ENGLISH SUMMARY

ES1   Summary and conclusions

ES1.1   Objective and research questions

This research sets out to examine firstly the current position of legislation on turnover tax (VAT) as it applies to enterprise financing (or corporate finance) and secondly the extent to which the applicable legislation and interpretations thereof currently align with the purport of this tax. Based on these objectives, the research questions and sub-questions are as follows:

1. What consequences do various methods of financing have for the application of the Dutch VAT Act 1968, both for the party providing the finance and for the enterprise receiving it, with answers specifically being sought to the following sub-questions:
   a. To what extent does the VAT Act 1968 apply consistently to the various forms of financing?
   b. Is the way in which VAT applies in the field of research clear? If not, which aspects are uncertain?
   c. Are any aspects in the field of research incompatible with European Union law? If so, which?
   d. What, essentially, is the quality of the current legislation and interpretations thereof in the field of research with regard to aspects such as lawfulness, respect for legal principles (specifically the principle of equality before the law and then, primarily, the principle of legal certainty), and simplicity, clarity and accessibility?

2. To what extent does the current legislation, as examined in the first research question, reflect the purport of VAT, with answers specifically being sought to the following sub-questions:
   a. What is the purport of VAT (i.e. who and what is intended to be taxed)?
   b. Are any existing anomalies justified?

To answer these questions, the relevant legislation (specifically the VAT Act [Wet OB] 1968 and EU Directive 2006/112/EC ('the VAT Directive') and its legislative history, as well as case law and the literature, were examined. The research conducted in answering the first question focused on four methods of
English Summary

providing finance: (i) equity; (ii) bonds and other transferrable debt instruments; (iii) the granting of credit, and (iv) factoring and other ways of assigning debt claims. Lastly, proposals were made for possible ways to resolve the various anomalies identified.

ES1.2 First research question

ES1.2.1 General aspects

Three general aspects were initially examined for the purposes of answering the first research question: the concept of economic activity, the right to deduct input VAT, and the criterion of the direct, permanent and necessary extension of a taxable activity ('the extension criterion'), with a model being developed to highlight the relationship between these concepts.

Firstly, an economic activity comprises the totality of activities resulting in a person or entity being classified as an entrepreneur (or taxable person) under Article 7 VAT Act 1968 (Article 9 VAT Directive). This involves the performance of business or professional activities, or the exploitation of tangible or intangible property for the purpose of obtaining income on a continuing basis. A characteristic feature of an economic activity is an effort to obtain income from taxable supplies (income production criterion). In principle, this effort should not be occasional or incidental (regularity criterion). Furthermore, an economic activity is also required to comprise inter alia a certain degree of professionalism (professionalism criterion). This is sometimes referred to in case law as an activity performed for a business or commercial purpose, although more recent case law seems quick to classify activities as economic activities, providing they generate income on a continuing basis.

With regard to the second aspect, a person or entity classified as an entrepreneur is entitled, under Article 15 VAT Act 1968 (Article 168 VAT Directive), to deduct input VAT insofar as the person uses goods or services purchased for consideration for the purposes of taxed transactions. Based on case law, the requirement for use for the purposes of taxed transactions should, in my view, be assigned a wide-ranging interpretation. This requirement is met if an entrepreneur incurs costs in respect of the economic activity, except if the goods or services purchased are used for exempt supplies. Causality, finality and the objective contents of supplies are tools that can be used to establish how goods and services are used. According to the Court of Justice, there should specifically be a direct and immediate link between costs incurred and outputs, or between costs incurred and the overall economic activity. If an entrepreneur incurs costs for non-taxed transactions, the Dutch Supreme Court examines whether the supplies performed for consideration are related, or are embedded in some other way in the enterprise. If so, costs are regarded as being incurred by the enterprise. In more recent judgments the Supreme Court
has stated that its rulings represent a more detailed elaboration of the approach adopted by the Court of Justice.

