

Impact of VAT regimes on organisation of producers' operations under CAP financial instruments for the fruit and vegetable sector

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Abstract

This work investigates the repercussions of VAT neutrality of the «operational funds». At this moment, this is one of the most important financial sources for the fruit and vegetables sector in the European Union, and specifically in Spain. The operational funds, financed fifty-fifty by the organizations' partners and by the community budget, have been regulated by the Community Agricultural Policies and are, therefore, not covered in the Spanish mercantile and tax regulations. Through this analysis, we have concluded that «reserve» is the most appropriate alternative for account identification of the partner's contribution to these funds. Also, we have built the models that allow for quantification of indirect taxes. These models, if the reserve option is chosen, lead to VAT neutrality for the organizations, thus avoiding extra charges for the partner.

Key words: European Community financing, accounting, reserves, operational fund, neutrality, indirect tax.

Resumen

El impacto en el IVA de las operaciones de las organizaciones de productores, derivado de los instrumentos financieros de la PAC para el sector de frutas y hortalizas

En el presente trabajo se investigan las repercusiones en la neutralidad del IVA de una de las más importantes fuentes de financiación con que actualmente cuenta el sector hortofrutícola en la Unión Europea y específicamente en España, los fondos operativos. Este recurso, financiado a partes iguales por los socios de las organizaciones de productores y por el presupuesto comunitario, ha sido regulado en el marco de la Política Agraria Comunitaria, por lo que no es tratado en el ordenamiento mercantil y fiscal español. Así, hemos desarrollado los modelos que permiten cuantificar la imposición indirecta, considerando las distintas opciones en la identificación contable de la contribución del socio a estos fondos. Se concluye que la opción de reservas es la única con la que se consigue la neutralidad en el IVA para la organización, y se evitan cargas adicionales en el socio.

Palabras clave: financiación comunitaria, contabilidad, reservas, fondos operativos, neutralidad, impuestos indirectos.

Introduction

After Spain entered what was then known as the European Economic Community, now the European Union (EU), our Spanish legal system changed to include all community regulations. This is what we call the common heritage. In the case of the Council Regulations, which apply directly to the member states, a series of problems have arisen which come from the regulations made for a heterogeneous set of countries, each of which have their own distinct mercantile rules.

Nevertheless, these regulations must be applied without making adaptations to the specific characteristics of the country in question.

The subject of this paper is one example of this. The situation we deal with here began in 1996, the year in which the framework of the Community Agricultural Policy reformed the common organization of fruit and vegetables through the enactment of (EC) Council Regulation No. 2200/1996. Many regulations continue to be formulated under its provisions. In the new regulation of the fruit and vegetable market, the community law-making offers financing to fruit and vegetable producer organisations (FVPO), which after complying with a series of requirements are obliged to

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ensure their partners make an equal financial contribution as that made by the EU, either directly or through contributions by the company in their name by making the contributions to the company.

It is noteworthy that the FVPOs make up 50% of the fruit and vegetable production in our country, Spain, corresponding to approximately 34 billion euros in the year 2001 (Commission of the European Communities, 2001). This is an important sector of the business.

Community support is subject to an action programme called «the operational programme» which must exist from three to five years in order to be admitted by the community authorities. Its objectives focus on improving the quality and competence of the organisation's products. The operational programme is funded by the operational fund and, as mentioned above, receives 50% of its funds from the partners and is calculated in relation to the volume or value of their market production and the other 50% from the European Union's EAGGF (European Agricultural Guidance and Guarantee Fund).

Thus, the mercantile nature of the financing given by the partners of the organisation for financing the operational fund has been under much debate and has currently produced many conflicts with the Public Treasury given its repercussions upon the Value Added Tax (VAT). We should bear in mind the agriculturally-related studies of VAT neutrality, which have been very important in these kinds of work (Juliá *et al.*, 1994; Gómez-Limón *et al.*, 1995).

With this paper we seek to analyse the indirect taxation required by the different accounting methods for the financial contributions made by the partners of an organisation of producers according to the community regulations, in order to receive the desired EU financing.

It is important to study the operational fund from both the accounting and fiscal viewpoints since, in the framework of the Community Agricultural Policy, it can be used as a model for other fields of production. This is due to it being a financial instrument which achieves two important objectives: consolidation of the organisations and obligation of the partner to take part in this process, thus clearly improving the earnings of our agricultural workers.

Methodology

In developing this paper we have used the concepts of the operational programme and the operational fund as set forth by the community regulations and their

mercantile nature in determining which events are taxable transactions as defined by the Value Added Tax Law. We have analysed the actions of the organisation and its partners in order to determine the impact of this tax within the field.

Thus, the applicable tax laws have been examined, especially the General Tax Management resolutions and the jurisprudence of the Superior Court of Justice of the European Communities.

Results

Operational programmes and funds

The fruit and vegetable producers organisations recognised by the competent authorities, according to Article 15 of (CE) Council Regulation 2200/1996, establishing the common organisation of fruit and vegetables, may constitute an operational fund which will be directly financed by the partners, which will be set by the amount or value of the fruits and vegetables on the market, as well as community financial support with matching funds. These funds must be used to finance the operational programme presented by the FVPO to the competent authorities for approval, and likewise finance withdrawals of products from the market, provided that they are part of the operational programme.

