

CJEU on deducting input VAT on service costs incurred on third party property (1/13/18)

In September 2017 the Court of Justice of the European Union (CJEU) ruled on a taxable person's right to deduct input VAT on expenses incurred to conduct business activities on a third party's property without receiving any consideration from that third party. This article explores CJEU findings and Latvian interpretations of relevant provisions.

Preliminary questions and background

A Bulgarian court asked the CJEU to answer preliminary questions as to whether Bulgarian national legislation is consistent with Article 26(1)(b), Article 168(a) and Article 176 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (the "VAT directive") which restrict the deduction of input VAT on services intended for transactions free of charge or for activities that are not closely linked to business. The Bulgarian court also asked the CJEU to explain the interpretation of these provisions with respect to expenses incurred on a property owned by a third party.

There was a dispute over a taxable person's right to deduct input VAT on construction and improvement expenses he had incurred on a third-party property that were necessary for conducting his business activities. The property owner benefited from those services without paying any consideration.

CJEU findings

In evaluating the right to deduct VAT in case C-132/16 the CJEU considered the following concepts:

- VAT neutrality for all business activities regardless of their purpose and outcome as long as they are within the scope of VAT;
- Goods or services being used for making taxable supplies;
- A link between a past transaction and any transactions giving the right to deduct VAT where the cost of those services are included in the price of goods or services sold.

Since the taxable person could not carry out his taxable business activities without first undertaking the construction and improvement work on the third-party property, the fact that the third party benefits from that work without paying any consideration is no obstacle to deducting input VAT. However, according to the CJEU, it should be assessed whether the expenses incurred in doing that work exceed what is necessary for the purpose.

Thus, the CJEU stated that the taxable person may deduct input VAT on construction or improvement services performed on a third-party property if that third party derives a free benefit and if both the third party and the taxable person use those services in their business, without exceeding what is necessary for the taxable person to make taxable supplies and given the extent to which those costs are included in the price of taxable supplies.

Latvian VAT legislation

Like the VAT directive, the Latvian VAT Act permits a taxable person to deduct input VAT on goods and

services acquired to make taxable supplies.

Although Latvian legislation seems clear enough about the taxable person's right to deduct input VAT, questions arise in practice about a link between expenses and business revenue, such as access roads that can be used by persons directly connected or unconnected with business, or expenses incurred in laying various cables or pipes across municipal land.

The CJEU findings imply that in order to keep the right to deduct input VAT, the taxable person must be able to prove that such expenses are necessary for conducting business activities and to justify the inclusion of those expenses in the price of taxable supplies.