. I think in VAT area it can be explained as consideration and the remuneration expressed in terms of money, discount or rebate granted and the original supply, that they have direct connection with each other and there are no extra chains in between two of them.

It is important element and criteria for court to judge whether the discount and rebate granted has direct link with the original supply, or the consideration of goods or services supplied have direct link with the payment received. If the chain is consisted of not only single element but of multiple elements, then it will be viewed by the court as separate independent supply chain. The VAT principles of neutrality, proportionality and equality are based within the same supply chain instead of multiple independent supply chains adding up together.

There are many of cases dealt with the direct link in various perspectives: between a service and a benefit, the level of benefits and the amount of mandatory charges, the level of benefits and agreed low charges, payment for services that are neither defined in advance nor personalized.

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27 Wikipedia dictionary and Oxford English dictionary
28 HvJ 05-02-1981 C-154/80, Coöperatieve Aardappelenbewaarplaats
29 EUR-Lex - 61986CJ0102, Apple & Pear Development Council
30 C-263/15 – CURIA, Lajvér
31 HvJ 27-03-2014 Le Rayon d'Or C-151/13
broadcasting activities funded by a compulsory statutory fee\(^{32}\) and the treatment of prize money\(^{33}\).

4.6.1 From a direct to an indirect link

The Court of Justice has repeatedly held that the notion of the supply of goods and services “effected for consideration”, within the meaning of Article 2(1), requires the existence of a direct link between the supply provided and the consideration received.

In BLP, the Court came to conclusion that a direct and immediate link of the acquired goods or services with the taxable transactions is necessary and that the “ultimate” aim pursued by the taxable person is irrelevant in this respect. The Court therefore refused the deduction of input VAT in a situation in which services had been provided to the taxable person in relation to the exempt sale of shares, even though this sale was a means of enabling the taxable activity of the taxable person.

Such a link or indirect link may nevertheless also exist with the economic activity of the taxable person as a whole if the costs of the input transactions form part of the general costs of the taxable person and are therefore cost components of all goods or services delivered or provided by him.

More and more the wider business context prevails over a strict application of a direct and immediate link criterion, ultimately the direct and immediate link of the acquired goods or services altogether looking at the ‘ultimate’ aim pursued by the taxable person, hence our reference to an indirect link.\(^{34}\)

4.6.2 Legal relationship

In addition to a direct link, between an activity and the payment, there must be a legal relationship between the person receiving money and the person paying it. Legal relationship is expressed in terms of contract and agreement.

4.6.3 Court cases to interpret direct link

Below court cases are not reflecting discount and rebate situation, but the reasoning of concluding

\(^{32}\) C-11/15, Český rozhlas
\(^{33}\) C-432/15 – CURIA, Baštová
\(^{34}\) Introduction to European VAT recasting. Ben Terra
whether there are direct link, the approach court views the direct link are very useful. I am trying to study in this thesis what perspective and criteria courts are interpreting direct link.

Case C-432/15 (Baštová),

In Baštová case in determining whether prize should be subject to VAT, the Court wanted to find out where the services provided is for consideration by examining whether there is a direct link between that supply and the consideration actually received by the supplier.

The criteria for determining such direct link is established on whether there is a legal relationship between service provider and the payment received by supplier.

In the end, the uncertain nature of the provision of any payment is such as to break the direct link between the service provided to the recipient and any payment which may be received.  

Case C-40/09 (Astra Zeneca)

Astra Zeneca UK Limited is a large pharmaceuticals company offered employees a benefit package. From the package the employee can select to have cash or the option to have vouchers instead. The vouchers have face value and can be redeemed in different shops.

The Court held that the company’s provision of vouchers gave a future right to goods or services on its employees (as the vouchers can be redeemed for various types of goods or services). The ECJ also explained that, the concept of the ‘supply of services effected for consideration’ requires the existence of a direct link between the services provided and the monetary consideration received. In this case, there is a direct link between the retail vouchers provided to the employees and the cash remuneration, because the employees must give up part of their cash remuneration in exchange for the vouchers.

