

Business samples and business gifts

[EMI Group Ltd \(C-581/08\)](#)

Summary

The ECJ has held that UK legislation which treats only the first sample (as defined by the ECJ) in a series of similar samples given away in the course of business as VAT-free is incompatible with EU legislation. However, the ECJ has confirmed that a Member State's business gift rules may, as in the UK, apply a cumulative £50 per annum monetary limit to gifts to the same person, provided that the value is aggregated per recipient employee rather than per recipient employer. It remains to be seen how the ECJ's guidelines on the definition of a 'sample' will be interpreted by the national court. However, businesses which consider that they have overpaid VAT in respect of business samples, or items valued at £50 or less gifted to employees of a single employer, should pursue claims for overpaid VAT.

Background

In order to promote music sales, EMI distributes free copies of its products to people who can influence sales, such as broadcasters, media contacts and 'pluggers', including multiple individual recipients within a single organisation (e.g. a number of broadcasters employed by the same radio station). In some cases any output VAT chargeable would be recoverable by the organisation. However, it also distributes free copies to the artists and other persons, e.g. entertainments officers at universities.

The EU law applicable where goods are freely given away by a business is to be found in art 16 Principal VAT Directive (2006/112/EC), formerly art 5(6) EC Sixth Council Directive (77/388/EEC), which provides as follows:

"The application by a taxable person of goods forming part of his business assets for his private use or for that of his staff, or their disposal free of charge or, more generally, their application for purposes other than those of his business, shall be treated as a supply of goods for consideration, where the VAT on those goods or the component parts thereof was wholly or partly deductible.

"However, the application of goods for business use as samples or as gifts of small value shall not be treated as a supply of goods for consideration".

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In UK law, para 5(1) Sch 4 VAT Act 1994 provides that the transfer of business assets for no consideration constitutes a taxable supply of goods for VAT purposes, but paras 5(2) and 5(3) Sch 4 VAT Act 1994 provide that:

"(2) Sub-paragraph (1) above does not apply where the transfer or disposal is—

(a) a business gift the cost of which, together with the cost of any other business gifts made to the same person in the same year, was not more than £50;

(b) subject to sub-paragraph (3) below, a gift to any person of a sample of any goods.

(3) Where—

(a) a person is given a number of samples by the same person (whether all on one occasion or on different occasions), and

(b) those samples are identical or do not differ in any material respect from each other,

sub-paragraph (1) above shall apply to all except one of those samples or, as the case may be, to all except the first to be given".

Consequently, in the UK the relaxations for samples and gifts of small value are restricted to:

- the first sample in a series of similar samples;
- a single gift valued at £50 or less; or
- a series of gifts given in any 12-month period valued cumulatively at £50 or less.

The Taxpayer essentially submitted that these restrictions are ultra vires the EU legislation and disputed the VAT treatment of goods freely given by the Taxpayer in order to promote its business, being either:

- 'samples', which the Taxpayer considers to be examples of its own goods or services intended to promote sales thereof; or
- 'gifts', being freely given goods other than 'samples'.

The Taxpayer contended that UK legislation limiting the relief from VAT for samples to the first item provided to a person was unlawful. HMRC accepted that the question of what comprised a

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'sample' was open to doubt and agreed that a reference to the ECJ was appropriate. The questions referred were:

"(a) How is the last sentence of Article 5.6 of the Sixth Directive to be interpreted in the context of the circumstances of the present case?

(b) In particular, what are the essential characteristics of a "sample" within the meaning of the last sentence of Article 5.6 of the Sixth Directive?

(c) Is a Member State permitted to limit the interpretation of "sample" in the last sentence of Article 5.6 of the Sixth Directive to-

(i) an industrial sample in a form not ordinarily available for sale to the public given to an actual or potential customer of the business (until 1993),

(ii) only one, or only the first of a number of samples given by the same person to the same recipient where those samples are identical or do not differ in any material respect from each other (from 1993)?