The third aspect, the extension criterion, has been developed in Court of Justice case law and refers to the direct, permanent and necessary extension of a taxable activity. In extending such activities, the person or entity acts in the capacity of an entrepreneur. Transactions (supplies) comprising a direct, permanent and necessary extension of a taxable activity should also not be incidental within the meaning of Article 174(2) VAT Directive. The income obtained from such supplies consequently has to be taken into account when determining the deductible proportion (or partial recovery rate) of input VAT on general expenses. The scope of this criterion is uncertain.

The following layered model was devised partly in order to place the extension criterion in a clearer context:

Layered model

This model seeks to highlight a subdivision in the types of transactions of which an economic activity may consist. Firstly, there is the taxable activity at the core of the model, comprising transactions that are characteristic of the relevant economic activity (i.e. the core business). Secondly, there is the direct, permanent and necessary extension of the taxable activity, consisting of activities that are not characteristic of, but arise systematically from the relevant economic activity (i.e. ‘must haves’). Lastly, there are other transactions, which are classified neither as a taxable activity nor as the direct, permanent and necessary extension of such an activity (i.e. ‘nice to haves’). Only these other transactions can be incidental within the meaning of Article 174(2) VAT Directive.
ES1.2.2 Examining various forms of financing

The provision of equity to a company does not constitute a supply for consideration within the meaning of Article 4 VAT Act 1968 (Article 24 VAT Directive). According to Court of Justice case law, this is because income obtained from the provision of equity, such as dividends in the case of shares, is a payment arising simply from ownership of the assets. It is unclear, however, as to what exactly characterises income arising simply from ownership, and how this differs from income obtained from transactions performed for consideration. In my view, it would be more appropriate to argue that the relationship between the party providing the equity (in other words, the shareholder) and the party receiving the capital contribution involves too little reciprocity for the transaction to be considered a supply for consideration. This means that transactions within a capital relationship cannot generally be considered to constitute taxable supplies. This conclusion would seem consistent with the approach adopted by the Court of Justice. An exception to the rule that income obtained from a capital investment does not constitute consideration for a supply can be found in Supreme Court case law, which states that, in certain circumstances, profits distributed by cooperative organisations to their members may constitute such consideration. As I see it, the relevant Supreme Court case law is incompatible with Court of Justice case law and so is in breach of EU law.

The provision of equity is characterised by the fact that, unlike a loan, it does not result in a debt for the recipient. This distinction is primarily of a legal nature as the economic distinction between equity and loans is not so unequivocal. In my view it is virtually impossible that funds provided as equity under private law will constitute a loan for the purposes of the VAT Act 1968. Owing to the criterion of economic and commercial reality, however, a loan between associated parties under private law could constitute the provision of equity under this same Act. Examples of loans constituting the provision of equity for the purposes of the VAT Act and taken from the sphere of direct taxes include sham loans [schijnleningen], participating loans [deelnemerschapsleningen] and loans where the creditor knew when granting the loan that the debtor would be unable to repay it [bodemlozeputleningen]. The provision of equity can also be assumed in the case of entities without legal personality and constituting ‘any person’ within the meaning of Article 7(1) VAT Act 1968 (Article 9(1) VAT Directive).

An activity seeking solely to obtain dividends and capital gains from the provision of equity is not an economic activity. More specifically, it does not involve exploiting tangible or intangible property for the purpose of obtaining income on a continuing basis, given that it does not entail supplying a service for consideration. Consequently the criterion of income production is not fulfilled. As a result, a person or entity who solely acquires and holds shareholdings is not an entrepreneur within the meaning of Article 7 VAT Act 1968.
(Article 9 VAT Directive) and is not entitled to deduct input VAT. Whether the parties contributing and receiving the capital are part of the same group of companies makes no difference whatsoever in this respect.

