VAT and PPP contracts

Review of key issues arising in the European context

July 2013

Contents

1 Introduction

1.1 Background

1.1.1 A *Value Added Tax ("VAT")*[1] regime has the potential to pose a range of unique challenges for EU *Public Private Partnership ("PPP")* projects, with the extent of those challenges being driven by a small but important number of aspects of the VAT model operated in a particular *Member State*.

Important note to readers

This paper is designed to provide those responsible for PPP procurement with a clear overview of the PPP/VAT interface. It highlights important principles, and is intended to equip stakeholders and decision-makers with a firm grounding in the subject.

However, the paper does have inevitable limitations. Specifically, the paper addresses general themes and concepts only; it is not intended to replace the need to obtain professional advice from qualified tax professionals in relation to specific projects, and non-standard contracts in particular.

1.1.2 PPP projects, as opposed to more traditional forms of *public sector* procurement, are generally long-term arrangements under which public infrastructure capacity is delivered by the private sector. There are a number of PPP variants representing differing mixes of public/private finance, risk and responsibilities. Broadly speaking, all forms of PPP seek to leverage a range of important capabilities that exist within the private sector for the benefit of the public sector.

1.1.3 With regard to large infrastructure projects in particular, public sector *procurers* generally adopt models that enable them to procure managed infrastructure services, rather than merely assets, from PPP *providers* (at least in the short to medium-term). These services may be paid for directly by: users through the imposition of user charges (e.g. road tolls); by a public sector procurer (e.g. *unitary charges*, *shadow tolls,* or *availability payments*); or a combination of both. In many cases, charges for services (as indeed is the case for most charges arising under PPP models) rendered by providers will be subject to VAT.

1.1.4 VAT incurred by procurers under a PPP arrangement can present a real additional project cost. The issue arises as a consequence of fundamental provisions contained in the *Principal VAT Directive*, legislation that applies to all public sector bodies within the EU and which prevents such entities from recovering VAT in a number of (but not all) instances.

1.1.5 Procurers do not only incur VAT under PPP arrangements; they are likely to incur VAT on most goods and services that they purchase externally. Importantly, however, it is the economics of VAT under PPP which differ from traditional procurement, in so far as:

- Large, modern-day PPP procurements in the EU tend to relate to activity types (such as the provision of roads, schools and hospitals) which, *prima facie*, prevent the recovery of associated VAT incurred by procurers as a consequence of key provisions contained in the Principal VAT Directive (this is referred to as the "primary VAT effect" in this paper);
- Sourcing is usually entirely external under PPP, whereas traditional procurement might have involved an element of VAT-free self-provision. Procurers therefore buy-in more VAT-bearing cost under PPP than they might otherwise have done, further enhancing the primary VAT effect (this is referred to as an "amplified VAT effect" in this paper);
- Commonly-used PPP models require providers to pre-finance the design, construction and operation of the relevant asset. And whilst VAT incurred by providers during these phases is likely to be recoverable in full in the short to medium term, a cash-flow cost remains nonetheless. Consequently, charges made to procurers and/or users under PPP also incorporate an element representing the cost of financing VAT alone (i.e. in addition to overall finance costs);

[1] See the glossary at the end of the document for definitions of italicised terms

- The making of capital contributions (including grants) and pre-payments by procurers to providers in order to help with funding requirements and overall cost can in fact create and accelerate VAT costs for procurers, a situation which might not otherwise have existed; and
- *Barter* arrangements also pose a challenge in that they may also generate an additional VAT cost for procurers.

1.1.6 Viewing all of the functions of government and the public sector as whole there is an argument to say that VAT should not, ultimately, be considered an absolute cost for the public sector under a PPP arrangement or indeed under any other procurement scenario. But with many public sector bodies being faced with fixed, delegated budget allocations and accountabilities, any additional VAT cost can present very visible and immediate costs to a particular function, department or body, and take a primary role in any decision to invest or not to invest under PPP.

1.1.7 Recognising the risk that VAT poses to infrastructure investment decisions, a limited number of Member States have introduced mechanisms that seek to *directly relieve*, in whole or in part, VAT costs arising in the public sector. Others have not, although certain other mechanisms exist within national VAT legislation which may mitigate the effect of VAT to some extent.

1.1.8 That is not to say that the threat of non-relieved additional VAT costs is driving PPP investment decisions in the EU; indeed whilst only eight[2] of the 27 Member States operate a mechanism which offers direct relief for VAT costs incurred in the public sector (including those arising under PPP), it remains a widely-used procurement tool across the other 19 Member States. This is likely a reflection on the residual value placed on PPP as a delivery mechanism irrespective of VAT cost. Nonetheless, it is notable that the UK, which is consistently the most significant user (in volume and value terms) of PPP within the EU, also benefits from what appears to be the most benign VAT regime with regards to VAT costs arising in the public sector.

1.2 Objectives and readership

1.2.1 Given the potential importance of VAT costs in the overall PPP affordability analysis, possessing a firm understanding of the basis on which VAT costs arise in the first instance, being aware of the important of incorporating those costs into project financial modelling, and having an appreciation of the ways in which that cost may be mitigated or removed entirely, is vital.

Key points

This paper should enable you to:

- Appreciate the important distinction between a "taxable person" and a "non-taxable person", exempt and taxable supplies, and what these concepts mean for VAT costs incurred by procurers under PPP;
- Appreciate the importance of building VAT into models to determine overall project affordability;
- Understand the approach taken in certain Member States with regard to mitigating VAT costs incurred by procurers and which present themselves as options for others;
- Understand how VAT effects providers; and
- Feel equipped to discuss VAT in a PPP context, or shape relevant PPP policy debate should the opportunity to do so arise.

1.2.2 The purpose of this paper is to provide an overview of the interaction between VAT and PPP arrangements in their broadest sense, highlighting the experience of both procurers and providers with a view to informing stakeholders and decision-makers on the subject. It serves to offer a understanding of the basis on which VAT cost arises in the first instance, highlights the importance of incorporating that cost into project financial modelling, and offers an overview of the ways in which that cost can be mitigated or removed entirely, drawing on iterative examples of approaches taken in certain Member States.

1.2.2 The *European Commission* is currently examining the existing EU rules relating to the application of VAT in the public sector as part of a wider reform agenda[3] designed to support *Europe 2020* objectives. It has

[2] Copenhagen Economics, *"VAT in the Public Sector and Exemptions in the Public Interest"*, p11, available online at http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_public_sector_exemptions_en.pdf
[3] http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/key_documents/communications/com_2011_851_en.pdf

recognised the inherent complexities and potential for distortions with the existing architecture and it is expected that it will seek out ways to address them in due course. This paper should sufficiently inform stakeholders that have the opportunity to shape national VAT policy development in this domain.

1.2.3 This paper has primarily been written with public sector officials responsible for PPP projects in the EU in mind, and in particular those of whom have little or no specific knowledge of VAT and key aspects of the tax which are important from a PPP perspective.

1.3 Structure of the paper

1.3.1 This paper initially highlights the most important aspects of PPP which are relevant in a VAT context. It goes on to provide a thorough overview of important VAT concepts, all of which have a bearing on the tax treatment of a particular PPP project. There then follows an examination of mechanisms which are, or could be, employed to eliminate or reduce additional VAT costs arising in relation to public sector procurement and PPP in particular. Drawing on all of the foregoing information, the PPP lifecycle is examined, highlighting the key VAT impacts at each stage. Finally, illustrative case studies have also been included.

1.3.2 Throughout the document, specific comment and analysis is provided in respect of four Member States, namely: France; Germany; Spain; and the UK, on the basis that these countries pioneered and remain significant users of PPP across a broad range of sectors as summarised in Figure 1.

1.3.3 Additional emphasis is placed on the UK experience in the paper. The UK was an early adopter of PPP, and whilst the UK Government has experienced challenges over perceived inflexibility and waste associated with the approach in the past, it continues to believe in the ability of the private sector to play a leading role in the delivery (and operation) of public infrastructure.[4] The design of the UK VAT system is also relatively amenable to PPP and is worthy of a more detailed exposition in this context.

	% number of projects (1990-2009 agg.)	% value of projects (1990-2009 agg.)
UK	67.1	52.5
Spain	10.1	11.4
France	5.4	5.3
Germany	4.9	4.1
Portugal	3.2	7.0
Italy	2.4	3.3

Figure 1: EU PPP projects by volume and value

Source: European Investment Bank, Economic and Financial Report 2010/04, July 2010

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/205112/pf2_infrastructure_new_approach_to_public_private_partnerships_051212.pdf

2 Executive Summary

2.1 Cause of the primary VAT effect

2.1.1 Under *directly effective* provisions contained in the Principal VAT Directive, public sector bodies (including procurers), are not generally considered to be acting as *taxable persons* when they are acting as a public authority. This paper refers to public sector bodies in this condition as acting in a *non-taxable* capacity for simplicity.

2.1.2 Acting in a non-taxable capacity essentially removes a public sector body from the "normal" VAT regime. As a consequence, the body concerned is neither allowed to charge VAT on services it renders, nor is it entitled to recovering most, if not all of the VAT incurred on external costs (including those arising under PPP arrangements) under normal VAT recovery rules. *Prima facie*, VAT incurred by a public sector body acting in a non-taxable capacity represents an actual additional cost. This paper refers to this impact as the primary VAT effect.

2.1.3 Importantly, a public sector body will not always be acting in a non-taxable capacity for the purposes of VAT. For example, a public sector body which is not carrying out a statutory function is unlikely to be acting in a non-taxable capacity. A body which is carrying out certain specified activities (e.g. the provision of telecommunications services), will also not be treated as acting in a non-taxable capacity. In addition, a body which is carrying out a statutory function but which is in direct competition with the private sector will also not usually be entitled to continue acting in a non-taxable capacity. Where this is the case, the "normal" VAT regime once again applies; VAT is likely to be chargeable on any charges for services rendered and, significantly, VAT incurred on goods and services procured may well be recoverable in full in the usual manner. Establishing from the outset the basis on which a public sector body is procuring goods or, more significantly for PPP, services, is therefore vital.

2.1.4 The problem needs to be assessed on a project-by-project basis. Even those PPP projects which relate to a procurer engaging in a non-taxable capacity may not automatically create a VAT cost. Under PPP, a provider may be remunerated directly by a procurer through unitary charges (calculated by reference to an appropriate metric), be entitled to make charges in respect of the use infrastructure directly to users (e.g. road tolls), or a combination of both. The more common unitary charge approach is usually that under which VAT generally becomes more of an issue, whereas the "user pays" options generally offer the more optimal VAT position as a consequence of a substantially reduced or even no charges being made directly to the procurer.

2.2 The consequences of the primary VAT effect for PPP

2.2.1 Examples of the activities in which a public sector body might engage as a non-taxable person include: the provision of roadways; medical care; or primary and secondary education. Of course, all of these feature heavily in most PPP programmes. Procurers of projects seeking to address these infrastructure needs and other affected projects must recognise that VAT incurred on provider charges will, *prima facie,* represent a cost as a consequence of the operative aspects of the Principal VAT Directive.

Key points

- Key provisions in the Principal VAT Directive give rise to VAT costs for procurers, principally when they are acting in a non-taxable capacity when procuring goods or services. This is referred to as the primary VAT effect in this paper.
- PPP projects have the capacity to further amplify these VAT costs (referred to as the amplified VAT effects in this paper):
  - Full outsourcing creates additional VAT cost in any event
  - Providers must pre-finance recoverable VAT costs
  - Capital contributions and grants passed or given to providers can create additional VAT costs, or advance VAT costs which might not otherwise have existed
  - Barter transactions (e.g. the passing of land to a provider for no charge) may also result in the creation of VAT costs
- Unrelieved VAT costs have the potential to drive investment decisions and prevent the public sector benefitting from the benefits of private sector involvement

2.2.2 The very nature of PPP further contributes the

primary VAT effect. A number of features of PPP have the potential to increase overall VAT costs for the procurer. Where appropriate, these features and their impacts are referred to as amplifying the primary VAT effect (or amplified VAT effects).

2.2.3 The issue is driven principally by the fact that PPP represents a shift to substantially external sourcing with charges for associated delivery generally being entirely subject to VAT. Coupled with this, providers are usually required to secure finance at a cost greater than that which would be the case in the public sector for the design, build and early operation phases of PPP; a cost which they will seek to pass on to procurers or users as the case may be. One particularly relevant aspect of project finance is the amount which is required to fund VAT incurred by the provider. That VAT amount is generally recoverable but the delay between it being incurred and it being recovered can be significant and will require funding in the interim. Thus, even VAT which is recoverable by a provider can still amplify the primary VAT effect for procurer.

2.2.4 Furthermore, the sourcing and making of capital contributions and other forms of pre-payment may also pose a challenge from a VAT perspective. Compared with a situation where no such payments are made, they can advance *taxpoints* (causing providers to have to charge and account for VAT at an earlier point than normal), or otherwise create an additional VAT cost which might not have existed in the first instance. Barter arrangements are another relatively common feature of large PPP projects, and might involve the passing of significant areas of land or existing properties to providers purportedly for no charge. Yet VAT may still accrue on such arrangements and represent a cost to procurers.

2.2.5 VAT therefore creates certain challenges for PPP. The implications that lifecycle VAT costs may have for PPP project economics can be substantial, and represent the difference between a decision to invest or not to invest. Arguably, the national public sector should be treated as a whole; VAT costs borne by one public sector body will be offset by VAT paid to another public sector body (i.e. the *tax authority*). But to approach the issue in that manner would be to forget that most public sector bodies must deal with fixed budgets against which they are measured and for which they are accountable. VAT costs can affect those budgets and restrain investment decisions impacting not only users, but creating a bias towards delivering needs based on existing or expanded capabilities (i.e. *insourcing*).

2.2.6 It is therefore vital to understand the implications of VAT exposures throughout the lifecycle of projects so as to be in a position to identify potential risks arising as a consequence of it. Equally it is also important to understand how those risks can or could be better managed.

2.3 Potential solutions to the primary and amplified VAT effect

Eliminating the primary and amplified VAT effect

2.3.1 Arguably a fully-taxable VAT system with no special rules for public sector bodies should remove the primary VAT effect. However, the introduction of a fully-taxable VAT system would be a radical development, requiring significant changes to national public sector funding systems and unlikely changes to the Principal VAT Directive. Therefore full taxation is not currently a practical option and it is appropriate to focus the attention of this study elsewhere.

Key points

- Bringing public bodies into the “normal” fully taxable VAT system is unlikely
- The extension of existing VAT rate reductions or exemptions to goods and services commonly found in PPP arrangements is also unlikely
- VAT compensation or refund schemes which can be accessed by procurers are a highly effective means by which VAT costs can be eliminated; only 8 Member States have deployed such schemes to date
- The reverse-charge mechanism could be extended beyond its current remit in order to remove costs for providers and procurers associated with financing VAT
- Procurers and tax authorities can work together more effectively to improve VAT recovery timescales and reduce the cost associated with financing VAT

Refunding VAT charged to procurers

2.3.2 In the alternative, VAT costs incurred by procurers can be relieved under a VAT compensation or refund scheme. These schemes, which have been deployed in France, the United Kingdom and six other Member States, are available only to qualifying bodies of the public sector. They allow those bodies to recover, or be reimbursed for all or a large proportion of VAT incurred in a non-taxable capacity. Such schemes can be very effective in relieving immediate VAT costs incurred under PPP; PPP usage in the UK is widespread and notably the country also operates what is perhaps the most systematic VAT refund scheme.

