



ECJ: Payments on premature termination of contracts are subject to VAT

31 | 2020

1 Facts

On 11 June 2020, the ECJ ruled on the following facts in the case *Vodafone Portugal* (C-43/19): The plaintiff offered its customers contracts for various telecommunication services (e.g. for fixed telephony, mobile telephony and internet). The customers could conclude the contracts for a predetermined minimum period (i.e. for 12 or 24 months). In the case of the minimum period, customers undertook to maintain the contractual relationship for the agreed period and to pay the monthly instalments contractually agreed for the telecommunications services. In return for concluding a contract for a minimum period, the plaintiff provided customers with special promotions (in the form of free installation and activation of the services). The minimum period was intended to enable the plaintiff to recover part of the costs incurred (for equipment, infrastructure and the promotional benefits provided to the customer). If a customer did not comply with the minimum period for reasons attributable to himself, he was contractually obliged to make a payment to the plaintiff for the premature termination of the contract. The amount of the payment was less than the amount which the plaintiff would have received from the customer in the case of regular performance of the contract. Instead, the plaintiff calculated the amount of the payment according to a previously contractually agreed formula, which took into account the legal requirements in Portugal. The payment was not to exceed the costs incurred by the plaintiff and had to be in reasonable proportion to the benefit that the plaintiff had granted to the customer. This benefit was specified and quantified in the contract. The key question in the proceedings was whether the amounts paid by the customers after termination of the contract were taxable remuneration for services supplied by the plaintiff or compensation for damages.



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2 Opinion

The ECJ held that there was remuneration subject to VAT. It referred to its judgment of 22 November 2018 in the case *Meo* (C-295/17). In this case, it had already ruled that a compensation payment made by a customer for premature termination of a contract, which was attributable to the customer himself, constituted taxable remuneration. The customer's payment was consideration for the right to benefit from the fulfilment of the telecommunications contract, which the customer had entered into. This also applies in the instance where the customer does not want to or cannot exercise this claim for a reason attributable to him.

In the *Meo* case, the customer's payment corresponded to the full amount that the customer would have had to pay until the end of the entire minimum contractual commitment. In the present case, the amount to be paid was lower. However, this did not make any difference to the ECJ. The customer's payment was made on a contractual basis. The payment and its amount were already specified in the contract. The amount to be paid was to be regarded as part of the remuneration for the services, which the plaintiff had contractually agreed to provide. If the minimum contractual commitment period was not observed, this amount was required to be added to the monthly instalments. The amount had a similar purpose to that of the monthly instalments. If the economic reality was considered, the plaintiff would have received a contractually guaranteed minimum remuneration for its supplies. It was precisely this supply, which was to be regarded as having been provided as soon as the customer could have used the services, even if he did not actually do so – given his failure to comply with the minimum contractual commitment period. The ECJ held the view that the amount paid by the customer also constituted the actual consideration for the services provided by the plaintiff. Both had already been agreed upon between the plaintiff and the customer at the time the contract was concluded. The amount of the payment was therefore not dependent on chance, nor difficult to quantify or even uncertain. Nor could the payment be equated with a payment owed by law, nor should the plaintiff be compensated.

3 Consequences for the practice

Only the consumable benefit should be taxed with VAT, but not just a mere cash flow. Against this background, the decision of the ECJ goes too far. From the premature termination of the contract, the customer no longer receives anything that he could consume. Should the mere fact that the contract provided for whether a payment should be made and in what amount, in the event of a premature termination of the contract, trigger taxation? How would the ECJ have decided if the contract had contained a different compensation clause which did not expressly provide for compensation for the costs of the promotional benefits? Would the ECJ now also subject contractual lump sum damages or contractual penalties to VAT? What would it be like in a case where nothing is contractually regulated, but only a statutory right exists? In the case of *Société thermale d'Eugénie-Les-Bains* (judgment of 18 July 2007, C-277/05), the ECJ had, in any event, still ruled that the deposit, a hotel guest had to pay to a hotel, even if he did not use the hotel room he had reserved, constituted a lump sum compensation not subject to VAT.

How would a comparable case be decided from a German perspective? This question is important not only for telecommunications companies, but also for leasing companies, fitness studios and other service provider offering contracts with minimum commitment periods. Sec. 1.3 para. 17 of the German VAT Circular contains a provision according to which compensation payments for future leasing instalments to be paid upon termination of the leasing contract constitute compensation not subject to VAT. This view must also apply to areas other than leasing. Thus, the German VAT Circular would first have to be amended if the tax authorities wanted to tax future transactions. From the point of view of protection of legitimate expectations, the German VAT Circular is opposed to retroactive application.