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Payment for early contract termination is subject to VAT

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In a new judgment in Case [C-43/19 Vodafone Portugal](#), the Court of Justice of the EU ruled that the compensation claimed by the VAT payer from customers for non-compliance with the minimum commitment period is subject to VAT.

The Court has ruled similarly in previous judgments, for example in Case C-242/18 Unicredit Leasing or C-295/17 MEO. However, there was a certain difference in that customers were charged the full amount as compensation, but discounted to the present value that they would have had to pay had they used the service until the end. The Court argued that the applicants' economic situation had not changed and that they had not suffered any damage.

In the case of Vodafone, on the other hand, it was not the full amount that was charged, but only the amount of the costs incurred calculated according to the formula set out in the contract. The method of calculation was governed by national rules requiring that the amount be proportionate to the original advantage obtained by the customer. In addition, the Portuguese referring court stated that Vodafone had suffered damage as a result of the early withdrawal.

Nevertheless, even in this case, the Court stated that the compensation claimed was subject to VAT. According to the Court, it was irrelevant that Vodafone did not receive the same amount. Compensation must be considered as part of the price of the service already provided, which is retroactively included in the amount of monthly instalments, if the premature termination occurred for reasons that lay with the customer. By failing to comply with the minimum commitment period, the customer did not exercise the right to such an advantage.

In practice, we often see payments referred to, for example, as contractual penalties, damages or severance pay, to which VAT is not applied. The judgment again confirms that it is not possible to simply treat all sanctioning instruments as outside the VAT scope. It is necessary to assess each case individually. The supplier must properly set the contractual conditions in order to be able to bill the customer potential VAT due.

This issue affects not only telecommunications services, but also operational leasing and, in general, any long-term business relationships.

We will be happy to discuss the impact of this judgment on your company with you.



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