2.3.3 That not all Member States have implemented such schemes is generally a reflection on the make-up of the country concerned combined with budgeting requirements and norms. Therefore there does seem scope for the other 19 Member States to consider introducing such schemes should it be possible to overcome any other existing domestic constraints. Importantly, the Principal VAT Directive does not prevent the existence of such schemes, and so it seems to be the most obvious short-term solution, absent a whole-scale redesign of the relevant features of the Principal VAT Directive.

2.3.4 Care does need to be taken with the design of any measures which are intended to relieve public sector bodies from the cost of VAT. Potentially they run the risk of creating distortions in the market, with the public sector benefitting at the expense of the private sector. For example, enabling the public sector to benefit from a broad-ranging refund regime without having to impose VAT on its charges could give rise to institutional growth, reduced economic efficiency and the potential private sector competitors being faced with unintended financial and competitive market barriers. This already occurs within the EU in limited areas, and failure to recognise the problem in the context of PPP could exacerbate the issue further.[5]

Mitigating VAT costs at source

2.3.5 Reducing the VAT that providers or procurers face on their costs (i.e. on charges imposed by providers), represents the next-best alternative to a refund or compensation scheme. But whilst many Member States operate a scheme of reduced rates or exemptions, their impact in a PPP sense is not generally felt given the goods and services to which these rates are usually applied. As a longer-term option it suffers from a number of challenges. Importantly, Member States are precluded from reducing rates beyond certain thresholds, and exemptions are difficult if not impossible to promulgate. The potential associated revenue loss to governments which could arise if other sectors disproportionately or unintentionally benefit from the implementation of a reduced rate structure is likely to render such an approach unattractive to governments.

2.3.6 Existing features contained in many Member State's VAT systems can be helpful in limiting the amplified VAT effect, specifically those effects relating to the requirement for providers to finance the absolute and cash-flow cost associated with VAT:

- Early registration enabling prompt VAT refunds from the *tax authority*;
- The use of monthly VAT periods to improve the frequency with which VAT refunds are made;
- Minimising irrecoverable VAT costs (e.g. third party costs paid by procurers) wherever possible; and
- Broad application of the *reverse-charge mechanism* for qualifying transactions.

All such aspects have important and beneficial implications for the working capital requirements of providers.

2.3.7 A difficult challenge when trying to control VAT cost at source relates to pre-payments, capital contributions (including grants), and barter transactions. Current rules usually create a VAT charge (i.e. a VAT cost for

[5] *Ibid*, p11

procurers) at the time when such payments or events take place, an issue which may never have arisen had the procurer retained the sums involved. Aside from simply not making such payments, these issues are likely to be difficult to eliminate under existing rules.

Best practice?

2.3.8 It is through a range of realistic measures that potential VAT barriers to PPP arrangements can best be reduced or overcome. A single solution suitable for all Member States does not seem achievable at this stage although, significantly, the matter is now being considered in more detail by the European Commission.

2.3.9 Figure 2 summarises the key issues and potential means by which the primary and amplified VAT effects could be mitigated.

Procurer activity	VAT cost	Reason	Effects	Origin	Potential mitigation	Potential impact
Taxable	No	Normal rules apply	N/A	N/A	N/A	N/A
Non-taxable	Yes	Article 13, Principal VAT Directive	Primary VAT effect	VAT on unitary charges or similar	Direct tax refund/compensation mechanism	High
					Full taxation of the public sector	High
			Amplified VAT effect	Full outsource	Reduction in VAT rates	Medium
				Impact of pre-financing VAT costs	Early voluntary VAT registration of providers	Low
					Faster refunds by authorities	Low
					Extensive deployment of the reverse-charge mechanism	High
				VAT impact of capital contributions and grants	Amendment to applicable tax-points	Medium
					Allow grants to be paid directly to providers	Medium
				VAT impact of barter	Amendment to tax-points	Medium
					Charge VAT on the land and recover associated VAT incurred	

Figure 2: Summary table presenting VAT effects and potential mitigation

3 PPP, PPP lifecycle and VAT exposures

3.1 General overview of PPP

3.1.1 The public sector's ability to provide goods and services will depend on the infrastructure available to it and its ability to deliver the capital projects necessary for improved infrastructure. This will depend on the financial resources available to it and its ability to raise debt.

3.1.2 Public sector procurement is the means by which public bodies acquire goods and services. Traditionally, public sector procurement meant that the public sector directly funded infrastructure projects, with it bearing the risk of cost overruns and delays. Accordingly, if the public sector is unwilling, or unable, to bear this risk, then infrastructure projects are not delivered and an infrastructure gap arises. This may have a negative impact on society.

3.1.3 PPP is a term that came into general use in the 1990s. However, there is no single definition of what PPP means or involves. Broadly, PPP involves the public and private sector coming together in a long-term partnership for the delivery of infrastructure projects.

3.1.4 PPP differs from traditional public sector procurement. Whereas previously the public sector generally shouldered both the burden of the costs and risks associated, PPP represents a departure from that norm. Private sector delivery capabilities are recognised under PPP: their ability to better manage large-scale projects; an alternative approach to return and reward; more efficient methods of delivery and operation; a greater aptitude for managing risk; and the relative ease with which they are ordinarily able to marshal significant amounts of finance (albeit at greater cost). Thus PPP arrangements typically share the following features:

- A long-term contract between a procurer and a provider based on procurement of services, not assets;
- The transfer of certain project risks to the private sector, notably with regards to designing, building, operating and/or financing the project;
- A focus on the specification of project outputs rather than project inputs, taking account of the whole life cycle implications for the project;
- The application of private financing (often project finance) to underpin the risks transferred to the provider albeit that procurers may well make capital contributions (including grants) in order to assist in this regard; and
- Payments to the provider which reflect services delivered. The provider may be paid either by users directly through user charges (for example, motorway tolls), by the procurer (for example, availability payments or shadow tolls) or by a combination of both (for example, user charges coupled with shadow tolls to make up any shortfall).

3.2 The PPP lifecycle

3.2.1 PPP projects are usually depicted as comprising a number of key phases as illustrated in Figure 3:

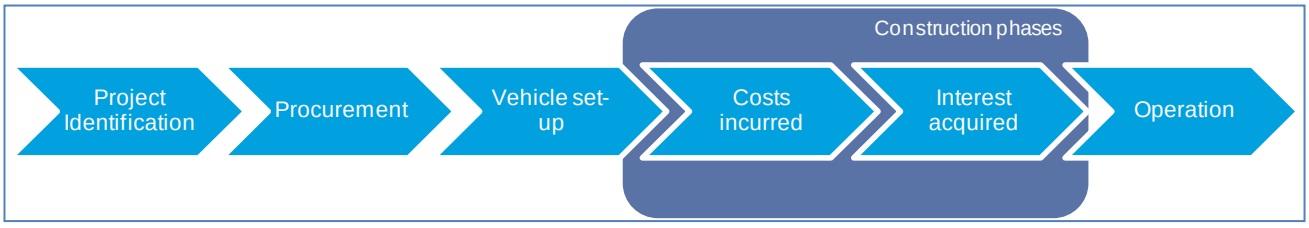


Figure 3: PPP lifecycle phases

3.2.2 A broad description of each phase is shown in Figure 4:

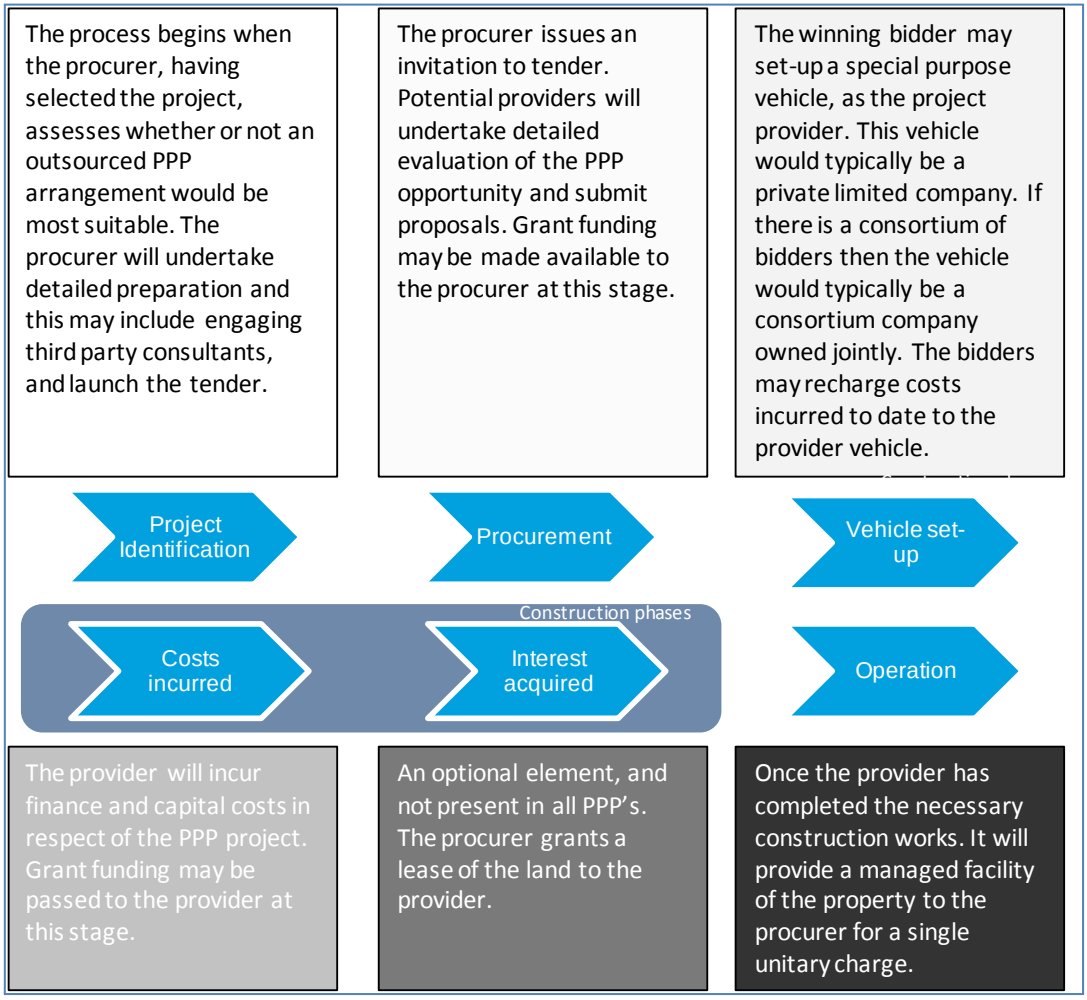


Figure 4: Description of phases

3.3 VAT exposures during the PPP lifecycle

3.3.1 Each phase is relevant from a VAT perspective, albeit the tax may be less relevant in some phases and more so in others. Importantly, understanding where the VAT exposures lie is vital; providers are concerned with VAT they incur whereas it becomes clear in this paper that procurers should not only be concerned with both the VAT that they themselves incur, but also the VAT incurred by providers. Figure 5 summarises these exposures:

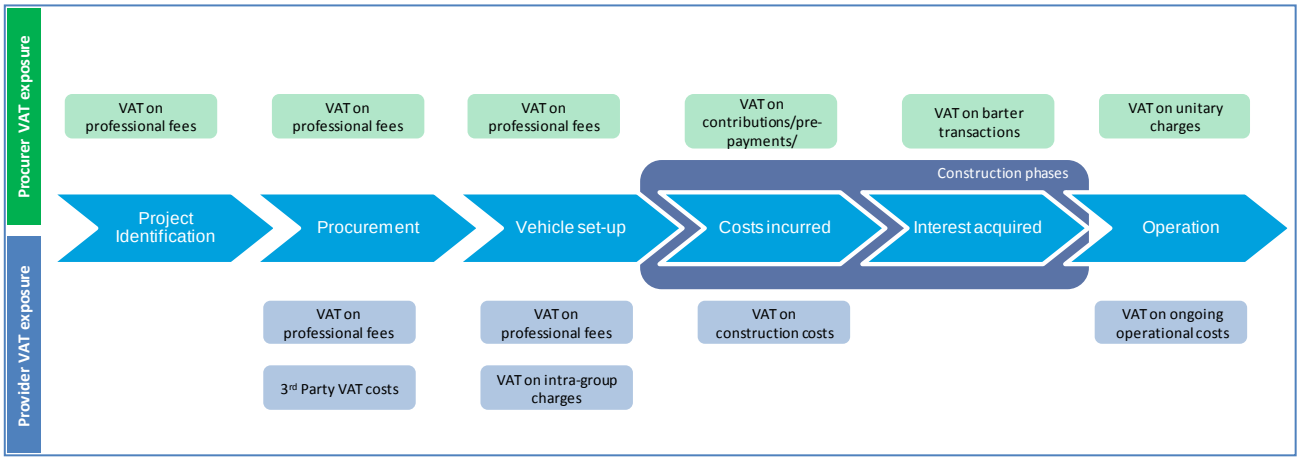


Figure 5: High-level illustration of VAT exposures during the PPP lifecycle

3.3.2 Bearing in mind the VAT exposures summarised above, the difference in the VAT analysis between traditional external procurement should not be overlooked. All public sector entities will incur VAT on external sourcing, however, the economics under PPP can be substantially different as a result of certain key features of PPP:

- Projects delivered under PPP tend to be of a type and for a purpose which prevents procurers recovering VAT incurred;
- Providers take responsibility for delivering a managed service on which VAT is chargeable, purchasing all of the goods and services necessary to enable it to do so. The transfer of overall responsibility to the provider usually reduces the opportunity for the procurer to make use of any in-house assets or people which might have been deployed under traditional procurement without incurring a VAT charge;

Key points

PPP, as opposed to traditional procurement, can be characterised as the long-term outsourcing of project delivery and management to the private sector. Services are procured rather than assets. Aspects of PPP important for VAT purposes and which can have implications for investment decisions include:

- The nature of projects being of a type that, *prima facie*, creates a VAT cost for procurers
- The overall VAT burden can be exacerbated as a consequence of procurers being unable to make use of existing resource
- Procurers incur VAT on the costs associated with provider project finance, which in turn reflects an element of funding required to finance short-term VAT costs
- Capital contributions (including grants) may feature, which themselves can either accelerate or create new VAT costs for procurers which might not otherwise have existed

- Charges to procurers under PPP will reflect (in part) overall project finance, including costs associated with the short-term funding of recoverable VAT. The scale of PPP procurement (and the VAT thereon) is often significant, and whilst the majority if not all of VAT incurred by providers may well be recoverable within a relatively short period of time, a reasonable portion of any funding package will be allocable to those short-term VAT costs; and
- Capital contributions, pre-payments, grants and land transfers are a relatively common feature of PPP arrangements, all of which can create VAT costs for procurers that might not have existed under traditional procurement methods.

3.3.3 The implications that lifecycle VAT costs may have for PPP project economics can be substantial, and may represent the difference between a decision to invest or not to invest. It is vital therefore to understand the implications of VAT exposures throughout the lifecycle of projects so as to be in a position to identify potential risks arising as a consequence of the tax. Equally it is also important to understand how those risks can or could be better managed, particularly where they are currently driving the investment landscape.

3.4 PPP contracts – VAT touchpoints

3.4.1 Bridging the conceptual gap between the wording of a PPP contract and that which is found in the VAT legislation can often prove difficult. Contracts provide the detail over which the VAT analysis must be overlaid, but whereas VAT legislation is designed to adequately cover the very many potential forms that a transaction involving goods and services may take, PPP contracts are written in very specific terminology, much of which might not be found in the normal reading of VAT legislation.

