

# VAT Treatment of forfeited deposits and cancellation charges

## 1. Introduction

1.1. Following the ruling issued by the European Court of Justice (ECJ) in case C-277/05 Société thermale d'Eugenie-Les-Bains, Revenue has revised its VAT treatment of:

- (a) a deposit, received by a supplier in respect of an order or request for a taxable supply of goods or services, when it is forfeit following a customer cancellation and where the supply has not taken place, and
- (b) a cancellation charge levied by a supplier where an order or request for a supply is cancelled by the customer and the supply does not take place.

1.2. This Notice now advises of the change in Revenue policy and procedures which has been implemented by measures in the Finance Act 2008 amending the Value Added Tax Act 1972 (VAT Act) and outlines the treatment of repayment claims for prior years.

## 2. ECJ Ruling - Société thermale d'Eugenie-Les-Bains (STELB)

2.1. STELB provides hotel and restaurant facilities in France. It received deposits paid in advance by customers when reserving accommodation. Following an audit by the French tax authorities, the company was deemed liable for VAT in respect of the deposits which had been paid to it by customers and which it had retained following cancellation of the reservations. The case was appealed through the appeal system and was eventually referred to the ECJ for a preliminary ruling.

2.2. The ECJ ruled "a sum paid as a deposit, in the context of a contract relating to the supply of hotel services which is subject to value added tax, is to be regarded, where the client exercises the cancellation option available to him and that sum is retained by the hotelier, as a fixed cancellation charge paid as compensation for the loss suffered as a result of client default and which has no direct connection with the supply of any service for consideration and, as such, is not subject to that tax".

2.3. The Court observed that in situations where the performance of the contract follows its normal course and a taxable supply takes place, the deposit is applied towards the price of the services supplied and is therefore subject to VAT.

## 3. Effect of Ruling in Ireland

3.1. The ruling affects the VAT treatment of forfeited deposits, owing to a cancellation by the customer, not only in the hotel services sector but also in relation to the supply of other services and goods.

3.2. A charge levied by a supplier when a customer makes a cancellation ("cancellation charge") and a supply does not take place, is to be treated as falling outside the scope of VAT by virtue of it being regarded as compensation and not a payment in respect of a taxable supply.

## 4. Position in Ireland prior to ECJ ruling

4.1. Payment of a deposit is a prepayment for the supply of the goods or services to which it relates, and the supply of those goods or services for a consideration equal to the amount of the prepayment is deemed to have taken place. Where such supplies are taxable, tax is chargeable on the deposit under Article 65 of Directive 2006/112/EC (the VAT Directive) and section 19(2) of the Value Added Tax Act 1972, as amended.

4.2. Relief from VAT was not available in respect of a forfeited deposit.

## 5. Position in Ireland following the ECJ ruling

5.1. There is no change in the tax treatment of a deposit when it is paid. The payment is a prepayment made in advance of the supply to which it relates and taxed as set out in paragraph 4.1.

5.2. However, where the amount of a deposit paid to a supplier is retained owing to a cancellation by the customer and:

- a supply does not subsequently take place,
- the cancellation is recorded as such in the books and records of the supplier,
- the deposit is not refunded to the customer, and
- no other consideration, benefit or supply is provided to the customer by any person in lieu of that amount,

the supplier may reclaim any VAT already accounted for on such amount in the VAT return for the period in which the deposit is forfeit. Section 102 of the Finance Act 2008 inserted section 19(2B) in the VAT Act to clarify taxpayers' entitlements following the ECJ ruling. While the provision came into effect on 13 March 2008 (the date of passing of the Finance Act 2008) taxpayers are entitled to claim similar treatment for earlier years, subject to the 4 year time-limit for repayment claims

5.3. If a VAT invoice has issued in respect of the deposit retained by the supplier at 5.2 the consideration on the invoice is reduced to nil. The supplier should issue a document, to be treated as a credit note, containing particulars of the reduction. The deductible amount in respect of the transaction is, therefore, reduced to nil. The relevant legislative provisions are contained in sections 17(3B) and 17(9)(aa) of the VAT Act, as inserted by section 101(1)(d) and amended by section 101(1)(e), respectively, of the Finance Act 2008.

5.4. Where a supplier levies a charge on a customer in the event of the customer cancelling an order or request for a supply of goods or services and the supply does not take place, VAT is not due on the "cancellation charge" as set out in paragraph 3.2 above.

## 6. Claims for Refund of VAT paid on Forfeited Deposits/Cancellation Charges in prior years

6.1. Claims for a refund of VAT accounted for on forfeited deposits referred to in paragraph 1.1 in prior years should be submitted to your district tax office.

6.2. The normal statutory period of four years applies to receipt of refund claims in accordance with section 20 (Refund of tax) of the VAT Act.

6.3. Where a refundable amount is payable under this article, interest calculated from the tax period(s) to which the claim relates (the period in which the deposit was forfeit as in paragraph 5.2 or the cancellation charge was paid as in paragraph 5.4 above), up to the date of the refund payment, will be paid under the provisions of section 21A(2) (interest on refunds of tax) of the VAT Act.

## 7. Adjustment for Income/Corporation Tax

7.1. Taxpayers who had reduced their liability for income tax or corporation tax to take account of VAT paid on retained deposits will need to adjust their income tax/corporation tax liability for the relevant years/accounting periods arising from the repayment of any such VAT.

7.2. For ease of administration, rather than re-opening prior years of assessment/accounting periods to give effect to these adjustments, the amount of the VAT repayment plus interest (if any) to be claimed for the years in question should be reduced by the amount of the additional liability arising to Income Tax or Corporation Tax.

## 8. Information to accompany claims

Claimants should:

- (a) submit evidence of the terms on which deposits were paid and retained, and
- (b) certify that such deposits were not applied to any other taxable supply.

## 9. Queries

Queries about this Notice should be addressed to your local Revenue District.

## 10. Application

This notice comes into operation with immediate effect.