

Deductible proportion of input VAT on untypical transactions (3/4/17)

The Court of Justice of the European Union (CJEU) has made a preliminary ruling (C-378/15) on questions submitted by the Italian tax court about applying a deductible proportion of input VAT to all goods and services acquired by a taxable person by reference to the structure of his revenue, and about identifying transactions considered incidental (untypical).

Background

The Italian tax office challenged Mercedes Benz's proportional method for calculating a deductible ratio of input VAT, which involved treating its financial transactions – loans to subsidiaries – as auxiliary to its taxable supplies and excluding the accrued interest from the fraction used for arriving at the deductible input VAT proportion.

After an audit the tax office imposed an additional VAT assessment of close to €1.8 million, claiming that the loan interest had been incorrectly excluded from the calculation of the deductible input VAT proportion because the lending activity was one of Mercedes Benz's main activities, with the accrued interest representing 71.64% of the company's total revenue.

In legal proceedings against the tax office, Mercedes Benz claimed that they were legally permitted to exclude the accrued interest from the denominator of the fraction used for arriving at the deductible input VAT proportion, and pointed out that the national lawmaker had incorrectly transposed articles 168 and 173-175 of the VAT directive (2006/112/EC), emphasising that the deductible proportion is consistently applied to all the goods and services acquired by the taxable person, regardless of whether they are intended for activities giving the right to a deduction or for activities not giving this right, or for both types of activities.

In such circumstances the Italian tax court decided to suspend the litigation and consult the CJEU.

The CJEU ruling

This was a reference to the CJEU for a preliminary ruling. In its ruling the CJEU analyses the relevant provisions of the VAT directive and case law. According to the CJEU, while income earned from those financial transactions, which fall within the scope of the directive, may indicate that such transactions cannot be considered untypical within the meaning of the directive, the mere fact that the company earns more income from such activities than from the activity it has indicated as its core activity does not mean that such activities cannot be considered untypical transactions within the meaning of the directive. The CJEU case law implies that a transaction cannot be considered untypical within the meaning of the directive if it is a direct, constant and necessary continuation of the company's taxable business, or if it involves the use of essential goods and services subject to VAT.

Having analysed the Italian VAT legislation and its practical application as well as the facts and circumstances of the case, the CJEU found that the provisions of the VAT directive should be interpreted so as to conclude that they do not prohibit the national legislation and practice invoked in the basic case,

which requires the taxable person to –

- apply to all goods and services he has acquired a deductible proportion based on revenue, without providing for a method of calculation that is based on the nature and actual destination of each of the acquired goods and services and that objectively reflects the portion of expenses actually attributable to each of the taxable and exempt activities;
- refer to the structure of his revenue in order to identify transactions to be considered untypical, to the extent that the assessment carried out for that purpose takes account of the relationship between those transactions and the person's taxable activities and possibly of the intended use of the goods and services that are subject to VAT.

PwC comment

In view of the CJEU ruling, it is important to remember that Latvia has also transposed the provisions of the VAT directive into section 98(4) the VAT Act. This clause provides that a taxable person is permitted to exclude an untypical financial or real estate transaction from the deductible input VAT proportion if that transaction is a one-off transaction clearly different from the taxable person's normal business. However, as stated by the CJEU, the taxable person should assess whether any transaction excluded from the deductible input VAT proportion is indeed considered untypical.