VAT on prize money: the Pavlína Bastová decision of the CJEU

BY DR. DICK MOLENAAR[1]

Introduction

The decision of the Court of Justice of the EU (CJEU) in the Pavlína Bastová case[2] is interesting for the sports' world.

The CJEU decided three issues: VAT on prize money (for horse races); the deductibility of input tax and the applicable tax rate; also on other services. The result was quite remarkable: prize money, which is not a fixed amount but is variable with the result of the horse race, is not a payment directly related to a service and, therefore, not taxable for VAT.

The CJEU based this decision on art. 2(1) of the VAT Directive and on its own jurisprudence, such as the Tolsma decision[3]; but it can be criticized whether this is correct. It seems not to be in line with the practice in some EU states.[4] The consequence of the non-taxability of prize money may be that the input VAT of a part of the expenses is not deductible, depending on the relation to other activities and earnings.

The activities of Pavlína Bastová

Pavlína Bastová has a VAT registered business of breeding and training racehorses in the Czech Republic. She trains her own race horses as well as horses owned by others, with a capacity of 25 places. In addition to the racehorses, Bastová has in her stables two horses which she uses for agro-tourism and for training young horses, and is breeding mares and foals, from which she hopes to derive future income from races or sales.

Her income comes from three sources:
- prize money for her own horses and for the trainer's share of prizes won by horses of others;
- income from the operation of the racing stables: payments made by horse owners for training their horses for races; and payments made for stabling and feeding the horses;
- income from agro-tourism.

The national procedure and the preliminary questions to the CJEU

Pavlína Bastová had taken two VAT actions:

- deduction of the full input VAT incurred on the costs of her business, such as the entrance and declaration fees for races; fees for the assistance of auxiliaries for races; consumables for the horses; feed and equipment for the riders; veterinary services and medicine for the horses; electricity in the stables; fuel for the vehicles; a harvester for hay and forage; and tractor equipment and consultancy services for running the stables. These expenses related both to her own horses and those of other owners;
- application of the reduced VAT rate of 10% as output tax on the training fees and her other earnings.

The *Financní úrad v. Ostrovy* (Tax Office in Ostrov, Czech Republic) refused the input tax claim, insofar as it related to Bastovás own race horses, on the basis that there was no direct link between the supply of a service and the compensation (prize money) received in return. It also rejected the application of the reduced rate to the taxpayer's training fees and other earnings, because it held the opinion that this did not qualify for the conditions for the "use of sporting facilities".

After an appeal at the *Krajsky soud v. Plzni* (regional tax court in Plzen, Czech Republic), the case came to the *Nejvyssí správní soud* (Supreme Administrative Court, Czech Republic), which decided to stay the proceedings and raise preliminary questions to the CJEU.

These questions were (summarized):

- Is the supply of a horse by its owner to the organizer of a race a supply of services for consideration as mentioned in art. 2(1)(c) of the VAT Directive and is thus the prize money subject to VAT?
- If not, should the input VAT on the expenses be reduced?
- Can the various services be regarded as one single service to which the reduced VAT rate for the "use of sports facilities" applies?

Decision by the CJEU

The CJEU had asked Advocate-General Nils Wahl to render an opinion on the case, which was published on 14 June 2016. With this advice, the CJEU came to the following

1 Partner with All Arts Tax Advisers and Researcher at the School of Law of Erasmus University Rotterdam, The Netherlands. Website: www.allarts.nl.

2 CJEU 10 November 2016, Odvolací financní reditelství v. Pavlína Bastová, C-432/15. The full text of the CJEU decision, including the preliminary questions and the A-G opinion, can be found at https://curia.europa.eu, choose language and search on "C-432/15".

3 CJEU 3 March 1994, *Tolsma*, C-16/93.

4 *E.g.* in The Netherlands, the *Hoge Raad* had decided on 12 June 1996 (nr. 31175, BNB 1996/346) that a golf player was a taxable person for VAT purposes and that his prize money was a compensation for his services and, therefore, taxable for VAT. In the UK, HMRC also held that prize money was taxable for VAT (VAT Notice 700/67).

answers to the above-mentioned three questions.

Taxability of prize money

The CJEU held that prize money for a horse in a race is not a compensation for the supply of services in line with art. 2(1)(c) of the VAT Directive, because the payment for the service is not fixed but uncertain and can also be nil. Such variable payments do not meet the condition set by the CJEU in earlier decisions that *"there be a direct link between that supply and the consideration actually received by the taxable person"*[5]. A fixed starting fee would meet that condition, thus would be subject to VAT, but variable prize money remains outside the scope of VAT.

The fact that the horse owners have to pay entrance fees for participating in the race, as compensation for the services of the race organizer, does not influence the qualification of the prize money for the horse owners.

Deductibility of input tax

For the deductibility of the input tax on the breeding and training of the race horses, the CJEU held that there has to be a direct and immediate link between the expenses and the taxable earnings.[6] This can be the case for the costs of breeding and training of horses, which can be considered as general overheads of the business, related not only to the races but also to the overall economic activity of Bastová, including the sale of the horses and the agro-tourism. The CJEU recalled that in general:

> *"The rules governing deduction introduced by the VAT Directive are meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT."*[7]

But the CJEU also stressed that the direct and immediate link is necessary for the deductibility of the input VAT, because with only an indirect connection the input VAT cannot be deducted. For Bastová, the CJEU believes that there can be a direct link between the breeding and training of the horses and the later sale of the horses and/or the promotion of the economic activities of the stables. The input VAT will be fully deductible in accordance with art. 167 and 168(a) of the VAT Directive when the horses are actually intended for sale or for promotion of the economic activity of the stables. To determine whether this is the case for Bastová, the CJEU has sent the case back to the Czech tax court.

