The status of Local Authority Trading Companies (LATCs) and similar wholly owned entities

Indirect Tax | Tax voice



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Ian Harris delves deeper into what is a non-taxable person

Background

In 2015 the CJEU in *Saudaçor – Sociedade Gestora de Recursos e Equipamentos da Saúde dos Açores SA v Fazenda Pública* (C-174/17) effectively held that a company

wholly owned by the Autonomous Region of the Azores, tasked thereby with services in connection with the planning and management of the local health service, is unlikely to be a body governed by public law and so is unlikely to be acting as a non-taxable person under Article 13(1) of the EC Principal VAT Directive when undertaking those activities.

The CJEU held that the services provided by Saudaçor to the Regional Government were economic activities under Article 9(1) and Article 13(1) might apply to those economic activities – meaning they would then fall outside the scope of VAT as supplied by a non-taxable person – but only if Saudaçor can be classified as a body governed by public law (in which case it would also then need to carry out the activities as a public authority and without non-VATable treatment causing a significant distortion of competition).

In so holding, the CJEU was actually clear, in its view, that Saudaçor was not a body governed by pubic law, not being part of the public administration of the Azores, notwithstanding it being wholly owned by and effectively controlled and wholly financed by the Regional Government.

The question that *Saudaçor* left open was whether a body exhibiting features of both public and private law can be a body governed by public law for the purposes of Article 13(1), a question of increasing relevance to UK local authorities as they set up so-called local authority trading companies, or LATCs, and similar wholly owned entities in connection with their delivery of public services.

Can a wholly owned company be a body governed by public law?

In the CJEU's Judgment in *Saudaçor* the answer to that question appears to be 'potentially yes' but only if the body's governing instruments are more public law than private law, typically the case with bodies created by the State, even if ostensibly private bodies.

Ironically, therefore, the CJEU actually increased the uncertainty as to when a provider of public services is a body governed by public law for the purposes of Article 13(1).

The CJEU, however, has come back to this question in *Nagyszénás Településszolgáltatási Nonprofit Kft ('NTN') v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága* [C-182/17].

The request for a preliminary ruling came in the NTN case and concerned its liability to VAT on activities undertaken under a contract with the Municipality of Nagyszénás in South-East Hungary.

NTN: the dispute

NTN, a non-profit-making limited company wholly owned by the Municipality of Nagyszénás, entered into a contract with the Municipality under which, in exchange for ‘compensation’ paid by the Municipality and the use of certain assets belonging to the Municipality, NTN undertook to carry out specified public service tasks, notably the management of housing and other property, of local public roads, quarantine, the control of vermin and mosquitoes, the maintenance of parks, public spaces and other green areas, the management of knackers’ yards, and the upkeep of the local market.

NTN was obliged to keep records concerning the performance of the tasks entrusted to it in order to enable the Municipality to check they were performed as required, otherwise NTN was required to repay an appropriate proportion of the ‘compensation’ received. NTN did not issue invoices to the Municipality and did not account for VAT on the ‘compensation’ received.

Following a tax inspection, the Hungarian tax authorities decided NTN was liable to VAT on the ‘compensation’, which decision was upheld on appeal. NTN, however, asserted that, under the contract, the Municipality simply entrusts it with the performance of public services funded out of the Municipality’s financial resources, hence the contract was not a contract for the supply of services.

NTN also maintained that it was a ‘budgetary entity’, since it fulfilled the responsibilities devolved to it by means of ‘aid’ provided by the Municipality. This is a question considered in *Gmina Wrocław v Minister Finansów* [C-276/14] in the context of whether such a ‘budgetary entity’ acts independently of its owning municipality for the purposes of Article 9(1).

This is beyond the scope of this article but, briefly, the CJEU held, if not independent, the consequence of the Article 9(1) independence criterion is that such an entity is not independently carrying out an economic activity and so cannot be a taxable person, regardless of the effect of Article 13(1).

Unsurprisingly, the tax authorities argued that NTN received payment from the Municipality as consideration for providing the specified services, hence that payment was liable to VAT.

The tax authorities felt the fact the Municipality could expressly request NTN to submit reports and keep it informed about its performance of the contract also points to NTN not receiving publically funded aid but rather being remunerated for a supply of the specified services.

The tax authorities also felt NTN did not have the status of a body authorised to exercise public powers, ie it was not a body governed by public law, not being financed through the State budget. Rather, the tax authorities saw NTN as a commercial company established by the Municipality, indeed it was registered in the commercial register as such.

In any event, the tax authorities observed that the activities carried out by NTN were not those pertaining to acts of a public authority but were rather economic activities, NTN contributing to the performance of the Municipality's public tasks rather than carrying them out directly. Indeed, as is common with such entities, NTN supplied similar services to other customers on a commercial basis subject to VAT.

The three questions

The dispute progressed to the Kúria, the Hungarian Supreme Court, which decided that a key question raised is whether a commercial company, such as NTN, can fall within the scope of Article 13(1) and so referred the following questions to the CJEU:

> '(1) Does the concept of 'bod[y] governed by public law' in the first sub-paragraph of Article 13(1)… include a commercial company which is 100% owned by a municipality?
>
> (2) If the answer to Question 1 is in the affirmative, may it be considered that the commercial company acts as a public authority when performing tasks that are the responsibility of the municipality but that the latter delegates to that company?
>
> (3) If the answer to either of the previous questions is in the negative, may it be considered that the amount paid by the municipality to the commercial company for performing the tasks constitutes consideration?'