In certain circumstances, however, it is possible for a shareholding to comprise part of a more comprehensive range of transactions performed by an operator and that in their totality constitute an economic activity. In this situation, the activity of acquiring and holding a shareholding is of an economic nature. According to case law, this applies in any event in the case of (i) securities traders, (ii) shareholders involved in managing the entity in which they invest and in the supplies performed for consideration (‘intervening shareholders’) and (iii) shareholders for whom the investment is a direct, permanent and necessary extension of a taxable activity (‘extension shareholders’). In my view, this list should not be regarded as limiting; in other words, there are also other circumstances in which the acquiring and holding of shareholdings may be regarded as being of an economic nature, and specifically as ‘other transactions’ performed by an entrepreneur. These circumstances could include the investing of temporary cash surpluses. The legal position in this respect, however, is not entirely certain as it is not generally easy to make a clear distinction, in the abstract, between shareholdings that are of an economic nature and shareholdings that are not, given that the distinction between these two categories depends very much on the facts of the case. If a shareholding comprises an economic activity, and so is of an economic nature, the costs that the shareholder incurs in order to acquire and hold the investment are part of the shareholder’s general expenses. The shareholder is then eligible to deduct input VAT, except insofar as any exempt supplies restrict that entitlement. Income obtained from shareholdings does not affect the deductible proportion.

In principle, disposing of a shareholding to another party constitutes the supply of a service for consideration. However, this service is exempt from VAT, even if the disposing party is an entrepreneur. This means there is no entitlement to deduct input VAT on the direct costs of the disposal, except if the acquiring party is established outside the European Union and the disposing party is an entrepreneur. The disposal also affects the deductible proportion of a disposing party who is an entrepreneur, unless the disposal is an incidental financial transaction. The disposal of a shareholding may consequently also have implications for the extent to which input VAT can be deducted on general expenses that are barely or not at all related to the shareholding. As far as the disposal of shareholdings is concerned, the judgment in AB SKF created legal uncertainty in a number of respects. The Court of Justice suggested, for example, that the disposal of a shareholding held by a party not classified as an entrepreneur could also be of an economic nature. That, in my view, is illogical. The judgment in this case can also be interpreted to mean that an entrepreneur’s disposal of a shareholding must always be part of the taxable activities or a direct, permanent and necessary extension of
those taxable activities. If that were the case, the disposal of a shareholding could never constitute an incidental financial transaction and would always affect the deductible proportion. As I see it, however, the disposal of a shareholding must also be able to constitute other transactions in the disposing party’s economic activities and be incidental. The judgment in AB SKF would seem to suggest lastly that the costs of disposing of a shareholding, even if they may appear to be direct costs, should nevertheless be regarded, as far as possible, as general expenses. This would mean that, in the case of disposals of shareholdings, costs incurred would be more likely than in other contexts to be regarded as general expenses rather than as direct costs, which would not be a very consistent approach.

Case law on shareholdings, which in my view also applies, in principle, to other types of participating interests (i.e. other rights, not being debt claims, participating in the profits of a company), shows general signs of a tension between systematic purity on the one hand and a wish on the other hand, wherever possible, to allow input VAT to be deducted. This is because there is often clearly no question of consumption in the case – primarily – of holding companies. The picture arising from case law is that subtle and sometimes rather arbitrary distinctions made between shareholders can result in very different practices with regard to the way VAT is imposed. Moreover, disposals by a fiscal unity (Article 7(4) VAT Act 1968) and disposals comprising all or part of a totality of assets (Article 37d VAT Act 1968) can also produce differing outcomes. Whether this sufficiently reflects the principles of equality before the law and legal certainty is very much doubted.

The entity in which a party invests, and so which receives the equity contribution, is in a clearer position. The Court of Justice has ruled that raising equity by issuing shares does not constitute a supply of services for consideration, and neither does the admittance of a person to a partnership. It can be concluded from this that issuing or creating shares or other types of participating interests does not generally constitute the supply of services for consideration. As far as the economic nature of the services and the right to deduct input VAT are concerned, the principle to be applied is ‘follow the money’; in other words, input VAT relating to expenses incurred when raising equity is eligible for deduction insofar as the funds raised are used to pursue an economic activity.