According to the ECJ, there is consideration received by Astra Zeneca from the employee, therefore voucher is subject to VAT. The conclusion on whether input VAT is deductible for the taxable supply made shall not be discussed here, but the direct link is always essential in analyzing between services provided or goods supplied and payment received.

35 B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017), page 197
36 B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017), page 269
Case C-461/12 (Granton Advertising)

Granton Advertising did not charge its affiliates anything in respect of the Granton cards, nor did it receive any fees from those businesses. The tax inspector consider that the sale of Granton cards by that company constituted a transaction subject to VAT, Granton Advertising took the view that the sale of Granton cards was exempt from VAT.

The court viewed that the amounts paid by the consumers to Granton Advertising for Granton card could not be considered a consideration for consumer paid to its affiliates. There is no sufficiently direct link between the amount paid by those consumers in order to obtain the Granton card and the goods or services which may be obtained by those consumers from the affiliated businesses. 37

Air France-KLM (Case C-250/14),

Air France-KLM case concerns a discussion on the compensation paid by Air France – LKM to Brit Air for flat rate on annual base in case of no shows of passengers. Tax authorities consider the compensation is subject to output VAT, taxpayer considers it not subject to VAT as no tickets are actually sold but pure a damage for not turning up by passenger paid by Air France-KLM to Brit Air.

There are different views on the no-show ticket whether it should be subject to VAT38, but here I will not further discuss on it rather focus on direct link.

The Court views that there is a contractual relationship between passengers and airline company for the non-restitution on no-show paid by passenger. Court view that the remuneration paid by Air France-KLM to Brit Air is a consideration for services/damage occurred for intermediary Brit Air, otherwise the payment on tickets received by Brit Air would be a normal revenue without loss. There is a direct link between the performance of the services provided and the remuneration received in this respect. 39

Direct link is not like principles written or unwritten in the EU law, but it is rather a case by case

37 B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017)m page 519-520
38 One view expressed is that the supplier is making the service (room or flight) available so VAT is payable whether or not the customer comes. A second view is that the supply only happens when the service is provided so no VAT is payable if the customer does not arrive and the supplier enjoys a tax-free windfall of the VAT-inclusive price.
39 B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017), page 415
explanation and definition. I do not think it is an interpretation from tax law, but interpretation from economic reality for court to understand the substance of the form, to determine the business operation model and its VAT treatment. However comparable situation and comparable legal personality should be granted equal treatment, which we are back to the discussion of principle of equality.

I do not think the interpretation of ECJ and the decisions has a standard approach to apply any of next case, which gives uncertainty for us in understanding the angel of legislator. It is an approach of rather looking at legal relationship and economic benefit based on case by case. It thus leaves a lot of uncertainties for business.

4.7 Conclusion

The VAT consequences of a transaction should derive from the actual supply, rather than the way the supply is labelled.

In my opinion, from the different court cases judgement, court is more looking at the economic label on whether the economic activities designed by tax payers have direct link between services provided or goods supplied and consideration received. Legal form of transactions is not decisive but there must be contractual relationship between parties at first place. In discount and rebate area, before voucher directive are proposed, courts have different results which leads to dispute and uncertainties for business.

It can still not explain in a persuasive way how should we interpret direct link in next case, it is rather a case by case analysis.

Direct link, as the key reasoning to come to decision, court is taking case by case approach. In fact most of business operation model are not as simple as the direct supply chain, it is rather a spinner web and interdependent with each other. If court only looks at a single supply chain by either direct legal contractual relationship, or direct payment between recipient and supplier, there are of course no direct link, but if we go back on step to look at the whole picture, from tax payer point of view, in my view business are carrying extra VAT burden.

Principles do not give us a stable answer in examining next court case. Perhaps it is important to go back a step to examine what is a definition of the same supply chain, what is multiple or separate independent supply chain. However, the literature does not give a definition, modern economy
develops rapidly with complex operation models, my question is if the criteria of looking at single legal supply chain is right benchmark by ECJ or other judges? Should not we have a look at the whole business operation picture? Does such regulation or rules encourage and stimulate economy? Or to bound business within the rules and not able to create added value to the world?
Chapter 5 Voucher Directive

Just because of these different decisions on discount and rebate, business are bring more and more appeals in front of the court. from last chapter Air France-KLM and AstraZeneca cases have resulted different conclusion in VAT treatment, in 2012 EU commission has issued proposal on voucher. The Council of the European Union adopted a directive to amend the European VAT Directive with the aim to achieve a harmonized VAT treatment of vouchers within the EU.