The CJEU also mentioned that when the outcome would be that a part of the expenses are made for non-taxable activities, only a proportion of the input VAT can be deducted under art. 173(1) VAT Directive[8].

Reduced VAT rate

Finally, the CJEU considered that the concept of "use of sporting facilities" to which EU Member States can apply the reduced VAT rate[9], refers to the use of immovable facilities by individuals practising sports. Therefore, whereas the use of a training track by individuals practising horse riding might be covered by this exception, the same may not be said for all the activities required for operating a racing stable, unless when the supplies of services have equal status and the total can be seen as one main service and some additional services, because then the additional services can follow the VAT rate of the main service. The CJEU has its doubts whether this applies to Bastová, but referred the case back to the national Czech tax court for practical determination.

Discussion of the CJEU decision

This CJEU decision is quite remarkable, because the outcome is in conflict with the fiscal neutrality of VAT. Where the Tolsma decision from 1994 was about payments by consumers on the streets to the player of a barrel organ, this Pavlína Basová decision is about payments from one taxable person to another taxable person. Sports tournament organizers will be taxable for VAT, because of the entrance fees, sponsoring and other taxable earnings, which means that sportspersons delivering services to them can charge VAT on their prize money without any negative consequence. When services are then considered to be non-taxable, with the result that (part of) the input VAT is not deductible, there will be an accumulation of VAT. It might be for Bastová that she gets away with this, because her expenses might have a direct and immediate link with the later sale of the horses and/or the promotion of her stables, but this will not be possible for many golf players, tennis players, cycle teams and other sportspersons and teams. The decision is especially strange, because the CJEU itself recognizes this fiscal neutrality in par. 42 of its decision, but seems to forget this in its later considerations. The result of the decision is in breach of the fundamentals of the VAT and the CJEU seems to wear legal blinkers here, to express it in horse terms.

There is another main difference, because, in the Tolsma case, there was no legal agreement between the people walking on the street listening to the barrel organ of Tolsma and deciding to give him a free gift for his music, and the horse races in which Pavlína Bastová is taking part and for which she reaches a legal agreement with terms and conditions and with clear perspective with which places prize money can be earned and with which not. In my understanding, this is a "consideration" for the supply of the horses to the race, but this consideration is

5 CJEU 29 October 2015, *Saudaçor*, C-174/14, par. 32. Same in *Tolsma*, par. 13.

6 CJEU 8 June 2000, *Midland Bank*, C-98/98, par. 30, and CJEU 21 February 2013, Becker, C-104/12, par. 20.

7 Par. 42 of the Bastová decision, with reference CJEU 14 February 1985, *Rompelman*, 268/83, par. 19, and CJEU 8 february 2007, *Investrand*, C-435/05, par. 22.

8 With reference to CJEU 22 February 2001, *Abbey National*, C-408/98, par. 37, and CJEU 26 May 2005, *Kretztechnik*, C-465/03, par. 37.

9 Point 14 of Annex III to the VAT Directive 2006/112/EC.

variable with the result of the race and might be nil under a certain place, but has been agreed legally beforehand. This is a business agreement, which should be recognized for VAT purposes. Whereas for Tolsma the gifts from the people on the streets had a "gambling" aspect, the prize money for Bastová can be influenced by the personal skills of the horses and jockeys. Unfortunately, the CJEU has a very strict financial interpretation of the term "consideration" from art. 2(1) of the VAT Directive.

Professional sportspersons will have a variety of income items, such as prize money; sponsoring; masterclasses; teaching; (perhaps) starting or appearance fees; and other income. After the Pavlína Bastová decision, prize money will not be subject to VAT, but sponsoring, masterclasses, teaching and starting fees will normally fall under the VAT. When the sportsperson can support the position that there is a direct and immediate link between the preparation and participation in the sports' matches and the sponsoring, masterclasses and/or teaching, the input tax on all expenses can be fully deductible. But when the sportsperson only lives from the prize money, there will be no other income to which the expenses can be linked and the input VAT will not be deductible. When the prize money is much higher than the income from the other sources it might be that the input VAT can only partially be deducted.

An example: a golf player on the European Tour earns per year 700,000 prize money, 250,000 sponsoring and 50,000 other sports related income, for which he makes 500,000 expenses (caddie, management, coaches, fitness, clothing, equipment, travel, accommodation, administration, legal and miscellaneous), from which 300,000 is taxable with 50,000 VAT. How much of this input tax is deductible after the Pavlína Bastová decision?

For full VAT deductibility, the golf player would have to support the position that his aim is to receive the sponsoring and other sports-related income and/or that his participation in the golf tournaments is necessary for his image as golf professional, with which he can earn his future income as a teaching professional when he is not playing on the tour anymore. Although it might be that the latter argument is considered as only an indirect link with the prize money.

It is more likely that the tax administration will not accept a proportion of the input VAT because his prize money is not a consideration for a taxable supply of service, so that he loses 70% of the input VAT, which would be 35,000. This can be the negative effect from the Pavlína Bastová decision of the CJEU, although, it should be noted, that the non-deductible VAT can be taken off as an extra expense from his taxable profit, which would save him income tax. When the top rate would be 45%, the income tax savings would be 15,750, so that the final net loss would be 29,250. Less than only the VAT, but still enough not to be pleased with, especially because it is in conflict with the VAT system as a consumer tax.

The Pavlína Bastová decision may also have consequences for the deduction of input VAT for other activities, such as fees for real estate agents; success fees for consultants; and no-win-no-pay fees for lawyers, but that discussion falls outside the scope of this article and sports journal.