The second method of financing examined was funding provided in the form of bonds and other transferrable debt instruments. Bonds are in any event treated in the same way as equity, specifically shares, under the VAT Act 1968. For the sake of brevity, reference is made to the discussions set out above. For the purposes of the VAT Act 1968, bonds are transferrable securities representing a monetary loan divided into equal parts. The fact that bonds are treated as equivalent to equities is remarkable, given that there is a clear *quid pro quo* for bondholders, who lend money in return for the right to receive an agreed rate of interest. That is clearly a contractual relationship, within which supplies for
consideration would in other circumstances be regarded as being performed. But not in the case of loans provided by bondholders. In Hamas & Helm the Court of Justice ruled there to be no reason to treat bonds differently from equities, given that transactions in these instruments are exempt in the same provision in the VAT Directive (Article 135(1)(f) VAT Directive).

Even more surprising was the Court of Justice’s finding in EDM that transactions in certificates of deposit and Treasury notes constituted the supply of services for consideration, and more specifically the provision of credit. These instruments share certain similarities with commercial paper (which is issued by enterprises) and, like bonds, are also transferrable debt instruments. There would not seem to be any good reason, therefore, to treat bonds differently from these instruments for the purposes of the VAT Act 1968. As no explanation for this differing treatment is given and as certificates of deposit and Treasury notes were largely of subordinate importance in the EDM case, I do not exclude the possibility that, to this extent, the decision taken was not a matter of principle. As I see it, it is also unlikely in any event that the Court of Justice has reconsidered its earlier ruling on bonds, as has sometimes been suggested in the literature. What is more likely is that the reason why commercial paper, certificates of deposit and Treasury notes are to be treated differently is that these instruments are not generally suited for private investors.

In other situations, case law has found the granting of credit to constitute an exempt service supplied for consideration, providing such consideration is indeed obtained. Although interest is the usual form of consideration provided in return for the granting of credit, other amounts payable under a credit agreement can also constitute consideration. It is important in this respect to note that the granting of credit does not relate only to private loans, but may also include deferred payments, instalment credits, hire purchase, financial leases and certain derivatives and commodity trades. The first three examples in any event require separate consideration to have been agreed if a transaction is to be recognised as the granting of credit. In contrast to what the Dutch State Secretary of Finance seems to believe, case law contains no requirement, in my view, for this consideration to be in the form of an agreed interest rate. It follows from the structure of the VAT Act 1968 (and the VAT Directive) that credit is not regarded as being granted in the case of prepayments and the granting of limited rights (beperkte rechten) constituting a supply under Article 3(2) VAT Act 1968.

One of the reasons why, in principle, the granting of credit represents the supply of a service for consideration is because it can constitute an economic activity on its own merits; i.e. the exploiting of tangible or intangible property for the purpose of obtaining income on a continuing basis. It can be concluded from case law that the business or commercial purpose required for this is quickly found to exist. Indeed, the provision of a single interest-bearing loan
English Summary

over a period of years can be sufficient in the case of legal entities. In cases
where the granting of credit is part of a more comprehensive economic activity
of a largely different nature, it has to be established whether the supply
comprises the direct, permanent and necessary extension of a taxable activity
or other transactions. In the latter case, the granting of credit may comprise an
incidental financial transaction within the meaning of Article 174(2)(b) or (c)
VAT Directive, the proceeds of which are excluded from the calculation of the
deductible proportion. As explained above, however, the distinction between
the direct, permanent and necessary extension of a taxable activity and other
transactions is vague.

The basic assumption with regard to the deductibility of input VAT is that
tax paid on costs incurred in the granting of credit is not deductible as these
activities’ exemption from VAT means that no taxed transactions occur. The
only exceptions are if the customer is resident outside the European Union or if
a direct relationship exists with goods designated for export. The scope of both
these exceptions can be interpreted in various ways and is, therefore, uncer-
tain. In my view, the first exception, which would seem the most important in
practice, should be subject to a strictly grammatical interpretation of the VAT
Act 1968 (and the VAT Directive); in other words, only the place of residence of
the customer matters, and not that of any permanent establishment for which
the credit may (ultimately) be intended. The current text of Article 15(2)(c) VAT
Act 1968 can produce outcomes that are at odds with the principle of equality
before the law. A Dutch bank, for example, can grant a loan on more favourable
terms to an entrepreneur resident outside the EU and wanting to invest in
Dutch real estate than it can to an entrepreneur resident within the EU.

