MONCKTON CHAMBERS

Royal Bank of Scotland (Case C-488/07)

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Introduction

The Court of Justice (ECJ) has recently had to deal with three references on a novel question, which is remarkable for not having been asked before: how to round amounts of VAT which contain a fraction of the lowest unit of national currency?

The decision in *Ahold*

In the first case, *Ahold (Case C-484/06)* (judgment of 10 July 2008), the ECJ had to deal with rounding of output tax. The issue was whether a supermarket was entitled consistently to round down the VAT charged on each item sold to its customers at VAT inclusive sale prices or whether those amounts should be arithmetically rounded up and down to the nearest whole unit of national currency.

So, for example, where an item was sold at a VAT inclusive price of 99 pence and the old VAT rate of 17.5% applied, the VAT element of the sale price was 14.74 pence. The issue was whether the taxpayer was permitted to account for 14 pence of VAT, on the basis that it would otherwise effectively be accounting for output tax at a higher rate than 17.5%; or whether it should round the 14.74 pence up to 15 pence and round down the VAT only where the relevant VAT amount included an amount below 0.5 pence.

The ECJ held in *Ahold* that it was a matter for the member states to determine the method and rules for rounding of output tax, provided that those methods complied with the general principles of fiscal neutrality and proportionality. Furthermore, the VAT Directives did not require member states to permit taxable persons to round down the output tax declared on each item sold.

The ECJ went on to reject a submission by the taxpayer in that case that member states were required to permit taxable persons consistently to round down output tax at item level. Instead, the

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ECJ stated that the principles of fiscal neutrality and proportionality did not require that any particular method of rounding be applied. Indeed, the ECJ observed that there were other methods of rounding which could satisfy those two principles. The ECJ also indicated that the method of rounding chosen should ensure that the rounded amount corresponded as closely as possible with the amount of VAT arising from application of the relevant rate of VAT in force, but that this also had to be reconciled with the practical need for effective operation of a system based on returns made by the taxable person.

JD Wetherspoon

In the second case, *JD Wetherspoon (Case C-302/07),* which also concerned rounding of output tax, the ECJ has since been asked to give guidance on the level at which Community law requires rounding to be applied: at the level of each individual item (eg each bottle of Stella Artois lager), each product line (eg all purchases of Stella Artois lager in the same sale), each supply (assuming that there is more than one standard rate or zero rated supply included in the same transaction/basket), each transaction/basket total, or each VAT accounting period.

The ECJ has not yet given judgment. In her Opinion of 20 November 2008, however, Advocate General Sharpston expressed the view that it was clear from the *Ahold* judgment that arithmetic rounding (rounding down amounts below 0.5 pence and rounding up amounts of 0.5 pence or more) met the requirements specified by the ECJ of fiscal neutrality, proportionality and effective operation of the VAT system. She also considered that rounding should take place at the latest possible stage which was consistent with the practical requirements of payment and accounting, so as to reduce distortions as much as possible between the exact proportion of the retail price which constitutes VAT and the amount of VAT declared by the trader to the tax authorities. In most cases, that meant rounding at the level of the periodic VAT return. Finally, AG Sharpston opined that the United Kingdom was allowed to differentiate between the methods of rounding permitted to be used by traders selling at VAT exclusive prices and those selling at VAT inclusive prices. It was permissible to require the latter to round arithmetically, while allowing the former consistently to round down, given the differences between those methods of setting prices.

The RBS case

By contrast, in the *RBS* case, the issue related to deduction of input tax and not accounting for output tax, as in *Ahold* and *JD Wetherspoon*. In particular, the question was one of partial exemption and concerned how much of RBS's input tax could be reclaimed in so far as that input tax was to be used for making both taxable and exempt supplies (residual input tax).

Under the standard method of partial exemption, the percentage of residual input tax which can be reclaimed is calculated by dividing the value of taxable supplies in the relevant period by the value of all supplies in that period. Pursuant to the second-subparagraph of Art 19(1) of the Sixth VAT Directive (now Art 175 of the 2006 VAT Directive), the percentage is then rounded up to the next whole unit (eg 19.23% is rounded up to 20%). A taxpayer may use the standard method without seeking the Commissioners' approval.

Article 17(5) of the Sixth VAT Directive (now Art 173 of the 2006 VAT Directive), however, allows member states to authorise taxpayers to use a number of different special methods of partial exemption. The issue referred to the ECJ by the Inner House of the Court of Session in *RBS* was whether the rounding up specified in relation to the standard method of partial exemption also applied to the special methods.

In 2002, RBS had negotiated a partial exemption special method with the Commissioners to deal with the attribution of its residual input tax. The agreement provided that, where the method applicable to a particular sector or part of a sector of RBS' business required recovery of input tax to be based on a calculated percentage, that percentage was to be rounded up – but only to two decimal places. RBS subsequently argued that the 2002 special method was invalid and that the

relevant partial exemption percentage should have been rounded up to the next whole percentage point, as would have been the case if the standard method had been used.

The ECJ rejected RBS's argument. It held that the special methods permitted by Art 17(5) do not lay down any specific rule as to which method member states must employ in order to round the deductible amount thus determined. Therefore, the rounding up rule specified in relation to the standard method in the second subparagraph of Art 19(1) of the Sixth VAT Directive does not apply where a particular type of case is subject to one of the special methods permitted by Art 17(5) of the same Directive. Indeed, the ECJ held that this analysis was confirmed by the purpose of the third subparagraph of Art 17(5), which was to permit member states to achieve greater accuracy in making partial exemption calculations by taking into account the specific characteristics of the taxable person's activities. Accordingly, member states had to be in a position to apply more accurate rounding up rules than the simplified rounding up rule provided for in the second sub-paragraph of Art 19(1).

Finally, the ECJ referred back to its earlier judgment in *Ahold* and held that member states were entitled to adopt their own rounding rules in relation to special methods of partial exemption, provided that those rules observed the principles of proportionality and fiscal neutrality.

Conclusion

The *RBS* case establishes that the principles regarding rounding of VAT established in *Ahold* apply generally to the VAT system as a whole and not just to the question of accounting for output tax. The case also reaffirms the discretion given to member states in choosing rounding systems. It will be interesting to see whether the upcoming judgment *JD Wetherspoon* confirms the Opinion of AG Sharpston in granting member states a very broad discretion in selecting different rounding systems for different types of trader.

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