5.1 Cases on Voucher

There are many cases regarding vouchers and business promotion schemes which analyzed in previous chapter.

– Boots: the question whether vouchers should be accounted for the cash received or based on the nominal value
– Naturally Yours: non-monetary consideration compared to the value that would normally have been given for the supply
– Bertelsmann: a bonus payable in kind including the delivery costs
– Yorkshire: settlement of the sales price partly in cash and partly by coupon
– Argos: the face value of the voucher or the sum actually obtained
– Marks & Spencer: removal with retrospective effect of a right under national law to reclaim sums paid
– Freemans: consideration is by the full price less the agents purchase discounts

5.2 Solution to Voucher scheme- VAT Directive

be transposed into the national legislation of all EU Member States by 31 December 2018. To avoid and reduce inconsistencies, distortion of competition and double or non-taxation. Without doubt, all EU Member States have agreed that this was urgent and necessary to agree upon. However, they did not agree on many other items regarding vouchers, which left question and space again for ambiguous of the directive as no consensus and be achieved and no compromises are made for those areas. I think this is one of main reasons that I would like to address in this paper, as long as no complete harmonization, there will be still uncertainties and problems in discount and debate cannot therefore be solved.

5.2.1 Definition and Characteristics of Voucher

The voucher Directive states that it is necessary to identify what constitutes a voucher as it can have different forms (physical and electronic) and should be distinguished from payment instruments. Article 30a to be included in the VAT Directive and to be transposed into national law, a voucher refers to an instrument in relation to an obligation existing for redeemers to accept it as consideration or part consideration for a supply of goods and services. The defining element of a voucher is a requirement for suppliers to accept it as a means of payment. 40

We presume that under the voucher Directive the differentiation with a payment service should follow from the fact that the final Article 30a also requires that the goods or services to be supplied or the identities of the potential suppliers are either indicated on the voucher itself or in related documentation. In other words, the redemption of a voucher against goods or services is not a payment but rather the exercising of a right subsequent to a payment which occurred then the voucher was issued or changed hands. 41

5.2.1.1 SPV

The voucher directive has given a definition of single purpose voucher SPV:

*single-purpose voucher’ means a voucher where the place of supply of the goods or services to which the voucher relates, and the VAT due on those goods or services, are known at the time of*

40 The Commission’s proposal to exclude explicitly payment services from being considered a voucher has not been included in the final Directive.
41 B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017) page 378
issue of the voucher\textsuperscript{42}

If an SPV is supplied by a taxable person acting in his own name, he himself is regarded to supply directly the underlying goods or services to which the voucher relates to its end customer. However, if the taxable person transferring the SPV is acting in the name of another taxable person, this other taxable person is to be regarded to supply the underlying goods or services to which the voucher relates in his own name to the end customer.\textsuperscript{43}

5.2.1.2 MPV

Multi-purpose voucher’ means a voucher, other than a single-purpose voucher.\textsuperscript{44}

According to the directive, the transfer of MPV transaction itself is not subject to VAT. The voucher Directive does not mention further impact of whether the deduction of input is possible for the supplier who transferred the MPV provided supplier is tax payer has right of deduction.

VAT becomes chargeable for MPV is the moment of goods are delivered to the customer or the services are rendered to customer, not the moment of voucher issued or transferred. The new Article 73a laid down that

\textit{The taxable amount shall be equal to the consideration paid for the voucher or, in the absence of information on that consideration, the monetary value indicated on the multi-purpose voucher itself or in the related documentation, less the amount of VAT relating to the goods or services supplied.}\textsuperscript{45}

5.2.1.3 Comparison between SPV and MPV:

Assume A is supplier, B is agent or intermediary, C is the consumer. The comparison between SPV and MPV in the VAT treatment from the moment of issuance of voucher to supply of goods or services and finally redemption of voucher can be listed as below:

