



EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Value added tax

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VALUE ADDED TAX COMMITTEE
(ARTICLE 398 OF DIRECTIVE 2006/112/EC)
WORKING PAPER NO 903 REV

QUESTION
CONCERNING THE APPLICATION OF EU VAT PROVISIONS

ORIGIN: Commission

REFERENCES: Articles 174, 175, 312 to 316, 319 and 322

SUBJECT: Special arrangements for taxable dealers and their supply of works of art

1. INTRODUCTION

The Commission has been faced on several occasions with questions concerning the application of certain provisions of the VAT Directive¹ on the special arrangements for taxable dealers in relation to supplies of works of art, notably in the context of a statement entered into the Council minutes when these special arrangements were introduced.

The issue was the subject of discussions at the 102nd meeting of the VAT Committee² which resulted in agreement on guidelines pertaining to the special arrangements for works of art³. In a follow-up to this discussion and with particular regard to these guidelines a new question has been raised regarding the margin scheme applicable under the VAT Directive to taxable dealers.

The Commission services consider it appropriate to submit this question to the VAT Committee for comments.

2. SUBJECT MATTER

Chapter 4 of Title XII of the VAT Directive sets out special arrangements for second-hand goods, works of art, collectors' items and antiques.

According to Article 313 of the VAT Directive, Member States must apply special arrangements for taxing the profit margin made by the taxable dealer, referred to as the "margin scheme" to, amongst others, supplies of works of art. Under Article 315 of the VAT Directive, the profit margin is equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price.

These special arrangements were introduced by Council Directive 94/5/EC⁴. When this Directive was adopted the following statement was entered into the Council minutes⁵:

"The Council and the Commission state that, for the application of Article 26a(B)(3), for the works of art referred to in point (a) of Annex I, where it is not possible to determine exactly the purchase price paid by the taxable dealer to his supplier, or where this price is not significant, Member States may provide that the margin on which the value added tax is applied shall be equal to a fraction of the selling price which may not be less than 30% thereof."

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006, p. 1).

² See Working paper No 833.

³ Guidelines resulting from meetings of the VAT Committee (see p. 191):

http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/vat_committee/guidelines-vat-committee-meetings_en.pdf.

⁴ Council Directive 94/5/EC of 14 February 1994 supplementing the common system of value added tax and amending Directive 77/388/EEC – Special arrangements applicable to second-hand goods, works of art, collectors' items and antiques (OJ L 60, 3.3.1994, p. 16).

⁵ Council's Information note to the Members of the Working Party on Tax Questions – Indirect Taxation (VAT), 6th VAT Directive (recast) – Statements entered into the Council minutes at the time of adoption of the Directives which will be repealed when the "recast" will be adopted, Brussels, 21 June 2005, GM/IV, second paragraph of point 76 of the note.

The interpretation of Article 315 of the VAT Directive in the light of the above statement was the subject of discussions at the 102nd meeting of the VAT Committee. As a result, the following guidelines were issued:

*"The VAT Committee **almost unanimously** agrees that Article 315 of the VAT Directive shall not allow for the adoption of a rule or administrative practice according to which in relation to all works of art that have been in the possession of a taxable dealer for more than a certain number of years the profit margin is deemed to be a set percentage (30% or more) of the selling price, irrespective of whether the actual purchase price is known or not.*

*The VAT Committee, on the other hand, is of the **almost unanimous view** that as regards situations whereby, even if the national law provisions relating to the obligation of keeping records are complied with, the purchase price cannot be determined, the application of a presumption that the profit margin amounts to a set percentage (30% or more) of the selling price, may be considered in line with the spirit and purpose of Article 315 of the VAT Directive, provided that the percentage chosen reflects the market reality in the sector of activity in the Member State concerned."*

In this context the question has arisen, whether it would be compatible with Article 315 of the VAT Directive to extend the use of such a presumption to situations where costs of promotions are incurred in relation to sales of works of art. Some seem to believe that associated costs of promotions, such as the cost of presentations, maintenance costs, transport and insurance costs, the cost of management of artistic projects etc., need to be taken into account when setting the purchase price of a work of art and since these are not attributable to each work of art, individual purchase prices cannot be determined.

