



On 7 June 2018 the Advocate General of the European Court of Justice delivered her Opinion in the case of MEO - Serviços de Comunicações e Multimédia (MEO) (Case C-295/17), with regards to whether the payment of an amount agreed beforehand in the case of early termination of a contract containing an obligation to be bound by a defined term (tie-in period) is subject to VAT.

### **1. Facts of the Case**

MEO is a legal entity involved in the construction, connection, management and exploitation of telecommunication networks and infrastructure and provision of telecommunication services to its customers. MEO offered its customers agreements of a minimum duration for a defined term (tie-in period). During this period, the customer paid a monthly fee for MEO's services. In case MEO cancelled the agreement before its termination (e.g. due to customer's failure to pay), the customer was required to pay an amount as compensation equal to the monthly fee multiplied by the number of monthly payments that were still to be made before the end of the tie-in period, even if the customer stopped receiving MEO's services.

While MEO charged VAT on its services, i.e. on the monthly fees for which it supplied services to its customers with its services, it did not charge VAT on the amount of the compensation. The Portuguese Tax Authorities disagreed with the treatment of the compensation and imposed a VAT assessment.

### **2. Questions referred to the ECJ**

As a result of the above disagreement, the questions referred to the ECJ related as to whether the payment of an amount considered as a compensation agreed beforehand in the case of early termination of a defined term (tie-in period) contract, for reasons attributable to the customer, constitutes a supply of services or just a mere financial compensation not subject to VAT.

### **3. Opinion of the Advocate General**

The Advocate General clarified that a supply of services for consideration exists when there is a legal relationship of reciprocal performance between the parties, for instance a supply of services for a payment where there is a direct link between these two elements, and the price paid is the actual service value. Hence, payments received without a supply in return or payments aiming to compensate for financial loss, are out of the scope of VAT.

The AG concluded that:

- i. The payment of an amount agreed upon beforehand in the case of early termination of a contract is subject to VAT when that payment is to be regarded as a consideration for the already supplied services and is not limited to the mere compensation for incurred damage.
- ii. The fact that intermediaries receive a higher amount of remuneration for contracts agreed upon for a minimum duration than those contracts without, and the fact that the relevant consideration amount is to be regarded as a contractual fine according to national law, do not affect the above interpretation.

#### **4. Significance of the case**

It will be interesting to see if the ECJ will follow the Advocate General's reasoning and proposals. We will be monitoring the developments and will be updating our newsletter when the decision of the Court is delivered.

#### **5. Way forward : how PwC can help you**

The dedicated team of VAT professionals at PwC is ready to discuss with you the above developments and how they may affect your business.

#### **Your contacts for Indirect Tax matters in PwC Cyprus**

***Theo Parperis***

Head of Tax and Legal - theo.parperis@pwc.com

***Chrysilios Pelekanos***

In charge of Indirect Tax Advisory - chrysilios.pelekanos@pwc.com

***Varnavas Nicolaou***

Partner, Indirect Tax Advisory - varnavas.nicolaou@pwc.com

***Martha Lambrou***

Director, Indirect Tax Advisory - martha.lambrou@pwc.com

***Michael Michael***

Director, Indirect Tax Advisory - michael.michael@pwc.com

PricewaterhouseCoopers Limited

PwC Central

43 Demostheni Severi Avenue

CY-1080 Nicosia

Cyprus

Tel. +357 - 22 555 000

**[www.pwc.com.cy](http://www.pwc.com.cy)**