In principle, remuneration received in return for credit should be taken into
account when calculating the deductible proportion. Two possible remedies
may be applied in situations where this distorts the deductible proportion.
The first of these is to disregard the interest, based on the direct effect of
Article 174(2)(b) or (c) VAT Directive, on the grounds that the granting of credit
is seen as an incidental financial transaction. This would require the activities
to be regarded as other transactions, while the granting of credit should also
imply only very limited use of supplies purchased and constituting general
expenses. The second remedy is to establish an apportionment formula for
determining the entitlement to deduct input VAT on the basis of actual use.
Court of Justice case law could conceivably be interpreted to allow an adjusted
turnover formula, in which only the net interest received (i.e. interest received
less interest paid) is taken into account, to be used as an apportionment
formula. Judging, however, by Supreme Court case law on the actual use
method, Dutch law would not currently seem to allow use of an adjusted
turnover formula.

Being granted credit has no other VAT-related implications for the borrower.
If, however, the borrower purchases non-exempt supplies in the process of
obtaining credit and does not use the borrowed funds exclusively for taxed
transactions, the input VAT is in principle non-deductible or not fully deductible. That is not so much a consequence of being granted credit, but rather the nature of the supplies performed as part of the borrower’s economic activity.

The odd man out, lastly, is financing provided through factoring and other forms of debt acquisition. The outcomes under the VAT Act 1968 in this respect can vary, depending on the circumstances. At one end of the spectrum is the incidental acquisition of non-interest-bearing debt at its economic value. In these circumstances, acquisition of the debt does not result in a taxable transaction on the part of the acquiring party. The acquiring party is not then regarded as performing an economic activity or as being entitled to deduct input VAT. At the other end of the spectrum is the continuing acquisition of interest-bearing debt in return for consideration. In these circumstances, the activity performed by the acquiring party will constitute an economic activity, within which the party performs both taxed and exempt supplies. The taxed supplies comprise factoring, or at least the collecting of receivables for the party transferring the assets. The exempt supplies are those in the form of credit granted to debtors and possibly also to the party transferring the assets. The extent of any entitlement to deduct input VAT in these circumstances depends, in principle, on the relative proportions of the remuneration received for the various supplies and on whether the credit granted falls within the scope of Article 15(2)(c), VAT Act 1968. In addition, and in exceptional circumstances, incidental financial transactions within the meaning of Article 174(2)(b) or (c) VAT Directive may be considered to exist. Any remuneration received on these transactions should be excluded when calculating the deductible proportion.

The case law shows, in my view, that the decisive issue in determining whether a taxed transaction exists is whether the parties have agreed remuneration for the supplies that are to be performed by the acquiring party. Although agreeing remuneration may indicate that the acquiring party is operating in an economic and commercial sphere when accepting the transfer of receivables, it also creates opportunities for tax planning. This is because by charging remuneration, a party acquiring receivables may be classified as an entrepreneur in certain circumstances and so be entitled to deduct input VAT. By simultaneously increasing the price agreed to be paid, the parties could achieve the same outcome as if agreement had not been reached on remuneration. In this way, the subjective nature of remuneration offers parties an element of freedom to set it at a level of their choosing.

Case law has certainly not yet clarified the right of debt purchasers operating in the economic sphere to deduct input VAT. The primary question is whether this is affected by any exempt granting of credit to the transferring party after the debt has been transferred. To this extent, the legal position can be regarded as uncertain. Legal uncertainty also exists with regard to the acquisition of non-performing, interest-bearing debts. Although there are
reasons to assume, in certain circumstances, that these activities constitute the
supply of services for consideration and that they are of an economic nature, it
remains a grey area.

