Charities and VAT

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Abstract

Many charities are out of scope of VAT because they do not perform economic activities. For that reason, they are not able to deduct input VAT. Other charities are in scope, but exempt and therefore unable to deduct input VAT. This results in the issue that the public policy objective of a different VAT treatment of charities is often not met. Various suggestions have been made to solve these problems, but it is questionable whether it is possible to find a solution within the VAT, especially for out of scope charities.

1 Introduction

Even though we shared the same nationality, for a long time, Ben Terra was for me a famous name but at the same time someone I had never met in person. Only when my visiting professorship in Lund started in February 2018, a time when Ben became very much involved again in the master in European and International Tax Law, I got to know him personally. Every month we met in Lund, shared a room and had interesting conversations. After the last EU VAT seminar he and Marta Papis gave in Lund in January 2019, we had a discussion on the then still pending Golfclub Schloss Igling case (C-488/18).[2] This case relates to charities and VAT, a subject which has my specific research interest and on which I teach in the indirect tax track of the master in Lund. This is the perfect reason to explore this theme in this book dedicated to Ben Terra's memory as a great tax professor and a kind man.

As is established in section 2, charities are not just a social force in the EU, but an economic force as well. Value added tax (VAT) is a very relevant, but often problematic tax for many charities. As they are in many cases either not deemed taxable persons for VAT, they cannot recover input VAT, as is discussed in section 3. In addition, even if they are deemed to be taxable persons for (part of) their activities, these activities may be exempt, which would also limit the possibility to deduct input VAT (section 4). Depending on a charities' activities, this might be a considerable cost. In section 5, several solutions for this problem will be analysed. This contribution ends with a conclusion in section 6.

2 Size of the philanthropic sector in the EU

Many charitable organizations are active in the European Union (EU). These range from small local initiatives carried out by volunteers to large international organizations managed by professionals. Complete information on the size of the philanthropic sector is lacking, not only in the European Union, but also elsewhere. The OECD noted in its 2020 Tax Policy Study on Taxation and Philanthropy that the number of entities varies widely between countries and that reliable data on economic contribution, the size of the workforce and the number of people volunteering are notoriously difficult to estimate across

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[2] DE: ECJ, 10 December 2020, Case C-488/18, Finanzamt Kaufbeuren mit Außenstelle Füssen v.Golfclub Schloss Igling eV, ECJ Case Law IBFD.

countries.[3] A 2015 report from the Observatoire de la Fondation de France estimated the total amount given to charities in Europe at €24.4 billion, expenditure at €54 billion, the relative importance of the sector at 0.45% of GDP, the total assets at €433 billion and the amount of charities at 130,000.[4] The latter figure is an underestimation. I assume that this is probably caused by using the French term 'foundation' was used. It seems that that registers that exist in some countries were not consulted as in that case the number would have been much higher. In the United Kingdom alone, which was in 2015 still an EU Member State, there were already over 165,000 registered charities, a figure which increased to well over 169,000 in 2021.[5] According to the OECD, in 2018 there were 130,000 philanthropic organizations in the Czech Republic, 600,000 in Germany, 98,231 in Italy, 99,300 in Sweden, 43,000 in the Netherlands and 28,524 in Slovenia to name some EU countries with many of such organizations.[6] Other countries seem to apply stricter requirements, resulting in less organizations, such as Romania (144), Austria (1230), Belgium (2241), France (4188), Portugal (8148), Slovak Republic (8687) and Ireland (9781).[7]

It is also clear from the footnotes included in the OECD's overview, that definitions vary heavily between countries. This makes a comparison difficult. Notwithstanding these problems of definitions and comparability, it is clear that philantropy is an important sector in the EU.

In this respect it is important to note that not only definitions and requirements differ across countries, but that such entities are also addressed by different names, including philanthropic organizations, non-profit organizations, public benefit organizations and non-governmental organizations (NGOs). This chapter uses the term charities aiming to include all such organizations and thus without limiting the concept to voluntary or traditional philanthropic organizations.

3 Charities not always taxable persons for VAT

Other than with most direct taxes, such as corporate income tax, it may be beneficial for a charity to be a taxable person for VAT. Charities that are in scope of the VAT may be able to recover VAT they paid on their inputs. Article 168 of the VAT Directive[8] provides that in so far as goods and services are used for taxed transactions of a taxable person, the latter is entitled to deduct the VAT in respect of supplies to him by another taxable person. Being a taxable person is, therefore, a first requirement for deduction of input VAT. For charities that are not a taxable person and thus out of scope, VAT is a cost that cannot be recovered. Therefore, being a taxable person may be of great relevance for charities that incur large costs for supplies and services (including investments in real estate and equipment) such as museums, universities and development aid and disaster relief charities.

Article 9(1) VAT Directive defines a 'a taxable person' as any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. In this respect, 'economic activity' has a wide scope and is an objective term in the sense that the activity is considered

[3] OECD, *Taxation and Philanthropy*, *OECD Tax Policy Studies no. 27* (OECD Publishing 2020), p. 14.
[4] Observatoire de la Fondation de France, *An Overview of Philanthropy in Europe*, (CERPhi 2015).
[5] https://www.statista.com/statistics/283464/number-of-uk-charities-in-england-and-wales/.
[6] OECD, *Taxation and Philanthropy*, *OECD Tax Policy Studies no. 27* (OECD Publishing 2020), p. 15.
[7] OECD, *Taxation and Philanthropy*, *OECD Tax Policy Studies no. 27* (OECD Publishing 2020), p. 15.
[8] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax as later amended.

per se and without regard to its purpose or results.[9] It is not relevant that activities are not for profit or have a charitable purpose. As such it can, therefore, include various activities of charities such as selling goods in charity shops, ticket sales of museums and activities in return for sponsoring.

However, the European Court of Justice (ECJ)[10] made clear that not every activity of a charity is an economic activity. If a charity only provides services free of charge, it is not a taxable person.[11] In addition, if only voluntary donations are received, there is no supply for consideration.[12] First of all, because there is no legal agreement between the donor and the charity and second because there is no necessary link between the service and the payments. Such activities are, therefore, also out of scope of VAT. The ECJ requires a direct link between the service supplied and the consideration received. Also, if the only income obtained on a continuing basis comes from public funding and members' contributions, and that income is raised to cover losses made by the activity of developing an informed political opinion with a view to participation in the exercise of political power, there is no participation in any market and thus no economic activity.[13] This case regarded a political party, which in some countries, such as the Netherlands would be regarded as a charity. However, as advocacy is an activity of many charities and as in many European countries certain charities perform those advocacy activities with public funding, it is also relevant for other organizations than political parties.

