

# Barter transactions

**Giles Salmond, Kunal Nathwani and Ed Griffiths** discuss the Court of Justice of the EU's decision in *A Oy* on contracts that contain an element of barter.

**U**nder EU law – as implemented in the EU states including the UK – the taxable amount of a supply of goods or services includes everything that constitutes consideration obtained or to be obtained by the supplier in return for the supply. What constitutes the consideration for VAT purposes was a key question considered by the Court of Justice of the EU in a reference for a preliminary ruling by the Finnish Supreme Administrative Court in *A Oy* (C-410/17). The case concerned the interpretation of the common European VAT system in respect of supplies of services in exchange for reciprocal supplies of goods.

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## Background

*A Oy* is a company that provides environmental services in the construction and real estate sectors. Some of its activities, particularly relevant to the current judgment, include the performance of demolition services for clients pursuant to demolition contracts and the purchase and subsequent dismantling of old machinery and equipment from clients under dismantling contracts.

The obligations under a demolition contract included the demolition of a client's buildings and the proper disposal and processing of the materials obtained from that demolition. However, part of the waste being disposed of contained scrap metals. It was understood that usually *A Oy* would resell the



scrap metals. So, when quoting its price for the demolition contract – the service subject to VAT – it would factor in the resell value of this scrap metal and correspondingly quote a lower price for the demolition services to maintain competitiveness. The price was a single figure and the client was unaware that the potential resale value of the scrap had been factored in.

The obligations under a dismantling contract included the purchase of the client's old machinery and equipment and the subsequent dismantling and removal of this machinery and equipment from the client's premises within a specified period. This required *A Oy* to incur its own costs which it factored into the proposed purchase price for the machinery and equipment from the client. Similar to the demolition contracts, *A Oy* also factored into the price the value of the goods which it acquired, so as to reduce the purchase price of the goods to be dismantled. This reduction in price was not discussed with the client. The client was presented with a single purchase price for the goods, unaware of how *A Oy* had calculated it.

The main questions referred to the CJEU were:

- **Demolition contract.** When a demolition company supplies a client with demolition services, but also receives materials – here scrap metals – which it may then sell to third-party purchasers, for VAT purposes, was there a single transaction of a supply of demolition services from the demolition company to the client? Or were there two transactions, namely a supply of demolition services from the demolition company to the client and a supply of materials from the client to the demolition company? Further, was it relevant when fixing the price that the demolition company took into account as a factor for discounting the price that it is possible to generate revenues by making use of demolition waste?
- **Dismantling contract.** When a demolition company concludes a contract with a client to buy an object(s) and then to dismantle and dispose of that object (subject to contractual penalties for failure to do so), for VAT purposes, was there a single transaction of a supply of goods – the machinery or

## Key points

- Interpretation of the European VAT system in respect of supplies of services in exchange for reciprocal supplies of goods.
- Contracts factoring in the resell value of scrap metal or other equipment.
- Consideration is the sum paid for the service provided plus the value of any discount.
- The decision in *A Oy* could produce a hidden VAT charge.

equipment – from the client to the demolition company or were there instead two transactions, namely a supply of goods and the supply of services from the demolition company to the client to dismantle and dispose of the object? Further, was it relevant when fixing the price for the goods that the demolition company took into account as a factor for discounting the proposed purchase price for the goods, the cost of the service of dismantling and disposing of the goods to be incurred by the demolition company?

### Demolition contract

In relation to the demolition contract, the CJEU decided there were two transactions:

- a supply of services from the demolition company to the client; and
- a supply of goods – the scrap metals – from the client to the demolition company.

So there are two potentially taxable transactions, although whether VAT was payable is subject to whether the client is a taxable person.

The second issue was the consideration for the service provided by the demolition company, and on what amount VAT was payable. The court found this consideration was equal to the monetary sum actually paid by the client for the service plus the value attributed by the service provider to the scrap metal, which was reflected in the reduction of the price charged for the demolition services.