Likewise, member states have been authorised to allow the producers organisations to use their own funds to contribute to the operational fund, and to set different contribution levels. This authorisation only exists if all the producers contribute to the fund and benefit from it. This important development is included in the Commission Regulation (EC) No. 1433/2003 of 11 August, which establishes a series of provisions for the application of Council Regulation (EC) No. 2200/96 dealing with the operational funds, operational programmes and financial assistance.

Objectives of the operational programme must include ensuring programming and adaptation of production to demand, especially those aspects relating to quality and quantity; promoting the concentration of offer and getting the production of the members to the market; this reduces production costs and standardises their prices. It also promotes agricultural practices and production and waste management techniques which respect the environment, especially those which protect water quality, soil and the landscape and preserve and/or promote biodiversity. These improve the quality of the

products, increase their commercial value, promote products to consumers, create biological product lines, promote integrated production and other methods of production which respect the environment and the reduction of waste. These must include measures taken by the members which respect the environment, farming practices and management of the materials used. Their financial projections must include the necessary human and technical means for guaranteeing control in compliance with phytosanitary regulations and provisions and the maximum allowed content of residual waste.

In order to achieve these objectives the community regulations require the operational program to last from three to five years. Additionally, they may take into account the withdrawal of products, for those which would receive financing with the Community Withdrawal Indemnity according to Annex II of (CE) Regulation 2200/1996, and also products not previously included whose withdrawal is financed by the «withdrawal compensation» of the operational fund.

In general, with these programmes the community legislators seek to articulate the performance of the organisation of producers by systematising it and encouraging the planning of future strategies.

It is evident that implementation of the operational programme benefits the organisation and, therefore, its members because this is the intrinsic objective which both the organisation of fruit and vegetable producers and any other commercial enterprise pursue as a last resort. In this case, and given the special characteristics of the agricultural industry, the European Union provides the means to achieve these objectives by financing the operational programme.

Definition of VAT tax events

Within the scope of Value Added Tax we must first specify the requirements which make a transaction

into a tax event. It is noteworthy that VAT Law 37/1992 carries out the transposition of the Sixth Directive of the European Council regarding VAT (Directive 77/388/EEC of 17 May), for Spanish legislation. Although this concept is developed in numerous articles, we should focus on its community definition because it is not always easy to discern whether we are dealing with a taxable operation. Interpretations of the Sixth Directive by the Court of Justice of the European Communities can be especially useful for this purpose.

This Court, through numerous sentences, focusing on the concept of the tax event, has established the need for a direct link between event and payment in order for an event to be considered taxable. Thus, the sentence of 3rd March 1994 regarding Case C-16/93 is often used as a reference for synthesising the doctrine of the direct link given the force that the Court exerts on it. Additionally, the Advocate General compiled the requirements for VAT events, which have been upheld by the Court through similar sentences made previously. Accordingly, these would be the following¹:

— There must exist a direct relationship between the event and compensation received. This relationship must be of such a nature that a connection can be established between the amount of the benefit received and the amount of the compensation.

— The compensation must be able to be expressed with money.

— This compensation must reflect the subjective value, since the taxable base is the compensation received and is not an estimated amount in accordance with objective criteria. Therefore, a service in which subjective compensation is not received does not constitute a for-value service.

Therefore, by referencing the jurisprudence, sentence of 5th February 1981, Case 154/80²; sentence Mohr, of

¹ Section 14 of the conclusions by the Advocate General in Case C-16/93, Sentence of 3rd March 1994. This Case consisted of the plaintiff playing music on his barrel organ in public while asking for «payment» from passers-by by ringing his collecting bowl. The Dutch Administration considered the plaintiff to be furnishing services for value and that these services were subject to VAT. The Court did not find this to be taxable.

² The plaintiff, which was a cooperative, used a refrigerated chamber for preserving the harvest of the partners. Each one of them had the right to store 1000 kg of their product per year in exchange for an amount set by the cooperative and payable at that time. The cooperative did not charge for the years 1975 and 1976. The Dutch Administration found that the operation was subject to VAT, although there were no charges for two years, interpreting that the payment would come from the reduction of the value of the partners' participation. The sentence of the Court was that there was no taxable event because there must exist a direct link between the service provided and the balancing payment received, which was not the case during the years 1975 and 1976. The emphasis on the vagueness of the taxable base was a decisive element in their decision. Thus, the principle of the taxable base as a subjective value establishes which is the actual balancing amount received and not an estimated amount using objective criteria.

29th February 1996³, Case C-215/94; and sentence of 18th December 1997 of Case C-384/95⁴, we can enumerate the requirements for a transfer of goods or services to be subject to VAT (Sánchez, 2002). A direct link must exist between the event and the compensation. The requirements are summarised below:

1. There must exist an economic operator which provides the service or goods.

2. There must exist a transaction which entails company input or an act of consumption if the recipient is an individual, given that VAT is a consumption tax. Thus, if there is no consumption, there is no VAT.

3. The recipient of the transaction must be identified or identifiable.

4. The operation must have a contractual base. The Court holds that the transaction must be carried out in such a way that the event and compensation are linked.

5. The taxable amount is determined as a subjective value, i.e. it corresponds to the balancing amount actually received, and not an estimated amount using objective criteria.

6. There must exist a balancing payment for this transaction, although this requirement must be analysed separately because its absence does not determine that it is not taxable since it could mean the existence of taxable self-consumption.

Thus, within the framework of the operational programmes, we can define the possible provision of goods and services in order to study whether they meet

the above mentioned requirements and, therefore, produce taxable events which lead to tax obligations.