3.4.2 That is not to say that establishing the correct VAT treatment of PPP contracts over their lifecycle is overly burdensome. As with most VAT-technical issues, real insight can often be found in the answers to five relatively straightforward questions. These questions, answered from a PPP perspective, are outlined below.

3.4.3 **Who** is the supplier and who is the customer? The precise status of the parties to a transaction has important implications for the overall VAT analysis. It can impact on issues such as the place of supply, as well as entitlements around VAT recoveries. A provider plays the part of both supplier (i.e. it makes supplies to the public sector procurer) and customer (when buying in goods and services from others in order to make its supplies) in a PPP context. Usually the provider is an SPV and generally its treatment is no different to any other business from a VAT perspective. The procurer principally plays the role of

customer under a PPP arrangement. As detailed in subsequent sections, public bodies are treated quite differently than providers in a VAT context.

3.4.4 **What** is the nature of the supply? The answer to this question has important consequences from a VAT accounting perspective. A provider usually makes supplies of services (e.g. the provision of a managed roadway, school or hospital facilitates).

3.4.5 **Where** is the supply taking place? The answer to this question dictates the jurisdiction in which any VAT liability arises and has implications for the VAT liability of the transaction concerned, the rate of VAT chargeable, and a host of other tax administration matters. As noted above, providers usually make supplies of services to public sector procurers and these are usually treated as being supplied where the public sector procurer is established. A provider or a procurer might find itself facing a slightly more complex VAT picture should it buy in goods and services from outside the country of its establishment.

3.4.6 **When** did/will the supply take place? Establishing the timing of a supply determines its taxpoint, being the date on which VAT becomes a liability owing to the relevant tax authority, and the date from which VAT charged should become recoverable by those that have paid it. A supply of services is usually treated as made when completed. Importantly, however, time of supply rules tend to include a range of provisions which can lead to tax points being advanced. Service provision under PPP is normally treated as supplied whenever a payment is made or an invoice is issued, whichever is earlier.

3.4.7 **What consideration** has passed? Supplies must be valued in order to establish the quantum of the VAT liability. Where consideration is expressed purely in money or money terms, that figure tends to be treated as the consideration for the supply (albeit provisions usually exist to counteract the effect of deliberate attempts to undervalue supplies in certain instances). In a PPP context, services are usually delivered in return for payment in money. This figure might be established as a regular unitary charge, availability payment, a shadow-toll, a user charge, or some other type of payment. The key point to bear in mind is that regardless of the calculation methodology or labelling of the relevant sum, it is in most cases a monetary charge for services rendered (i.e. there is little further distinction to be made from a VAT perspective). Additional complexity can arise as a consequence of barter, however, and this paper examines the issue in more detail.

3.4.8 In summary, identifying the potential VAT interactions throughout the VAT lifecycle is not overly complicated when compared to general compliance with the VAT system that any normal business must deal with. Establishing answers to the five key questions outlined above throughout the VAT lifecycle should greatly assist providers and public sector procurers alike understand and manage their VAT liabilities more effectively. Additional complexities do arise and the outline above is intended as a general guide only.

4 VAT principles relevant to PPP

4.1 General overview

4.1.1 The following summary is intended to provide a broad guide to the key features of VAT, with particular reference to PPP arrangements. It has been included in order to fully explain the VAT-technical context in which PPP exists and on that basis it is an important aspect of this paper. It has been written in general terms and is not exhaustive. It should not be relied on to cover specific situations.

EU VAT law and its interaction with national VAT systems

4.1.2 Operating a VAT system is compulsory for Member States. VAT is imposed on almost all goods and services that are imported into or supplied within in the EU. The primary EU VAT legislation is the Principal VAT Directive, which provides for a common design of VAT across all Member States.[6] Each Member State must effectively translate the provisions of the Principle VAT Directive into national law; any directly effective provision contained in the European text overrides anything contradictory contained in national law. Member States have a degree of flexibility in certain areas over the implementation of certain elements of the Principal VAT Directive, but there is no flexibility around significant points of principal (such as the "non-taxable" treatment of public sector bodies carrying out activities in which they are "engaged as public authorities" – see 4.1.5 below).

4.1.3 The extent to which the Principal VAT Directive has direct effect is beyond the scope of this paper. However, the Court of Justice of the European Union (CJEU) has held that wherever the provisions of a Directive appear to be unconditional and sufficiently precise, then those provisions may be relied upon against any national provision which is incompatible with the Directive insofar as the provision defines rights which individuals are able to assert against the relevant Member State.

4.1.4 Written into the Principal VAT Directive are certain exceptions and derogations available to Member States with regard to elements of the domestic implementation of VAT. Amongst other things, matters relating to the rates of VAT applied by each Member State to certain types of goods and services or registration thresholds are dealt with in this manner.

Taxable persons, registration and accounting for VAT

4.1.5 The term *taxable person* refers to any person who, independently (i.e. is not in employment), carries out in any place any economic activity whatever the purpose or result of that activity. It is a vital term and underpins the standard functionality of the EU VAT regime. By definition any person who is not a taxable person falls outside the scope of the VAT system and is neither subject to its provisions, nor (ordinarily) able to take advantage of its benefits. See Box 1 and section 4.2 for a more detailed analysis of the concept.

4.1.6 VAT is ordinarily charged on transactions carried out by taxable persons. However, VAT incurred by intermediaries in a supply chain is

Box 1: Taxable person vs "business"

The term "taxable person" requires further explanation for UK readers. The UK VAT legislation uses the term to describe a person that *"...is, or is required to be registered..."* for VAT purposes (i.e. not only is the person concerned simply carrying on an economic activity, but they have also met the other tests provided for in law necessitating registration).

The equivalent term for "economic activity" in the UK VAT context is in fact that of "business"; in the sense that the UK defines a person as conducting activities *"...in the course or furtherance of any business...."* instead of carrying on an economic activity *per se*. The meaning of "economic activity" is not materially different from the meaning of "business" in the UK legislation.

Thus a "taxable person" in the UK is, by definition, someone who is in business (i.e. carrying on an economic activity), and who is also (having met certain other criteria) either registered, or liable to be registered for VAT purposes.

This concept is important to bear in mind with regard to the VAT position of the public sector in the UK.

[6] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:347:0001:0118:en:PDF

generally recoverable under an invoice-credit system (i.e. it is not a cost to producers), and its effect is usually borne in full by the final consumers of goods and services.

4.1.7 A taxable person is required to register for VAT when the value of their supplies has exceeded a certain threshold. This threshold varies from one Member State to another but would typically be exceeded by a provider. A person may, in any event, voluntarily register for VAT if that person's taxable supplies are below the relevant threshold.

4.1.8 A taxable person is ordinarily required to charge and account for VAT to the tax authority in the Member State where the supply is, or is deemed to be, made and at the time it is made. The time at which a supply is made and when tax becomes chargeable is referred to as the taxpoint. Taxpoints can be altered as a consequence of certain events. For example, in Figure 6 above a basic tax point for services could be brought forward or advanced as a consequence of early invoicing or payment.

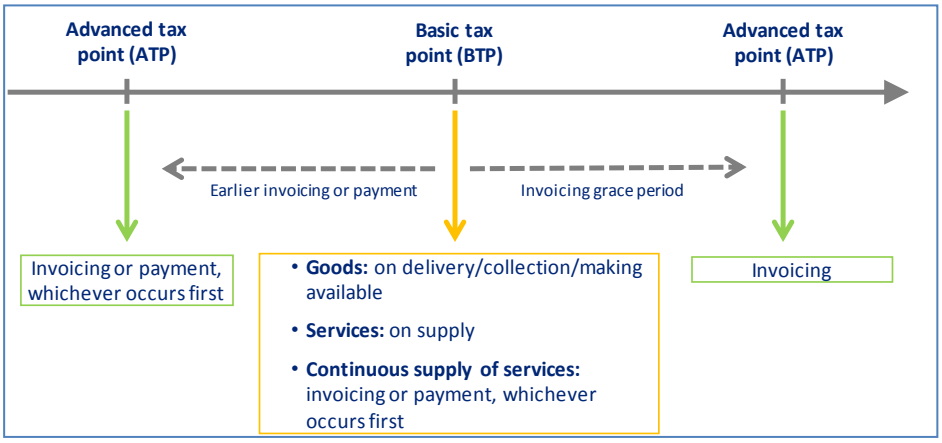


Figure 6: Summary table presenting VAT effects and potential mitigation

4.1.9 The VAT chargeable (i.e. *output VAT*) at the taxpoint is calculated as a percentage of the net selling price. The amount is paid over by the taxable person to the relevant tax authority after first having deducted from that gross liability that amount of VAT which they are entitled to deduct (i.e. *input VAT*) in respect of the transaction. The net amount is then paid to or recovered from the authorities in practice as necessary.

4.1.10 The timing of VAT recoveries is important. Member States have adopted a range of tax periods, from one month to 12 months, only following the completion of which and submission of a corresponding tax return will a VAT credit be refunded. Even if a VAT credit exists, it may take a significant amount of time before it is repaid. VAT costs borne in the interim can present a substantial cash-flow cost even to those entitled to recover it in full. The cash-flow cost problem will of course be exacerbated by the amount of the VAT credit and in a PPP context, is a very real consideration for providers given the impact it has on interim and long-term funding requirements.

VAT liability

4.1.11 Generally, VAT is imposed at a standard rate. This rate is set by the Member State but in all cases cannot be less than 15% (Hungary operates the highest standard VAT rate at 27%). Most supplies of goods or services by a taxable person are subject to VAT at the standard rate.

	Reduced rates	Standard Rates
France	2.1%, 5.5%, 7%**	19.6%**
Germany	7%	19%
Spain	4%, 10%	21%
UK	5%	20%

*Notes: As at March 2013.** denotes planned changes to: 2.1%, 5%, 10% and 20% from 1 January 2014.*

Figure 7: VAT rates by country

4.1.12 Many Member States operate reduced VAT rates (and indeed super-reduced rates) which apply to certain goods or services. Reduced rates tend to reflect attempts to protect certain elements of society from significant VAT cost and are subject to an EU-wide floor of 5%. Super-reduced rates can be lower than 5% (but strictly are defined as being greater than 0%) and reflect agreements made at the time of accession. They are not available generally, and their scope cannot be broadened. A summary of rates applied in France, Germany, Spain and the UK can be found in Figure 7.

4.1.13 Certain supplies of goods or services are not subject to VAT (i.e. they are *exempt* from VAT). Again, such exemptions are either designed to relieve exports from domestic VAT, for societal purposes, or eliminate difficulties otherwise faced when attempting to impose the tax accurately. Exempt supplies may either carry a right to recover VAT on associated costs or not, depending on the nature of the supply made (see 4.1.16 *et seq* for an explanation of the recovery process).

4.1.14 Certain Member States have enacted provisions enabling suppliers to opt to tax certain supplies which would otherwise be exempt from VAT. Examples of transactions often include financial services (e.g. in France) and, more commonly, supplies involving land. Opting to tax land transactions is explored in more detail below.

4.1.15 In certain instances, it may be necessary to determine whether a taxable person is making multiple supplies of individual component parts or a single supply of bundled components (sometimes referred to as a composite supply). This is because if more than one supply is being made, each of those supplies might be subject to a different VAT treatment. EU VAT law does not provide rules to determine this. However, the courts have provided guidance. Substantial guidance on whether transactions constitute multiple supplies or a single supply was provided by the CJEU in *Card Protection Plan Ltd v C & E Commissioners, ECJ Case C-349/96*. In particular, the essential features of the transaction must be ascertained in order to determine whether there are several distinct principal supplies or a single supply. Consequently, each supply must be considered separately to see whether it is, itself, a principal supply or merely ancillary to another principal supply.

Attribution and recovery of VAT

4.1.16 VAT incurred can only become eligible for recovery under the normal rules where it was incurred by the person making the claim and relates to activities undertaken in a taxable capacity. Importantly, VAT incurred by one person cannot be recovered by another, and VAT incurred in a non-taxable capacity is not recoverable under these rules). Only once it has passed these initial tests can it become input VAT.

4.1.17 Input VAT which is attributable to making actual or, importantly, intended taxable supplies (being those chargeable to a *positive rate of VAT*), or in respect of exempt supplies which carry an entitlement for the supplier to recover VAT on associated costs (hereafter "exempt with credit" or "zero-rated" supplies), is generally recoverable. On the other hand, VAT incurred making actual or intended exempt supplies (hereafter "exempt without credit") or when engaged as a non-taxable person (see section 4.2 below) is not recoverable. A taxable person's ability to recover input VAT depends on the ability for it to be attributed to a taxable supply (and to the extent of that

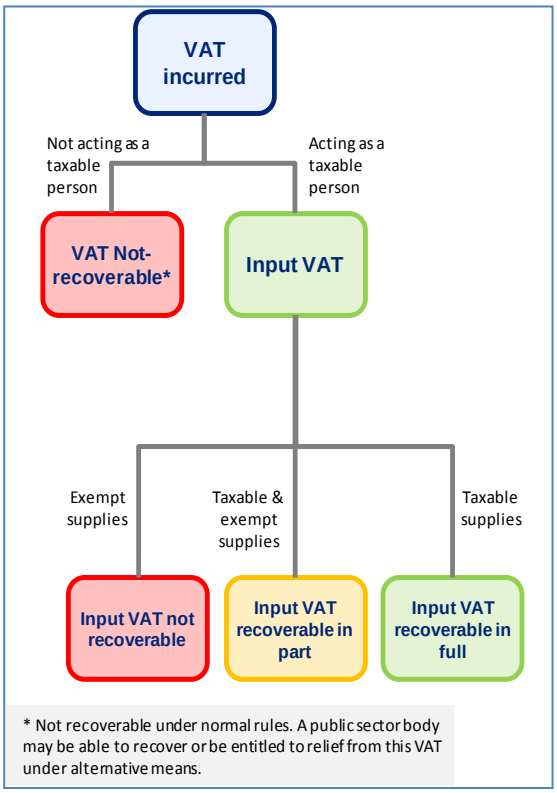


Figure 8: Attribution of VAT

taxable supply), which has been or is intended to be made. Figure 8 depicts this process.

4.1.18 Input VAT attribution takes place on a supply-by-supply basis. This is a straight-forward exercise if individual inputs can be directly linked to individual outputs, but often this is not possible such as in the case of overheads (e.g. utilities or office rental charges). Input VAT which cannot be directly attributed to a particular supply is treated as a *residual*, and is apportioned between output types. Naturally if a taxable person only makes taxable supplies, the attribution of the residual is straight-forward and the VAT should be recoverable in full.

4.1.19 However, if a taxable person makes or intends to make a mixture of taxable and exempt or non-business supplies, the attribution process becomes more complex, requiring an apportionment between the output types under a so-called “pro-rata” or “partial exemption” calculation. Importantly, the calculation establishes a proxy for the use of input VAT and identifies only that proportion of the residual amount which is attributable to taxable supplies and which is recoverable.

4.1.20 While, generally, a person’s ability to recover VAT is determined by the extent to which that VAT is attributable to taxable supplies made or intended to be made, some Member States allow certain public sector bodies to recover VAT even when it is not so attributable. This is considered in more detail in section 4.2 below.

Further consideration of exempt supplies

4.1.21 Exemption can have both positive and negative outcomes for consumers and suppliers alike. Turning to exempt without credit supplies, the recipient of a supply does not have to pay VAT; the supplier is instead forced to bear the burden of the tax instead. That is not to say that the cost of the tax cannot be passed on in some other form to the final consumer (e.g. higher prices), but that on the face of it the person consuming the goods or services has in effect become the intermediary in the supply chain. Examples of such exempt supplies may include (and which are relevant in a PPP context): hospital and medical care; and financial (including insurance) services. VAT incurred by medical providers or the by the finance sector typically presents an absolute cost.

