

CJEU in *KPC Herning*: The Supply of Land with a Building to Be Demolished Is not Necessarily a VAT Taxable Supply of Building Land

Stijn Vastmans*

On 4 September 2019, the Court of Justice of the European Union delivered an interesting judgment on a real estate transaction relating to the sale of land together with a building for which the parties had the intention of demolishing the building to make room for a new building. (DK: CJEU 4 September 2019, Case C-71/18, KPC Herning, ECLI:EU:C:2019:660.) Although this judgment is based on the specific facts of the case, the Court has provided some interesting guidance on the concept 'building land' and, more generally, the distinction between multiple or single supplies for Value Added Tax purposes.

Keywords: VAT and real estate transactions, Single and multiple supplies, VAT exemption for transfer of land and existing building, VAT taxable supply of building land, Parties' intention, Demolition and reconstruction, Case KPC Herning, Case Don Bosco Onroerend Goed

I FACTS

KPC Herning, a Danish property development and construction company, and Boligforeningen Kristandsdal, a low-rent housing body, decided to design a project for the creation of youth housing on land belonging to Odense Havn (the port of Odense, Denmark).

In autumn 2013, KPC Herning purchased, from the port, the land with an existing and fully operational warehouse. The sales contract was subject to the condition that KPC Herning was to conclude a contract with a low-renting housing body for the construction of youth housing on the land.

In December 2013, KPC Herning sold the land with the warehouse to Boligforeningen Kristandsdal. Based on the different contracts between the parties, Boligforeningen Kristandsdal took the obligation to partially demolish the existing warehouse, at its own expense and risk. KPC was required to supply a fully completed building for residential use on the land.

KPC Herning asked the National Tax Board in Denmark whether the sale of the land and the warehouse by the port and the resale of the same property to Boligforeningen Kristandsdal were exempt from VAT. KPC Herning took the view that both sales transactions should be classified as VAT exempt supplies of land occupied by an old building. The National Tax Board replied in the negative. During the subsequent

proceedings before Danish Courts, the Danish tax authorities argued that both sales qualified as VAT taxable supplies of building land.

Finally, the High Court of Western Denmark decided to refer the following question to the Court of Justice of the European Union (CJEU):

Is it compatible with Article 135(1)(j), and Articles 12(1)(a) and (2), on the one hand, and with Article 135(1)(k), and Articles 12(1)(b) and (3), on the other, of {Directive 2006/112} for a Member State, in circumstances such as those in the main proceedings, to consider a supply of land on which, at the time of supply, there is a building as a sale of building land subject to {VAT}, when it is the parties' intention that the building is to be wholly or partly demolished in order to make room for a new building?

2 THE COURT OF JUSTICE'S DECISION

The CJEU narrowed the question to the discussion of the issue whether the various transactions should be classified as independent of each other or as a single transaction composed of several indivisibly linked services. The Court summarized its established case law on single and multiple supplies stating that all the circumstances of a transaction should be taken into account, including the parties' intentions, provided that this is supported by objective evidence.

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* Partner Tiberghien, head of VAT, customs and excise department; www.tiberghien.com. Email: stijn.vastmans@tiberghien.com.

Referring to the *Don Bosco Onroerend Goed* decision,¹ the Court referred to the following decisive elements: the state of advancement of the demolition or transformation works carried out by the vendor at the date of supply, the use of the immovable property on the same date and the undertaking by the vendor to carry out demolition work in order to enable future construction.

The CJEU also referred to an old decision in *Kerrutt*² in which it had been decided that transactions relating to land and supplies of property and services under legally distinct agreements and carried out by different contractors, despite economic links, should not be classified as a single transaction for VAT purposes.

According to the CJEU, the first sale should be classified as a VAT exempt supply of a former building as this sale was distinct and independent from the subsequent transaction. The mere fact that this sale was subject to the condition to conclude a contract with a low-rent housing body for constructing social housing units, could not bind the various transactions in a way that they may be regarded as a single, indivisible economic service.

Regarding the second sale, the Court emphasized that at the time of supply the warehouse could still be used. Furthermore, KPC Herning was not involved in the partial demolition of the warehouse. Also, the single fact that KPC Herning was responsible for the construction of the new building, while retaining certain existing elements, did not trigger a single indivisible economic service for VAT purposes.