Goods and services provided by the organisation are:

- Products removed from the market to third parties.
- Products or services derived from the operational programme for members of the organisation.

Likewise, the partner will provide the following:

- Products from partners to the organisation.

In Figure 1 we find:

⇒ Provision of goods and services.

⇄ Money flow.

VATs = VAT rate paid by the producers organisation for receiving goods or services.

VATr = VAT rate passed on by the producers organisation for providing goods and services.

V = Production value marketed by the organisation.

α = Annual percentage set by the European Union, established at 4.1% in 2001 and limits the amount of community financing to the operational fund.

αV = Contribution by partners and the European Union to the operational fund. The total amount for the operational fund will be $2 \alpha V$.

The cases from Figure 1 are analysed below.

Taxable events by the producer organisation

Here, it is being questioned whether the two cases of economic nature, providing to third parties products

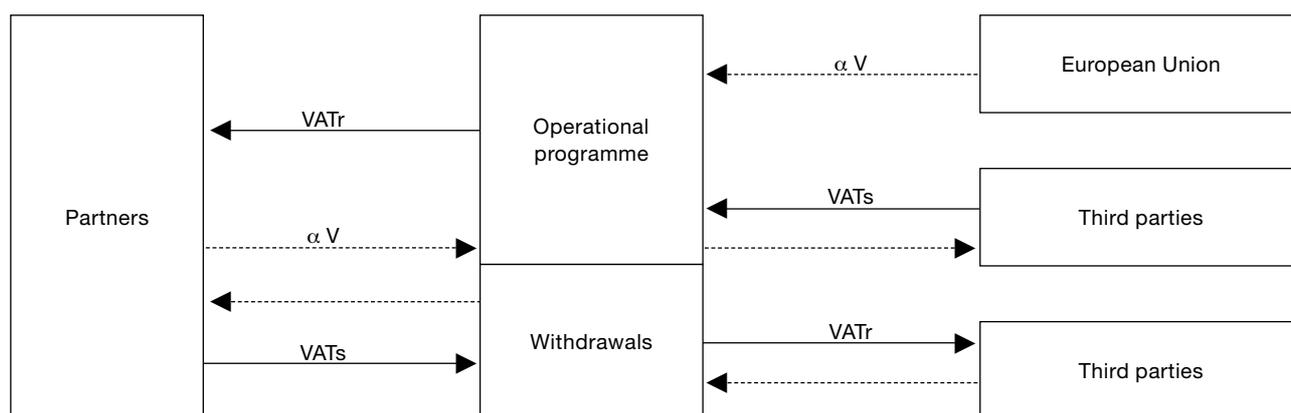


Figure 1. Taxable events related to the organisation, its partner, third parties and the European Union.

³ Mr. Mohr was the proprietor of a dairy business. Within the framework of a community programme he obtained funding to cease production. The German tax authorities considered the funding received to be payment for the service provided by Mr. Mohr, consisting of the abandonment of dairy production. The Court did not find a taxable event to exist.

⁴ The German administration consulted the High Court as to whether the indemnity received by an agricultural producer for reducing potato production by 20% can be considered as a payment for services rendered, being a reduction in production. The Court upheld the Mohr sentence and answered in the negative.

withdrawn by the organisation and providing services derived from the operational programme, can be identified as VAT taxable events.

In the first case, there is clearly a transaction which is subject to VAT, due to partial or total financing by the EAGGF, since when financing is linked to price it becomes part of the VAT taxable base (Article 78. Dos. 3 of *LIVA*). An exception is made when the withdrawn products are to be destroyed by biodegradation, as indicated in numerous consultations not bound to the General Tax Board⁵.

Nevertheless, in the latter case, the General Tax Board considers the tax event to have taken place. However, if we consider only the above-mentioned requirements, which must be met in order to produce a tax event, a tax event would not have taken place.

The situation in which the producer organisation implements the operational programme carrying out all of its actions will undoubtedly benefit the partners of the organisation (Fig. 2).

The questions which arise are:

— When the organisation implements the operational programme does it provide goods or services to partners which are subject to VAT?

— If the partners finance 50% of the operational fund, does this financing constitute a payment received for these goods or services?

In answering these questions we should remember that the operational programme may include the financing of product withdrawal as well as investment in stock whose use by the organisation will positively affect its consolidation and development, ultimately benefiting its members. Likewise, investments can be made by its members with the object of improving the

quality of its product, thus improving the collective image.

Additionally, according to Article 3 of (CE) Regulation No. 601/01, the programme must be of a collective nature which involves the participation of a considerable number of the members of the organisation and be approved by their vote.

The partners of the organisation are clearly obliged to contribute to financing the operational programme, which may consider action which does not affect any specific partner. They are also financed by partners who do not directly receive any benefits. On the other hand, the taxable base is determined according to objective criteria in function of the volume and value of the commercial production of each partner; its relation to the services received is scant given that these are difficult to determine and quantify.

The financing by partners corresponds to 50% of the total sum provided. However, (CE) Regulation No. 2200/96 does not establish that each producer contributes to the operational fund in relation to the services and/or goods received, but rather, in this case, the objective is to bind the members of the organisation to its financing.

Using the above reasoning, we should add the new community regulation articulated in (EC) Regulation No. 1433/03, which stipulates that the member states may authorise the producer organisations to make the partners pay their contribution using their own funds which were earned by the sale of fruit and vegetable products by their members, with the exception of those received from other sources of public funding. With this measure it is evident that the community legislator understands the contribution to the fund to be of general interest to the organisation and therefore may be paid by the organisation instead of its partners, if it has sufficient funds.