4.1.22 With regard to exempt with credit or zero-rated supplies, aside from certain types of exports and international passenger transport (which are available throughout the EU), the UK is the only Member State which offers this treatment for a range of other supplies, including (and relevant in a PPP context): domestic passenger transport; the provision of construction services for certain residential buildings; and the supply of newly constructed residential buildings. France, Germany and Spain do not operate these additional concessions. Certain supplies that are treated in this manner in the UK may be reduced-rated in other Member States.

VAT in the supply chain

4.1.23 A range of potential outcomes could therefore arise as a consequence of the liability of supplies made within a particular supply chain. If only taxable supplies are made VAT flows through each transaction, being charged and recovered at each stage of production and distribution, with the total VAT burden being levied at the final supply point on the consumer of the goods or services concerned. Figure 9 depicts this process:

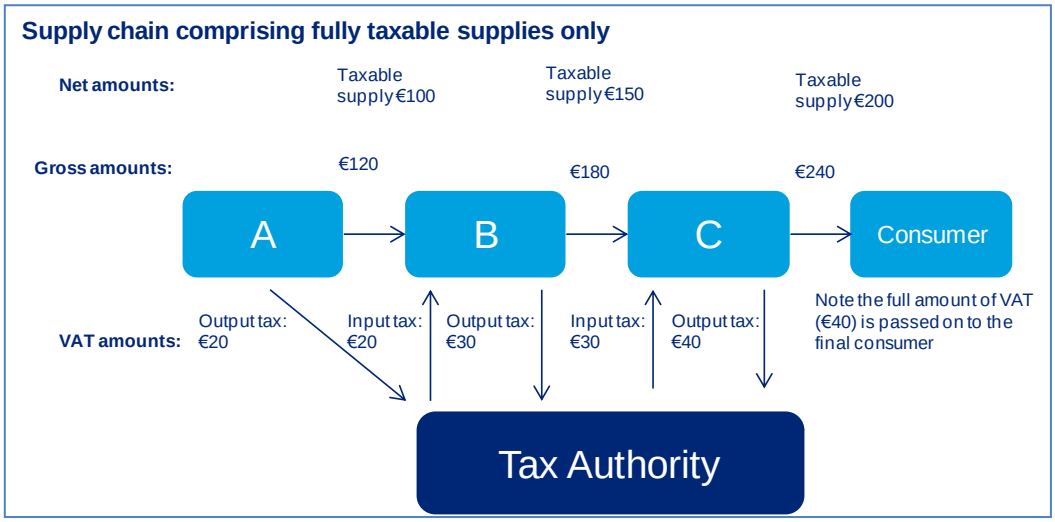


Figure 9: VAT flows within a fully taxable supply chain

4.1.24 Alternatively, exempt supplies or transactions which are not an economic activity might be interposed into a supply chain (see Figure 10). In broad terms the effect of both is the same; the person making the supply of the VAT exempt goods or services is not, on the face of it, entitled to recover VAT that has been charged to it and instead suffers a VAT cost. In turn, VAT is not chargeable to the final consumer (albeit the VAT costs borne by the supplier may well be incorporated in a less obvious sense):

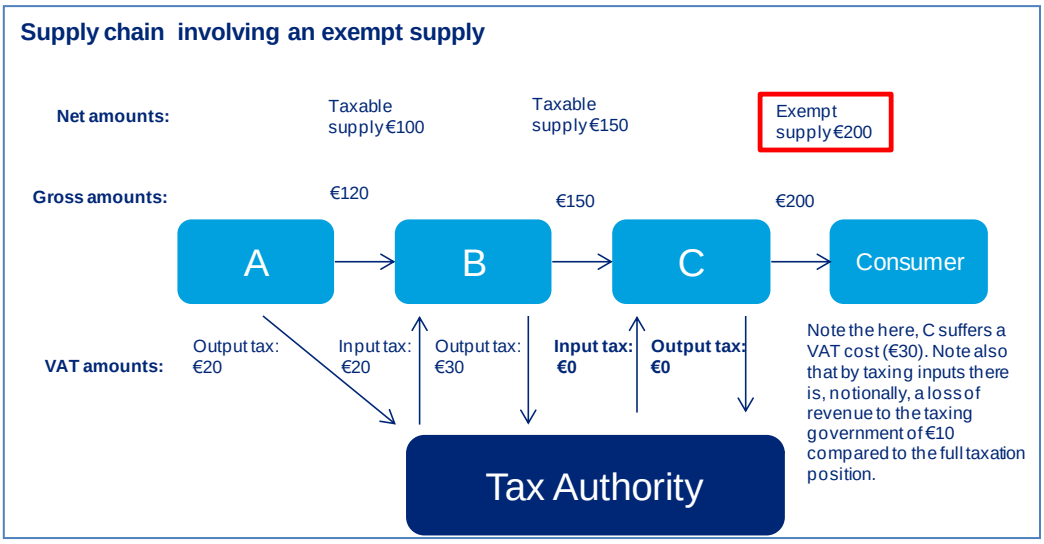


Figure 10: VAT flows within a partly taxable supply chain

4.1.25 Consider then the position of a person undertaking both business and non-business activities (see Figure 11). From an outputs perspective, the various supplies made would be subject to their respective liabilities. Taxable supplies would be subject to VAT which would be charged, collected and remitted to the tax authority in the normal manner. Exempt supplies or transactions which are not an economic activity would not be subject to VAT. Turning to the inputs associated with each supply type, an attribution exercise would have to be undertaken. Shared inputs would have to be apportioned between the different supply types in the appropriate manner and either recovered or not recovered as the case may be:

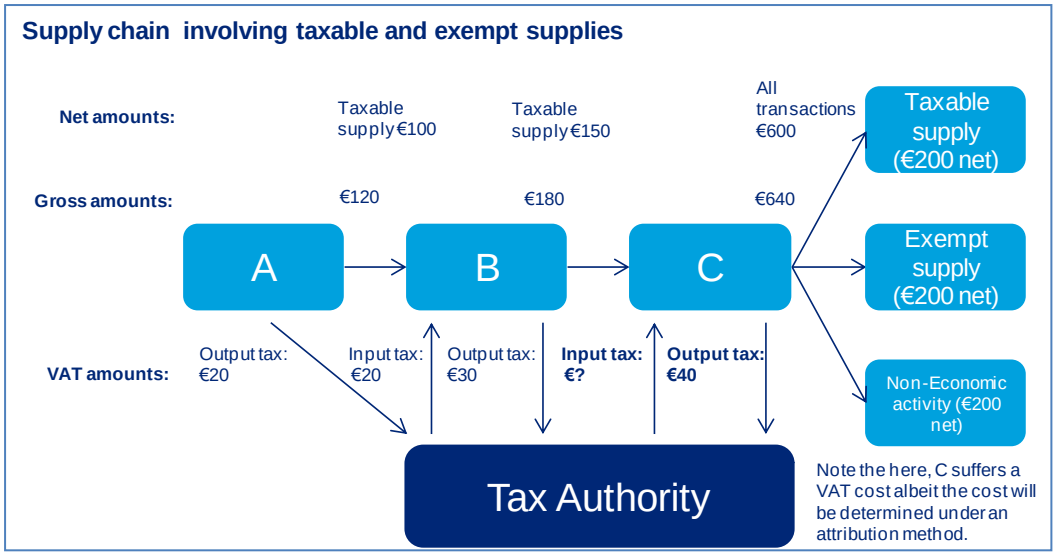


Figure 11: VAT flows where a person acts in a taxable and a non-taxable capacity

4.1.26 With all of the foregoing illustrations, the important point to bear in mind is that a public sector procurer or a provider in a PPP contract arrangement could play any of the roles depicted and so face any or all of the consequences outlined above. A procurer is, however, more likely to find itself in the position of "C" in the final diagram, whereas a provider is more likely to find itself in position B.

4.1.27 In certain instances it may be possible to tax, optionally, certain goods and services which are ordinarily exempt without credit. This means that the person making the supply may elect to charge VAT on that supply – effectively converting an exempt supply without credit into a taxable supply. An example of such optional treatment in a PPP context would be with regards to land (see below).

Land transactions

4.1.28 Article 135 of the Principal VAT Directive requires Member States to exempt from VAT: the supply of buildings; the supply of land; and the letting or leasing of immovable property. This is, however, subject to certain exclusions and transitional provisions (see below) and, under Article 137, Member States may also allow taxable persons the option to tax relevant transactions. Box 2 contains additional detail in respect of the option to tax in France, Germany and the UK.

4.1.29 Article 12(1) provides that Member States may exclude from the exemption certain supplies of buildings or incomplete buildings that have not been first occupied and building land rendering such supplies taxable. However, transitional provisions in Article 371 allow Member States which, as at 1 January 1978, exempted such supplies, to continue to do so.

Box 2: VAT and land transactions

Supplies of land are generally exempt from VAT with the option to tax. In France, however, whilst the exemption and option exist, it is notable that the supply of building land by a taxable person is taxable. The option to tax turns an otherwise exempt supply into a taxable supply. The significance of this is that it enables the VAT incurred, and that is attributable to that now taxable supply, to be recovered.

The option is not always effective. In Germany, the option has no effect where the recipient of the supply is using it in a non-taxable capacity. As section 4.2 this might well be the case in transactions involving the public sector. In the UK, the option to tax has no effect where the land concerned has a building on it which is intended to be used as a dwelling, for charitable purposes, or as a result of certain anti avoidance provisions in relation to property which is intended to be used for exempt purposes (e.g. by a bank).

Certain supplies of buildings intended for residential or charitable use are zero-rated in the UK. Construction services and building materials, supplied in connection with the construction or conversion of a building intended for a residential or charitable use are also zero-rated or reduced rated. Residential buildings include: dwellings; children's homes; care homes; hospices; and student accommodation. Notably, residential buildings do not include: hospitals; prisons; or hotels.

The reverse-charge

4.1.30 The provision of services to VAT registered entities (a definition which now includes many if not all public bodies) is usually treated as being the country where the recipient is established. Rather than have suppliers register for VAT in order to charge and account for the amounts chargeable on what could be a one-off transaction, there exists a requirement for the recipient to account for VAT chargeable under what is known as the reverse charge mechanism. In essence, the reverse-charge reflects a cash-less tax accounting exercise, with the recipient standing in the shoes of the supplier in order to account for output tax, whilst in the same return treating the same amount as input tax and recoverable to the usual extent. The reverse-charge is depicted in Figure 12.

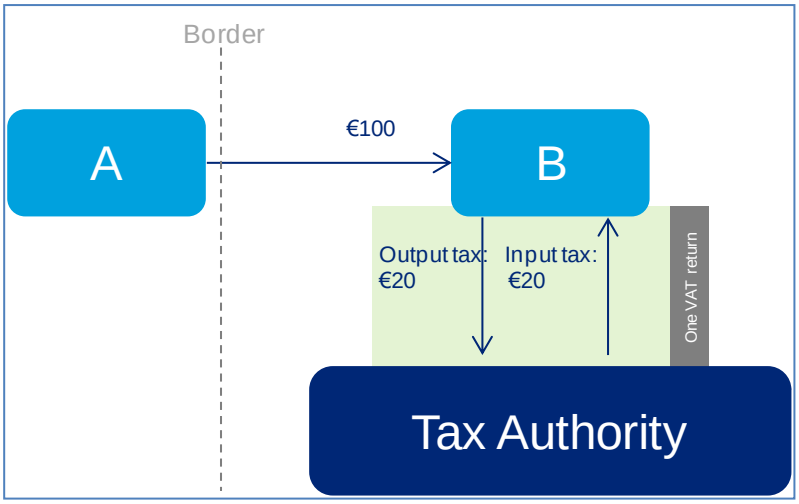


Figure 12 The reverse charge

4.1.31 In a PPP context it is useful to note that a provider may be required to account for VAT on professional services (such as design services) received from abroad, recovering the imputed output tax in full as input tax. Should procurers purchase services from abroad, recovery of the imputed output tax charge will be governed in the same manner as all other VAT costs that they incur, with VAT attributable to a non-taxable activity not recoverable in the normal manner. The mechanism thus places recipients in exactly the same position as if they had purchased the services concerned from a supplier located in the EU.

4.1.32 Notably the use of the reverse charge in relation to domestic transactions is becoming more widespread in the EU. Primarily it is seen an anti-avoidance measure, eliminating the potential loss of tax revenues by making provisions ensuring that no VAT is chargeable (in cash terms) in the first instance. With no actual tax chargeable, there is no risk to public treasuries of that tax being collected by businesses which then fail to account for it.

Avoidance

4.1.33 There is no general perception that PPP arrangements constitute or are connected with tax avoidance. On the contrary, absent the usual forms of VAT cost mitigation PPP projects will in fact generate more VAT revenues for government. Nevertheless, VAT regimes which tip the balance in favour of PPP over insourcing may tempt designers to make more extensive use of the approach than might usually be warranted. This is of course a point for consideration for Member States when designing and implementing the relevant VAT provisions.

5 Additional public sector/procurer VAT considerations

5.1 The primary VAT effect

The impact of the Principal VAT Directive

5.1.1 As outlined in paragraph 4.1.5, the concept of a taxable person is an important one; it underpins the functioning of the EU VAT system and is particularly important in a PPP context. Those that are not engaged as a taxable person fall outside of the scope of VAT, need not charge VAT on outputs, nor are they ordinarily entitled to recover VAT that they incur.

5.1.2 Article 13 of the Principal VAT Directive provides that:

"1. States, regional and local government authorities and other bodies governed by public law shall not be regarded as taxable persons in respect of the activities or transactions in which they engage as public authorities, even where they collect dues, fees, contributions or payments in connection with those activities or transactions.

However, when they engage in such activities or transactions, they shall be regarded as taxable persons in respect of those activities or transactions where their treatment as non-taxable persons would lead to significant distortions of competition.

In any event, bodies governed by public law shall be regarded as taxable persons in respect of the activities listed in Annex 1[7], provided that those activities are not carried out on such a small scale as to be negligible.

2. Member States may regard activities, exempt under Articles 132, 135, 136, 371, 374 to 377, and Article 378(2), Article 379(2), or Articles 380 to 390, engaged in by bodies governed by public law as activities in which those bodies engage as public authorities."

5.1.3 The Article is a relatively challenging piece of legislation, but is perhaps best understood by first examining Annex 1 to establish which activities will generally result in a public body being treated as a taxable person (and required

Box 3: Additional detail on Article 13

EU law does not specify the activities in which bodies governed by public law are *"...engaged as public authorities..."* – it does not follow that simply because a body is a public authority all the activities it undertakes are non-taxable activities.

In *Communie di Carpeneto Piacentino and Others v Ufficio Provinciale Imposta sul Valore Aggiunto di Piancenza* the CJEU held that activities pursued as public authorities are those engaged in by bodies governed by public law under the special legal regime applicable to them, but did not include activities pursued by them under the same legal conditions as applying to private traders. Instances where a body is acting as a public authority include those where the law provides a public authority to make people or organisations pay for a service provided but without giving them a right in what is or how it is provided, or powers to impose penalties where people do not comply.

As for the determination of *"...would lead to significant distortions of competition..."* the same Italian case decided that each Member State should determine whether distortion of competition was significant; precise quantitative limits have not been set down. In HMRC v Isle of Wight Council (No 2), the CJEU held that the determination of the level of competition must be evaluated by reference to the activity in question without such evaluation relating to any local market in particular. Furthermore, *"...would lead to..."* encompasses both potential and actual competition.