The CJEU's Judgment

Perhaps unsurprisingly given the case-law – notably '*Saudaçor*' – the CJEU proceeded direct to Judgment without an Advocate-General's Opinion,

The third question

Addressing the third question first, the CJEU observed that, in essence, this asks whether Article 2(1)(c) must be interpreted as meaning that an activity such as that performed by NTN under the contract with the Municipality constitutes a supply of services for consideration and so is subject to VAT.

As familiarly recited in that regard, the CJEU observed that a supply of services for consideration requires only that there is a direct link between the supply and the consideration, this being established by a legal relationship between the provider and the recipient pursuant to which there is reciprocal performance, payment received by the provider constituting the value given in return (see most pertinently '*Saudaçor*' and *Lajvér Meliorációs Nonprofit Kft &another v Nemzeti Adó-És Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* [C-263/15], another recent Hungarian reference).

To that end it is settled law that an activity is 'economic', within the meaning of Article 9(1), if engaged in for the purposes of obtaining income on a continuing basis.

Effected for a consideration

As to whether the activities of NTN were effected for consideration in those terms, the CJEU observed that NTN undertook, 'in exchange for compensation paid by the Municipality', to perform certain public tasks incumbent upon the Municipality. Furthermore, both the services provided by NTN and the 'compensation' paid therefor by the Municipality were of a permanent and continuous nature, demonstrated by the fact that NTN had been providing the services since 2007.

Direct link

And the fact the consideration was determined, not on the basis of individual services but as a flat rate annually intended to cover NTNs' operating costs, does

not affect the direct link (see '*Saudaçor*'). Nor is it relevant that the amount payable was fixed at a level lower than the open market value of the services, provided it is determined in advance on the basis of well-established criteria, eg to ensure it is sufficient to cover the operating costs of NTN (see '*Saudaçor*' and '*Lajvér*').

Legal obligation of the Municipality

Finally, the fact the services devolved to NTN constitute a legal obligation imposed upon the Municipality does not call into question their classification as a supply of services or the direct link between those services and the consideration given in exchange (see, by analogy, '*Lajvér*').

The fact that activities consist in the performance of duties conferred and regulated by law in the public interest is irrelevant in determining whether an activity must be classified as a supply of services for consideration. Even where the object is the fulfilment of a constitutional obligation, exclusively and directly incumbent upon the State, the direct link between its supply and the consideration received cannot be called into question by that fact alone (see '*Lajvér*').

In consequence

The CJEU, therefore, answered the third question, that Article 2(1)(c) must be interpreted as meaning that an activity whereby a limited company performs public tasks under a contract between it and a municipality, constitutes a supply of services for consideration and so is subject to VAT.

The first and second questions

By its first and second questions, the referring Court asked whether Article 13(1) must be interpreted as meaning that, where a company performs public tasks under a contract between it and the responsible municipality, those activities are to be treated as performed as a non-taxable person under Article 13(1).

The CJEU observed that two key conditions must be fulfilled for treatment as a non-taxable person under Article 13(1)

- the activity must be carried out by a body governed by public law, and
- it must be carried out by that body acting as a public authority.

In addition, treatment as a non-taxable person under Article 13(1) cannot cause a significant distortion of competition but this was beyond the scope of the reference in NTN.

As regards the first condition, the CJEU has held that the fact a body has powers conferred on it by public law is not in itself decisive for classification as a body governed by public law, given this is an essential characteristic of any public authority, albeit it is an important determining factor (see '*Saudaçor*').

In the circumstances, however, it appeared to the CJEU that, in performing the public tasks delegated to it, NTN enjoyed none of the rights and powers of public authorities, as enjoyed by the Municipality.

It also appeared to the CJEU that other characteristics of NTN militate against it being classified as a body governed by public law, in so far as these call into question whether it could be considered to be sufficiently integrated into the public administration of the Municipality.

Given it was established by the Municipality as a non-profit-making limited company, NTN is primarily a legal person governed by private law, under which it enjoys autonomy vis-à-vis the Municipality. There was no 'organic link' between NTN and the Municipality and neither was NTN established by a legislative act adopted by the Municipality (see by contrast '*Saudaçor*').

While NTNs' autonomy was undoubtedly limited by it being wholly owned by the Municipality, other factors indicate the Municipality was not in a position to exercise decisive influence over NTN:

1. the Municipality was not NTNs' only 'customer' and the services supplied to third parties were of more than marginal importance and were treated by NTN as subject to VAT;
2. the contract permitted the Municipality to monitor performance of the tasks delegated to NTN, suggesting the Municipality did not have effective control over NTN otherwise; and
3. the contract did not permit the Municipality to impose binding guidelines on NTN in the performance of the tasks delegated to it, which rather NTN was free to undertake within its own autonomy.

So, taking into account the principle that Article 13(1) must be interpreted strictly as an exception to the general rule that any activity of an economic nature is subject to VAT, the CJEU held that NTN cannot be classified as a body governed by public law.

As regards the second condition, that only activities carried out by a body governed by public law acting as a public authority are covered by Article 13(1), the CJEU felt it apparent from the settled case-law that that condition is not satisfied (see '*Saudaçor*' and the case-law cited).

NTN, being governed by private law and enjoying none of the rights and powers of a public authority, could not be said to carry out the activities delegated to it by the Municipality within the framework of the rules of public law.

The CJEU, therefore, answered the first and second questions, that Article 13(1) must be interpreted as meaning that, where a limited company performs public tasks under a contract concluded between it and a municipality, it does not fall within the scope of treatment as a non-taxable person.

Implications

In this Judgment, the CJEU seems to have finally addressed the uncertainty left by '*Saudaçor*', effectively holding that a wholly owned limited company – such as an LATC – or similar body 100% owned by a local authority, is not, itself, a body governed by public law and so cannot be treated as a non-taxable person under Article 13(1).