Bearing in mind all these considerations, we regard that a direct link between the event and compensation does not exist and, therefore, there is no taxable event as such.

This position has been endorsed by the last modification (30th December, 2003) in law 20/1990 of fiscal regime of cooperatives, in which a new additional sixth disposition has been included, by law 62/2003 of fiscal, administrative measures and of social order. This disposition specifies that the performances derived from implementation of the operational

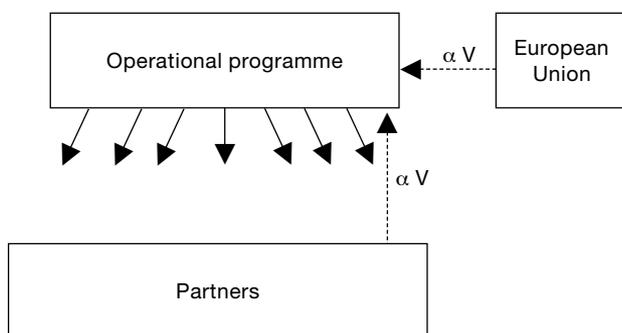


Figure 2. Operational programme operation.

⁵ Consultation No. 0204-01 to the General Tax Board of 6th February 2001. Consultation No. 0005-99 of 7th January 1999. Consultation No. 1891-98 of 4th December 1998. Consultation No. 1581-98 of 1st October 1998.

program for the organisation of fruit and vegetable producers, won't be considered in any case benefits of service. Therefore, the legislator, responding in this way to the interests of the sector, is rejecting the concept previously defended by the General Tax Board, which identifies the contribution from the partner to the operative fund as an operating income.

At this point, it is useful to discuss the relevant literature (Server *et al*, 2002; Abella, 2003). The contribution can correspond to a loan, or an income to the entities own funds, or an operating income (an opinion defended by the General Tax Board), or for distribution in different accounting periods (Institute of Accounting and Account Auditing). In this sense, its identification as a payment from operations or for distribution over different accounting periods does not seem suitable from either the mercantile or the indirect taxation viewpoints, as we have seen above. Results of the quantification of its impact on VAT neutrality confirm this conclusion as we see below.

Tax events by the partners of the producer organisation

As mentioned above, the partner will provide products to the organisation. This operation is subject to VAT and therefore will be taxed. The tax base will be integrated by the total amount of the payment to be received by the producers of these products.

In the case of products provided by the producers of the organisation made to third parties as a result of their withdrawal made in its name, including those which correspond to cases in which the products withdrawn from the market are destined for destruction through biodegradation, the tax base of the corresponding VAT for these products must be included in the corresponding amount to the Community Withdrawal Indemnity, which the organisation receives in its own name and which in turn pays the producer. Therefore, if relevant, the amount of compensation and allowance for the withdrawal which the organisation pays to the producer and which finances the operational fund is reduced by the amount of the financial contribution made by the producer to the fund which is destined to finance the withdrawal of products from the market and is provided by the producer to the organisation.

On this point there is agreement and endorsement of the criteria with the Tax Administration according to consultations not related to this material.

Quantification of the impact of the contribution made by the partner to the operational fund on the neutrality of the VAT derived from the execution of the operational programme

The commercial nature of the partner's contribution to the operational fund will determine whether a tax event exists or not. Below we quantify the VAT liquidation which is derived in each of the accounting alternatives.

VAT liquidation in the producer organisation when the contribution by the partner is considered an operation income for the organisation

The General Tax Board considered the partner's contribution an operating income for the organisation. In this case, given that the partner generally pays taxes into the Special System of Agriculture, Stockbreeding and Fishing (SSASF) of VAT (i.e. a supported VAT for the organization of 8%, a special type for this system), we can quantify the impact of indirect taxation as shown in Table 1 whilst keeping Figure 1 in mind.

Table «P» represents the amount paid by third parties for the withdrawal of products, and «λ» represents the limit established by the regulations for financing the withdrawal of products from the operating fund, which will vary according to the year. Thus, for the year that the programme is approved, this is fixed at 60%, for the second year at 55%, the third year at 50%, the fourth year at 45%, the fifth year at 40% and for the sixth and following years at 30%.

In order for the calculations to be distinct from the rest, the community financing from EAGGF, the amount earmarked for withdrawals (financing linked to the price of the products) is considered to be capital financing. The latter will not lead to the application of limiting mechanisms with the right to deduct any supported VAT quotas in any case, given that its source is EAGGF.