In the UK, HMRC takes the view that significant distortions of competition can occur when:

- a body does not charge VAT on a supply while its competitors making similar supplies have to; or
- a body can recovery VAT attributable to an exempt supply or a non-taxable activity while the VAT incurred by its competitors is an actual cost to them.

[7] Annex 1 lists the following: (1) Telecommunications services;(2) supply of water, gas, electricity and thermal energy;(3) transport of goods;(4) port and airport services;(5) passenger transport;(6) supply of new goods manufactured for sale;(7) transactions in respect of agricultural products, carried out by agricultural intervention agencies pursuant to Regulations on the common organisation of the market in those products;(8) organisation of trade fairs and exhibitions;(9) warehousing;(10) activities of commercial publicity bodies;(11) activities of travel agents;(12) running of staff shops, cooperatives and industrial canteens and similar institutions;(13) activities carried out by radio and television bodies in so far as these are not exempt pursuant to Article 132(1)(q).

to charge VAT as required and recover VAT charged to it in the normal manner). Assuming that the activity being undertaken does not feature in Annex 1, then the first paragraph of Article 13(1) applies. What this means in a practical sense is that whilst the affected public sector body cannot impose VAT on charges for relevant services, and that on the face of it, it will also be unable to recover the VAT that it incurs and which is attributable to such activities. This is referred to this as the primary VAT effect in this paper. Box 3 provides further analysis on the practical application of Article 13.

5.1.4 Note that the second paragraph of Article 13(1) provides a safeguard against unfair competition from the public sector by removing the potential upside benefits of the first paragraph (see also Box 4). In addition, Article 13(2) enables Member States to simplify VAT accounting for public bodies removing the need to account for otherwise VAT exempt transactions separately from their non-taxable transactions, as both types of transactions give rise to a restriction in input tax recoveries (see section 4.1.16 *et seq*).

Box 4: "Competition" – an illustrative example

Where there is a legal obligation imposed on event organisers to request the presence of police officers, this creates a statutory monopoly and any charges made for those officers would be in respect of non-taxable activities by a police authority (i.e. they are engaged as a public authority and by definition cannot be in competition with the private sector).

However, where event organisers are merely required to "police" the event, and may either obtain the services of police officers or a private security firm to do so, no statutory monopoly is created. Provision of police officers for a charge in this instance would be in competition with the private sector and the activity would be taxable.

5.1.5 Article 13 and its implications can be illustrated as follows:

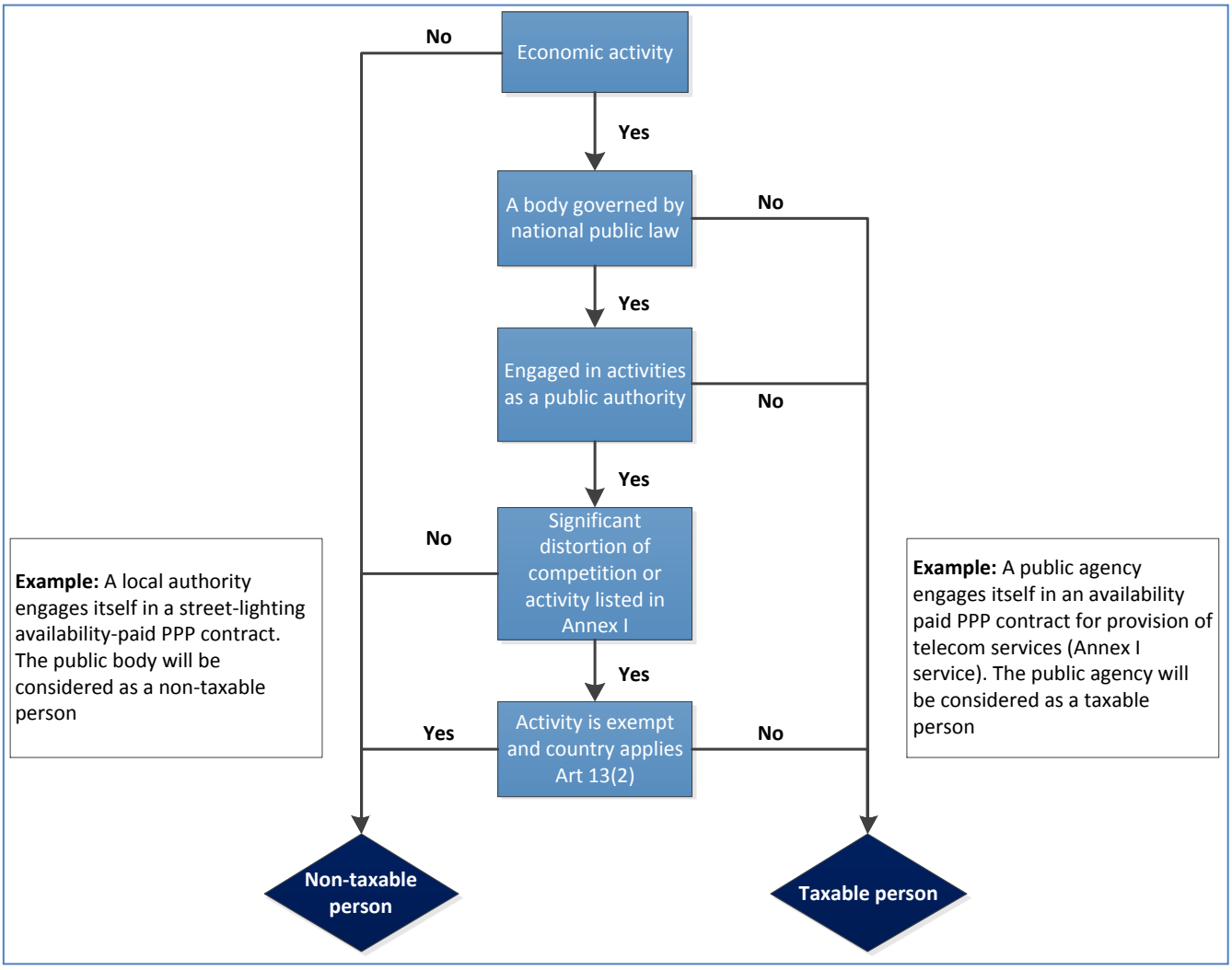


Figure 13: An illustration of the effect of Article 13 of the Principal VAT Directive

5.1.6 From the analysis above we can see that a public sector procurer that undertakes some kind of activity which does not feature in Annex 1, and which is not an activity which may lead to competition with the private sector, will not be regarded as a taxable person in respect of that activity. The analysis could extend to a range of potential items including: the provision and maintenance of roadways; the provision of medical care; and the provision of primary and secondary education amongst others. VAT incurred in connection with such activities, whether or not under a PPP arrangement, will not, on the face of it, be recoverable.

Box 5: Mixed use transactions

A regional government in France, via a newly-formed hospital authority, is procuring a new medical facility under a PPP arrangement. The facility is principally designed to support public healthcare requirements, although excess capacity has been incorporated into the design of the facility. Consideration for the facility is in the form of a unitary charge imposed by the provider on the regional government and is subject to VAT.

The facility is put to use in its principal public health mode, an activity which falls under Article 13. However, the excess capacity lies unused, and a decision is taken to allow private health practitioners to make use of the unused parts of the property (it is entitled to do this as it has itself been granted a licence over the facility by the provider) for which the hospital authority imposes a facilities charge. The charge is also subject to VAT.

The hospital authority also sub-lets parts of the grounds of the new facility to a nearby school as it has no use for them. It has not opted to tax the property, and to that end the lease over the land is exempt from VAT.

The VAT incurred by the hospital authority on the unitary charge must be apportioned. That part which relates to the use of the facility as a public healthcare facility falls under Article 13 and cannot be recovered under the normal rules. That part which relates to the use of facilities by third party private healthcare providers should be recoverable in accordance with the normal rules. That part which relates to the sub-letting of land is cannot be recovered.

5.1.7 Likewise a public sector procurer that undertakes any kind of activity which does not fall within Article 13, an activity within Annex 1, or an activity which may lead to competition with the private sector, will be regarded as a taxable person in respect of that activity. VAT incurred in connection with such activities will be dealt with under the normal rules and is less likely to represent a cost to procurers. Thus VAT which is attributable to taxable supplies would be recoverable in full. That which is attributable to exempt supplies would not be recoverable. Whilst VAT which is attributable in part to both taxable and exempt supplies would be recoverable in part. It is worth noting that potentially, VAT could relate in part to an Article 13 activity, a taxable and an exempt activity requiring an even more detailed apportionment between each activity type. See 4.1.16 for further information and Box 5 for an illustration of the issue.

5.1.8 But even where PPP provision is being sourced in respect of an Article 13 activity, procurers may take steps in order to limit the impact of VAT through the design of the scheme. This situation may well arise under PPP arrangements where users, rather than the procurer, are responsible for paying for provider services. Box 6 illustrates just such a scenario.

Box 6: "User pays" scenario

A procurer enters into a PPP arrangement whereby a provider is responsible for the design, construction and operation of a new toll highway.

In accordance with the contract, for 20 years the provider will operate the highway and be entitled to collect tolls from road users as principal (i.e.it is not collecting payment from users on behalf of the procurer) to defray the cost of construction and operation (including maintenance aspects) of the road. No unitary charge will be imposed on the procurer.

Toll shortfalls will be reimbursed by the procurer; a payment will be made by the procurer to the provider in respect of the difference between agreed and actual toll revenues (i.e. similar to a shadow-tolling arrangement with a collar and cap).

In this instance, VAT chargeable on road tolls will be payable by road users and will not be suffered by the procurer. The exposure of the procurer to VAT should be limited to the extent of shortfall payments.

5.1.9 Importantly there, project by project analysis is often necessary in order to establish precisely the likely impact of VAT on procurers. The analysis outlined above is likely to apply to most forms of PPP, even, for example, where that takes place under a Public-Public partnership (PuP) arrangement. Nevertheless, new or non-standard types of project merit particular care and attention and professional advice should be sought wherever necessary.

5.2 Amplifying the primary VAT effect

Full external sourcing

5.2.1 The nature of PPP further amplifies the primary VAT effect. Principally this is driven by the fact that PPP represents a shift in responsibility, up-front cost and project risk out of the public sector into the private sector, substantially reducing or indeed eliminating altogether the need for the procurer to contribute in terms of people or materials. Procurement under PPP is thus almost exclusively external with charges for associated delivery generally being entirely subject to VAT.

The "carry-cost" of recoverable VAT

5.2.2 By shifting risk and delivery responsibility, providers are required to finance the design, build and early operation phases without receiving much by way of return. It is generally acknowledged that the cost of finance alone is higher in the private sector than it is in the public sector (a reflection of the relatively risk-free nature of government lending), and that aspect alone further drives up overall costs to procurers. Of more direct relevance for these purposes is the fact that providers are generally required to obtain additional interim finance to fund VAT incurred during the design, build and operation phases. And whilst that VAT is generally recoverable in full by a provider, the delay between the payment of the tax and the refund being made can be significant. Thus the interim funding of VAT has an implication for the finance costs borne by providers and, ultimately, the charges made to procurers. In short, the carry cost of VAT can be substantial.

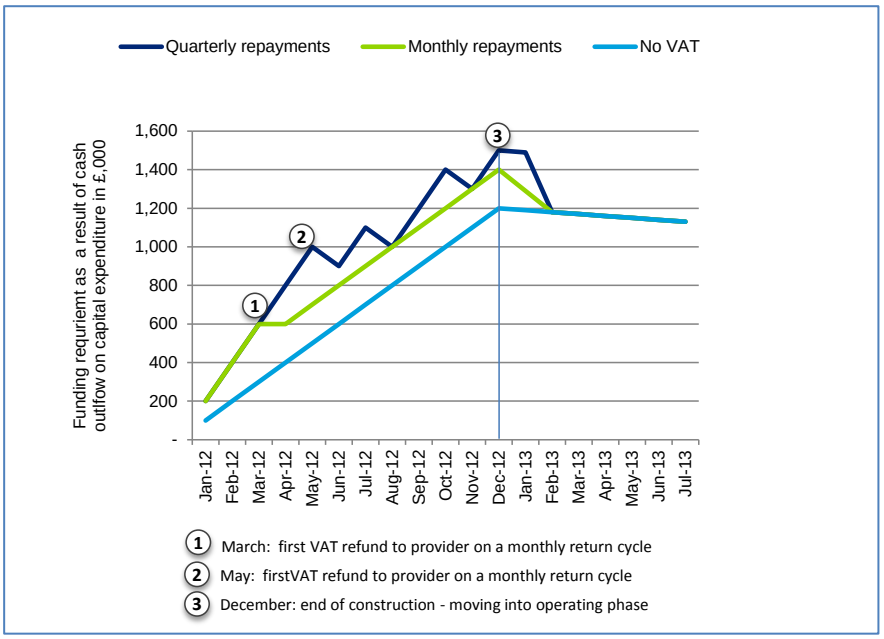


Figure 14: An illustration of the project funding implications of VAT

5.2.3 Figure 14 provides an illustration of the VAT carry-cost considerations. The analysis presumes a registration date of 1 January with the first quarterly return period being 1 January to 31 March, or to January 31 when on a monthly return cycle. A further assumption is that returns are submitted in the month following the period concerned and any repayments by the tax authority made one month thereafter. The repayment of the first return is delayed as a consequence of normal pre-credit checks undertaken by the authority.

5.2.4 Note that a provider on a quarterly return cycle must bear a greater VAT carry cost than a provider on a monthly cycle. However, in all cases the VAT carry costs can represent a substantial uplift of the no-VAT scenario depicted.

Capital contributions

5.2.3 Capital contributions, pre-payments and grants (regardless of source) also pose a challenge from a VAT perspective. They are a common feature of PPP arrangements and tend to be made by procurers in order to reduce overall funding requirements and/or user charges. Compared with a situation where no such payments are made, they can create issues insofar as they are very likely to trigger a taxpoint, with the recipient (in this case the provider) being required to charge VAT on the amounts received. The issue relates to the fact that in many instances, capital contributions and grants are simply treated as advanced payment for services rendered by a provider under a PPP arrangement, with VAT being due on the amounts received at the time of payment. In short, they can create an additional VAT cost which might not have existed had the monies not been passed to the provider in the first instance.

5.2.4 When grant funding is passed to a public sector body is unlikely that VAT will be due; a grant is generally not treated as consideration or payment for a supply provided the grantor does not expect to receive anything in return for the amounts paid. A secondary argument in support of the position would be that provided the public sector body receiving it was engaged in an Article 13 activity with regard to the amounts received, the payment would be outside the scope of VAT in any event. Unfortunately, however, if these same funds are then passed down by way of a capital contribution to the provider, the analysis outlined above applies. In other words grant monies outside the scope of VAT in the hands of one party can attract VAT in the hands of another.

5.2.5 Consequently EU funding applications can often be made on a gross (i.e. VAT inclusive) basis, affording a degree of cost protection to recipients of such amounts with respect to the projects that the funds are to be put. Importantly, applicants must be able to evidence that the VAT amounts being sought are not recoverable. To the extent that gross funding requests are made therefore, the result of this is that the EU is effectively funding domestic VAT revenues.

Barter transactions

5.2.6 The absence of cash passing between provider and procurer (such as might be the case under a user pays-type road-toll arrangement illustrated in box 5) does not necessarily mean procurers will not be faced with a VAT cost under PPP. Barter transactions are another relatively common feature of large PPP projects, and might involve the passing of significant areas of land or existing properties to providers purportedly for no charge. But VAT may still accrue on such arrangements and represent a cost to procurers. Box 7 illustrates an example barter transaction.