\textsuperscript{43} B.J.M. Terra & J. Kajus, -Introduction to European VAT (Recast), Commentaries on European VAT Directives IBFD (accessed 6 March 2017) page 378
\textsuperscript{44} Voucher Directive [http://eur-lex.europa.eu/legal-content/EN/TXT]
\textsuperscript{45} COUNCIL DIRECTIVE (EU) 2016/1065 of 27 June 2016 Voucher
### Type of Voucher

<table>
<thead>
<tr>
<th>Type</th>
<th>Issue of voucher</th>
<th>Supply of goods/services</th>
<th>Redemption of voucher</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SPV</strong></td>
<td>Of its own</td>
<td>A→C is taxable supply</td>
<td>Not independent supply, no VAT purpose</td>
</tr>
<tr>
<td></td>
<td>B On behalf of A</td>
<td>A→C is taxable supply</td>
<td>Deemed supply A→B</td>
</tr>
<tr>
<td><strong>MPV</strong></td>
<td>On own name</td>
<td>A→C not subject to VAT</td>
<td>Taxable VAT art. 2</td>
</tr>
<tr>
<td></td>
<td>B On behalf of A</td>
<td>A→B taxable amount: margin between voucher face value and consideration paid (distribution service)</td>
<td>Goods are delivered is taxed or redeemed</td>
</tr>
</tbody>
</table>

### 5.2.2. Issues and problems of Voucher directive

#### 5.2.2.1 SPV

Voucher directive regarding SPV has still shortcoming and uncertainty on how to treat discount of vouchers. Particularly where the discount is ultimately met by the issuer rather than the redeemer of a voucher. Existing case law provides that the issuer is entitled to adjust its taxable base taking into account the discount. This issue has not been addressed in the voucher Directive. The voucher Directive has not in state anything about the right to input VAT deduction when output VAT is payable in respect of vouchers. However for the relevant of this thesis, I will not go in deep to discuss SPV.

#### 5.2.2.2 MPV

The new proposed voucher directive has raised concerns by many scholars. Does MPV solve

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46 Introduction to European VAT recasting. Ben Terra. One of situation is: Never redeemed: such as the situation when an MPV is never redeemed, a supplier could obtain a real saving (besides the cash flow advantage that already applies based on the fact that VAT is only payable upon redemption). The preamble of the voucher Directive has noted that it does not target situations where an MPV is not redeemed by the final consumer during its validity period, and the consideration is kept by the seller. In my thesis I will not be focusing on the shortcoming of the directive from this.
the problems mentioned in previous chapter?

I would like to use two examples to demonstrate within the single (same) supply chain in domestic situation and cross border situation.

**In a pure domestic situation**

Manufacturer grant voucher to distributor for the services distributor provides related to selling of goods, voucher is VAT inclusive passed on to distributor, distributor can deduct VAT and pay VAT from the same tax authorities; Subsequently distributor sells goods to wholesaler and wholesaler provides services and get voucher in return, VAT is charged on services of wholesaler and deducted on voucher, similar to last stage wholesaler sells goods to retailer and retailer provides services by receiving voucher as return. In the last stage, retailer sells voucher to consumer, VAT is inclusive on output VAT, consumer redeems voucher at manufacturer, receiving cash, manufacturer reduce VAT on voucher returned. Same tax authorities are involved in the whole supply chain. Only consumer beard VAT in the last stage, which is in line with VAT neutrality principle.

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**Another situation is below face value:** In a supply chain a voucher may, however, be sold against an amount that is below the face value of a voucher. If in such a scenario a customer pays a lump sum fee for both the MPV and the services of the supplier, we are not sure if a service can be identified and what the taxable amount of this service would be. Interestingly enough, the preamble also only refers to a situation where a taxable person not acting in his own name receives a “separate consideration” on the transfer of a voucher. This is, however, not made explicit in Article 30b.
In a cross border situation

Not all cross-border situation creates problems, when supply chain is only consisted of 2 countries, it is remaining neutral. However, when the supply chain takes place in three different countries, there is extra VAT paid to the tax authorities.
The manufacturer who is resident of MS 1 supplies the MPV to the distributor situated in MS 2. Distributor renders distribution service to manufacturer, the distributor sends invoice to manufacturer, according to the Voucher directive 30a and art 44 which will be subject to reverse charge, manufacturer will be reporting output VAT and input VAT to MS1 tax authorities.