The VAT supported by the organisation is calculated over the amount paid to the partners for the withdrawal (supplements and compensations for withdrawal) which is reduced by the sum of the contribution paid by the partner to the fund destined to finance the withdrawal, applying the amount raised for compensation. Additionally, the organisation gives VAT support for acquisitions which the programme makes for third parties; for this we have applied the rate of 16%,

Table 1. VAT liquidation derived from the operational programme, in a producer organisation which considers the contribution of the partner to be an operating income

Origin	Destination	VATr	VATs	Liquidation
50% EAGGF	Withdrawal investments	0	$0.08 \lambda \alpha V$	$-0.08 \lambda \alpha V$
		0	$0.16 (1 - \lambda) \alpha V$ <i>$\{0.07 (1 - \lambda) \alpha V\}$</i>	$-0.16 (1 - \lambda) \alpha V$ <i>$\{-0.07 (1 - \lambda) \alpha V\}$</i>
50% Partner	Withdrawal investments	$0.04 [P + \lambda \alpha V]^*$	0	$0.04 P + 0.04 \lambda \alpha V$
		$0.07 (1 - \lambda) \alpha V$	$0.16 (1 - \lambda) \alpha V$ <i>$\{0.07 (1 - \lambda) \alpha V\}$</i>	$-0.09 (1 - \lambda) \alpha V$ <i>$\{0\}$</i>
Liquidation withdrawal		$0.04 P - 0.04 \lambda \alpha V$		
Liquidation investments		$-0.25 (1 - \lambda) \alpha V$ <i>$\{-0.07 (1 - \lambda) \alpha V\}$</i>		
Total		$0.21 \lambda \alpha V - 0.25 \alpha V + 0.04 P$ <i>$\{0.03 \lambda \alpha V - 0.07 \alpha V + 0.04 P\}$</i>		

* VAT rate affecting non-partner third parties who sell or give away the withdrawn products. *Source:* the authors.

although it could also be 7%, depending on the type of goods being acquired. This possibility is shown in brackets and in italics in Table 1.

Conversely, the VAT accrued by the organisation which corresponds to the transfer of withdrawn products to third parties will include in the tax base the funding given by EAGGF for the withdrawals since this is financing linked to the price. The greatly reduced rate of 4% is applicable in this case (if the destination were fertiliser manufacturers a rate of 7% would be applied).

Likewise, in Table 1 it can be seen that the organisation, considering the contribution by the partner to be an operating income were obliged, until 31st December 2003, to accrue VAT on the amount which was used to finance investments. This posed the problem as to how to determine the tax base for calculating the VAT amount. This problem became even greater if community financing was included. In this case, this would not be included because it is not linked to the price of the products marketed by the organisation. We consider the applicable rate to be 7% because we are dealing with operations between the organisations, which are predominantly agricultural cooperatives⁶, and their partners. For other legal forms, the rate may be either 7% or 16% depending on the nature of the activity.

According to the General Tax Office, the tax base always corresponded to the payment received and did not include community financing. In any case, they specify that because linked transactions are being dealt with, the payment would be assessed and if found to

be flagrantly lower than the market norm, it would be corrected by including the community financing⁷.

After the regulation amendment 1st January 2004, and endorsing our opinion, the contribution made by the partner to the operational fund can not be considered as payment for implementation of the programme because the provision of goods and services derived from implementation of the operational programme and received by the group of partners of the organisation, is not directly linked to this payment and does not meet the criteria for being subject to taxation, as already explored in the above section when defining a tax event.

VAT liquidation when the contribution by the partner is made as a contribution to the net worth of the organisation, or a loan, or an operating income since 1st January 2004

If the contribution by the partner is made as a contribution, or grant to the net worth of the organisation, or a loan, or an operating income since 1st January 2004, a tax event does not exist. Thus, in this section we analyse the first two cases and the liquidation of the appropriate VAT, which is shown in Table 2. The case referring to the grant is studied in the following section. The final case, referring to an operating income, has already been studied in the above section.

⁶ Applicable after 1st January 2000.

⁷ Response to non-binding Consultation 0204-01.

Table 2. VAT liquidation derived from the operational programme in a producer organisation which considers the contribution by the partner to be a contribution to its net worth, or a loan

Origin	Destination	VATr	VATs	Liquidation
50% EAGGF	Withdrawal investments	0	$0.08 \lambda \alpha V$	$-0.08 \lambda \alpha V$
		0	$0.16 (1 - \lambda) \alpha V$ $\{0.07 (1 - \lambda) \alpha V\}$	$-0.16 (1 - \lambda) \alpha V$ $\{-0.07 (1 - \lambda) \alpha V\}$
50% Partner	Withdrawal investments	$0.04 [P + \lambda \alpha V]^*$	$0.16 (1 - \lambda) \alpha V$ $\{0.07 (1 - \lambda) \alpha V\}$	$0.04 P + 0.04 \lambda \alpha V$ $-0.16 (1 - \lambda) \alpha V$ $\{-0.07 (1 - \lambda) \alpha V\}$
		0		
Liquidation withdrawal		$0.04 P - 0.04 \lambda \alpha V$		
Liquidation investments		$-0.32 (1 - \lambda) \alpha V$ $\{-0.14 (1 - \lambda) \alpha V\}$		
Total		$0.28 \lambda \alpha V - 0.32 \alpha V + 0.04 P$ $\{0.10 \lambda \alpha V - 0.14 \alpha V + 0.04 P\}$		

* VAT rate affecting non-partner third parties who sell or give away the withdrawn products. *Source:* the authors.

The main difference between this liquidation and the one above lies in the repercussions of the VAT upon the partner as a result of the provision of goods or services derived from operational programme operations. With the exception of this case, the amount to be returned by the public tax authorities is increased with respect to the above option; the rates are 8% (for compensation) and 16%, although this rate may be only 7%, as mentioned above.

VAT liquidation when the contribution by the partner is considered to be a grant

If the contribution by the partner is considered to be a grant⁸ then it should be determined whether it is linked or not to the price, which would allow us to know whether it finances a withdrawal or if it is an investment.