Next to donations and government subsidies, income from investments can also be an important source for charities to fund their activities. This is especially the case for so called endowment funds. These are usually not allowed to spend their funds (called endowment) but must invest it and fund their activities with the proceeds of their investments. This can be a strategy to ensure that the charity will be able to perform its activities on a long term. The ECJ decided that the regular acquisition and sale of shares and other securities by a trustee in the course of the management of the assets of a charitable trust is not an economic activity.[14] The mere exercise of the right of ownership by its holder cannot, in itself, be regarded as constituting an economic activity. Typically, the aim of such endowment fund is maximizing the income from its investments which is used to pursue its charitable object, such as the promotion of medical research. Such charities can, therefore, not be compared with commercial undertakings. Instead, the activities are confined to managing an investment portfolio in the same way as a private investor. Neither the scale of these activities nor the employment in connection with it, are criteria for distinguishing between the activities of a private investor, which fall outside the scope of VAT and those of an investor whose transactions constitute an economic activity. The classification of a transaction as an economic activity cannot depend on the investor' s skill and experience. The principle of neutrality did not come into play, as that regards equal treatment of *economic* activities. Treating these activities as economic activities would in the view of the ECJ mean that such charities would have an advantage over private investors.

[9] AT: ECJ, 6 Oct. 2009, C-267/08, SPÖ Landesorganization Kärnten, para. 16-17, ECJ Case Law IBFD.
[10] A term and abbreviation I use to refer to both the current Court of Justice, one of the courts of the Court of Justice of the European Union and the Court of Justice of the European Communities.
[11] NL: ECJ, 1 Apr. 1982, Case C-89/81, Hong Kong Trade Development Council, ECJ Case Law IBFD.
[12] NL: ECJ, 3 Mar. 1994, Case C-16/93, R.J. Tolsma v. Inspecteur der Omzetbelasting Leeuwarden, ECJ Case Law IBFD.
[13] AT: ECJ, 6 Oct. 2009, C-267/08, SPÖ Landesorganization Kärnten, para. 23-25, ECJ Case Law IBFD.
[14] UK: ECJ, 20 June 1996, Case C-155/94, Wellcome Trust Ltd v. Commissioners of Customs and Excise, ECJ Case Law IBFD.

This means that several important activities for charities are not regarded as economic activities for VAT and thus outside of its scope. Therefore, for a substantial amount of charities, VAT is – at least in part - a non-recoverable cost.

4 Exemptions can result in VAT being a cost for charities

Even charities that are taxable persons for VAT purposes may not always be able to fully deduct the input VAT. As was mentioned in section 3, a first requirement for deducibility of input VAT is being a taxable person. However, article 168 VAT Directive also stipulates that input VAT is only deductible insofar as the goods and services are used for taxed transactions. The VAT Directive includes various exemptions. Insofar as a taxable person uses goods and services for exempt transactions, the input VAT is not deductible. Again, in contrast with direct taxes such as corporate income tax and gift and inheritance tax, being exempt for VAT is often not beneficial from a VAT point of view. This is relevant for charities, as there are several exemptions that may apply to their activities.

4.1 VAT Exemptions relevant to charities

Other than most domestic direct taxes, the VAT Directive does not include a specific reference to charities. This makes sense, as the VAT is, in principle, linked to the nature of *supplie*s of taxable persons, not to the nature of taxable persons themselves. This is different from direct taxes such as corporate income tax and gift and inheritance tax where the nature of the taxable person is often relevant.

Chapter 2 of Title IX of the VAT Directive (article 132-134) includes exemptions for certain activities in the public interest. Several activities that Member States must exempt based on article 132 VAT Directive, are deemed charitable in many Member States. Examples are hospital and medical care; supply of human organs, blood and milk; the supply of services and of goods closely linked to welfare and social security work and to the protection of children and young persons; education; the supply of staff by religious or philosophical institutions for specific activities with a view to spiritual welfare; supplies by non-profit-making organizations with aims of a political, trade-union, religious, patriotic, philosophical, philanthropic or civic nature to their members in their common interest in return for a subscription, provided that this exemption is not likely to cause distortion of competition; the supply of certain services closely linked to sport or physical education by non-profit-making organizations to persons taking part in sport or physical education; the supply of certain cultural services, and the supply of goods closely linked thereto; and the supply of services and goods, by organizations whose activities fall under specific other exemptions of article 132 in connection with fund-raising events organized exclusively for their own benefit, provided that exemption is not likely to cause distortion of competition.

The wording of these exemptions differs widely. Some, such as the supply of human organs, blood and milk are extremely specific: no matter what kind of taxable person provides for these supplies, Member States must exempt these. Given the specific wording, such provisions have direct effect as such provisions meet the requirement that they are, so far as their subject matter is concerned, unconditional and sufficiently precise.[15] This means that they can be relied on if a member state did not (correctly) implement these.

[15] UK: ECJ, 15 February 2017, Case C-592/15, British Film Institute, ECJ Case Law IBFD.

Other exemptions use more subjective wording both on the supplies and the supplier. Some exemptions only apply to specific organizations such as bodies governed by public law or other bodies recognized by the member state (for example social wellbeing activities, education and cultural services) or, as is the case for hospitals which are not bodies governed by public law, those governed under social conditions comparable with those applicable to bodies governed by public law. Currently, a question is pending before the ECJ on when hospitals governed by private law provide hospital care under comparable social conditions.[16] According to Advocate General Hogan,[17] this concept should be interpreted as referring to all conditions that private institutions must meet in order to be subject to either identical or comparable rules prescribed by law governing the relationship between bodies governed by public law and their patients to which they must comply with in all circumstances when they provide hospital treatment, medical care or operations closely linked to such services. Compliance with that condition by a private establishment may be inferred from the obligations that that establishment has contractually imposed on itself with respect to patients. A requirement of carrying out at least 40% of hospital services invoiced for an amount lower than the amount reimbursable by the social security bodies may constitute such social condition. A formal requirement, such as being part of a hospital plan of a Land or to have concluded an agreement with a health insurance fund is not a social condition in his view.

Other exemptions only apply to non-profit making organizations (sports, supplies to members). Some exemptions require that these may not likely cause distortion of competition (supplies to members, supplies in connection with fund raising events), others apply only to 'certain' services (sport, culture). The ECJ made it clear that the provisions using indefinite wording of 'certain' services do not have direct effect.[18]

For several exemptions, article 133 VAT Directive allows Member States to include conditions in the domestic VAT legislation. These requirements are similar to conditions various Member States impose on charities and include a prohibition of systematically aiming to make a profit and to distribute any profit that nevertheless arises; management by volunteers; approved prices or prices that are lower than commercial prices; and the exemptions not being likely to cause distortion of competition to the disadvantage of commercial enterprises subject to VAT. Member States may impose these requirements on bodies other than those governed by public law regarding the exemptions of article 132(1) provided for in points b (hospitals), g (welfare and social security work), h (protection of children), i (education), l (non-profit making organizations with members), m (sports) and n (culture). Many of these activities are regarded as charitable in various Member States. The Member States are not obliged to impose all conditions. They are free to decide not only whether or not to impose these conditions, but also which of the conditions they want to impose.

