

## Tax Alert

# ECJ rules on VAT treatment of product samples



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**In an important decision issued on 30 September 2010, the European Court of Justice (ECJ) clarified the definition of free product samples and small value gifts.**

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"Member States have a certain amount of discretion in defining what constitutes a "sample" and "gifts of small value"

The case involved EMI, a company engaged in the production and distribution of recorded music and music publishing. To promote new recordings, EMI distributes free copies of the music on vinyl records, cassette tapes and CDs to persons who are able to assess the marketability of the recordings and influence the level of exposure of the recording artist. Sample copies are distributed to individuals working in the press, television, radio stations, advertising agencies, retail outlets and cinemas, as well as to "pluggers," i.e. individuals who are in a position to promote the recordings in the media.

The question in the main proceedings was whether EMI was required to account for VAT on the free copies of the music.

Under the EU VAT Directive, no tax liability arises on product samples and gifts of small value. EU Member States have a certain amount of discretion in defining what constitutes a "sample" and "gifts of small value."

## Product samples

In ruling that product samples are not subject to VAT, the ECJ clarified the definition of a sample as an item that is intended to promote the sale of a product to allow the characteristics and qualities of the product to be assessed by the potential or actual buyer. Therefore, samples must possess all basic characteristics of the final product.

Specifically, the ECJ attributes characteristics to a product sample: a (1) specimen product that (2) is aimed at the promotion of that product and (3) allows the characteristics and quality of the product to be assessed (4) without such final consumption which is different from that involved in promotional transactions. The general restriction of this concept (e.g. to a form not ordinarily available to the public or to the first one of a number of identical samples provided to the same buyer) without considering the nature of the product and the specific commercial background of the transaction is inconsistent with the purpose of samples as formulated in the Directive.

To prevent abuse of product samples, the ECJ said that Member States can impose regulations, such as mandatory labelling or applying contractual clauses concerning civil liability. The Court also acknowledged that it may be necessary for an entity to distribute a number of samples to the same recipient.

When comparing the above definition of product samples to the definition in the VAT Act and that used in Hungarian practice, it is questionable whether Hungarian rules and practice meet the requirements, since according to the ECJ, a product sample (1) can also be provided in forms, units and types of packaging ordinarily available to the public, and (2) can be provided to individuals other than final consumers.

### **Gifts of small value**

With respect to the treatment of gifts of small value, the ECJ held that Member States are free to set a monetary ceiling for gifts under domestic law. However, the ECJ noted that Member State rules that treat gifts provided to different individuals having the same employer as gifts provided to the same person are inconsistent with the purpose of the Directive. This is because the ECJ decision provides that whether a gift qualifies as a gift of small value is to be determined by the identity of the targeted final recipient; this will not be affected by the work relationship between the recipient and his/her employer or the fact that multiple recipients have the same employer.

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