In the case that it is used in withdrawals then it is a grant linked to price and so will be included (together with the part coming from the EAGGF) in the imputable tax base for the goods and services provided to third parties, provided that they are not earmarked for destruction (Díaz, 1999). Nevertheless, it is clear that there is no sense in taxing the grant by the partner for the withdrawal of his own products since the organisation will return this sum to him in payment for the withdrawn products. In accordance with the above, we understand that this is not included in the tax base, as indicated by the general tax board.

Investments made by the programme can be considered to be a capital grant which finances specific assets, or can be considered to affect the general structure. In our opinion both are possible depending on the content of the operational programme. If they are understood to finance all of the activity of the programme, 50% VAT will be deducted in the implementation of this activity. This is the case shown in Table 3.

If the contribution made by the partner is considered to be a grant, then it is not financing specific assets and the pro-rata regulation should be applied. Thus, in all of the operations carried out by the entity, the right to deduct the VAT should be limited since the pro-rata percentage indicates the deductible amount. This case is shown in Table 4.

In this case the pro-rata can be determined if the organisation only carries out operations which give the right to deduct VAT, and bearing in mind that after 2001, $\alpha = 4.1\%$, calculated as follows:

$$pr = \frac{V}{V + \alpha V} = 0.9606$$

giving a pro-rata of 97%⁹.

If we decide to include the grant in fifths in the denominator of the pro-rata equation, selecting this option places us in VAT regulation article 104:

$$pr = \frac{V}{V + \alpha V^{1/5}} = 0.9918$$

giving a pro-rata of 100%.

⁸ Institute of Accounting and Account Auditing, response to non-binding Consultation, 1997.

⁹ According to Article 104 of the VAT Law, the general pro-rata must be rounded to the higher percentage point.

Table 3. VAT liquidation derived from the operational programme in a producer organisation which considers the contribution of the partner to be a grant financing specific assets

Origin	Destination	VATr	VATs	Liquidation
50% EAGGF	Withdrawal investments	0 0	0.08 $\lambda \alpha V$ 0.16 (1- λ) αV 0.5 $\{0.07 (1-\lambda) \alpha V 0.5\}$	-0.08 $\lambda \alpha V$ -0.08 (1- λ) αV $\{-0.035 (1-\lambda) \alpha V\}$
50% Partner	Withdrawal investments	0.04 [P + $\lambda 2 \alpha V$]* 0	0.16 (1- λ) αV 0.5 $\{0.07 (1-\lambda) \alpha V 0.5\}$	0.04 P + 0.08 $\lambda \alpha V$ -0.08 (1- λ) αV $\{-0.035 (1-\lambda) \alpha V\}$
Liquidation withdrawal			0.04 P	
Liquidation investments			-0.16 (1- λ) αV $\{-0.07 (1-\lambda) \alpha V\}$	
Total			0.16 $\lambda \alpha V$ - 0.16 αV + 0.04 P $\{0.07 \lambda \alpha V - 0.07 \alpha V + 0.04 P\}$	

* VAT rate affecting non-partner third parties who sell or give away the withdrawn products. *Source:* the authors.

Table 4. VAT liquidation derived from the operational programme in a producer organisation which considers the contribution by the partner to be a grant which finances general assets

Origin	Destination	VATr	VATs	Liquidation
50% EAGGF	Withdrawal investments	0 0	0.08 $\lambda \alpha V$ pr 0.16 (1- λ) αV pr $\{0.07 (1-\lambda) \alpha V pr\}$	-0.08 $\lambda \alpha V$ pr -0.16 (1- λ) αV pr $\{-0.07 (1-\lambda) \alpha V pr\}$
50% Partner	Withdrawal investment	0.04 [P + $\lambda 2 \alpha V$]* 0	0.16 (1- λ) αV pr $\{0.07 (1-\lambda) \alpha V pr\}$	0.04 P + 0.08 $\lambda \alpha V$ -0.16 (1- λ) αV pr $\{-0.07 (1-\lambda) \alpha V pr\}$
Liquidation withdrawal			0.04 P + 0.08 $\lambda \alpha V$ (1 - pr)	
Liquidation investments			-0.32 (1- λ) αV pr $\{-0.14 (1-\lambda) \alpha V pr\}$	
Total			0.24 $\lambda \alpha V$ pr + 0.08 $\lambda \alpha V$ - 0.32 αV pr + 0.04 P $\{0.06 \lambda \alpha V pr + 0.08 \lambda \alpha V - 0.14 \alpha V pr + 0.04 P\}$	

* VAT rate affecting non-partner third parties who sell or give away the withdrawn products. *Source:* the authors.

Table 5. Result of VAT liquidation derived from the operational programme in a producer organisation which considers the contribution made by the partner to be a grant in which the pro-rata regulation is applicable

	Pro-rata = 97%	Pro-rata = 100%
Liquidation withdrawal	0.04 P + 0.0024 $\lambda \alpha V$	0.04 P
Liquidation investments	-0.3104 (1- λ) αV $\{-0.1358 (1-\lambda) \alpha V\}$	-0.32 (1- λ) αV $\{-0.14 (1-\lambda) \alpha V\}$
Total	0.3128 $\lambda \alpha V$ - 0.3104 αV + 0.04 P $\{0.1382 \lambda \alpha V - 0.1358 \alpha V + 0.04 P\}$	0.32 $\lambda \alpha V$ - 0.32 αV + 0.04 P $\{0.14 \lambda \alpha V - 0.14 \alpha V + 0.04 P\}$

Source: the authors.