4.2 Reason for indeterminate wording of some exemptions

The subjective wording of the exemptions may lead to different views of Member States on how these exemptions should be interpreted. This is not ideal for a tax that is supposed to be harmonized in the EU. It can probably be explained by the fact that under the Second VAT Directive[19] Member States had

[16] DE: Case C-228/20, I GmbH v Finanzamt H.
[17] DE: AG Hogan, 23 September 2021, Case C-228/20, I GmbH v Finanzamt H.
[18] UK: ECJ, 15 February 2017, Case C-592/15, British Film Institute, ECJ Case Law IBFD and DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD.
[19] Second Council Directive (67/228/EEC) of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes OJ No 71, 14. 4. 1967, p. 1303/67.

quite a bit of freedom to introduce exemptions.[20] The Sixth VAT Directive[21] harmonized the exemptions in the list that is currently included in article 132 VAT Directive. According to the European Commission, these exemptions already existed in the majority of Member States.[22] This was probably the only way to get all Member States to agree, but it may also be an explanation for the diversity in the wording used in this list.

Originally, the plan was to have more harmonisation. In article 14 of the Proposal for a Sixth Directive,[23] exemptions similar to the ones currently included in article 132(b) (medical services), 132(g) (welfare and social security), 132(h) (protection and education of children) and 132(n) (culture) only applied if supplied by bodies governed by public law, non-profit-making organizations or private charitable organizations. Article 14(2) provided for rather precise definitions of non-profit-making organizations and private charitable organizations. Non-profit-making organization was defined as an organization that could not have as its object the making of profits, had to assign any profits made to the improvement and continuance of the services which it provided and it could not obtain material advantages for persons other than the customers or users of the organization (this did not include the employment by the organization of wage or salary-earning staff). Private charitable organization was defined as an organization whose activities are directed to the public good or to benevolent ends and of which the prices are approved by the competent public authorities, or its profits are assigned to promoting the public interest or benevolent ends in accordance with rules to be laid down under national laws. Apparently, the Member States could not agree on these definitions and in article 13A of the Sixth Directive (just as in article 132 of the VAT Directive) no definitions of non-profit-making organizations and private charitable organizations were included. Similarly, instead of the current exemption for 'certain' cultural services, the Proposal for a Sixth Directive provided for a very precise list of cultural activities on which it would apply. As the Member States could not agree on this list of cultural activities, the compromise was found in the current wording.

4.3 Interpretation of the exemptions

The indeterminate wording of some exemptions and the possibility to impose the conditions included in article 133, do not mean that Member States can interpret these in whatever way they like. Preamble 35 of the VAT Directive states that a common list of exemptions should be drawn up so that the Communities own resources may be collected in a uniform manner in all the Member States. A similar preamble preceded the Sixth VAT Directive.

This was tested by Spain in the 1998 Commission v Spain case in which Spain argued that 'certain' supplies of services permits Member States to limit the scope of the exemption, not only by expressly excluding certain services provided by sports establishments from the exemption, but also by applying

[20] Article 10(3) stated: "Each Member State may, subject to the consultations mentioned in article 16, determine the other exemptions which it considers necessary".
[21] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment as amended by later directives.
[22] Proposal for a Sixth Council Directive on the harmonisation of Member States concerning turnover taxes. COM (73) 950 final, 20 June 1973. Bulletin of the European Communities, Supplement 11/73, p. 15.
[23] Proposal for a Sixth Council Directive on the harmonisation of Member States concerning turnover taxes. COM (73) 950 final, 20 June 1973. Bulletin of the European Communities, Supplement 11/73, p. 41-42.

other criteria, such as the amount of the consideration for the services in question.[24] The ECJ did not allow adding any conditions other than those laid down in the VAT Directive. The Court repeated this in the Canterbury Hockey Club case which was also on the exemption for the supply of certain services closely linked to sport.[25]

Similarly, in the British Film Institute case[26] and the Golfclub Schloss Igling case[27] the ECJ held that the expression 'certain supplies of services' indicates that this expression does not oblige Member States to exempt all services that are closely related to culture or sports respectively. As the provision does not include a limited list of services which are closely related to sports or for which Member States must provide an exemption and does not entail an obligation to exempt all such services, Member States have a discretion to decide on what services the exemption applies.[28] This also means that not all services that meet the requirements of articles 132(1)(m) and 134(a) must be exempted as only 'certain' and not all services that meet the requirements are exempt. Article 134(a) only entails a restriction of the margin of appreciation, not the abolition of it.[29] The same applies to the provision of article 132(1)(n) on the supply of certain cultural services. Regarding the definition of organizations devoted to social wellbeing, the ECJ also acknowledged that Member States have the discretion to recognise certain organizations as being devoted to social wellbeing (and others not).[30] When exercising their discretion, Member States must be consistent with the general principles of EU law.

On the other hand, exemption from VAT of a specific transaction cannot depend on its classification in national law.[31] The exemptions constitute independent concepts of Union law whose purpose is to avoid divergences in the application of the VAT system from one Member State to another. More in general, the Court held, for example in the Gregg case, that the terms used in the exemptions must be interpreted strictly since these constitute exceptions to the general principle that VAT is to be levied on all services supplied for consideration by a taxable person.[32]

This has induced the ECJ over time to give some rather subjective interpretations on the meaning of concepts used in the exemptions of article 132. For example, the ECJ observed that the concept of 'sport' in article 132(1)(m) is an autonomous concept of EU law.[33] As this term is not defined in the VAT Directive, the ECJ held it must be determined by considering its usual meaning in everyday language, while also taking into account the context in which it is used and the purposes of the rules of which it is part. It is not limited to certain types, or (professional or amateur) levels of sport, nor is it relevant

[24] SP: ECJ, 7 May 1998, C-124/96, Commission of the European Communities v Kingdom of Spain, ECJ Case Law IBFD, para 14.
[25] UK: ECJ, 16 October 2008, C-253/07, Canterbury Hockey Club, ECJ Case Law IBFD.
[26] UK: ECJ, 15 February 2017, Case C-592/15, British Film Institute, ECJ Case Law IBFD.
[27] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 30.
[28] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 31.
[29] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 33.
[30] FR: ECJ, 11 January 2001, C-76/99, Commission of the European Communities v. the French Republic, paragraph paragraph 41.
[31] For example, FR: ECJ, 11 January 2001, C-76/99, Commission of the European Communities v. the French Republic paragraph 26, in which the ECJ refers to Case C-124/96, ECJ Case Law IBFD.
[32] UK: ECJ, 7 September 1999, Case C-216/97, Jennifer Gregg and Mervyn Gregg and Commissioners of Customs & Excise, ECJ Case Law IBFD, paragraph 12.
[33] UK: ECJ, 26 October 2017, Case C-90/16, English Bridge Union, ECJ Case Law IBFD and CZ: ECJ, 21 February 2013, Žamberk, Case C-18/12, ECJ Case Law IBFD.