When it came to the classification as a VAT taxable supply of building land, the Court considered that a distinction should be made between old and new buildings, the sale of an old building not being subject to VAT. The *ratio legis* for this distinction was the relative lack of added value generated by the sale of an old building. In this case, neither the first nor the second sale appeared to have increased the economic value of the property.

Furthermore, the referred sale of the fully operational warehouse could not be qualified as the sale of building land, solely on the basis of the parties' intention in the sale contract. This would undermine the principles of the VAT Directive and would likely make the VAT exemption for supply of old buildings meaningless.

Finally, the Court repeated that the circumstances in this case were different than the facts in another EU ruling (*Don Bosco Onroerend Goed*³), in particular the state of advancement of the demolition or transformation works carried out by the vendor at the date of supply, the use of the immovable property on the same date and the

undertaking by the vendor to carry out demolition work in order to enable future construction.

The Court concluded that the supply of land supporting a building at the date of supply could not be classified as a supply of building land where that transaction was economically independent of other services and did not form a single transaction, even if the parties' intention was that the building should be wholly or partly demolished to make room for a new building.

3 CONSIDERATIONS

The practical impact of this judgment on the concept of building land will be different in each Member State as the VAT rules on real estate transactions differ between the Member States. In Belgium, for example, the sale of building land is, for the moment, still a VAT exempt transaction, which could lead to the conclusion that the impact of this judgment would be limited in Belgium.

However, this Court ruling could have a broader impact as the Court has given more clarification on the distinction between single and multiple supplies. This discussion has already been subject to various Court decisions. The Court repeated the principles as applied in previous case law, which can be summarized as follows:

- A supply must be regarded as a single supply in which two or more elements or acts supplied by the taxable person are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split
- That is also the case where one or more supplies constitute a principal supply and the other supply or supplies constitute one or more ancillary supplies that share the tax treatment of the principal supply. In particular, a supply must be regarded as ancillary to a principal supply if it does not constitute, for customers, an end in itself but a means of better enjoying the principal service supplied.
- To determine whether the services supplied constitute independent services or a single service, it is necessary to examine the characteristic elements of the transaction concerned.
- In the course of an overall assessment of the circumstances of a transaction, the declared intention of the parties concerning the VAT liability of a transaction must be taken into consideration, provided that it is supported by objective evidence.

It must be said that these principles, as they are linked to the factual circumstances, are often hard to apply in

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¹ NL: CJEU 19 Nov. 2009, Case C-461/08, *Don Bosco Onroerend Goed*, ECLI:EU:C:2009:722.

² DE: CJEU 8 July 1986, Case C-73/85, *Kerrutt v. Finanzamt Mönchengladbach-Mitte*, ECLI:EU:C:1986:295.

³ *Don Bosco Onroerend Goed* (C-461/08), *supra* n. 1.

practice. This could also lead to, at first sight, contradictory decisions. For example, the supply of a (VAT exempt) immovable lease together with an ancillary services transaction has been treated in one decision as separate supplies for VAT purposes (the CJEU ruling in *Tellmer Property*,⁴ on cleaning services and immovable lease) and in another decision as a single supply (the CJEU ruling in *Field Fisher*,⁵ on immovable lease together with the supply of water, heating, etc.).

Although the decision in the *KPC Herning* case is linked to the specific facts, a general principle has clearly been stated by the Court. The intention of the parties involved in a transaction can be an element for determining whether a transaction covers a single supply or multiple supplies but this intention 'as such' is not decisive. The parties' intention alone cannot determine if a transaction for VAT consists of a single or multiple supplies. This should be supported by objective elements.

The latter does not mean that 'subjective' or intentional elements are no longer relevant or decisive. For example, when it comes to ancillary services, the Court always refers to the question whether these ancillary services do not constitute an end in itself for customers but a means of better enjoying the principal service supplied. In practice, this is a distinction that is not easy to decide referring to 'objective' elements but often concerns a subjective assessment (see for example the judgment in *BGZ leasing*,⁶ on leasing services supplied together with insurance for the leased item).

In the *KPC Herning* case, the Court has concluded that the supply of land (both in the first supply and in the second supply) should be classified as a VAT exempt supply of an old building, regardless of the parties' intention to demolish and rebuild new social housing units by referring to the following objective elements:

- At the moment of the transaction, the existing building (warehouse) was still operational and could be used for economic activities.
- The demolition of the building was an obligation of the final purchaser. For this purpose, the final purchaser needed to instruct, at its own expense and risk, a third-party undertaking. The demolition was therefore independent of the supply of the existing building.
- The mere fact that KPC Herning had the obligation to construct social housing units after the demolition of the existing building did not alter the conclusion. The construction of the new dwellings was, again,

independent from the supply of the land and existing building.