This is best illustrated by an example. Let's assume a demolition company (A) provides a demolition service to client

(C). The normal cost for the demolition service provided by A is £2,000. However, the resale value of the scrap metal recovered during the demolition is £1,000. So, A instead provides the demolition service to C for £1,000 – at a £1,000 discount. VAT would be payable on £2,000 being £1,000 for the demolition service price and £1,000 for the value attributed to the scrap metal as reflected in the discounted service price.

### Dismantling contract

The CJEU adopted a similar approach in its decision on the dismantling contract. There were two transactions:

- a supply of goods – the machinery or equipment – from the client to the demolition company; and
- a supply of services – dismantling and disposal – from the demolition company to the client.

Both elements were taxable independently as with the demolition contract.

Similarly, the consideration under the dismantling contract was comprised of both cash and the costs of the dismantling and disposal services which were used to reduce the purchase price.

### Implications

The tax impact of this decision is significant, especially for businesses in the construction, infrastructure and similar industries. More importantly, in the UK, under existing law, the effect may not be limited to just one party in the transaction, that is the supplier of certain services or seller of certain goods, but could create a VAT liability for both parties

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to a transaction, which may not have been apparent until this decision.

The effect is that the decision could impose a hidden VAT charge that may not have been anticipated. Taxpayers should therefore be cautious in relation to such barter transactions. Parties should, before entering into such contracts, consider whether the contract price may have been reduced due to such arrangements and, if so, whether these are taxable.

It should be noted that, this analysis is not altered by the fact that the client – as recipient of the services – may not know the various elements factored into arriving at the final price charged by the service provider. Depending on the individual fact pattern and contractual terms, the recipient (C) may still need to account for VAT on any goods or services provided to A as part consideration for the services it receives from A.

“The effect is that the decision could impose a hidden VAT charge that may not have been anticipated.”

In such circumstances, C, as the recipient of the service, may have to account for VAT on its supply of goods to A, based upon the value attributed by A to the goods it obtains from C. This is so, even if the value attributed to the relevant barter good or service is difficult for C to ascertain. So, from a practical perspective, both parties should be clear as to what is being supplied under a relevant contract and should ascertain whether there are any goods or services to which the other party has attributed value to arrive at the final price.

An important point is that the courts will wish to ensure that there is no abuse of this principle and that the value attributed to any supply should reflect the economic and commercial reality. This is a key tenet of the VAT system, which was highlighted by the CJEU in this case.

As mentioned, there are two potential taxable supplies in such situations – a supply of the service and the supply of any goods.

It is also noteworthy that EU law provides an option for member states to elect to implement a reverse charge mechanism in respect of the supply of construction work, including repair, cleaning, maintenance, alteration and demolition services in relation to immovable property, and the supply of used material that cannot be re-used in the same state, scrap, industrial and non-industrial waste, recyclable waste, and part-processed waste, such that if these elections are made, the customer is the taxable person – an exception to the normal rule.

Finland had correspondingly opted to implement such a reverse charge mechanism for purchases of scrap metal and waste. Conversely, the UK has not made such

elections so the liability to account for VAT to HMRC would fall on the client which, as mentioned, may be an unanticipated consequence. Advisers to clients in a similar situation to that described above, should consider the VAT consequences.

Practical examples of what may be caught by this decision are:

- in the context of a brownfield project, when several contractors are engaged such as demolition, construction and environmental companies, and they are removing materials as a by-product of their work, or the engaging company is paying them to take down materials, which often may be scrap metal or other waste, and the price at which the service has been provided takes account of the resale value of the materials collected;
- a roofer engaged to repair a roof and replace tiles or leading at a company's premises who reduces the price of the roofing service due to the sell-on value of the materials they obtain from the old roof, even if the customer is unaware of any potential resale, although whether VAT will be payable by the customer will depend on whether the customer is a taxable person; or
- a plumber engaged to replace a heating system which results in the removal of old copper piping and the resale value of the copper piping is factored into the price – the same consideration as that for the roofer would also apply here.

This decision highlights a little known issue for VAT and is particularly relevant for those operating in the construction, infrastructure and real estate. Contracts old and new should be reviewed to ensure that there are no VAT surprises, if barter could be a factor. ●

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#### Planning point

Clients should, before entering into contracts for, say construction work, consider whether the price may have been reduced to take into account barter arrangements and, if so, whether these are taxable.

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