whether it is practiced in an organized or systematic way.[34] According to the ECJ in everyday language 'sport' refers to an activity of a physical nature, an activity characterized by a not negligible physical element. The Court does not give references for this deemed meaning in everyday language. In addition, the Court referred to the title of the chapter in which article 132 falls, meaning that only certain, listed, activities in the public interest are concerned. The ECJ held that this means that the provision seeks to promote sports participation by large sections of the population.[35] This, according to the Court, argues in favour of an interpretation that the concept of 'sport' is limited to activities satisfying the ordinary meaning of the term 'sport', characterized by a not negligible physical element, but not covering all activities that may, in one way or another, be associated with that concept. Activities of pure rest and of amusement[36] are not covered under this concept. The same applies to activities of pure rest or relaxation, even if they prove beneficial to or promote physical and mental health.[37] The fact that an activity promoting physical and mental well-being is practiced competitively does not lead the ECJ to come to a different conclusion.[38] The competitive nature of an activity cannot, per se, be sufficient to establish its classification as a 'sport', failing any not negligible physical element.[39] This, according to the Court, is in line with the requirement of strict interpretation of VAT exemptions and the objective of strict circumscription of the exemption at issue. Therefore, as in the view of the ECJ 'sports' requires an activity with a non-negligible physical element, the ECJ does not regard bridge to be a sport. The Court opened the possibility that an activity with a physical element that appears to be negligible may, where appropriate, be covered by the concept of 'cultural services' and thus be covered by the exemption of article 132(1)(n), if the activity, in the light of the way in which it is practiced, its history and the traditions to which it belongs, in a given Member State, holds such a place in the social and cultural heritage of that country that it may be regarded as forming part of its culture.[40] The Dutch Ministry of Finance has already decided that bridge, chess, checkers and go, on which the sports exemption applied before this case law, are not part of Dutch cultural heritage and are therefore no longer eligible for the exemption.[41]

The Court pointed out many times that the Directive only exempts certain activities which are in the public interest. Therefore, not every activity performed in the public interest is exempt, but only those which are listed.[42]

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[34] CZ: ECJ, 21 February 2013, Žamberk, Case C-18/12, ECJ Case Law IBFD, paragraph 22, 24, 25.
[35] CZ: ECJ, 21 February 2013, Žamberk, Case C-18/12, ECJ Case Law IBFD, paragraph 23.
[36] CZ: ECJ, 21 February 2013, Žamberk, Case C-18/12, ECJ Case Law IBFD, paragraph 22.
[37] UK: ECJ, 26 October 2017, Case C-90/16, English Bridge Union, ECJ Case Law IBFD, paragraph 24.
[38] UK: ECJ, 26 October 2017, Case C-90/16, English Bridge Union, ECJ Case Law IBFD, paragraph 25.
[39] UK: ECJ, 26 October 2017, Case C-90/16, English Bridge Union, ECJ Case Law IBFD, paragraph 25.
[40] UK: ECJ, 26 October 2017, Case C-90/16, English Bridge Union, ECJ Case Law IBFD, paragraph 25.
[41] NL: Letter of the Ministry of Finance, 31 August 2020, nr. 2020-0000046656, NTFR 2020/2533, file:///C:/Users/16899she/Downloads/kamerbrief-onderzoek-toepassing-culturele-btw-vrijstelling-op-denksporten.pdf.
[42] See, for example, DE: ECJ, 11 July 1985, 107/84, Commission of the European Communities v Federal Republic of Germany, , ECJ Case Law IBFD, paragraph 17; NL: ECJ, 15 June 1989, 348/87, Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën, , ECJ Case Law IBFD, paragraph 13; UK: ECJ, 12 November 1998, C-149/97, The Institute of the Motor Industry v Commissioners of Customs and Excise, ECJ Case Law IBFD, paragraph 18; DE: ECJ, 28 January 2010, C-473/08, Ingenieurbüro Eulitz GbR Thomas und Marion Eulitz v Finanzamt Dresded I, , ECJ Case Law IBFD, paragraph 26; SV: ECJ 10, June 2010, C-262/03, CopyGene A/S v Skatteministeriet, ECJ Case Law IBFD, paragraph 25.

Nevertheless, even though it is settled case law that the exemptions must interpreted strictly, the Court observed that the concepts used in the exemptions for certain activities in the public interest do not call for an especially narrow or strict interpretation since the exemption is designed to ensure that the benefits flowing from these activities or access to the benefits from such activities are not hindered by the increased costs of providing it that would follow if such activities were subject to VAT.[43]

This does not mean that there are no limits to the interpretation of the concepts used in the exemptions. The interpretation of the terms must be consistent with the objectives pursued by the exemptions and comply with the requirements of the principle of fiscal neutrality inherent in the common system of VAT.[44] This led the Court to the conclusion in the Horizon College case that the requirement of strict interpretation does not mean that the terms used to specify the exemptions should be construed in such a way as to deprive the exemptions of their intended effect.[45] It is not the purpose of the case law of the Court to impose an interpretation which would make the exemptions more or less inapplicable in practice.[46] The interpretation of the terms must be consistent with the objectives pursued by the exemptions, to make sure the exemptions have their intended effect and comply with the requirements of the principle of fiscal neutrality.[47] This calls for an interpretation which is not too narrow, but which is restricted by the objective of the exemption.

Finding the objective of these exemptions is not an easy task. Gjems Onstad and Melz observe that the exemptions are not based on any clear theoretical foundation.[48] Melz noted that when the exemptions were included in the Sixth VAT Directive, nothing was said about their purpose and that he could not find other sources explaining the aim.[49] He mentions that in the Council of Europe's European Convention on the Recognition of the Legal Personality of International Non-Governmental Organizations[50] it is recognized that international non-governmental organizations carry out work of value to the international community, particularly in the scientific, cultural, charitable, philanthropic, health and education fields, and that they contribute to the achievement of the aims and principles of

[43] For example, FR: ECJ, 11 January 2001, C-76/99, Commission of the European Communities v the French Republic, ECJ Case Law IBFD, paragraphs 21-24 regarding activities closely related to hospital and medical care; DE: ECJ, 20 June 2002, C-287/00, Commission of the European Communities v Federal Republic of Germany, ECJ Case Law IBFD, paragraph 47 regarding the supply of services closely related to university education; and DE: ECJ 6 November 2003, Case C-45/01, Christoph-Dornier-Stiftung für Klinische Psychologie and Finanzamt Gießen, ECJ Case Law IBFD, paragraph 48 regarding the term medical care.

[44] DE: ECJ, 6 November 2003, Case C-45/01, Christoph-Dornier-Stiftung für Klinische Psychologie and Finanzamt Gießen, ECJ Case Law IBFD, paragraph 42.

[45] NL: ECJ, 14 June 2007, Case C-434/05, Stichting Regionaal Opleidingen Centrum NoordKennemerland/West-Friesland (Horizon College) v Staatssecretaris van Financiën, ECJ Case Law IBFD, paragraph 16, DE: ECJ, 28 January 2010, C-473/08, Ingenieurbüro Eulitz GbR Thomas und Marion Eulitz v Finanzamt Dresden I, ECJ Case Law IBFD, paragraph 27, SV: ECJ 10, June 2010, C-262/03, CopyGene A/S v Skatteministeriet, ECJ Case Law IBFD, paragraph 26.

[46] NL: ECJ, 11 December 2008, C-407/07, Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing v Staatssecretaris van Financiën, ECJ Case Law IBFD, paragrap 30.