(d) Is a Member State permitted to limit the interpretation of "gifts of small value" in the last sentence of Article 5.6 of the Sixth Directive in such a way as to exclude-

(i) a gift of goods forming part of a series or succession of gifts made to the same person from time to time (to October 2003),

(ii) any business gifts made to the same person in any 12-month period where the total cost exceeds £50 (October 2003 onwards)?

(e) If the answer to question (c)(ii) above or any part of question (d) above is "yes", where a taxable person gives a similar or identical gift of recorded music to two or more different individuals because of their personal qualities in being able to influence the level of exposure the artist in question receives, is the Member State permitted to treat those items as given to the same person solely because those individuals are employed by the same person?

(f) Would the answers to questions (a) to (e) above be affected by the recipient being, or being employed by, a fully taxable person, who would be (or would have been) able to deduct any input tax payable on the provision of the goods consisting of the sample?"

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Held

Definition of a 'sample'

The ECJ first pointed out that the taxation of the applications of goods outside of the business for the purposes of art 5(6) was designed to prevent situations in which final consumption went untaxed. The exceptions for business samples and gifts therefore had to be construed narrowly, but not so narrowly as to render it ineffective in practice.

The non-taxation of samples was not intended to apply where the objective was to satisfy the end consumer's needs in relation to the product in question, but that did not mean that 'samples' must exclude goods in the finished format which could ultimately be consumed and include only, for example, specimens of materials or component parts. Although there was a risk that finished goods distributed as samples might become the subject of final consumption, in many cases making available specimens of products in their final format was a necessary prerequisite for the process of assessment of their essential qualities, so that those qualities could be demonstrated to the potential or actual buyer.

For example, the Taxpayer's CDs had to be distributed in their final form in order to be fully assessed by the recipient in order that, within the course of his work, that individual could promote the Taxpayer's business supplies by ensuring public exposure for its product. For similar reasons, the VAT relief for samples could not be restricted to samples given directly to potential buyers of the end product, as the relationship with intermediaries (broadcasters, media contacts and 'pluggers' in the Taxpayer's case) was a method of business promotion in which use of the sample was inherent in the process of assessment and promotion.

On the question of whether only the first copy of identical goods given to the same recipient could be classified as a 'sample', the ECJ held that the distribution of a number of specimens by way of 'samples' could not, in principle, be excluded from the VAT relief for 'samples'. The number of 'samples' which could be distributed to the same recipient, in the Taxpayer's case, an intermediary, depended on the nature of the product and the use to which the recipient was likely to put those samples.

For example, it might be necessary to give many specimens, hundreds in the case of the Taxpayer's CDs, to intermediaries so that they could forward those copies to individuals with the ability to promote sales of the CDs. The VAT relief could still apply provided that the number of specimens was consistent with the nature of the product represented and with the use which the intermediary would be expected to make of those specimens.

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It would therefore be for the national court to determine whether the giving of specimens was within these parameters, but the national court should not be influenced by the possibility that improper use of the specimens would result in them entering into the normal sales chain. It would be for the Member State to put in place requirements for taxable persons distributing samples for the purposes of their business to take precautions in order to avoid the risk that those samples might be used improperly, e.g. mandatory labelling indicating that the product was a sample, or contractual clauses relating to the civil liability of intermediaries who receive samples for the purpose of forwarding them to other individuals.

Finally, the ECJ stated that, where the distribution of samples led to final consumption which was not inherent in the assessment of the product represented by those samples, that consumption would constitute an abuse of art 5(6).

Gifts of small value and national value limitations

The ECJ noted that art 5(6) did not define uniformly and precisely 'small value' and therefore the Member States had a margin of discretion to set, in national legislation, a monetary ceiling such as the £50 in the UK legislation. The same applied to a rule under which such a ceiling applied cumulatively to gifts made to the same person in the course of a 12-month period or, alternatively, forming part of a series or succession of gifts. The ECJ considered that such ceilings were compatible with the objectives of art 5(6), while not rendering the relief for gifts of small value ineffective.

Aggregation of the values of gifts to employees of the same employer

Having held that the Member State could put in place monetary and temporal limits for cumulative gifts of small value, provided that those limits did not render the VAT relief ineffective, the ECJ considered that aggregating the values of all gifts to the employees of a single employer would render the relief ineffective and therefore held that this would be contrary to the purposes of the Directive.