- It appeared that the first and second sale of the property did not increase the overall economic value.

These factual elements, as the Court has explained, distinguish this case from the previous decision in *Don Bosco Onroerend Goed*⁷ in which the sale of land with a building to be demolished was qualified as a VAT taxable supply of building land. In *Don Bosco*, the vendor was responsible for the demolition of the building, the demolition had already begun and the cost of the demolition had been borne (partially) by the purchaser, which made it clear for the Court that this was a single VAT taxable supply of building land.

This distinction gives some interesting elements for further consideration. By structuring real estate transactions and dividing obligations/liabilities between the seller and purchaser, it could be possible to alter the VAT classification of the transaction. By making the purchaser of an existing building responsible for the demolition, the transfer should not qualify as the VAT taxable supply of building land, even if the supplier would be responsible for the construction of a new building on the same land after the demolition. Of course, contracts should always correspond with the facts and economic reality and it should be clear that there is no 'artificial' split of transactions (see CJEU in *Part Services*⁸).

Another consideration in the judgment that could, in our view, raise new questions is the economic value criterion, although it is only one objective element taken into consideration by the court. In real estate transactions, the economic values of land with existing buildings are often multiplied, even though the vendor does not undertake any obligation regarding the demolition of an existing building and/or construction of a new building (e.g. if the vendor only has obtained building permits for realizing a future project). In such a scenario not only an existing building is transferred but a future building project. If so, could this alter the VAT classification of the sale?

Finally, the referring Danish court, unfortunately, did not ask a question about the scenario as argued by the EU Commission. Regarding the second supply, the EU Commission took the position that this should have been classified as a VAT taxable supply of a new building and the land on which it stood, as KPC Herning was responsible for the construction of the new social housings. While the Court did not analyse this scenario, as it

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⁴ CZ: CJEU 11 June 2009, Case C-572/07, *RLRE Tellmer Property*, ECLI:EU:C:2009:365.

⁵ UK: CJEU 27 Sept. 2012, Case C-392/11, *Field Fisher Waterhouse*, ECLI:EU:C:2012:597.

⁶ PL: CJEU 17 Jan. 2013, Case C-224/11, *BGŻ Leasing*, ECLI:EU:C:2013:15.

⁷ *Don Bosco Onroerend Goed* (C-461/08), *supra* n. 1.

⁸ IT: CJEU 21 Feb. 2008, Case C-425/06, *Part Service*, ECLI:EU:C:2008:108.

was not asked to, Advocate-General Bobek did make some interesting considerations in his Opinion. He takes the view that this was not a single supply of a new building based on the following elements:

- KPC Herning was merely identified as a ‘contractor’ for the design and conversion into housing units.
- KPC Herning could not begin any construction work before the demolition that was organized by Boligforeningen Kristiansdal, the latter being fully liable for the demolition works. This would indicate that before the housing units were built, Boligforeningen Kristiansdal acted as owner of the property.
- The property did not undergo any works that increased the value before the resale.

Again, these considerations could have an important impact for real estate transactions and VAT. If we follow the Advocate General’s view, there should be two separate supplies by KPC Herning: a VAT exempt supply of an existing building with the land on which it stands and a supply of VAT taxable construction services. The classification as construction services could significantly alter the

VAT treatment as such a service could be subject to a local reverse charge rule for construction work and/or could potentially be subject to reduced rates that do not apply for the supply of a new building or building land.

More specifically, this raises questions regarding the VAT treatment of a supply of a building in a future state. Should such a transaction classify as a VAT taxable supply of a new building, if the vendor transfers an existing building with land and the vendor is fully responsible for a substantive renovation, resulting in a new building on the same land? If it would be clear that the purchaser is partly responsible for some of the demolition or construction work of the existing building, then would this mean that there is no longer a supply of a new building? What if the purchaser already acts as the ‘owner’ prior to the start of the renovation works? This could mean that the transfer of the existing building and land is a VAT exempt transaction, while the reconstruction is a VAT taxable construction service that could follow a different VAT treatment than the VAT taxable supply of a new building.

This is all ‘food for thought’ and, without doubt, a discussion to be continued in future case law.