[47] UK: ECJ, 26 May 2005, Case C-498/03, Kingscrest Associates Ltd, Montecello Ltd v Commissioners of Customs and Excise, ECJ Case Law IBFD, paragraph 29.

[48] Ole Gjems Onstad & Peter Melz, *NPOs (Charities) and VAT* in *Taxation of charities* (Frans Vanistendael ed., IBFD 2015), pp. 75-85, p. 76.

[49] Peter Melz, *Value added tax for non-profit-making organizations*, in *Hvor din skatt er, vil også ditt hjerte være. Festskrift til Ole Gjems-Onstad - 70 år* (Tore Bråthen, Eivind Furuseth and Anders Mikelsen eds., Cappelen Damm Akademisk 2020), p. 533-550, p. 535-536.

[50] https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/124.

the United Nations Charter and the Statute of the Council of Europe. However, one may question whether this can be of relevance for the interpretation of the exemptions in the VAT Directive as this convention of the Council of Europe is only ratified by a minority of EU Member States. In his search for the aim of the exemptions Melz suggests that their character may vaguely indicate their aim, a favorable treatment of the exempt activities and to encourage certain activities in the public interest. He makes clear that the scope of the exemptions is generally a political decision based on views outside the VAT system, such as the degree of public interest of these activities and their impact on the national budget.[51]

It seems that the ECJ has followed this route of the character of the exemptions. The Court seems to have had no problem in finding an objective. To the Court it was 'clear' (without any reference or argumentation) that the exemptions for the social sector which were under discussion in Kingscrest case were intended to reduce the cost of those services and to make them more accessible to the individuals who may benefit from them.[52] It is likely that the Court will deem it equally clear that this is also the purpose of the other exemptions in article 132 VAT Directive.

4.4 Non-profit organization

Some exemptions do not specify that they apply to non-profit organizations only. In such case, the exemption also applies to for-profit-organizations. In the Kingscrest case, the ECJ observed that the principle of fiscal neutrality would not be observed if activities covered in those exemptions were treated differently for VAT purposes depending on whether the entities which provide them are profit-making or not.[53] This is different for the exemptions in which it is explicitly stated that they only apply to non-profit organizations.

The VAT Directive does not include a definition of non-profit organization. However, this does not give Member States the freedom to apply their own domestic definitions and requirements to decide whether an entity qualified as such.

In the Kingscrest case, the ECJ held that the exemptions and the conditions for exemptions to apply, especially regarding the status or identity of the economic agent performing the services covered by the exemption, have their own independent meaning for VAT and must therefore be given a harmonized definition.[54] The expression 'charitable' which was used in the English language version of the Sixth VAT Directive, could, therefore, not be interpreted along the lines and requirements set out in the domestic legislation of the United Kingdom.

The Court observed that it follows from settled case-law that the need for a uniform interpretation of directives makes it impossible for the text of a provision to be considered, in case of doubt, in isolation. Instead, it requires that it be interpreted and applied in the light of the versions existing in the other

[51] Peter Melz, *Value added tax for non-profit-making organizations*, in *Hvor din skatt er, vil også ditt hjerte være. Festskrift til Ole Gjems-Onstad - 70 år* (Tore Bråthen, Eivind Furuseth and Anders Mikelsen eds., Cappelen Damm Akademisk 2020), p. 533-550, p. 544.
[52] UK: ECJ, 26 May 2005, Case C-498/03, Kingscrest Associates Ltd, Montecello Ltd v Commissioners of Customs and Excise, ECJ Case Law IBFD, paragraph 30.
[53] UK: ECJ, 26 May 2005, Case C-498/03, Kingscrest Associates Ltd, Montecello Ltd v Commissioners of Customs and Excise, ECJ Case Law IBFD, paragraph 42.
[54] UK: ECJ, 26 May 2005, Case C-498/03, Kingscrest Associates Ltd, Montecello Ltd v Commissioners of Customs and Excise, ECJ Case Law IBFD, paragraphs 22-26.

official languages. In later case law, the Court elaborated on this and observed that it is clear from the ninth and eleventh recitals in the preamble to the Sixth Directive that it is designed to harmonise the basis of assessment of VAT and that the exemptions from that tax constitute independent concepts whose purpose is to avoid divergences in the application of the VAT system from one Member State to another and which must be placed in the general context of the common system of VAT introduced by that directive.[55]

Also in the Schloss Igling case the court made clear that the concept of 'non-profit-making organizations' is an autonomous term of Union law.[56] According to the ECJ, an organization is 'non-profit-making' by having regard to the aim which the organization pursues. It must not have the aim of achieving profits for its members.[57] In the Kennemer Golf case, the ECJ held that is was for the competent national authorities to determine whether, having regard to the objects of the organization in question as defined in its constitution, and in the light of the specific facts of the case, an organization satisfies the requirements enabling it to be categorised as a non-profit-making organization.[58] If that is the case, then the fact that an organization subsequently achieves profits, even if it seeks to make them or makes them systematically, will not affect the original categorisation of the organization as long as those profits are not distributed to its members as profits. For the Court it was clear that it is not prohibited to finish the accounting year with a positive balance.

The Court interprets 'non-profit-making' as being the same as 'not systematically aim to make a profit' in article 133(1)(m).[59] According to the Court, not having an aim to make profit (or being non-profit making) presupposes that these organizations during their entire existence and upon liquidation, may not make a profit for their members.[60] Therefore, liquidation proceeds may not be paid out to members insofar as the equity of these organizations upon liquidation exceeds the paid-up capital of the members and the assets transferred in kind by members.[61]

The Court does not give much leeway to national legislators and courts in this respect. This very detailed definition at the same time raises the question how the concepts of being 'non-profit-making' and 'not systematically aim to make a profit' must be interpreted for organizations without members such as foundations. This question has not (yet) been answered.

In any case, this case law makes it clear that Member States cannot apply their domestic regulations to qualify an entity as being charitable or non-profit making. In fact, the second question that the Bundesfinanzhof asked in the Golfclub Schloss Igling case and which the ECJ conveniently ignored, was whether the German charity requirements, which included that (liquidation) proceeds could only be

[55] For example, NL: ECJ, 14 June 2007, Case C-434/05, Stichting Regionaal Opleidingen Centrum NoordKennemerland/West-Friesland (Horizon College) v Staatssecretaris van Financiën, ECJ Case Law IBFD, paragraph 15; UK: ECJ, 16 October 2008, C-253/07, Canterbury Hockey Club, Canterbury Ladies Hockey Club v The Commissioners for Her Majesty's Revenue and Customs, ECJ Case Law IBFD, paragraph 16; NL: ECJ, 11 December 2008, C-407/07, Stichting Centraal Begeleidingsorgaan voor de Intercollegiale Toetsing v Staatssecretaris van Financiën, ECJ Case Law IBFD, paragraph 29.
[56] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 46.
[57] UK: ECJ, 21 March 2002, Case C-267/00, Zoological Society of London, ECJ Case Law IBFD and NL: ECJ, 21 March 2002, Case C-267/00, Kennemer Golf, ECJ Case Law IBFD.
[58] NL: ECJ, 21 March 2002, Case C-267/00, Kennemer Golf, ECJ Case Law IBFD, paragraph 27.
[59] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 49.
[60] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 50.
[61] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 51.

used for charitable purposes (including other charities) could be applied.[62] Given the clear case law of the Court, more specifically the Kingscrest judgement,[63] this was a superfluous question, an acte éclairé. The fact that an organization does not have a charitable status under domestic law, which could also be caused by not meeting formal requirements such as being registered, does not lead to the conclusion that it is not eligible for the VAT exemptions.