If we assign the values calculated in the pro-rata equation we obtain the results shown in Table 5.

It can be seen in the above table that for the producer organisation it is more beneficial to calculate the grant made by the partner by including it in fifths in the denominator of the pro-rata equation which gives a pro-rata of 100%, while in the other case the acquisition costs are increased by 3% in the VAT rates in applying the pro-rata of 97%.

Balance for the organisation of producers with regard to indirect taxation

We can summarise the results of these calculations in two tables: one in which no withdrawals are carried out (Table 6) and the other when there are withdrawals in the operational programme (Table 7), allowing us to see the effect that the withdrawals can have on VAT liquidations. The values given to the different variables are based on the following:

1. Three cases for the organisation (Table 7):

— Case 1: Withdrawn products earmarked for destruction ($P = 0$, $VATr = 0$);

— Case 2: Withdrawn products provided free ($P = 0$);

— Case 3: Minimum price (P) is obtained.

2. The organisation is in its sixth year or more from the time the programme was approved, and therefore can only use 30% of the operational fund for financing a withdrawal. Thus λ has the value of 0.30.

3. It is presumed that there are no product withdrawals included in Annex II of the base regulations, because the VAT liquidation in these cases depends on the product in question. Only product withdrawals that are different from those in Annex II are used for the calculation in Table 7.

4. The calculations are carried out using the value of αV for 100 monetary units (m.u.).

Thus, from the viewpoint of a partner of the organisation, normally individuals are subject to the Special System of Agriculture, Stockfarming and Fishing (SSASF) of the VAT and are, therefore, included in the Objective Estimation System of the Individual Income Tax. The most disadvantageous alternative was when the contribution to the operational fund was considered to be an income for organisation operations subject to VAT. In this case they would be

Table 6. VAT liquidation in relation to the identification of the contribution of the partner when no withdrawals are carried out ($\lambda = 0$)

Identification of the contribution of the partner	Liquidation organisation	Contribution by partner = = operational fund – – withdrawal amount
Operating income until 31 st December 2003	-25 {-7} -0.25 (1 - λ) αV {-0.07 (1 - λ) αV }	107
Contribution to net worth, or loans, or operating income since 1 st January 2004	-32 {-14} -0.32 (1 - λ) αV {-0.14 (1 - λ) αV }	100
Grant given for specific assets	-16 {-7} -0.16 (1 - λ) αV {-0.07 (1 - λ) αV }	100
General grants. Pro-rata = 97%	-31.04 {-13.58} -0.3104 (1 - λ) αV {-0.1358 (1 - λ) αV }	100
General grants. Pro-rata = 100%	-32 {-14} -0.32 (1 - λ) αV {-0.14 (1 - λ) αV }	100

Source: the authors.

Table 7. VAT liquidation in relation to the type of contribution made by the partner and the destination of the withdrawn products

Type of contribution of partner	Case	Liquidation organisation		Contribution by partner = = operation fund – – withdrawal amount
Operating income until 31 st December 2003	1	-19.9	$\{-7.3\}$	42.5
	2	-18.7	$\{-6.1\}$	
	3	+0.04 P - 18.7	$\{0.04 P - 6.1\}$	
	General	$0.21 \lambda \alpha V - 0.25 \alpha V + 0.04 P$ $\{0.03 \lambda \alpha V - 0.07 \alpha V + 0.04 P\}$		
Contribution to net worth, or loans, or operating income since 1 st January 2004	1	-24.8	$\{-12.2\}$	37.6
	2	-23.6	$\{-11\}$	
	3	+0.04 P - 23.6	$\{0.04 P - 11\}$	
	General	$0.28 \lambda \alpha V - 0.32 \alpha V + 0.04 P$ $\{0.10 \lambda \alpha V - 0.14 \alpha V + 0.04 P\}$		
Grant given for specific assets	1	-13.6	$\{-7.3\}$	37.6
	2	-11.2	$\{-4.9\}$	
	3	+0.04 P - 11.2	$\{0.04 P - 4.9\}$	
	General	$0.16 \lambda \alpha V - 0.16 \alpha V + 0.04 P$ $\{0.07 \lambda \alpha V - 0.07 \alpha V + 0.04 P\}$		
General grants. Pro-rata = 97%	1	-24.06	$\{-11.83\}$	37.6
	2	-21.66	$\{-9.43\}$	
	3	+0.04 P - 21.66	$\{0.04 P - 9.43\}$	
	General	$0.3128 \lambda \alpha V - 0.3104 \alpha V + 0.04 P$ $\{0.1382 \lambda \alpha V - 0.1358 \alpha V + 0.04 P\}$		
General grants. Pro-rata = 100%	1	-24.8	$\{-12.2\}$	37.6
	2	-22.4	$\{-9.8\}$	
	3	+0.04 P - 22.4	$\{0.04 P - 9.8\}$	
	General	$0.32 \lambda \alpha V - 0.32 \alpha V + 0.04 P$ $\{0.14 \lambda \alpha V - 0.14 \alpha V + 0.04 P\}$		

Source: the authors.

obliged until 31st December 2003 to increase their payments for investments by 7%, if it is a cooperative. In other types of legal entities depending on the goods or services, the rate may be 16%.