The question for the recipient of financing (also the party transferring the
receivables) is whether the transfer constitutes a supply of services for con-
sideration. In my view, that should not be the case because this would
otherwise result in irrational double counting. It would also mean that the
service would be exempt, with the result that the transferring party’s entitle-
ment to deduct input VAT could be substantially restricted. In my estimation,
however, the Court of Justice is likely, in principle, to consider the transfer of
receivables to constitute an exempt service. This is because interpreting the
provisions differently would not readily accord with the approach that the
Court has adopted with regard to disposals of equities and bonds. If such
transfers are treated as an exempt service, input VAT would not be deductible
on direct costs incurred. In my view, however, transfers of receivables would
still not, in principle, affect the deductible proportion. This is because I would
regard such transfers as other transactions performed during the course of an
economic activity and having little if any effect on purchases of supplies
classified as general expenses. This means that the transfer would constitute
an incidental financial transaction within the meaning of Article 174(2)(b) or (c)
VAT Directive. This view is certainly open to debate, however. If the judgment
in AB SKF is seen as assigning particularly wide-ranging scope to the extension
criterion, this could easily extend to the transfer of receivables.

All in all, the method of financing chosen by an enterprise has been found to
make a difference from a VAT perspective. The differences arising concern
entrepreneurship, the imposition (or otherwise) of VAT on financing provided
and the deductibility of input VAT. Not only do the various funding methods
produce different outcomes with regard to these aspects of the VAT Act 1968
(and the VAT Directive), but the final outcomes in terms of VAT payable are also
not necessarily the same.

ES1.2.3  Incompatibility with EU law

In summary, I have found Dutch law to be incompatible with Union law in the
following respects:
1. Based on the State Secretary of Finance's policy on the holding and dispo-
sing of equities, the extent to which input VAT may be deducted sometimes
exceeds the scope provided for by the Court of Justice in its interpretation of
the provisions of the VAT Directive;
2. It seems unjustified that only purely holding companies with a controlling
and policy-making role in a group that are not classified as entrepreneurs
can be part of a fiscal unity, whereas other non-entrepreneurs cannot;
3. The territorial restriction on the fiscal unity in Article 7(4), VAT Act 1968 would seem to be incompatible with primary Union law, even though it complies with the VAT Directive;

4. The Supreme Court case law whereby certain profit distributions by cooperatives constitute consideration for a supply is not compatible with Court of Justice case law;

5. Article 174(2)(b) and (c) VAT Directive has wrongly not been implemented in national law;

6. The effect of Article 15(2)(c) VAT Act 1968 is wrongly not excluded in the case of Dutch VAT refunds granted to entrepreneurs resident or established outside the European Union and without a permanent establishment in the European Union.

**ES12.4 Quality of legislation in the field of research**

With regard to the quality of the legislation in the field of research, it is argued that a number of points in national VAT legislation are incompatible with Union law and are consequently not lawful. In my view, however, these are not the most essential points. They have also been known about for quite some time; the question consequently arises as to why Article 174(2)(b) and (c) VAT Directive, for example, has not been transposed into national law. The extent to which certain aspects of the legislation respect the principle of equality before the law can also be questioned, although these comments are not limited to national legislation. The tax imposed on a sole shareholder actively intervening in a company and demanding some form of remuneration can, for example, differ substantially from that imposed on the same type of shareholder who does not receive remuneration. This difference in treatment is, in my view, disproportional to the differences between the two situations. Another example is the striking difference in the treatment of bonds on the one hand and other transferrable debt instruments, such as commercial paper, on the other hand. A more important point relating to the quality of the current legislation is, in my opinion, the issue of legal certainty. The legislation contains various vague standards, including economic activity, service, use for the purpose of taxed transactions and incidental financial transactions. To a certain extent, the vagueness of these standards is inevitable and can be clarified through case law. When the issue becomes problematic, however, is when no line of reasoning, or at least no clear line of reasoning, can be discerned with regard to the circumstances playing a decisive role in any specific decision. In my view, this applies primarily to the case law of the Court of Justice, specifically that relating to shareholdings. As a result, the clarity and accessibility of the law are less than optimal.
ES1.3  Second research question

ES1.3.1  Purport of VAT

The purport of VAT (in other words, its legal nature), as elaborated in the VAT Directive and the VAT Act 1968, is that of a tax on turnover and also a tax on consumption. This explains the generality of the tax, the proportionality of its effect on prices of goods and services, and the avoidance of distortions of competition, as shown in the following diagram:

*Purport of VAT*

![Diagram of VAT purport](image)

It is important, in my view, that consumption within the meaning of VAT assumes that goods and services are created by the adding of value – production – by enterprises. The requirement for consumption to be the result of production by enterprises means that consumption cannot exist in the case of money held in trust, equities and comparable abstractions. Disposals and transfers of equities and money, along with the granting of credit, consequently do not, as such, result in consumption from a VAT perspective, and similarly do not represent the production or propulsion of goods or services in or through a production or distribution chain.
ES1.3.2 Assessment of current legislation in the field of research

The main issues within the field of research – enterprise financing – relate to the purport of VAT and the way in which it is interpreted in practice with regard to entrepreneurship and the right to deduct input VAT. Although these issues primarily affect those providing finance, they may also affect those receiving it. This applies specifically when a liability for VAT arises on non-consumption by financers as the latter will normally seek to pass on the tax charge to the recipient of the financing.

As far as entrepreneurship is concerned, another possible problem is that, with a certain element of good will, the economic activity of exploiting ‘tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis’ can be interpreted so widely that even private individuals with a savings account can be seen as entrepreneurs. In my view, this interpretation goes too far. Whatever the case, however, the boundary lines essentially distinguishing businesses from consumers have become blurred. In addition, the effort to obtain income from supplies for consideration (income production criterion) that is required for an activity to constitute an economic activity also results, for example, in group holding companies and certain businesses that purchase receivables not being regarded as entrepreneurs. Such parties are certainly not consumers and, in line with the purport of VAT, should properly be regarded as entrepreneurs. Lastly, there is the regularity criterion, which sometimes results in incidental economic activities falling outside the liability for VAT, but sometimes not. Reasons justifying these anomalies can be found primarily in the case of the income production criterion.

The fact that the provision of finance does not usually constitute a taxed supply largely accords with the purport of the tax. This is because, in itself, this does not result in consumption, certainly not if the financing is provided to businesses. For the same reason, the fact that disposals of equities and bonds are not subject to VAT also reflects the purport of the tax. The fact that the value added by, for example, banks and securities traders is not liable for VAT is admittedly a problem, but only insofar as this value accrues directly to end users (or entrepreneurs not entitled to deduct all their input VAT). This anomaly can be justified by the technical difficulty of taxing such added value.

Various problems are associated with the right to deduct input VAT. This is because, in view of the purport of the tax, an entrepreneur providing finance to a business could be expected to be fully entitled to deduct input tax on the costs incurred in this respect, given that there is no consumption by this party. The same applies to the disposal of shareholdings or transferrable debt instruments. As it currently stands, however, the legislation does not always allow full deduction of input VAT. This applies specifically in the case of exempt services, such as the granting of credit and the disposal of securities. De facto,
English Summary

therefore, non-consumption is taxed. Although certain grounds justifying this position are conceivable, none is entirely convincing.

The only problem affecting the recipients of financing in this respect is that transfers of receivables may restrict their right to deduct input VAT. In my view, there are no strong grounds to justify this restriction.

Lastly, opportunities currently exist for tax planning in the capital sphere, partly because there is no requirement in VAT to apply arm’s length pricing in relationships between associated parties. In certain cases, parties may have an incentive to agree lower (or higher) remuneration for supplies of goods or services. The loss (or surplus profit) can then be adjusted through the capital relationship, providing this effectively serves to reduce the VAT payable. One reason that may justify allowing these tax planning opportunities to persist is that seeking to combat them by introducing an open market value would have a substantially adverse effect on legal certainty, simplicity and enforceability, while the extent to which such planning occurs is also unclear. Maybe the problem is not particularly widespread.