In this respect, VAT clearly differs form direct tax law for which the ECJ held that Member States may apply their own definitions and requirements as long as these are not in breach of the Treaty on the Functioning of the European Union (TFEU), such as a residency requirement.[64] This different approach is explained by the fact that where there is no harmonization of direct taxes with regard to charities, the VAT is a harmonized tax. The exemptions should therefore be interpreted in the same way in all Member States to ensure fiscal neutrality and not to distort conditions of competition or hinder the free movement of goods and services (as is laid down in preamble 4 and 7 of the VAT Directive).

5 Solutions for the VAT problems of charities

The exemptions and being out of scope seems to work well for charities at the end of the distribution chain who make relatively small costs or do not outsource many activities and therefore do not suffer much from the fact that they cannot get a refund of input VAT. This is different for other charities that are out of scope or have activities that fall under an exemption and suffer a significant burden of non-recoverable input VAT. For those charities, the objective of exemptions for the public benefit as stated by the ECJ, reducing costs for listed activities in the public benefit within the boundaries of fiscal neutrality, is often not met.

According to the European Charities' Committee on Value-Added Tax (ECCVAT), charities in the EU lose about €6 billion a year in irrecoverable VAT.[65] A November 2020 report of London Economics which was commissioned by the UK Charity Tax Group even showed that irrecoverable VAT costs UK charities £1.8bn a year.[66] The report points out that when the VAT system was developed, charities were not considered. Because charities often provide services that are either exempt from VAT or outside the scope of the VAT system, they are unable to recover the VAT they pay on the purchases incurred to achieve their charitable aims. As the report puts it: “They are, in effect, treated as the final consumer, even when they are not.” In addition, the report estimated that VAT charged on supplies of goods and services by charities (output VAT) amounts to £1.7 billion per year. The report guessed that significant amounts of this output VAT are absorbed by charities rather than being charged to their ‘customers’ and therefore is a burden on the charity sector. [67] It is likely that these figures may be similar for other countries, making the ECCVAT €6 billion an underestimation.

[62] DE: ECJ, 10 December 2020, C-488/18, Golfclub Schloss Igling, ECJ Case Law IBFD, paragraph 24.
[63] UK: ECJ, 26 May 2005, Case C-498/03, Kingscrest Associates Ltd, Montecello Ltd v Commissioners of Customs and Excise, ECJ Case Law IBFD.
[64] DE: ECJ, 14 September 2006, C-386/04, Centro di Musicologia Walter Stauffer, ECJ Case Law IBFD, paragraph 39 and DE: ECJ, 27 January 2009, Case C-318/07, Hein Persche, ECJ Case Law IBFD, paragraph 43.
[65] https://www.eccvat.org/resources/.
[66] London Economics, *The value of VAT reliefs for the charity sector*, (November 2020), https://www.charitytaxgroup.org.uk/wp-content/uploads/CTG-Value-of-VAT-relief-for-charities_Final-Report.pdf.
[67] London Economics, *The value of VAT reliefs for the charity sector*, (November 2020), p. ii-iii, https://www.charitytaxgroup.org.uk/wp-content/uploads/CTG-Value-of-VAT-relief-for-charities_Final-Report.pdf.

Not only the aim to reduce costs for listed activities is regularly infringed by the current VAT system. In addition, it may infringe the principle of fiscal neutrality. For example, if an exemption only applies to non-profitmaking organizations, profit-making organizations can deduct the VAT charged to them and thus, under certain circumstances, charge a lower price for their supplies than the exempt taxpayers. Furthermore, the fact that input VAT is not deductible will be a disincentive for out of scope or exempt organizations to outsource activities such as catering and cleaning, even though –without taking into account the input VAT – outsourcing would be more efficient. In addition, and as is reflected in VAT case law, exemptions have induced non-profit making organizations such as schools, universities and hospitals to engage in costly schemes to avoid the applicability of an exemption. The 2020 OECD report concludes that distortions from VAT concessions for philanthropic entities typically arise from the exemption from VAT of the output of these entities and that these may both result in a competitive advantage or in a disadvantage.[68] All in all, the exemptions in certain cases have the effect of distorting economic decisions and competition, thereby creating economic inefficiencies and a deadweight loss.[69]

The OECD observed that VAT exemptions, reduced rates, and zero rates can create unfair competition, especially if the VAT exempt goods or services supplied by a philanthropic entity are also provided by businesses that charge VAT on their sales.[70] From the OECD survey it followed that for that reason some countries, such as Canada and Ireland, do not exempt from VAT certain goods and services provided by philanthropic entities. Belgium, Chile, Colombia, Estonia, Indonesia, Italy, and the Slovak Republic, do not have preferential VAT treatment for philanthropic entities and apply the standard VAT rules.

Over the years several solutions have been suggested to solve the problems charities encounter because of the VAT. These solutions will be analysed in the remainder of this section.

5.1 Reduced rate instead of exemption

A reduced rate does not restrict the possibility to deduct input VAT irrespective of whether that input VAT was based on the regular or a reduced rate. The VAT Directive optionally allows to implement a reduced rate instead of an exemption for several activities included in article 132 VAT Directive.

Currently, article 98(2) VAT Directive only allows two reduced rates of at least 5% for supplies of goods or services set out in Annex III. These include (6) supply, including on loan by libraries, of books (…), newspapers and periodicals (…); (7) admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities; (8) reception of radio and television broadcasting services; (13) admission to sporting events; and (14) use of sporting facilities. For example, as of 1996 the Netherlands abolished the exemption of entry fees to museums and replaced it with a reduced rate.[71] This allowed museums, amongst others, to deduct the input VAT on their often costly renovations. Some exemptions are obligatory. In addition, the reduced rate may only be applied to the goods and services included in Annex III.

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[68] OECD, *Taxation and Philanthropy*, *OECD Tax Policy Studies no. 27* (OECD Publishing 2020), p. 32, https://doi.org/10.1787/df434a77-en.

[69] S. Cnossen, *Is the VAT‟s Sixth Directive Becoming an Anachronism?* European Taxation, December 2003, p. 436, R. de la Feria, *The EU VAT treatment of public sector bodies: slowly moving in the wrong direction* Intertax 37(3) 2009, p. 148–165.

[70] OECD, *Taxation and Philanthropy*, *OECD Tax Policy Studies no. 27* (OECD Publishing 2020), https://doi.org/10.1787/df434a77-en, p. 65.

[71] NL: Act of 18 December 1995, Staatsblad 660.