Box 7: Barter

A agrees to transfer land X to B in return for B paying €1m to A and also transferring land Y to A. The open market value of land X is €2m and the open market value of land Y is €3m, these are also the valuations agreed by A and B. In such circumstances, the tax authority may consider that A has made a supply of land X and that the value of that supply is €3m. A tax authority may consider that B has made a supply of land Y and that the value of that supply is €2m. In such circumstances, the tax authority may not consider that the value of the supplies is limited by the fact that the only monetary consideration that is passing is €1m.

Barter transactions can be problematic where land is involved. This is because the VAT treatment of a supply of land might be taxable or exempt, and an exempt supply would restrict the supplier's ability to recover VAT. Following on from the example above, suppose that A opted to tax land X but B had not opted to tax land Y. A may be required to account to the tax authority for VAT on the value of its supply of land X to B. If A were to require B to pay an additional amount equal to such VAT (as is usual), in money (and in addition), then, under general principles, B may not be entitled to recover such VAT from the tax authority because it would be attributable to B's exempt supply of land Y.

5.3 VAT and the insource bias

5.3.1 Aside from the cost implications that VAT may have for infrastructure investment decisions under PPP, it also plays an important with regard to the shape and size of the public sector in the general sense. Arguably, the government should be viewed as a whole, with no net change in the treasury position as any VAT incurred will have been paid over to the tax authorities and made its way, largely, into the government purse thereby offsetting the equivalent VAT cost borne by the procurer. But the reality is that cost and performance of the government

sector is measured at departmental levels or lower with the consequence that non-recoverable VAT poses a real challenge for those with budgetary responsibilities.

5.3.2 Importantly, those items that a qualifying body can source in-house (such as building experts or labourers employed under land services departments), can be deployed without incurring VAT. Thus in instances where, all other things remaining the same, a procurer is faced with a known or potential absolute VAT cost arising as a consequence of buying in goods or services versus a position of not incurring any VAT on the use of in-house resources, it would be natural to favour the latter option.

5.3.3 Absent a neutral VAT regime, therefore, there may exist a natural bias towards insourcing public sector procurement projects, particularly where the procurer is able to meet resource needs from its own resources. The by-products of such an approach can of course be those of public-sector growth, relative inefficiency or, ultimately, the emergence of an infrastructure gap.

6 Mitigating VAT costs

6.1 Managing the primary VAT effect – current and realistic options

Acting as a taxable person

6.1.1 Where a public sector procurer incurs VAT which is attributable to a taxable activity, the usual implications of Article 13 of the Principal VAT Directive no longer apply. Instead, the VAT incurred will be dealt with under the normal VAT rules which apply to any other business transaction. This is an important point: not all VAT incurred by a procurer necessarily represents a cost.

User pays

6.1.2 User payment, as opposed to procurer payment, offers an opportunity to eliminate or substantially reduce VAT costs for procurers, particularly where the arrangements are wholly self-contained and self-supporting. Such arrangements are usually part of a concession agreement whereby user income that might ordinarily be payable to the procurer is, by agreement, payable by users to the provider for a given length of time in order defray the cost of designing, building and/or operating the asset in question.

6.1.3 User charges essentially replace unitary charges (and the VAT thereon) otherwise payable by procurers, significantly controlling VAT costs at source. Asset transfers at the end of the concession period may create a VAT cost for procurers, albeit their quantum is likely to be substantially reduced over what might have been payable for the asset when new. Arrangements such as these are not appropriate in all circumstances, however, due to a limited willingness to pay on the part of users, affordability issues, or indeed legal constraints over the granting of rights over the asset concerned.

6.1.4 In cases where the procurer has to provide financial support to ensure financial feasibility either at the start of the project or on a regular basis, some form of top-up payment (however calculated or whatever it may be called) will be made. VAT-inclusive grants from the EU may be available to cover all or part of payments made to bridge any funding gap.

Targeted VAT relief

6.1.5 Eight[8] of the 27 Member States, have introduced some form of direct VAT compensation or refund scheme for qualifying public sector bodies. The schemes can vary in terms of design and funding, but the key feature is that the qualifying body concerned is somehow compensated or reimbursed in respect of some or all of the VAT that it incurs.

6.1.6 Importantly, the Principal VAT Directive does not mandate or even hint that such schemes must operate in the Member States. This is important; their existence is a purely domestic matter, offering governments significant flexibility over design (particularly in respect of how they are funded), scope, scale, and of course whether to introduce such a scheme at all. The remaining 19 Member States could therefore, if they so wanted, implement similar schemes.

6.1.7 Such schemes offer perhaps the most obvious solution to mitigating VAT costs arising on PPP projects for procurers, and removing the bias to insource. The refunds are offered outside the VAT system itself, requiring no radical redraft of VAT legislation. Recipients of public sector services continue to not pay VAT on the services that they consume, and so on a presentational level the status quo is maintained.

[8] Austria; Denmark; Finland; France; Netherlands; Portugal; Sweden; and the UK

6.1.8 On the other hand a VAT refund or compensation scheme might create higher compliance costs for the public sector. Compared to the default Article 13 position (no VAT recovery), expenditure has to be monitored closely, with compensation or refunds being sought only for relevant amounts. Governments have of course to design, write and agree the features of such schemes in the first instance, a process which can be time consuming and present a range of additional challenges.

6.1.9 Perhaps more importantly, the schemes may require changes to revenue allocation within a national economy, a process which may, at the extreme, require constitutional change. Federal government combined with regional-level revenue collection and distribution is most likely to present the most challenging backdrop with regard to such change. And finally, as VAT refund or compensation schemes tend to operate at a national level, they may also fail to adequately remove VAT barriers to *outsourcing* where the provider is based in a different Member State to the procurer.

6.1.10 All other things remaining the same, unlike with a fully-taxable VAT system (see 5.5 below), a VAT refund or compensation scheme enables the public sector to internalise VAT costs and not charge the same to users. Poorly executed, there is a risk therefore that *de facto* refunds or compensation could tip the balance in favour of outsourcing rather than merely removing the disparity between the public sector and the private sector.

Targeted VAT relief in practice

France

6.1.11 A VAT compensation scheme, the *Fonds de Compensation pour la TVA*, operates in France. Under the scheme, certain public sector bodies at a local/regional level (but not central government) receive a subsidy to compensate most VAT incurred on the fractions of uitary charge corresponding to investment costs (capital not revenue). The subsidy is at a rate of 15.482% (to be applied on the VAT-inclusive amount of capex costs) and therefore it reimburses a large proportion of VAT incurred (the standard rate of VAT in France is currently 19.6%). In case of reduced-rated expenditures, the public body might be left even better off, as the rate of subsidy is fixed. The subsidy is usually granted two years after the investment cost is incurred albeit compensation can be secured more rapidly subject to certain conditions being met.

United Kingdom

6.1.12 UK VAT law categorises qualifying bodies as follows: the first category includes local authorities, police authorities, and the BBC amongst others (*VATA 1994 section 33*); the second includes all Government departments and the National Health Service (*VATA 1994 section 41*). Unusually among Member States the UK refund mechanism is embedded in the VAT system itself.

6.1.13 The first category of qualifying bodies is entitled to recover any VAT incurred on goods or services purchased or imported for "non-business" (in EU terminology this would be the same as "non-taxable") purposes. Typically this is VAT incurred in the furtherance of the body's statutory obligations. The provision is intended to prevent funds distributed from central government to these bodies being diverted back to central government in the form of VAT costs that they have had to bear. In effect, central government provides public funding for irrecoverable VAT incurred by certain public sector bodies so that those bodies may avoid

Box 8: PPP and the COS for the UK's NHS

As a body falling within section 41 of VATA 1994, the NHS is entitled to avail itself of the COS rules and recovery VAT incurred on certain outsourced services. VAT recovery is provided for under COS heading 45, which is concerned with the provision of a fully operational and managed hospital or health care facility where most services, short of medical and nursing services.

PPP arrangements for the NHS fall under COS heading 45. Non-PPP arrangements involving property leases and where minimal or no additional supporting services are provided under contract fall outside of the rules. Non-PPP arrangements involving property leases which include a full package of services necessary for the operation of the facility will fall under COS heading 45.

It is notable that, ordinarily, long leases in property in the UK are treated as supplies of goods for VAT purposes and so technically VAT recovery on any land component cannot be obtained under the COS rules (which only apply to services). However, a change was made to the wording of the relevant headings to allow for VAT recovery under COS on the land element provided it is associated with a package of other managed service features.

having to obtain increased funds by way of local taxation or a larger direct grant from central government.

6.1.14 The second category of qualifying bodies (i.e. primarily Government departments) must make use of an alternative VAT refund mechanism referred to as the Contracted Out Services scheme ("COS"). The COS rules allow for the recovery of VAT incurred on eligible services. The eligible services are listed on HM Treasury Directions and publicised in the London and Edinburgh Gazettes. In principle, the rules ensure that VAT recovery is available for activities which would previously have been carried out in-house by the government body concerned. As a corollary, under the COS rules VAT recovery is not available on the supply of goods or services which would never have been undertaken in house. See Box 8 for an examination of the COS rules.

6.1.15 The key distinction therefore is that whilst the first scheme allows for VAT recovery on goods and services, in principal the second scheme supports services only. However, it is notable that the COS rules have evolved over time in recognition of ever increasing levels of outsourcing and the different forms which that outsourcing might take, a point which is particularly relevant in a PPP context.

Germany

6.1.16 Germany does not operate any form of direct compensation or refund scheme. Tax administration is carried out on a state level (by the *Länder)*, with revenues collected being distributed through the system to the federal, state and municipal governments under a complex formula. Effectively transposing a VAT compensation or refund regime into the existing framework therefore presents real challenges and would require agreement by each of the 16 *Länder.*

Spain

6.1.17 Spain does not operate any form of direct VAT refund or compensation scheme due, principally to reasons similar to those of Germany. Nevertheless, there is a general requirement (albeit not contained in VAT law) that PPP bidders must include an estimate of the VAT charge so that the public sector body concerned knows what the VAT cost is likely to be in order that if necessary, additional funding from central sources may be obtained.

Budget measures

6.1.18 Viewing the public sector as a whole, taxes charged to public sector bodies could be restored to their budgets in exactly the same or reasonably similar proportions (i.e. in a sense an indirect VAT refund or compensation scheme). In Germany and Spain in particular this is generally the means by which all or part of the additional VAT costs arising under PPP arrangements are addressed. As noted in 5.3.7, PPP bidders in Spain are required to provide an estimate of VAT charges arising in connection with their bid in order, it is assumed, to allow for early negotiation over increased budgets with central government.

6.1.19 The approach goes some way to managing down the significance of VAT costs as a determinant of PPP investment. But regardless of the ultimate effect of rebalancing budgets (where and to what extent it occurs), arguably it has little real-time impact on investment decisions on the basis that departmental-level budgeting and cash-flow analysis tends to focus on and be measured against actual present-day expenditures rather than budgeted income. Thus whilst it has not been measured, it would be expected that a targeted immediate VAT refund mechanism is more likely to promote stakeholder decisions in favour of PPP projects than indirect budget rebalancing measures.

6.2 Managing the amplified VAT effect – current and realistic options

The reverse charge

6.2.1 Some Member States, including Spain, apply the reverse charge to certain high value domestic transactions, eliminating a potentially significant source of reclaimable VAT cost which would otherwise have to be financed by providers and be passed on to procurers. The benefit of the reverse charge would be felt even more strongly in Member States where input tax credits are normally set off against output liabilities until fully used up (e.g. Italy); given the usual lead times associated with PPP projects and the structuring of payments, the additional interim working capital otherwise required to fund these VAT costs in the interim could be substantial. Box 9 illustrates the reverse charge in a PPP context.

Box 9: The reverse charge

A provider incurs €5m of VAT on the purchase of land on which a new hospital will be built under a PPP arrangement. Costs are likely to be substantial coupled with a long completion time. All of the VAT incurred is intended to be attributable to an onward taxable supply of a managed medical facility and can therefore be treated as input tax which may be recovered in full.

Even if this VAT cost is funded for a very short period of time, it represents a substantial finance issue. Clearly, during the intervening period the provider must pre-finance this input tax credit, and will most likely increase its charges to the private sector procurer as a consequence.

Applying the reverse charge to land transactions in particular, and high-value transactions in general, should eliminate this problem. Under the reverse charge, the purchaser assumes responsibility for accounting for output tax on the supply, but is also entitled to treat that same amount as input tax on the same VAT return. Potentially the two entries offset each other exactly, and the purchaser need not pre-finance any VAT.

The reverse charge also offers governments an anti-fraud measure in so far as large sums of VAT which could potentially be at risk are in essence eliminated.

VAT management

6.2.2 Of course, simply recovering input tax from the authorities as early as ordinarily possible helps alleviate the problem of carrying the cost of VAT. This is an efficient VAT accounting point, and, unless 'reverse charge' is a feature of national VAT legislation, it is one which providers should focus on. Early VAT registration, the use of monthly return staggers during the construction phase and generally improved VAT management should all assist with the reduction of VAT financing.

6.2.3 In 5.2.2 it was noted that a provider making use of a quarterly return cycle must bear a greater VAT carry cost than a provider on a monthly cycle. The reality is that often, where possible, providers make use of monthly returns during the construction phase, reverting to quarterly returns on completion.

Sourcing grants direct from grantors

6.2.4 Grants given to procurers and then passed down to providers can create a VAT cost for procurers and indeed, ultimately, the funding institutions. Recognising this, it would be more effective for procurers to source funding direct from the funding institutions. It may even be possible for the provider to obtain the sums VAT-free on the basis that they constitute "pure" grant income (as opposed to a pre-payment or capital contribution from a procurer, on which VAT must be charged). At worst, a VAT liability still arises albeit the procurer is not required to fund that cost in the first instance.

Eliminating early taxpoints

6.2.5 One of the challenges of capital contributions is that they can create taxpoints on payment, generating a VAT cost for procurers in advance of when payment might ordinarily have been due (i.e. under a unitary charge). An option might be to cease making such contributions and holding back funding and using it to make payments following delivery instead.

Barter transactions

6.2.6 Barter transactions can be problematic, sharing the implications of capital contributions noted above. Where the barter relates to land, one option worth pursuing would be to ensure that VAT is chargeable in respect of the value attributed to the land transferred. The provider should be entitled to recover the VAT

charged and so the cost to it would be cash-flow only. On the other hand, the procurer may, as a result of having charge VAT on the supply, be entitled to recover the VAT incurred on the corresponding barter supply from the provider.

6.3 Managing the primary and amplified VAT effects – radical options

6.3.1 A radical option would be to remove Article 13 from the Principal VAT Directive and have public sector bodies operate within the normal VAT regime. In essence, public sector bodies would be placed on a par with private sector operators, would generally make taxable supplies, and recover much of the VAT that they incur without the need of a special compensation or refund scheme.

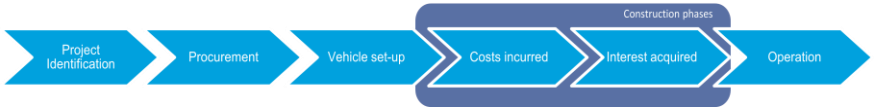
6.3.2 EU legislation would, however, have to be changed to accommodate this deletion; a difficult process which would require consent from all 27 Member State. Furthermore, recipients of public services would be forced to bear VAT on costs which until that point they had not – a likely consideration of legislators when asked to consider a deletion of Article 13 and clearly the politics of this may be difficult.