One may wonder why there could be possibly an interest in or a need for applying the above presumption. In many cases, the application of it would be probably more advantageous than the calculation of the profit margin carried out on the basis of the general rules set out in Article 315 of the VAT Directive. It would be worrying, if recourse would be made to the presumption because the right to deduct the input VAT included in the promotion costs would be denied.

A detailed analysis of the question is presented below.

3. THE COMMISSION SERVICES' OPINION

3.1. Scope of the special margin scheme

Under Article 314 of the VAT Directive, the special arrangements for taxable dealers cover the supplies by a taxable dealer of second-hand goods, works of art, collectors' items or antiques where these goods have been acquired from persons who are not susceptible to account for VAT on their supply, i.e.:

- a non-taxable person,
- another taxable person as regards supplies exempt under Article 136,

- another taxable person as regards supplies covered by the exemption for small enterprises and involving capital goods,
- another taxable dealer as regards supplies under the margin scheme.

The common feature of those supplies is that notwithstanding the residual tax included in the price of the goods in question, the persons supplying those goods could not issue an invoice indicating the VAT that the taxable dealer could deduct as input tax.

However, the margin scheme may also cover other transactions, as indicated in Article 316 of the VAT Directive. On the basis of this provision taxable dealers are entitled to opt for application of the margin scheme to supplies of:

- works of art, collectors' items or antiques, which they have imported themselves,
- works of art supplied to them by their creators or the successors in title,
- works of art supplied to taxable dealers by a taxable person other than a taxable dealer where the supply by that other taxable person was subject to the reduced rate pursuant to Article 103 of the VAT Directive.

Opting for the margin scheme to cover the transactions specified in Article 316 will result in the same treatment of those transactions as of transactions which must be subjected to the margin scheme. In consequence, on the basis of Article 322, the taxable dealer is not entitled to deduct the input VAT on goods acquired pursuant to Article 316 for which the margin scheme is applied.

3.2. Profit margin as the taxable amount

As mentioned above, under Article 315 of the VAT Directive, the taxable amount of goods covered by the special margin scheme is the profit margin made by the taxable dealer less the amount of VAT relating to the profit margin. The profit margin is equal to the difference between the selling price charged by the taxable dealer for the goods and the purchase price.

Where the purchase price cannot be determined, even though the national law provisions relating to the obligation of keeping records are complied with, the application of a presumption by which the profit margin amounts to a set percentage (30% or more) of the selling price, may, according to the guidelines agreed, be considered in line with Article 315 of the VAT Directive.

In order to assess whether this presumption applies in situations in which promotional activities are carried out by taxable dealers, it should be determined first, whether the costs of promotions incurred by the dealer, such as the cost of presentations, maintenance costs, transport and insurance costs, the cost of management of artistic projects etc., can be seen as forming part of the purchase price and secondly, whether, where these costs are not attributable to a specific piece of art, it can be said that the purchase price cannot be determined.

3.3. Elements serving as basis for calculating the profit margin

The purchase price is defined in Article 312(2) of the VAT Directive as "*...everything which constitutes the consideration, for the purposes of point (1), obtained or to be obtained from the taxable dealer by his supplier*". Article 312(1) of the VAT Directive defines the selling price as "*...everything which constitutes the consideration obtained or to be obtained by the taxable dealer from the customer or from a third party, including subsidies directly linked to the transaction, taxes, duties, levies and charges and incidental expenses such as commission, packaging, transport and insurance costs charged by the taxable dealer to the customer, but excluding the amounts referred to in Article 79*".

On the basis of Article 312 of the VAT Directive it can be therefore said that the purchase price consists of everything that the taxable dealer paid for a given piece of art to its supplier, including charges and incidental expenses such as commission, packaging, transport and insurance costs as long as these costs had been incurred by the latter and they had been directly linked to the transaction in question.