Some Member States could apply super reduced rates below the minimum of 5%. The reason was that they already had such rates before 1 January 1991 and were – 'temporarily'- allowed to keep them. France, for example, applies a super reduced rate of 2.1% to specific tickets for theatrical performances and circus performances.[72] The theatrical performances of works of drama, opera, musical or choreography must be of newly created works or of classic works in a new staging. The circus performances must feature exclusively original creations designed and produced by the company and using the regular services of a group of musicians. This super reduced rate only applies to the first 140 performances.

On 18 January 2018 the European Commission proposed to give Member States more flexibility when setting VAT rates.[73] The current list in Annex III of goods and services to which reduced rates can be applied would be abolished and replaced by a negative list in a new Annex IIIa of supplies of goods and services to which reduced rates *could not* be applied (originally proposed article 98(3)).

On 4 June 2021, the General Secretariat of the European Council published a note in which the main developments and the state of play regarding this proposal were discussed.[74] It seems that Member States preferred a positive list over a negative list. At the same time, Member States that have derogations,[75] wanted to keep those. As the note mentioned in point II.6: "Apart from that, delegations held different views on most substantial issues". The Portuguese Presidency focused on identification of the guiding principles for drafting a positive list: benefit of final consumer and pursue objectives of general interest, health protection, consistency with the EU Green Deal, taking into account the digital transformation of the economy, neutrality principle; modernising the current Annex III based on such features and resolve other fundamental issues raised by the proposal, such as the scope of zero rates and rates lower than the minimum of 5%, the derogations, the need to include a revenue safeguard, and the use of CN/CPA codes.

On 7 December 2021, the Council reached an agreement on an update of the rules for VAT rules. As expected, the compromise[76] differed substantially from the original proposal. Annex II will remain a positive list. Member States will only be allowed to apply the current two reduced rates of at least 5% to a maximum of 24 points of the supply of goods and services listed in Annex III (article 98(1), third subsection). In addition, Member States may apply a reduced rate lower than 5% and an exemption with deductibility of input VAT to a maximum of seven points from the list in Annex III (article 98(2). This may only be applied to points 1 –5 (food, water, pharmaceutical products, medical equipment, passenger

[72] FR: article 281 quarter Code général des impôts, https://www.legifrance.gouv.fr/codes/section_lc/LEGITEXT000006069577/LEGISCTA000006191656/#LEGISCTA000006191656.
[73] Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax, COM(2018)20, https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2018)20&lang=en.
[74] General Secretariat of the Council, Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax - Policy debate, 4 June 2021, 9420/21, https://data.consilium.europa.eu/doc/document/ST-9420-2021-INIT/en/pdf.
[75] A derogation means that a Member State can deviate from the VAT Directive. A list of derogations is laid down in Title XIII of the VAT Directive (Article 370 and following).
[76] Council of the European Union, Outcome of proceedings. Proposal for a Council Directive amending Directive 2006/112/EC as regards rates of value added tax. 14754/21, ECOFIN 1214, 7 December 2021. Retrieved from https://data.consilium.europa.eu/doc/document/ST-14754-2021-INIT/en/pdf

transport), 6 (supply, including on loan by libraries, of books (…), newspapers and periodicals) and the new point 10c (solar panels).

At first sight this does not bring much for charities other than libraries. However, point 6 is amended to include also production of publications of non-profit-making organisations and services related to such production. In addition, not only will the derogations for super reduced rates certain Member States have be brought under the maximum of 7 points for super reduced rates (article 98(2)), but other Member States may also apply these super reduced rates for those specific supplies within the boundaries of the maximum of 7 points in total (article 105a(1)). This means that also other Member States would be able to apply the French super reduced rate for first performances notwithstanding the fact that point 7 on admission to cultural events is not in the list of points that can be brought under the super reduced rate. In addition, the scope of point 7 is expanded to include access to the live streaming of the events or visits (or both) mentioned in point 7. This reflects the developments during the Covid-19 lock downs.

In any case, this change is not a solution for charities with activities that are currently exempt from VAT. Furthermore, even if all (including the obligatory) exemptions for certain activities in the public interest had been replaced by the possibility to apply the reduced rate, the objective of cost reduction would not be achieved in full. The reduced rate increases the costs of these supplies, especially for organizations that currently do not suffer much from being unable to deduct VAT. This problem is mitigated by (super) reduced rates. However, (super) reduced rates would, in any case, not solve the problem for organizations that are out of scope, for example because their supplies are for free, such as development and disaster aid charities.

5.2 Zero rate or exemptions with deduction of input tax

A solution that would not have the effect described in section 5.1 of potentially increasing consumer's costs, is to replace the exemptions with a zero rate or to abolish the rule that input VAT regarding exempt activities is not deductible. This would basically make the supplies of article 132 VAT Directive free of any VAT and would, therefore, achieve the object of reducing the costs of such supplies. The 2018 proposal of the European Commission would have allowed to introduce a 0% rate and an exemption with deductibility of the VAT paid at the preceding stage. However, as was discussed in section 5.1, such exemption with deductibility of VAT will under the final proposal only be allowed for some very specific points of Annex III that are not of relevance for most charities.

In addition, also this solution would put charities with out of scope activities in a worse position as compared to in-scope charities. An example is a museum or nature reserve which does not charge entry fees. For such organizations the input VAT is an additional burden. A museum or nature reserve which charges entrance fees would not have this burden. Charities would therefore have an incentive to charge fees even though the object of the exemption (and probably the domestic policy regarding such charities) is to reduce the costs of charities' activities, not to increase them.

In addition, the zero percent rate, super reduced rate or exemption-with-deduction system would burden the treasuries of the Member States. This might be a reason for Member States not to make use of (or to reject) this option leaving charities in the same situation as they are now.

5.3 Solution outside of VAT?

The problem of not being able to deduct input VAT is difficult to solve within the framework of VAT. This is especially the case for out of scope charities, but it seems that also for charities with exempt activities the problems will not be solved in the short term. Contrary to the objectives of the exemptions as defined by the ECJ, the input-VAT-problem raises instead of decreases the prices of supplies.

In my view, more effective solutions can be found outside the VAT system. The problem that exemptions or being out of scope can increase costs if substantial investments have been made for which the input VAT cannot be reclaimed, can also be addressed by granting direct subsidies to charities suffering from this problem. Obviously, direct subsidies will also have budgetary implications, but these are probably less than solutions within the VAT system.

Governments can better target direct subsidies than VAT incentives, leading to less spill-over effects. Member States may apply their domestic charity legislation to direct subsidies, thus enabling them to better aim government funds at organizations which are domestically deemed charitable. For example, commercial organizations may be excluded from direct subsidies under domestic law and requirements may be imposed regarding the legal form of the charity. In addition, opposed to VAT, neutrality is not a basic principle of direct subsidies. Strict, qualitative criteria can be established to decide whether a charity qualifies for a direct subsidy or not. In addition, a direct subsidy can also be granted to charities which are out of scope of VAT.