6.3.3 One potential benefit of the creation of these VAT costs for recipients is that it would cause public sector bodies to seek greater balance in the way in which they deliver public services. This would be an EU-wide option and would remove the existing disparity between the public sector and the private sector. However, this option may have potentially negative consequences. The recipients of the services, typically private individuals, would be unable to recover VAT incurred on those services. Accordingly, there would be an additional cost to those recipients. However, this effect may remove what might otherwise produce a bias towards outsourcing under the alternative option (described above).

6.3.4 Given the range of complexities involved in a removal of Article 13, further consideration of this option is beyond the scope of this report and it is mentioned only for completeness. However, the European Commission is currently considering its options in relation to the treatment of public sector bodies, particularly in the context of greater deregulation and increased competition with the private sector, and whether reform of the current EU approach is needed.

6.3.5 Another challenging option would be an attempt to increase the coverage or reduced rates or exemptions in order to reduce the amount of VAT incurred at source. But whilst many Member States already apply reduced, super reduced rates and exemptions to a range of goods and services, substantial restrictions have been placed on the further expansion of existing reduced rates and exemptions it the effect of these lowered VAT rates is rarely felt in a PPP context given the nature of goods and services concerned.

7 Country experiences



7.1 Introduction

7.1.1 The following section examines the PPP lifecycle and, drawing on the foregoing analysis, provides an overview of likely VAT impacts felt during the PPP lifecycle in France, the UK, Germany and Spain. The analysis is not exhaustive but provides greater insight into the practical implications of VAT.

7.2 Project identification

7.2.1 At this stage, there are generally no VAT consequences for the provider. However, in examining its requirements and delivery options, a procurer, particularly those without in-house expertise, are likely to turn to external advisors for assistance. Costs incurred by the procurer during this phase are most likely to be subject to VAT.

7.2.2 As with all VAT incurred by the procurer, recovery will be determined by reference to the nature of what, ultimately, the VAT is attributable to. Assuming the VAT is attributable to an intended non-taxable activity, immediate or near-immediate recovery of it will be determined by whether the Member State concerned operates a VAT refund or compensation scheme. If no refund or compensation scheme is operated, the VAT will not be recoverable, and instead fall as an absolute cost. The procurer may be entitled to seek additional funding from Government to ameliorate the impact of such costs.

7.2.3 The important note to here is that, as noted previously, it is the intention of the procurer that is important. If the project was, ultimately, deemed not suitable to pursue, VAT incurred up to the point of that decision being taken would still be subject to the same attribution and recovery analysis outlined above.

Country summary	Project type	Liability	France	UK	Germany	Spain
Procurer	Non-taxable / Non-business	N/A	• Project planning costs are unlikely to be capitalised. • VAT incurred on a non-taxable project and which cannot be capitalised are not recoverable under the compensation scheme. It will represent a cost to procurers • For local/ regional bodies capital costs may be recovered under the compensation scheme, but recovery will be a subsidy at a rate of 15.482% which is applied on the full cost including VAT. Such compensation may take up to 2 years to be recovered	• The UK operates a broad VAT refund scheme that does not distinguish between capital and revenue costs. • VAT likely to be recoverable	• No compensation scheme • Budget uplift may be available	• No compensation scheme • Budget uplift may be available
	Taxable / Business	Taxable	• Recoverable even if the project is ultimately not implemented	• Recoverable	• Recoverable	• Recoverable
		Exempt	• Not recoverable	• Not recoverable	• Not recoverable	• Not Recoverable

7.3 Procurement

7.3.1 The procurement phase is often an extensive period of time with potential providers determining the delivery mechanism, preparing detailed costings, cash-flow and revenue forecasts, whilst also potentially seeking partners and financial backing. Costs incurred by procurers could be significant.

Country summary	Project type	Liability	France	UK	Germany	Spain
Procurer	Non-taxable / Non-business	N/A	• Grant funding received is not likely to constitute consideration for a supply. Even if it was considered consideration, it would be in respect of a non-taxable/non-business activity. No VAT will be due			
	Taxable / Business	Taxable	• Grant funding received may not constitute consideration for a supply. If it is considered consideration, VAT will be due			
		Exempt	• Grant funding received may not constitute consideration for a supply. If it is considered consideration, VAT will be not be due			
Provider	Non-taxable / Non-business or Taxable/ Business	Taxable	• PPP projects may result in potential providers incurring substantial amounts of VAT on bid costs. Preferably, such bid costs should be incurred in such a way that the VAT can be recovered. Particular care may be required with regards to VAT on costs where bids may be unsuccessful. • Generally, it will be more VAT efficient for bid costs to be incurred by existing VAT registered entities that make wholly-taxable supplies. This is because an entity that does not make wholly-taxable supplies (other than to a minimal extent) is not entitled to recover all of the VAT that it incurs. • There is a disparity in the treatment between potential providers from typically VAT-exempt sectors, such as finance, and those from typically taxable sectors, such as building contractors. Providers from typically taxable sectors will generally be better placed to recover VAT on bid costs, including on failed bid costs, compared with unsuccessful bidders from typically exempt sectors. • Potential providers may need to reimburse costs, such as third party professional fees, incurred by other parties connected with the project. As only a recipient of a supply is entitled to recover VAT and the provider is just paying for it, the VAT charged by the third party will not be recoverable by the provider. However, as the VAT on the third party fees may be recoverable by the recipient of the supply (so that it is not an absolute cost), the provider should only reimburse, or indemnify, VAT on third party costs to the extent that it is not recoverable by the recipient of the supply.			

7.4 Vehicle set-up

7.4.1 The creation of a special purpose vehicle, “op-co”, by the winning provider is a relatively common feature of PPP projects. An op-co assumes the primary responsibility for any construction and the provision of services to the procurer for the duration of the contract. An affiliated and specialised finance company “fin-co” may also be established for the purposes of securing construction finance, which it might either receive itself and pass on to op-co in the form of a loan at interest. Alternatively, and more commonly, it may simply arrange for op-co to receive the finance directly. Ordinarily op-co and fin-co would be grouped for VAT purposes.

7.4.2 Costs incurred by the parties to the SPV to date are likely to be re-charged to the op-co.

Country summary	Project type	Liability	France	UK	Germany	Spain
Provider finance	Non-taxable / Non-business or Taxable/ Business	Exempt	• The provision of finance by the fin-co to the op-co at interest would constitute an exempt supply and no VAT would be due. Alternatively, op-co and fin-co may be VAT grouped, in which case the supply would be disregarded.			
Provider costs	Non-taxable / Non-business or Taxable/ Business	Taxable	• VAT registration of the SPV will be necessary. This will be on the basis of the SPV’s *intention* to make taxable supplies in the future. • The SPV may apply to submit monthly VAT returns. Whilst on the one hand this may accelerate VAT recoveries, it will also advance the time at which VAT must be accounted for on supplies made by the SPV at this time.			
			• VAT incurred at this stage will generally be recoverable to the extent that it is relates to a cost borne by the SPV. A challenge arises in respect of re-charged costs which may not be in respect of supplies made to the SPV. Where this is the case, VAT recovery may not be possible.			• VAT recovery becomes a challenge for Spanish SPV’s at this stage. VAT recoverable is held as a credit and offset against VAT payable in the future (subject to time limits), and to the extent that the SPV has, thus far, not made any taxable supplies, VAT incurred may not be recoverable

7.5 Construction phase: costs incurred and interest acquired

7.5.1 Having established and registered the SPV, construction now commences. Significant costs are likely to be incurred throughout the design and build phase throughout which the SPV is likely to be paying interest on its borrowings. Grant funding may also be passed from the procurer to the provider at this stage, and the SPV may also acquire an interest in the land necessary for it to fulfil its delivery obligations. A charge may or may not be made for the granting of this interest.

Country summary	Project type	Liability	France	UK	Germany	Spain
Procurer	Taxable / Business	Taxable	• Providing a free of charge interest in land may not simply mean that the supplier has not made a supply. Indeed, it may be seen as part of a barter transaction with the procurer seen as receiving construction services to the value of the land provided. If this is the case, and the procurer is making a supply, VAT will be due if the land concerned is subject to an option to tax.			
		Exempt				
Provider revenue	Non-taxable / Non-business or Taxable/ Business	Exempt	• The provision of finance by the fin-co to the op-co at interest will constitute an exempt supply and no VAT would be due. Alternatively, the op-co and fin-co may be VAT grouped, in which case the supply would be disregarded.			
Provider costs	Non-taxable / Non-business or Taxable/ Business	Taxable	• Interests in land received for free may not necessarily escape a VAT charge. The most likely analysis is that they will be seen as part of a barter transaction, with the provider being treated as providing construction works to the value of the land provided. VAT will be due on this supply of construction works			
			• VAT incurred at this stage will generally be recoverable to the extent that it is relates to a cost borne by the SPV. A challenge arises in respect of re-charged costs which may not be in respect of supplies made to the SPV. Where this is the case, VAT recovery may not be possible.			• In order to alleviate cash-flow issues related to the usual VAT credit and offset method used in Spain, providers self-account for VAT on land and construction costs incurred under a domestic reverse-charge mechanism.

7.6 Operation

7.6.1 Once completed, the provider will commence service provision. A charge is usually made to the procurer for this service provision, albeit the precise nature of and quantum consideration may take a variety of forms: it may be a unitary charge, such as a charge for building and maintaining a property; it may be a charge determined by reference to availability of use such as a shadow toll. Alternatively, a provider may instead be entitled to make charges the public directly, such as is the case with certain types of road-tolling arrangements. In such cases the procurer is not the recipient of the providers' supplies under the PPP arrangement.

7.6.2 Procurers may find themselves with excess capacity, particularly during the early phases of operation. In many cases the procurer may well be entitled to on-supply this capacity to other users under separate commercial arrangements and for which a charge is likely to be made.

7.6.3 Provided costs incurred by the provider to date, together with on-going costs, are wholly attributable to taxable supplies, any VAT incurred on such costs by the provider should be recoverable. There are two issues which need to be considered. First, will the provider make a single supply, or multiple supplies, to the procurer. Second, to what extent is that supply, or to what extent, are those supplies of the type which will permit VAT recovery. Any exempt supply of finance or any supply of non-opted land by the provider may restrict its ability to recover the VAT that it has incurred.

Country summary	Project type	Liability	France	UK	Germany	Spain
Procurer	Non-taxable / Non-business	N/A	• Capital costs may be recovered under the compensation scheme, but recovery will be a subsidy at a rate of 15.482% which is applied on the full cost including VAT. Such compensation may take up to 2 years. The VAT paid on the part of the unitary charge covering the financing (financing interests…) and pure service (operating maintenance…) is irrecoverable and is therefore lost by the procurer	• The UK operates a broad VAT refund scheme that does not distinguish between capital and revenue costs. • VAT likely to be recoverable • The UK offers additional concessions whereby the provider does not charge VAT on certain transactions. The provision of residential care homes may benefit under such reliefs	• No compensation scheme • Budget uplift may be available	• No compensation scheme • Budget uplift may be available
	Taxable / Business	Taxable	• VAT incurred will be recoverable to the extent that it is attributable to taxable supplies. This includes VAT incurred on unitary charges and such which are attributable, even in part, to the sub-letting of a facility which has been opted to tax, or where facilities within that facility are provided to a third party.			
		Exempt	• VAT incurred which is not attributable to taxable supplies is not recoverable.			

Country summary	Project type	Liability	France	UK	Germany	Spain
Provider	Non-taxable / Non-business or Taxable/ Business	Taxable / Exempt	• VAT law in France clarifies that there would be multiple supplies and that each supply must be treated accordingly for VAT purposes. The unitary charge must be apportioned between the land (if reduced rated VAT supply of building land for social housing) and the facility management service (standard rate VAT supply).	• If there is a single unitary charge then the tax authority would typically consider there to be a single supply with land as the dominant feature. Accordingly, unless special zero-rated VAT treatment applies, the supply would be exempt with the option to tax – which would convert the exempt supply into a standard-rated taxable supply. • If services are the dominant feature then the supply (usually an analysis accepted by the authorities only in highly-technical health service contracts) would be a standard-rated taxable supply. In practice, land is likely to be seen as the dominant feature, with any services that are being provided ancillary to the supply of land and following that VAT treatment. • If there are multiple supplies then there would likely be both: supplies of services that are standard-rated taxable supplies; and supplies of land that would be exempt, with the option to tax. • By opting to tax the land, the provider may eliminate certain effects of any uncertainty that may otherwise exist with regards to whether or not there is a single supply and, if so, whether or not land is the dominant feature, or multiple supplies including land. However options are not necessarily always effective and can be disapplied in certain instances.	• Typically, three supplies would be identified: construction works, maintenance (both taxable for VAT purposes) and credit (exempt for VAT purposes). • It would also be unusual for the provider to take an interest in the land. Therefore the provider would make a supply to the procurer of construction works, rather than a supply of land, for VAT purposes.	• In Spain, prior to 2005, the tax authority would have regarded there to have been a supply of land by the private sector provider to the procurer. • However, from 2005 the tax authority only recognises a single taxable transaction, of a supply of services, by the provider to the procurer.

8 Summary table

8.1.1 The following table summarises the findings in the previous section

	France	UK	Germany	Spain
Is there a VAT refund/compensation scheme for the public sector?	Yes	Yes	No	No
Is there a disparity, with regards to the recovery of VAT on unsuccessful bid costs, between taxable and exempt sectors?	Yes	Yes	Yes	Yes
Is VAT on certain construction works and land dealt with under a reverse charge mechanism?	No	No	No	Yes
Is land generally exempt with the option to tax?	Yes[9]	Yes	Yes	Yes
Is zero-rating available for certain residential land transactions?	No	Yes	No	No
Barter transactions: is a taxable event typically recognised where the private sector bidder acquires a land interest?	Yes	Yes	Yes	Yes
Does the tax authority typically see a single supply or multiple supplies?	Multiple supplies	Single supply (typically of land)	Multiple supplies	Multiple supplies

[9] Except building land which is standard rated or reduced rated (if used for social housing)

9 Case Studies

9.1 Toll bridge

Country: UK

Project type: legacy concession arrangement

Project funding: User charges

VAT refund/compensation provisions exist in the country concerned: Yes

Key issue: legacy structuring is not VAT efficient

9.1.1 This is an early example of procurement concession arrangement which pre-dated the introduction of VAT into the UK in 1973. A body corporate (the company) was established by statute to build a toll bridge over a river. The company was empowered to raise money by issuing shares and allowed to pay dividends to its shareholders.

9.1.2 The statute enabling the establishment of the company also included detailed provisions for the construction and maintenance of the bridge, and set out powers overriding certain property rights that might ordinarily have affected the project. The statute also ensured that the tolls charged to users would also not be subject to taxes. In effect a publicly-enabled statute (which was to remain in force in perpetuity) removed a range of barriers (both legal and tax related) which might otherwise have worked against private sector participation in the project.

9.1.3 At the end of the existing structure's useful life, a replacement bridge was required. However, VAT had been enacted in the UK at this point, presenting a new problem that would not have been considered at the time the statue was originally enacted. As a consequence of tolls not being subject to tax, the company was effectively acting in a non-taxable capacity. Equally, it was unable to recover VAT charge to it under the normal rules. With VAT now being chargeable on the construction of any new bridge this new cost became a critical factor.

