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How to deal with VAT and Taxes in FP6 Projects

Identifiable taxes that go to Central government like VAT are classed as being non-eligible to FP6 Projects.

"Non-eligible costs are[1]:
Article II.19.2. "The following non- eligible costs may not be charged to the project:
a) any identifiable indirect taxes, including VAT or duties;
b) .....i).....
II.19.1.[definition of eligible costs]*"*

Two important points to note:

1. To be non-eligible the tax must be identifiable (on the invoice/receipt/document).
2. Even if the VAT or other taxes cannot be recovered (e.g. against "output taxes" for VAT) because of State law, non-registration of the organisation for VAT (e.g. non-profit organisations and in some States Higher education establishments), or the tax is a duty or purchase tax etc. that cannot be offset against other taxes, indirect they remain a non eligible cost.

1. To be non-eligible the tax must be identifiable

Not all taxes can be easily identified e.g. VAT on taxi fares, airport taxes not shown on invoices from travel agents, VAT on some hotel invoices (even where the rates of tax are stated - often multiple rates -but not the actual figures are not shown), excise duties on fuel, purchase taxes (we believe that the Commission requires States to phase these out but some States may still have them) etc. Where the amount of tax is not clearly stated it will, by default, be an eligible cost.

Under the text of the FP6 model contract 'any **identifiable** indirect taxes, including VAT or duties' are non-eligible costs. The EU's first approach is to see if the tax is identifiable. If the tax is not identifiable it will be eligible. However, auditors of the External Audits Unit in their audit practice are not in particular examining cost claims or invoices (e.g. airplane tickets) with the specific aim of 'finding' the 'tax' element. Nonetheless, if the indirect tax is identified, it is generally disallowed.

If the tax is identifiable, then the nature of this 'tax' has to be examined and as an example of the EU's view project partners have been informed that:

"In general, airport taxes are not real taxes in the sense of tax law but a fee for a service delivered by public or semi public body in charge of a (public) service, such as airports. The fact that some airports might have a private legal form is not relevant to this analysis. Therefore, although many airport "taxes" imposed by these authorities may be considered a fee and therefore eligible because not a duty or indirect tax, it is also possible that a particular airport 'tax' may well be considered to be a 'duty' applied to the cost of the airline ticket in which case it would be non eligible.
For the reasons above, the External Audits Unit cannot confirm ..(that) …. these charges [airport taxes] as legitimate costs on an EU project". As mentioned above, 'airport taxes' will be allowed when not identifiable. Where they are identifiable, they will be disallowed if they can be considered as ' duties' in the sense of Article II.19.2. a of the FP6 model contract."

Thus even where the "tax" is identifiable, its nature must be considered. It is for this reason that most municipality taxes are considered a cost of providing services (garbage collection, roads and pavements, local services etc) are usually considered an eligible expense.

Taxes on fuel and imports purchased from an importer (but not where project partner makes own import, and therefore the import duties and perhaps excise taxes will appear on invoices and/or import documents) cannot be easily quantified or identified and therefore will be considered an eligible cost.

[1] [based on principles established by the second paragraph of Article 109 of the FR56, the first paragraph of Article 165 of the IM57, indent (d) of the second paragraph of Article 14 of RP58, and the second paragraph of Article II.19 of Annex II (General conditions) to the FP6 model Contract]

But note that, if the partner's normal accounting procedures do quantify the amount of the taxes and the figure is shown separately in the books of account (even if only as a separate line or as a note in the account where the cost is recorded) the cost is not eligible – because it is now identifiable!

As unfair as it seems, even where the organisation cannot recover the VAT (or for that matter any other tax levied in their own or another State), the tax is not an eligible cost.

VAT is frequently quoted as "the" example of unrecoverable taxes within EU funding, because organisations not registered for VAT cannot recover it but it is still a non eligible cost. However, it should be noted that the definition of "indirect taxes" is not restricted to taxes within the EU and even where a tax can be identified on an invoice from another non-EU State it is not an eligible cost. Thus VAT and other identifiable indirect taxes applied in non-EU States cannot be considered eligible costs. As an extreme example, to demonstrate the point, US sales tax shown on an invoice should be considered an ineligible cost.

2. Even if the VAT or other taxes cannot be recovered, if the indirect tax is identified it is still ineligible.

Commercial organisations are normally "registered" with the authorities for VAT and are able to offset VAT "input" taxes paid on purchases in their own Country against VAT "output" taxes they remit to their government. Indeed, they can also reclaim from another EU State VAT "input" taxes paid there (usually subject to about a 25 Euro charge and claims being accepted only annually – unless they are above certain figures – and sometimes VAT on meals and hotel bills cannot be reclaimed). So, in general, VAT on purchases etc are not part of the organisation's costs/expenses, since they are effectively only acting as a "collection" agent for the government in respect of the VAT on ithe organisation's sales/income.

Not so non-profit organisations (often including institutions of higher education, but not always – in some States university etc. fees are subject to output taxes and, therefore, such organisations in those States can recover their "input" taxes on costs). Again, as unfair as it seems, even where the organisation cannot recover the VAT etc., the indirect tax is not an eligible cost and must be funded from the organisations own resources and not included in eligible costs in the form C.

Final note:
The definition of non eligible costs is "*any identifiable **indirect taxes**, including VAT or duties"* and therefore do not seem to include some "direct taxes", except in so far as they are an expense not directly related to the project (e.g. taxes on profits). It is well known that National Insurance (Social Security) payments, pension contributions, severance pay funding from monthly salary, etc are all eligible personnel costs. Likewise deductions of all forms taken from the gross salary of each employee are also eligible, because the employer is merely acting as a collection agent and is really liable to pay the gross amount to the employee. From the EU definitions it seems also that payroll taxes levied by central government on salaries is also an eligible cots, because it is incurred for the purpose of the project, is not a tax on income or profit and is not an indirect tax.

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