This solution has already been applied by several countries. In 1998, the UK government made a commitment to restore free public access to the principal collections on display in museums and galleries. This resulted in the inability to recover VAT as providing free admittance would not be an economic activity within the realm of VAT. To compensate for this disadvantage of free access, a special VAT refund scheme[77] was introduced in 2001 for museums and galleries which meet strict criteria, and which are listed in the VAT (Refund of Tax to Museums and Galleries) Order 2001 (SI 2001/2879).[78] Eligible museums can reclaim VAT incurred in relation to free rights of admission. The scheme does not form part of the general VAT system, but certain rules in UK VAT legislation apply to it.

In addition, in 2015 the UK introduced a VAT Refund Scheme for charities.[79] This only applies to charities which are defined as a qualifying charity in section 33D of the VAT Act 1994. These are palliative care charities, air ambulance charities, search and rescue charities and medical courier charities. In addition, these charities must meet the charity definition included in Schedule 6 to the Finance Act 2010. It must be: based in the UK, Isle of Man, an EU member state, Iceland, Liechtenstein or Norway, established for charitable purposes only, registered with the Charity Commission or corresponding regulator, where required run by 'fit and proper persons' and recognised by HMRC.

In Ireland, a VAT compensation scheme for charities applies.[80] It aims to reduce the VAT burden on charities and to partially compensate for VAT paid by the charity. Charities are entitled to claim a refund

[77] Article 33A VAT Act 1994 and VAT Notice 998 VAT refund scheme for museums and galleries (last updated 5 March 2021) https://www.gov.uk/guidance/vat-refund-scheme-for-museums-and-galleries-notice-998.
[78] https://www.gov.uk/guidance/vat-refund-scheme-for-museums-and-galleries-notice-998#annex.
[79] Article 33C and 33D VAT Act 1994 and VAT Refund Scheme for charities (VAT Notice 1001) https://www.gov.uk/guidance/vat-refund-scheme-for-charities-notice-1001.
[80] https://www.revenue.ie/en/companies-and-charities/charities-and-sports-bodies/vat-compensation-scheme/vat-compensation-scheme-for-charities/index.aspx and https://www.revenue.ie/en/tax-professionals/tdm/value-added-tax/part12-refunds-and-repayments-of-tax/vat-compensation-scheme/vat-compensation-scheme-guidelines.pdf.

of a proportion of their eligible VAT costs, based on their level of non-public funding. Charities can submit one claim per year, which should relate to VAT paid in the previous year only. The fund for the scheme is capped at €5 million annually. If the total amount of claims exceeds the capped amount, refunds are paid on a pro-rata basis. To qualify for the scheme, a charity must be registered with the Irish tax administration and hold a charitable tax exemption registered with the Charities Regulatory Authority.

Member States have to keep in mind that they are not completely free to introduce such direct subsidies. Not only is it important that such schemes do not form a breach of the VAT Directive. In addition, these must not infringe the state aid rules of articles 107-109 of the Treaty on the Functioning of the EU (TFEU). Article 107 TFEU prohibits Member States from granting aid through state resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods. However, several forms of such aid are allowed, for example aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned (article 107(2)(a) TFEU) and aid granted to any one undertaking not exceeding €200,000 over any period of three fiscal years.[81] Often, direct subsidies to charities will probably not exceed this de minimis amount.

Furthermore, aid to promote culture and heritage conservation may be considered to be compatible where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest (article 107(3)(d) TFEU). Notification and approval of the European Commission is necessary before Member States can introduce such aid. In addition, section 11 of the General Block exemption Regulation[82] provides that if certain requirements are met, aid for culture and heritage conservation is compatible with the internal market and exempted from the notification obligation. This includes the following cultural purposes and activities: museums, archives, libraries, artistic and cultural centres or spaces, theatres, cinemas, opera houses, concert halls, other live performance organizations, film heritage institutions and other similar artistic and cultural infrastructures, organizations and institutions; tangible heritage including all forms of movable or immovable cultural heritage and archaeological sites, monuments, historical sites and buildings; natural heritage linked to cultural heritage or if formally recognized as cultural or natural heritage by the competent public authorities of a Member State; intangible heritage in any form, including folklorist customs and crafts; art or cultural events and performances, festivals, exhibitions and other similar cultural activities; cultural and artistic education activities as well as promotion of the understanding of the importance of protection and promotion of the diversity of cultural expressions through educational and greater public awareness programs, including with the use of new technologies; and writing, editing, production, distribution, digitisation and publishing of music and literature, including translations.

In this respect it is also important to note that in 2005, European Commissioner Kovács stated that: “The Commission has always considered that any scheme designed to relieve the VAT burden for charitable activities can be regarded as compatible with EU legislation if it is clearly separated from the VAT system itself (since under this system VAT can only be refunded if it is connected with taxable supplies) and does not affect the own resources of the Community. The essential difference is that, under such a

[81] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid,

[82] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

scheme, the tax is collected in the first place and then the Government chooses to allocate it back to the bodies from which it has been collected. This is a subtle but important accounting distinction. I have to underline that the decision to set up such a refund mechanism is strictly a national budgetary issue over which the Commission has no say or influence."[83] In 2011 the Commission observed that Member States can introduce targeted compensation mechanisms, outside the VAT system, to alleviate the cost of VAT on acquisitions of non-profit-making organizations. The Commission called on Member States to make use of the existing options to alleviate the burden of VAT on non-profit making organizations.[84]

As long as Member States remain within the boundaries mentioned above, direct subsidies offer various ways to mitigate negative effects of VAT exemptions in a more effective and efficient way than would be possible through a solution within the VAT system.

6 Conclusion

The impossibility to deduct input VAT means that the main object of the charitable exemptions, to reduce the costs of these activities, is not always achieved. Furthermore, the fact that VAT exemptions must adhere to the basic VAT principle of fiscal neutrality, obliging Member States to interpret the terms and concepts in the exemptions in the same way, if necessary in conflict with domestic charity legislation, may make these exemptions less effective from a public policy point of view. The 2021 agreement on updated rules for VAT rates will not solve these problems.

It would be best to mitigate the negative VAT effects by direct subsidies and not within the VAT system. The advantage of direct subsidies is that these can be targeted better than VAT measures. Direct subsidies allow for strict, qualitative criteria, which may vary between Member States and which can better reflect domestic charity legislation and policy priorities. Obviously, when implementing direct subsidies Member States are also restricted by EU legislation, in particular the fundamental freedoms and state aid prohibition in the TFEU. However, these restrictions leave more freedom to Member States to reflect domestic policy regarding charities and, in the view of the European Commission, do not seem to hinder the introduction of VAT refund schemes.

[83] László Kovács, *VAT for Charities – State of Play and Plans for the Future*, speech at the International Philanthropy Conference, Brussels 15 September 2005, https://ec.europa.eu/archives/commission_2004-2009/kovacs/speeches/philanthropy_conference.pdf , p. 3-4.

[84] Communication from the Commission to the European Parliament, the Council and the European economic and social committee, On the future of VAT Towards a simpler, more robust and efficient VAT system tailored to the single market, 6 December 2011, COM(2011), https://ec.europa.eu/taxation_customs/sites/default/files/resources/documents/taxation/vat/key_documents/communications/com_2011_851_en.pdf, p. 10.