ES2 Recommendations

ES2.1 Eliminating breaches of Union law

Based on the findings of this research, it is proposed making various amendments to Dutch legislation and regulations in order to remedy the breaches of Union law:

1. Implementation of Article 174(2) (b) and (c) VAT Directive in national law as this provision in the VAT Directive is not discretionary;
2. Ending the restriction of the fiscal unity regime to entrepreneurs in Article 7(4) VAT Act 1968. This amendment will also bring the way VAT operates more into line with its purport;
3. Amendment of Article 31(4) VAT Act 1968 so that the provisions of Article 15(2)(c) VAT Act 1968 do not apply to refunds requested by entrepreneurs from outside the European Union, as proscribed by Article 2(1), Thirteenth Directive;
4. Amendment or repeal of various policy decisions insofar as the taxation (or non-taxation) provided for is incompatible with Union law.

ES2.2 Possible solutions to the problems identified

Various solutions to the problems identified in the second research question were examined, with a distinction being made between matters that the Netherlands can arrange unilaterally and matters requiring amendment of the VAT Directive.
English Summary

The following unilateral solutions are, in my view, recommended:
1. Introducing an option to impose VAT on financial services transacted between members of the same group. This would eliminate the possibility of non-deductible input VAT within groups that perform exclusively (or almost exclusively) taxed supplies. This non-deductible input VAT currently arises in situations involving, for example, holding or group financing companies whose sole activity comprises the provision of exempt supplies to other members of the same group;
2. Introducing a reverse charging mechanism in combination with the option referred to in point 1. above so that no VAT effectively has to be charged on, for example, interest payable. Under Article 395 VAT Directive, this will require authorisation by the Council.

A general option for imposing tax merits further research, but goes beyond the limited scope of the current research. A broader application of the open market value as the standard for taxation may also be a useful instrument for combating tax planning in the capital sphere. However, adopting the open market value as the standard would infringe upon the principle of legal certainty. In my view, therefore, this would be justified only if further research were to find evidence of tax planning in the capital sphere on a large scale.

The following solutions requiring amendment of the VAT Directive are, in my view, recommended:
1. A more precise description of the forms of asset exploitation that should be regarded as constituting an economic activity. There is an overlap between genuine economic exploitation and the activities of a service provider. In only a few specific situations is extension of the definition of entrepreneurship regarded as desirable;
2. Parties actively participating – as a shareholder, for example – in an entity of which they are the owner or part-owner should be regarded as entrepreneurs. This will eliminate the peculiar situation where, for instance, holding or interim holding companies within a group are not regarded as entrepreneurs, even though they are anything but end consumers;
3. The right of intervening shareholders to deduct input VAT should generally be arranged in a way that eliminates the distinction between the acquiring, holding and disposing of the enterprise (i.e. its assets and liabilities) and the acquiring, holding and disposing of an interest in the entity that operates the enterprise;
4. Parties that acquire receivables on a commercial basis should always be regarded as an entrepreneur, with transfers of receivables to such persons being treated as if they constituted the transfer of a totality of goods or services;
5. Replacement of Article 12(1) VAT Directive by provisions that are more appropriate for small enterprises. This would eliminate the anomaly that an
English Summary

incidental, large-scale economic activity does not result in classification as an entrepreneur, whereas a more permanent economic activity on a more limited scale does result in such classification;
6. Disposals of receivables, shareholdings (equities) and bonds, for example, should be excluded from the definition of a service, unless the party transferring the securities is a securities trader. If the service is no longer exempt, costs can no longer be attributed to the disposal. This recommendation is linked to the recommendation in point 3 above;
7. **Amendment of Article 15(2)(c) VAT Act 1968, such that the customer’s place of residence no longer determines whether input VAT is deductible. Instead, the place where exempt financial services are actually used or exploited should be the decisive factor;**
8. **Amendment of Article 174(2)(b) and (c) VAT Directive to include provision for income from financial transactions to be excluded from the calculation of the deductible proportion if it represents only a very limited share of supplies purchased and the costs are included in general expenses.**

Other possible solutions include introducing a cross-border fiscal unity regime, allowing a general exclusion from the definition of a service for transactions that do not imply consumption and introducing a zero rate of VAT for financial services that are currently exempt. Examining these solutions goes beyond the scope of this research, but may well merit further in-depth study in the future.