9.1.4 In an attempt to eliminate this issue, the company sought to be granted the same status as other public sector procurers in the UK, and to avail itself of the special VAT refund mechanism that operates for such bodies. However, to be eligible for such treatment, a body needs to be fulfilling a function usually carried out by local government, whilst also having the power to levy local taxation. The company could fulfil the first of these criteria but not the second.

9.1.5 Consequently, the company was unable to access the refund regime. Instead, it had to fund the cost of VAT incurred itself, essentially suffering both the primary and amplified effects of VAT outlined previously. Tolls charged to users were, of course, used to defray the entire construction cost over time, albeit in this scenario users were to suffer (indirectly) a VAT cost which they would not have done had the bridge been operated by a public sector body eligible for the refund regime.

9.2 Housing for the elderly

Country: UK

Project type: service-only PPP

Project funding: Unitary charges and user charges

VAT refund/compensation provisions exist in the country concerned: Yes

Key issue: whether a barter transaction took place and if so whether VAT incurred could be recovered

9.2.1 As part of its public responsibilities, a local authority sought to procure a number of assisted living/supported housing units for elderly citizens. Having considered its options in this respect it elected to procure the necessary units under a PPP arrangement.

9.2.2 A special purpose vehicle (the provider) was established jointly by a local housing association (usually these are charitable bodies), and a construction company. The provider entered into a project agreement with the procurer, under which it agreed to design, build and maintain an assisted living property (containing the required units) for the local authority (the procurer), payment for which would be by way of a unitary charge. The quantum of the unitary charge was driven by a service level agreement which guaranteed a given level of availability amongst other performance measures. The agreement was to last for 25 years and VAT would be imposed on the unitary charges which would be recovered under the special refund regime that exists for qualifying public bodies in the UK.

9.2.3 In addition to the unitary charges, user charges would also be made to individuals residing in the units to the extent that they could afford to make them. The letting of residential property in the UK is exempt from VAT, and to that extent no VAT would be imposed on user charges.

9.2.3 Funding for the design and construction of the property took the form of equity investment on the part of the construction company combined with third-party debt. The provider was registered for VAT on the basis of its intention to make taxable supplies to the procurer (i.e. the unitary charges); a position that enabled it to recover a significant proportion of the VAT incurred on construction and associated costs under the normal rules even before the unitary charges became due – being on the date of practical completion of the property. Throughout the construction phase the provider was in a VAT repayment position therefore. On practical completion, this transformed into a payment position as a consequence of the unitary charges.

9.2.4 Initially the provider was to design and build the assisted living property for the procurer. Importantly, the provider did not acquire an interest in the land on which the assisted living property was built prior to construction. Instead, on practical completion of the construction work, the provider granted a long lease (exceeding 25 years), to the provider over the property for no monetary consideration or rent. In return, the provider granted nomination rights to the procurer enabling it to nominate which individuals would live in the units over the 25-year arrangement.

9.2.5 The procurer took the view that the lease that it granted to the provider was in fact a non-taxable activity, not in the sense that it was covered by Article 13 of the Principal VAT Directive, but on the basis that no consideration had been paid on the arrangement. As a consequence, no VAT was charged on the lease granted by the procurer.

9.2.6 Arguably this arrangement constituted a barter transaction on the basis that the grant of the nomination rights constituted consideration (albeit non-monetary) given by the housing association for the grant of the lease by the local authority. However the position of the procurer was also that even if the transaction was subject to VAT, that which was charged to the provider would have been recovered by it as attributable to its own grant of the nomination rights. Equally, VAT charged to the procurer would also have been

recoverable under the special refund regime available to public bodies in the UK. Thus overall the net VAT position was unchanged.

9.3 Football stadium

Country: France

Project type: fixed asset PPP arrangement

Project funding: Capital contributions and unitary charges

VAT refund/compensation provisions exist in the country concerned: Yes

Key point: Structuring projects properly can significantly reduce the cost of PPP

9.3.1 A city (the procurer) is seeking to construct a new football stadium on land under the ownership of the state. Having considered its options may procure the stadium under a PPP arrangement.

9.3.2 The procurer will initially grant a 30-year lease to a newly established special purpose vehicle (the provider) in order to enable the construction and operation of the stadium. A nominal rental charge will be imposed by the procurer in respect of the lease which it will grant. On completion, the provider will lease the facility back to the procurer for a period equivalent to that remaining on its own head lease. At the end of this term, the property will become wholly owned by the procurer. During the intervening period the provider will also manage the stadium.

9.3.3 The procurer, together with other public bodies including the local departmenté, the region and the state, is due to make capital payments to the provider during the construction phase. These payments are likely to only cover a proportion of the total cost, with the procurer making up the shortfall by way of a unitary charge payable annually to the provider. The unitary charge will be in respect of both the lease and the management of the property, and will be subject to VAT in full.

9.3.4 The procurer will sub-let the stadium on a non-exclusive basis to a local football club. It will also let the property to other users for concerts and other significant events. The income received under these arrangements should be treated as partial funding towards the cost of the unitary charges that it will incur.

9.3.5 The provider is required to finance, design and built the new stadium, incurring VAT on a range of associated costs in the process. In order to avoid any challenge over VAT recovery, the provider will opt to tax the property at the outset; this should ensure that any attempt to split out the lease element of the unitary charge should not result in the identification of an otherwise exempt supply of land and result in the procurer suffering a VAT cost.

9.3.6 The procurer had not opted to tax the site however. As a consequence, no VAT was chargeable on the head-lease to the provider. Nevertheless, as a consequence of the special VAT compensation regime that exists in France, the procurer was eligible to a payment almost equivalent to all of the VAT charged to it on the unitary charges, and in respect of the VAT up-front capital contributions. The compensation was paid two years after the costs were incurred.

9.4 Airport

Country: Germany

Project type: joint venture

Project funding: Private sector equity investment

VAT refund/compensation provisions exist in the country concerned: No

Key point: Asset ownership arrangements have an important bearing on the VAT analysis

9.4.1 An existing airport was owned and operated by an existing company which was jointly controlled by the Federal Government, the individual state and the municipality. Modernisation and expansion plans for the airport required a significant capital injection, the funds for which would be secured in part via private sector equity investment.

8.4.3 In contrast to fixed-asset PPP projects, where land interests pass directly between the public and private sector, this is an example of a joint venture between the public and private sector where the operative asset, the airport, remained owned by the same company. Accordingly, the VAT treatment concerning the operation of the airport remained the same both before and after the private sector participation, with VAT being recoverable under the normal rules, and in so far as it could be attributed to onward taxable supplies being made to airport customers.

9.5 Road toll

Country: Germany

Project type: contract debtor PPP arrangement under an “Availability” model

Project funding: Private finance; availability payments; revenue share

VAT refund/compensation provisions exist in the country concerned: No

Key point: Domestic VAT rules are not all the same; be aware of country differences

9.5.1 A transport department (the procurer) is seeking to develop road transport infrastructure capacity through the addition of an additional lane to each carriageway of an existing roadway. The procurer is seeking private sector involvement in the venture which will involve the design, construction and operation of the upgraded roadway for a fixed annual sum. The procurer will retain possession of the asset on completion and for the duration of the arrangement. It is recognised that any VAT incurred by the procurer is likely to represent a VAT cost.

9.5.3 The procurer will make a contribution to the provider in respect of a portion of total construction costs over the course of the design and build phases. Once operational, the procurer will impose a toll on HGV motorway users. Importantly, it will always act as principal in this regard, albeit under the terms of the arrangement the provider will collect these revenues as agent on behalf of the procurer.

9.5.4 Under the terms of the contract, the provider is entitled to a redistribution of toll revenues to the extent that these satisfy total availability charges due from the procurer, determined in accordance with contractually agreed performance measures. Where they do not, the provider may impose additional charges on the procurer to cover any remaining balance. Total charges to the procurer will therefore be tied to the availability metric.

9.5.5 The initial contribution is considered a prepayment for the construction work and, as would ordinarily be the case, VAT is due to be accounted for by the provider on the amounts that it receives. The provider will be required to raise VAT invoices to the procurer in respect of the amounts received, calculating the VAT due on an inclusive basis (i.e. the VAT is due at a rate of 19/119 of the grant received). At this stage therefore the impact of VAT erodes the cash value of the contribution as the provider must account for VAT out of the grant received. Overall project financing must take this into account, thereby amplifying the primary VAT effect felt by the procurer.

9.5.6 During the construction phase, VAT will become due either as a consequence of the receipt of any subsequent capital contributions, or as construction work is completed and approved by the procurer. The basis on which the tax is assessed in the latter case is by reference to the cost value of the completed element. As above, VAT due as a consequence of these milestones represents a cost that must be financed by the provider to the extent that it has not already been financed by earlier contributions.

9.5.7 Despite being responsible for the collection of toll revenues, they do not constitute consideration for a supply by the provider; rather they represent consideration for a supply (of a managed roadway) by the procurer. Thus passing those revenues back to the procurer does not attract VAT *per se*. However, any amounts returned to the provider will be treated as additional consideration in respect of settlement for any remaining construction works and any availability charges if no other discrete availability charge is imposed. They will, at this stage, be subject to VAT.

9.5.8 However, the fixed-price nature of the arrangement necessitates an apportionment of the amounts involved in order to establish the correct tax base and VAT amounts due. For example, on the basis of an assumed construction budget of EUR 150m (net), VAT on construction costs arising would be in the region of EUR 28.5m (given an assumed VAT rate of 19%). An initial contribution by the procurer of EUR 87m would result in a VAT liability arising on that payment of EUR 13.89m. The balance of VAT due on the construction, EUR 14.61m will become due in whole or in part over the course of the 30-year arrangement.

9.5.9 Assuming annual VAT-inclusive toll revenues of EUR 29m per annum, a portion of these amounting to EUR 3.05m of these would reflect the annual contribution towards any remaining construction works. This is calculated as being the original net construction cost plus the VAT thereon (EUR 150m + EUR 28.5m) less the value of any VAT inclusive contributions made to date (EUR 87m), divided by the contract length. After having deducted this annual contribution from net toll revenues (i.e. EUR 29m - EUR 3.05m / 1.19), the balance remaining (EUR 21.81m) reflects the amount attributable to the maintenance and operating services, the VAT due thereon being EUR 4.14m per annum.

10 Glossary

Availability payments	A payment for meeting certain performance objectives. These objectives are not normally linked to procurer or user demand.
Barter	Also known as part exchanges and contras: where the consideration is not, or not wholly, monetary.
Contract debtor PPP arrangement	Unlike a fixed asset PPP arrangement, this does not involve the provider acquiring any interest in the land. An example of a contract debtor PPP arrangement would be a motorway project. Under such a contract debtor arrangement the provider would design, construct, finance, operate and/or maintain the motorway, without ever taking any interest in the land. In return the procurer would pay a unitary charge to the provider. The unitary charge would be agreed at a level that would reflect the provider's costs of construction, operation and/or maintenance. It may also reflect the extent to which the motorway is used and is sometimes referred to as a shadow toll (unlike an actual toll, which would be paid by the user, a shadow toll would be paid by the procurer).
Directly effective	In the context of the European Law, means a provision which the courts in the constituent Member States are bound to recognise and enforce.
Direct relief	Terminology used to cover instances where a Member State has taken steps to give partial or whole refunds or compensation to public sector bodies incurring VAT on certain project costs
European Commission	The executive body of the EU.
Europe 2020	The European Union's ten-year growth strategy. See http://ec.europa.eu/europe2020/index_en.htm for details.
Exemptions	This is an EU term that means no VAT is charged on a particular supply. VAT incurred on associated costs may or may not be refunded in a Member State. Certain exempt supplies may carry a right for the supplier to recover VAT that has been incurred in the course of making the supply (e.g. a UK "zero-rated" supply). Alternatively, no VAT recovery right may exist (e.g. a UK "exempt" supply).
Fixed asset PPP arrangement	This involves the provider being granted a lease by the procurer. The lease would be of the relevant site for the infrastructure project. An example of a fixed asset PPP arrangement would be a new hospital project, where the procurer grants the provider a lease of the site upon which the new hospital is to be constructed. The term of the lease would reflect the length of the public and private sector partnership. Typically, the provider would design and carry out construction works to the site and would then provide a managed facility to the procurer. In return, the procurer would pay

	a unitary charge to the provider, over the term of the project. The unitary charge would be agreed at a level that would reflect the provider's costs of raising finance, the design and construction works undertaken and its performance in delivering a managed facility for the term of the project. Sometimes, in addition to the unitary charge, there is an upfront payment (sometimes referred to as a bullet payment) or other in-kind consideration given to the provider. Upfront consideration, whether monetary or in-kind, reduces the unitary charge payable by the procurer.
Input VAT	Also known as input tax. VAT incurred which is attributable to business activities is treated as input VAT. It is recoverable to the extent that it is attributable to taxable supplies. VAT incurred which is attributable to non-business activities is not input VAT.
Insourcing	The opposite of outsourcing. The internal performance of a process or function.
Länder	The Federal Republic of Germany is made up of 16 partly soverign constituent states. Sometimes referred to as Federal States.
Member State	A state that is a party to the treaties of the European Union (EU).
Non-taxable	Terminology used in this paper to describe a public sector body when engaged as a public authority
Output VAT	Also known as output tax. VAT chargeable on a taxable supply at the appropriate VAT rate becomes due to the authorities and payable as output tax.
Outsourcing	The opposite of insourcing. Contracting out of an internal process or function to a third party provider.
Positive rate of VAT	A rate of VAT greater than 0% (or zero-rated or exempt with credit) and in contrast to supplies that are exempt and have no entitlement to credit for input VAT.
Public Private Partnership	A contract between a public sector body with a private sector entity to render managed infrastructure services over an agreed period of time in return for an agreed consideration.
Principal VAT Directive	Council Directive 2006/112/EC, effectively a consolidation of the Sixth Directive on VAT of 1977.
Procurer	The public sector body purchasing managed infrastructure services under a PPP arrangement.
Provider	The private sector body providing managed infrastructure services under a PPP arrangement.
Public Sector	The public sector means that part of the national economy that is controlled by the state and consists of national, regional, local and municipal government and authorities and that is responsible for

	providing certain goods and services that are not, or cannot be, provided by the private sector. For these purposes public sector is also used to describe government departments.
Residual VAT	VAT on general overheads that are not directly attributable to a specific supply. For example, office costs such as electricity.
Reverse Charge	A mechanism whereby no VAT is charged by the supplier. Instead the liability to charge and account for VAT is passed to the recipient of the supply (the customer).
Shadow tolls	A mechanism by which the quantum of a charge to a procurer in respect of the provision of a managed roadway can be measured.
Tax authority	Direction Générale des Finances Publiques or DGFiP (France); Finanzamt (Germany); Agencia Estatal de Administración Tributaria or AEAT (Spain); and HM Revenue & Customs or HMRC (UK), and any other body with similar responsibilities elsewhere in the EU.
Taxpoint	The date or time at which VAT becomes chargeable and, absent specific tax accounting provisions, payable to the authorities.
Taxable Person	Any person who carries out, in any place, any economic activity. This could be a natural person, namely an individual, or a legal person such as a company or body corporate. It may also include an entity that does not have legal personality such as a partnership.
Unitary charge	Also known as a royalty. This is typically a single annual payment or monthly payments made by the procurer for the services provided to by the provider under the PPP arrangement.
Value Added Tax	A tax on the consumption of goods and services. In the UK it is referred to as Value Added Tax or VAT, but is referred to differently in other Member States, in particular: Taxe sur la valeur ajoutée or TVA (France); Mehrwertsteuer / Umsatzsteuer or MwSt. / USt. (Germany); and Impuesto sobre el valor añadido or IVA (Spain).

Notes