If the taxable dealer bears the costs of promotions, such as the cost of presentations, maintenance costs, transport and insurance costs, the cost of management of artistic projects etc., those costs clearly have no impact on the purchase price. Whether they form part of the selling price is a different issue. Even though Article 312 does not settle this question in a definitive manner, it seems that in mentioning "*packaging, transport and insurance costs*" it refers rather to costs that are directly linked with the taxable supply and not to any such costs borne by the taxable dealer in connection with activities aimed at promoting sales, such as exhibitions, artistic events and so on.

It stems from the above that the situations in which promotional activities are carried out by taxable dealers do not automatically qualify as situations in which the purchase price cannot be determined. The cost of promotional activities or, more widely, the general cost of carrying out business does not influence the determination of the purchase price, under Article 312 of the VAT Directive, at which a taxable dealer acquired a given work of art.

To conclude, applying a presumption by which the profit margin amounts to a set percentage (30% or more) of the selling price, in situations where costs are borne by art dealers in carrying out promotional activities would not be compatible with Article 315 of the VAT Directive if the purchase price paid by the taxable dealer, to which such costs are not attributable, can be established through the relevant documentation kept by him or through any other means of proof admitted by the domestic law of the Member State concerned.

It should be noted that if a taxable dealer feels that such a VAT treatment under the special margin scheme does not properly address the circumstances of his particular case, he may always opt, in accordance with Article 319 of the VAT Directive, for the application of the normal VAT arrangements to any supply covered by the margin scheme.

3.4. Right to deduct the input VAT

According to Article 322 of the VAT Directive, in so far as goods are used for the purpose of supplies carried out by him and subject to the margin scheme, the taxable dealer may not deduct the following from the VAT for which he is liable:

- (a) the VAT due or paid in respect of works of art, collectors' items or antiques which he has imported himself;
- (b) the VAT due or paid in respect of works of art which have been, or are to be, supplied to him by their creator or by the creator's successors in title;
- (c) the VAT due or paid in respect of works of art which have been, or are to be, supplied to him by a taxable person other than a taxable dealer.

Therefore, under the margin scheme, in principle, the input VAT included in the purchase price cannot be deducted from the output VAT paid on the profit margin. This seems only logical due to the way of calculating the taxable amount – by subtracting the purchase price including the input VAT, from the selling price.

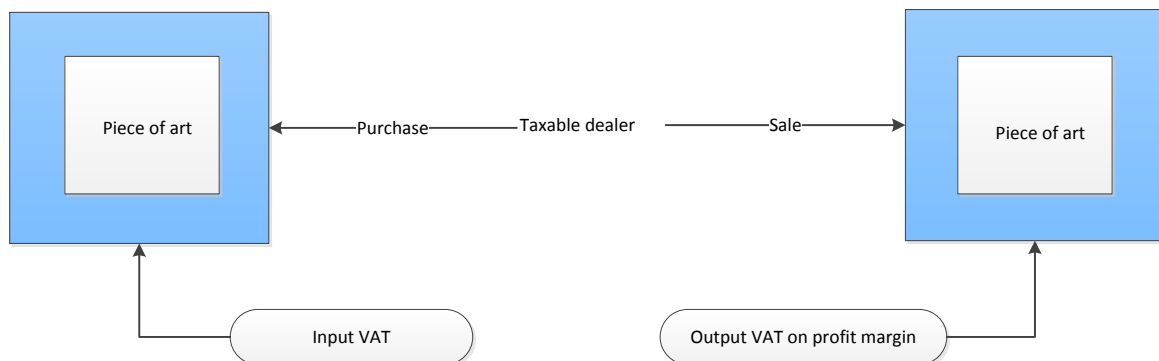
The question then may arise whether, in the situation referred to in this paper, the input VAT linked to the costs of promotional activities carried out by a taxable dealer can be deducted by him from the output VAT.

In order to answer this question one may analyse the following three scenarios:

1. The taxable dealer purchases a piece of art and then resells it,
2. The taxable dealer purchases a piece of art, repairs it and then resells it – i.e. he incurs costs directly linked with the subsequent supply of this specific piece of art,
3. The taxable dealer purchases a piece of art, promotes it by placing it in an exhibition together with other pieces of art and then resells it – i.e. he incurs costs which are not directly attributable to the subsequent supply of any specific piece of art.