The distributor who is resident of MS2 supplies the voucher to the wholesaler who is resident of MS 3. Similar to last step that wholesaler renders distribution services to distributor, wholesaler sends an invoice to distributor which is subject to reverse charge. The distributor will report output VAT and input VAT with no impact on VAT balances (assuming it conducts 100% taxable activities) to the MS2 tax authorities.

The wholesaler who is resident of MS3 supplies the voucher to the retailer who is resident and activities conducted in the same MS 3. Since both parties are located in the same member states, domestic VAT of MS will be charged on the invoice for services retailer rendered to the wholesaler. VAT based on the taxable amount of distribution services will be paid to the tax authorities of MS3.

In the last step the retailer sells the voucher to the final consumer who is also situated in MS 3. The voucher is subject to VAT of MS 3, but there is no services rendered back from Consumer to retailer. The manufacturer in MS 1 redeems the voucher and the redemption of voucher is subject to VAT which will be paid to tax authorities of MS1.

In such case, when supply chain is consisted of five parities across three member states, VAT neutrality is not achieved, there is clearly difference than the first case when supply chain take place within the same member state or across two member states. Extra VAT burden occurred in the supply chain for tax payer.

Due to the fact that Voucher directive requires supply of distribution services are levied at each stage of distribution and final redemption of voucher is taxed between manufacturer and final consumer.

5.3 Sub Conclusion

Voucher directive is not solving the problems for MPVs in a cross-border distribution chain. Since the MPV is to be taxed at redemption and the supplies of the MPV to intermediaries is not to be taxed at all. If we do not tax distribution service, the VAT treatment in this situation would be neutral and in line with the proposal regarding the nature of the MPV; no extra VAT burden for tax
payer, however not tax distribution service is not meeting the nature of taxable events of VAT system. Therefore, there must be a further amendment to the directive in order to achieve VAT neutrality.
Chapter 6 Comments, Recommendation and Conclusion

6.1 Comments

Based on primary EU law, when goods or services are supplied cross-border, they should receive equal treatment compared with locally produced goods or services. The ability to achieve this is significantly impacted by the design of the VAT system no matter on principle of origin or principle of destination. In a destination-based VAT system, exports are VAT free and the goods or services subject to equal VAT treatment in the place of destination. Providing the condition that taxable amount of goods or services can be precisely determined. When such condition is not met a cumulative cascading VAT will occur. In order to reach equal treatment from the manufacturing to final consuming stages, a full deduction of input VAT should be granted but final consumer bear the tax burden.

When tax payer is not able to deduct input VAT due to exemption legal personality, special regime at transaction level or in this paper discussed uncertain legal treatment in VAT deduction on discount, some of tax payers shall try to set up structure in order to reduce VAT burden, or certain sector will suffer discrimination and loose competition equality. Such integration has created distortion in the market and competition, discrimination for business with lower degree of integration, which are the result we do not want to see.

In some court case, the ECJ drew a line between two existing aspects of neutrality.

On the one hand, the Court stated that the common system of VAT seeks to ensure neutrality of taxation of all economic activities, provided that those activities are subject to VAT, taxpayer shall be relieved from all its VAT burden all its economic activities during the supply chain.

On the other hand, Fiscal neutrality request that similar products and services to be treated equally without discrimination. The Court has also defined the concept of similar supplies which requires that the goods/services have similar characteristics and meet the same needs of final consumers. However the comparable situation do not results in same results in decision of court cases.

