

EU Court: adjusting input VAT on property transactions (1/11/18)

On 28 February 2018 the Court of Justice of the European Union (CJEU) ruled in favour of a taxpayer by denying a member state's right to restrict recovery of input VAT where more than two calendar years have passed with no revenue earned from using real estate (RE). This article explores some of the CJEU findings and related Latvian rules.

Background

A Portuguese court asked the CJEU to answer preliminary questions about whether the national provisions of law are consistent with Articles 137, 167, 168, 184, 185 and 187 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "VAT directive"), which requires the taxpayer to adjust any recovered input VAT if the conditions underlying its amount later change.

As stated in CJEU Ruling C-672/16, Portuguese legislation provided for a one-off input VAT adjustment to be made by a taxable person using any RE that allows him to partly or wholly recover input VAT paid on the purchase if the company has not used the RE in a period exceeding two consecutive years.

Although the disuse period of the RE on which input VAT had been recovered exceeded two years, the Portuguese taxable person had made efforts indicating the intention of leasing the RE out as a taxable supply, since the company had held various marketing events, including advertising placements and press releases, and made competitively priced offers to potential tenants.

CJEU findings

The CJEU points out that under Article 167 of the VAT directive a right to recover input VAT arises when the recoverable VAT becomes chargeable, and that right depends solely on the entity's status as a taxable person. The goods or services the entity acquires as a taxable person determine the application of the recovery scheme, and the actual or intended use of those goods or services affects only the amount of initial recovery under Article 168 of the VAT directive and the amount of possible future adjustments, but such use does not affect the right to recover input VAT as such.

The CJEU also points out that the right to recover input VAT is essentially retained even if the taxable person later fails, for reasons beyond his control, to use the goods and services on which the input VAT was recovered. Any national rule that provides for adjusting input VAT on RE considered unusable for taxable supplies because it has been out of use for more than two years, is also not permissible.

The Latvian VAT Act

These provisions of the VAT directive have been passed into Latvian legislation, giving the taxable person a right to initially recover input VAT and imposing an obligation to adjust the input VAT on RE transactions and to keep the State Revenue Service informed of how the RE is used over a period of ten years after it was acquired or accepted for use.

Section 99 of the VAT Act permits a taxable person to make the initial recovery of input VAT based on the intended use of RE.

Since the VAT Act and the Cabinet of Ministers' rules are silent as to how the taxable person should prove the intended use of RE, useful bits of information can be gleaned from CJEU case law.

There are many developers and companies that acquire unused RE and then build, renovate, rebuild or restore it for making taxable supplies. Intended uses will depend on each company's line of business and type of RE, and revenue from using the RE may arise over periods of varying lengths, but proving that the RE is intended for making taxable supplies is crucial. According to CJEU case law, such evidence may include contracts signed for taxable activities, advertising events held, including the creation of a website offering information to prospective customers, and other promotions.

Section 102 of the VAT Act provides for adjusting input VAT on RE transactions over a period of ten years after it was acquired or accepted for use and annually recalculating the difference between one-tenth of the input VAT recovered and the input VAT recoverable for the tax year according to the actual use of RE for making taxable supplies.

The CJEU findings imply that when making an annual adjustment of input VAT on RE, the taxable person is permitted not to recalculate the ratio of recoverable input VAT even if no revenue has been earned from that RE but the intention of using it for taxable supplies stands.