The analysis should take into account the role of the right to deduction as an inherent construction element of VAT as a tax on added value and the jurisprudence, according to which the right to deduction can only be limited in so far as clearly permitted by the Directive⁶.

Scenario 1: The taxable dealer purchases a piece of art and then resells it



⁶ See e.g. case 50/87 *Commission v France*, ECLI:EU:C:1988:429, paragraph 17.

Example:

Total purchase price: 125

For cases where VAT is identifiable

Purchase price (without VAT): 100

Input VAT (rate 25%): 25

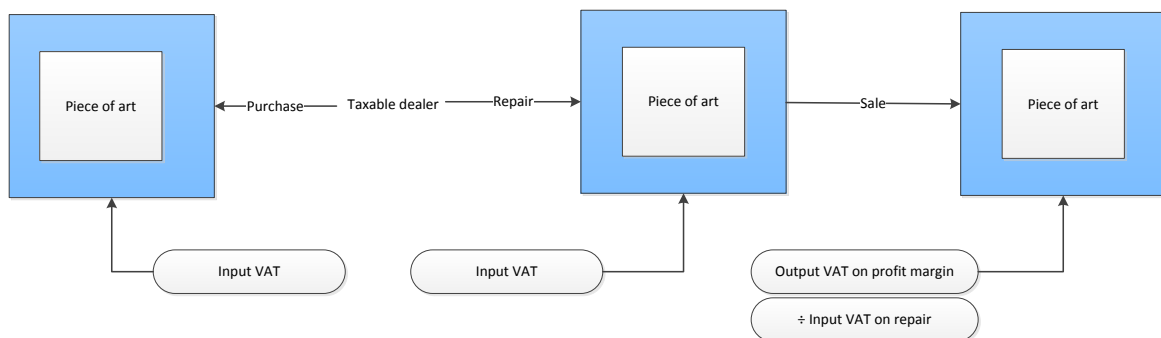
Sale price: 200

Output VAT (rate 25%): $\frac{(200-125) \times 0.25}{1.25} = \frac{75 \times 0.25}{1.25} = 15$

Under the first, the most simple, scenario, the taxable dealer buys a piece of art. The input VAT included in the purchase price cannot be deducted. The dealer subtracts then the purchase price from the selling price and obtains the profit margin, on which he pays the output VAT.

Scenario 2: The taxable dealer purchases a piece of art, repairs it and then resells it

- Input VAT on Repair



Example:

Total purchase price: 125

For cases where VAT is identifiable

Purchase price (without VAT): 100

Input VAT (rate 25%): 25

Repair cost (including VAT): 240

Input VAT included in the repair cost: 48

Sale price: 500

Output VAT (rate 25%): $\frac{[(500-125) \times 0.25]}{1.25} - 48 = \frac{[375 \times 0.25]}{1.25} - 48 = 75 - 48 = 27$

If it was not possible to deduct the input VAT related to the repair:

Output VAT (rate 25%): $\frac{(500-125) \times 0.25}{1.25} = \frac{375 \times 0.25}{1.25} = 75$