CJEU in certain cases viewed payments discounts and rebates should reduce the taxable amount of the business paying, in other cases similar situation the CJEU consider these payments as indirect discount and paid by third party outside of supply chain, thereby implying that these payments cannot reduce the taxable amount. In my view these views are not compatible with the legal system as laid down in the EU VAT Directive. In theory, from an economic perspective, there should be no
difference in result (in the sense of amount of tax levied) between a value added tax at different moment of price reduction. Therefore, whether the payment made by the manufacturer to the person redeeming the voucher is a cost (an input) or an adjustment of the output should not make a difference: the total VAT amount payable should be reduced as a result of this payment. This does not fit into the harmonized legalization of the VAT system.\footnote{VAT: ‘Money Off Vouchers’ and ‘Cash Back Schemes’—What Are the Problems and How Can They Be Solved? Jeroen Bijl \textit{2012-5} EC Tax review}

6.2 Recommendation

It is a dilemma that EU legislator is facing, there is not an easy solution to the problem on voucher scheme, from last chapter we can see that in cross-border supply chain regarding voucher redemption extra VAT burden occurred, what can be possible solution is to treat distribution service as out of scope for VAT purpose, subsequently, there will be no VAT relating to the distribution of the MPV levied and therefore no extra VAT burden occurred. However, not to tax distribution service and being out of scope of VAT does not justify by sound reason, it is against the aim of EU VAT system which VAT should be levied at each stage of supply chain. The nature of distribution services should be taxed according to EU VAT system, there is no justification on exempting or not taxing such supply.

One Uniform VAT rate- for all member states would not solve the problem in such situation and against the Treaty of EU that member states is competent to level its own VAT rate.

Non-discrimination between tax payers, Rhineland-Palatinate and Boehringer Ingelheim Pharma two comparable German tax payers with opposite decision mentioned in chapter 5, in my opinion regardless it is private insurance company or public health body, there should be same VAT treatment to avoid distortion. Interpret VAT directive in a consistent way, clear concrete definition in voucher directive and close the gap to ensure cross border no double VAT taxation. Guidelines in interpreting directive in a united way across EU is my recommendation.

6.3 Conclusion

When EU first VAT directive laid down in decades ago, its initial intention is to ensure VAT is levied at all stage of supply chain and taxable person in the supply chain should not be born in VAT burden unless it is justified by legal objective.
Even in OECD guideline which 160 countries in the world are following, its principles are similar to EU VAT principles in which VAT should be neutral and do not burden taxpayer in the supply chain.

EU VAT law under the Treaty of EU has to balance between interests of 27 member states and trying to achieve freedom of movement of goods and services within the union. In the meanwhile, of tax competition between member states still allowed, member states still have certain competence to choose their own VAT rate and choice.

The principle of neutrality and proportionality serve as spin fill in the gaps between member states domestic laws and EU tax laws. The aim of principle in VAT system is to place no VAT burden on cross border supply chain and length of supply chain. However, with the development of business models in modern time, the existing tax legislations and interpretations are not keeping up with the development of market and economies. Courts are not in consistent with its decision in comparable situations, uncertainty therefore arises in both domestic and cross border situations. Although the court seems to have overcome its understanding and sympathy to eliminate VAT burden for taxpayers within the union, but it does not have the legal tools and competence to completely achieving it. It is slower process in acknowledgment and reaction to the development of business models, in the meanwhile bring burden and extra charges to tax payers. Some cases rather anomalous to the principles positioned, rather making too simple comparison, disregarding the fact of economic reality.

EU legislative bodies are trying to resolve the problem on distribution chain but current voucher directive still partially causing the misinterpretation for member states. Looking at all the court cases mentioned in this thesis, contractual terms of reimbursement of intermediaries leads to different decisions when court made analysis whether there is a direct link, such link is so crucial in the conclusion of whether the price reduction should be taken place for the discount granted in distribution and rebate vouchers. Court and legislative bodies are too much focusing on legal terms and ignored a reality that actually have resulted in extra VAT paid to the tax authorities which no consumption has performed. Discount granted due to lengthy supply chain lost its initial principle of neutrality and levied with twice VAT, which is not in proportion. All of them together has not lead to a neutrality result from economic point of view.

However, there is not an easy solution to existing VAT system, due to the historic background of EU, due to the increasing complexity of modern economy. Court is a dancing artist balancing
between interests of 27 member states and EU’s integration. A clear guideline to interpret directive should be necessary, a complete harmonization of VAT without transposition to member states law will be the ultimate solution to remove the unequal treatment in cross-border situation, quick response to the development of economy will at least help the taxpayers and stimulate the economy to bring added value into this world.
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