VAT status of the recipient

Art 5(6) did not draw a distinction between the VAT treatment of samples or gifts on the basis of whether they were given to persons able to recover input VAT, and this was not a factor which should affect the answers to any of the other questions referred to the ECJ.

The ECJ summarised its judgment as follows:

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"1. A 'sample', within the meaning of the second sentence of Article 5(6) of Sixth Council Directive 77/388/EEC ..., is a specimen of a product which is intended to promote the sales of that product and which allows the characteristics and qualities of that product to be assessed without resulting in final consumption, other than where final consumption is inherent in such promotional transactions. That term cannot be limited, in a general way, by national legislation to specimens presented in a form which is not available for sale or to the first of a series of identical specimens given by a taxable person to the same recipient, unless that legislation allows account to be taken of the nature of the product represented and of the specific business context of each transaction in which those specimens are distributed.

2. The concept of 'gifts of small value', within the meaning of the second sentence of Article 5(6) of Sixth Directive 77/388, must be interpreted as not precluding national legislation which fixes a monetary ceiling of the order of that established by the legislation at issue in the main proceedings, namely GBP 50, for gifts made to the same person in the course of a 12-month period or forming part of a series or succession of gifts.

3. The second sentence of Article 5(6) of Sixth Directive 77/388 precludes national legislation which establishes a presumption that goods constituting 'gifts of small value' within the meaning of that provision, distributed by a taxable person to different individuals having the same employer, are to be treated as having been made to the same person.

4. The tax status of the recipient of samples has no bearing on the answers given to the other questions."

Comment

The UK legislative provisions concerning business gifts are likely to remain unchanged, i.e. para 5(1) will apply and VAT will be due on all business gifts, except where the gift is:

- an individual gift valued at £50 or less; and
- the gift does not form part of a series of gifts given to an individual recipient in any 12-month period which, taken together, are valued cumulatively at more than £50.

However, the ECJ has clarified that the value of gifts given must be determined per individual recipient, rather than aggregated to take into account all gifts given to the employees of a single employer.

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As regards 'samples', the ECJ has confirmed that output VAT is not due provided that they fall within the criteria for treatment as a 'sample', or a number of 'samples', set out in its judgment, but the ECJ has left it to the national court to determine whether, on the facts in particular circumstances, the handing over of goods to a person outwith the business falls within those criteria.

The fundamental criteria for treatment of an item (or items, as the ECJ is clear that there is no limit to the number or value of samples which can be given to a single recipient, provided that each one satisfies these criteria) of goods as a 'sample' appear, from the ECJ's judgment, to be as follows:

- the item is either an example of a 'finished article' which the supplier intends to supply for consideration in the course of its business, or a component or specimen of the materials etc. from which the 'finished article' will be made; and
- the item enables the recipient to assess the product's characteristics and qualities with a view to:
 - acquiring further finished articles from the supplier for consideration with a view to consuming them for its own purposes;
 - acquiring further finished articles from the supplier for consideration for onward supply to others in the course of its business; or
 - using its ability to influence others to acquire further finished articles for consideration:
 - directly from the supplier; or
 - from the recipient of the sample; or
 - from other businesses which the recipient has, through its use of the sample(s), encouraged to promote the supplier's product.

It remains to be seen how the First Tier Tribunal will interpret the ECJ's judgment.

Retrospection

Businesses which have accounted for output VAT on 'samples' as defined by the ECJ, or on the value of gifts aggregated per recipient employer rather than per employee, should **WE HOPE YOU FIND THIS NEWS ARTICLE HELPFUL. IF YOU WOULD LIKE TO REGISTER TO RECEIVE FUTURE UPDATES BY EMAIL THEN PLEASE SEND A REQUEST TO**

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submit claims for overpaid VAT, and those which have submitted such claims already should now press for payment of those claims with interest.

If you would like to discuss the implications of this judgment in more detail, please contact 4 Eyes Ltd.

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