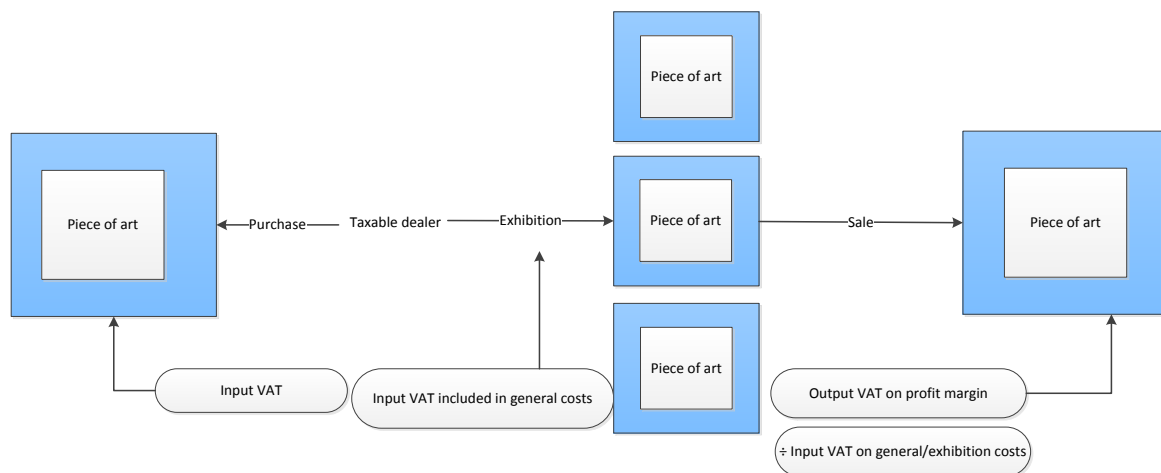
"Sticking", unrecoverable VAT: 48

Under the second scenario, the taxable dealer buys the piece of art, repairs/transforms it and finally sells it. He pays VAT as part of the price of materials and tools used in the course of the repair. These costs are not included in the purchase price of the piece of art and the input VAT included in the repair costs is therefore not deducted from the selling price when calculating the profit margin as the taxable amount. The question then arises whether the taxable dealer, who carries out only supplies covered by the margin scheme, is entitled to deduct the input VAT included in the price of materials and tools used in the course of the repair. In the opinion of the Commission services such a dealer has the right to do so. The reasoning behind this conclusion is the following.

Special schemes provide special solutions for certain elements of VAT taxation within their scope. In relation to elements not covered by the provisions of a given special scheme the general rules will apply. Such is the case of deduction of the input VAT included in the price paid by the taxable dealer for the materials and tools used for the repair of a piece of art that he will then sell under the margin scheme. The provisions of the special arrangements for taxable dealers indicate how to calculate the taxable amount, which under the scheme is the profit margin.

It is stipulated that a taxable dealer cannot deduct the input VAT paid in respect of works of art which he will then supply further, because this input VAT has been already taken into account when calculating the profit margin. No such exclusion of the right of deduction is envisaged for input VAT included in the price of materials and tools used in the course of repairs and the like. As that particular issue is not addressed in the provisions on the special scheme, the general rules on deduction apply, which means that a taxable dealer is entitled to deduct the input VAT related to the repair/transformation. The VAT Directive does not contain any provisions that would allow limiting this right.

Scenario 3: The taxable dealer purchases a piece of art, promotes it by placing it in an exhibition together with other pieces of art and then resells it



Example:

Total purchase price: 125

For cases where VAT is identifiable

Purchase price (without VAT): 100

Input VAT (rate 25%): 25

Total exhibition cost: 1 250

Exhibition cost (without VAT): 1 000

Input VAT (rate 25%): 250

Sale price: 500

Output VAT (rate 25%): $\frac{(500-125)}{1.25} \times 0.25 = \frac{375}{1.25} \times 0.25 = 75$

Input VAT to be deducted at the end of tax period: 250

If it was not possible to deduct the input VAT related to the exhibition:

"Sticking", unrecoverable VAT: 250

Under the third scenario the taxable dealer buys a piece of art, places it in an exhibition together with other pieces of art and then sells it. He pays the input VAT included in the price of organising and management of the exhibition, rent, transport etc. Similarly to the repair costs under the second scenario, these costs are not included in the purchase price and are not taken into account when calculating the profit margin. On the basis of the general rules on deduction, the input VAT included in these general costs can therefore be deducted.

An additional argument in favour of such an interpretation is that any other conclusion would lead to qualification of the input VAT included in the cost of promotional activities as unrecoverable, "sticking" VAT of, sometimes, important value.

4. DELEGATIONS' OPINION

Delegations are invited to express their views on:

- the applicability of a presumption whereby the profit margin amounts to a set percentage (30% or more) of the selling price in the case of art dealers carrying out promotional activities,
- the deductibility of the input VAT included in the price of supplies linked to promotional activities paid by a taxable dealer carrying out only supplies covered by the margin scheme.

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