In the case of the producer organisations, the results obtained can be deduced by calculating that for every 100 m.u. of financing they receive and invest, if there are no product withdrawals, the most advantageous liquidation will be for the organisation to consider the contribution made by the partners to be net worth or a loan. This is because 32 m.u. will be returned, i.e. 16% of the total (200 m.u.), or 14 m.u. if a rate of 7% is applied. These results coincide with the case of grants which finance general assets and in calculating the pro-rata including the contribution made by the partner (grant) in the denominator of this equation which would be in fifths (pro-rata 100%). Furthermore, its

identification as an operating income implies that the recovery of VAT through the impact upon the partner will be 7 m.u. and the recovery with the amount of VAT liquidation of 25 m.u.

This is still considered a grant which finances the organisation in general with an applicable pro-rata of 97% since 31.04 m.u. (13.58 m.u. if the rate is 7%) is returned from the 32 m.u. owed. This determines a cost increase for the entity of approximately 1% (3% of the VAT owed). Finally, the least favourable situation is the case in which there is a grant which finances specific assets, so 50% of the VAT in these acquisitions becomes acquisition costs.

This coincides with the case of product withdrawals (Table 7). The largest VAT returns occur when the products are earmarked for destruction. There would be no tax repercussions in this case. In this situation the organisation finances the VAT accrued for products provided free.

The liquidations of the calculated VAT have been carried out applying the VAT regulations applicable to grants, which is clearly beneficial when the grants come from EAGGF, given that correcting mechanisms are not applied.

Discussion

The intention of the community legislator to strengthen and consolidate the fruit and vegetable producer organisations by implementing a new financing instrument, operational funds, is faced with many obstacles in our country.

The first problem derives from the community regulations which leaves the member states subject to regulation in many important aspects. Nevertheless, in Spain there is a lack of regulations which develop, clarify and give solutions to the existing loopholes, basically at the tax and commercial level, and specifically in treatment of the contribution made by the partner to the operational fund organisation.

To date, different consultations made to both the Institute of Accounting and Auditing and to the general tax board have generated non-binding as well as conflicting responses.

Thus, the Spanish Institute of Accounting and Auditing considers the contribution made by the partner to the operational fund to be a payment distributed over several accounting periods, i.e. the partner is subsidising the entity. The general tax board, however, through tax analysis carried out within the framework of indirect taxation, identifies this as an operating income or pre-counter-payment, of the provision of goods and services which are derived from operational programme operations.

Considering the contents and objectives of the operational programme, both these solutions seem to be inaccurate because they consider the partners to be customers of the entity, thus excluding their responsibility. In our opinion, the contribution made by the partners to the operational fund should be defined as a contribution to the Net Worth, especially if we take into account the authorisation of the commission through regulation 1433/2003 which stipulates that the organisation itself endows it with its net worth provided that this net worth comes from the sale of recognised products of the partners.

Nevertheless, these preferences have important consequences for VAT scope. Thus, this paper has analysed their influence on VAT neutrality for both the

organisation which creates the fund and the partners who contribute 50% in creating it.

Thus, from the viewpoint of the organisation and based on the jurisprudence of the Court of Justice of the European Communities and the applicable national and community regulations, we can conclude that the only goods and services subject to VAT are those which the partner of the organisation provides, as well as those provided by the organisation as a result of marketing or withdrawal (without their destruction). At the same time, contrary to the general tax board, the goods and services provided which are derived from implementation of the operational programme are not subject to VAT because there is no direct link between the amount contributed by the partners, calculated objectively, and the value of the goods or services received by the partner.

This analysis has been confirmed by the legislative modification valid from the 1st January 2004 that stipulates that performances derived from implementation of the operational program for the organisation will not be considered as benefits or services.

In order to quantify the effect of the different accounting options for indirect taxation, a series of financial models have been proposed from which we can deduce that the neutrality of the VAT is only affected when the contribution made by the partner is identified as a grant of specific assets or a general grant. The last case is considered in calculation of the pro-rata in the first year.

In these two cases, application of the mechanism which tends to avoid the loss of revenue by the tax authorities as a result of receiving funding not linked to the price of the products, and which consists of limiting the right of deducting the amount of VAT owed, creates an increase in costs. The increase is 50% of costs derived from the operational programme, in the case in which the specific financial assets are considered, and 1% of all expenses of the accounting year if a general grant is being dealt with, including the first year of financing in calculation of the pro-rata.

In the remaining cases, the VAT owed by the implementation of the operational programme is recovered by the entity.

For the individual partner producer the worst alternative would be that in which his contribution to the fund was considered to be an operating income for operations because the contribution would be increased by either 7% or 16%, depending on whether this is a cooperative and the nature of the activity carried out in the operational programme. Additionally, if we consider

that the most partners of the organisation contribute to the Special Agricultural System of Stockfarming and Fish of the VAT, we find ourselves with an increase in tax liability because these amounts can no longer be deducted and would, therefore, penalise consumption that was not directly taxable, as specified by the legislator on 30th December 2004. This was the solution given by the Tax Board which attributed the taxable amount to the partner by defining his contribution to the operational fund as an operating income.

We, therefore, conclude that given the lack of regulations regarding this matter, and based on what we understand to be the spirit of the community regulations by their introduction of this new financial instrument and respecting current accounting and tax regulations in our country, the best option is to consider the contribution by the partner to the operational fund as a reserve, since the best given financial information takes into consideration both the source of the contribution (the partners) and the destination, and is included in the net worth of the entity and is considered to be part of the operational programme.

Moreover, this implies that the principle of neutrality of VAT for the organisation is preserved thus avoiding additional payments by the partner and preserves the rights of the partner regarding the activity of the operational programme.

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