

# Input VAT on prepayment for goods never delivered (3/26/18)

On 31 May 2018 the Court of Justice of the European Union (CJEU) announced its ruling on joined cases C-660/16 and C-661/16 concerning the deduction of input VAT on prepaid goods the seller never delivered. This article explores some of the findings issued by the CJEU and the Attorney General on this case.

## Background

A fraudulent seller failed to supply goods for which the buyer had made a prepayment. The contract of sale included all the essential elements of a supply, except for the date of supply.

The Federal Fiscal Court of Germany asked the CJEU to explain whether the buyer was allowed to deduct input tax on the prepayment and whether the deducted input tax needs adjusting if the goods are not supplied and the prepayment not refunded.

We have put together key findings and guidance from the CJEU and the Attorney General for use in day-to-day business when it comes to charging VAT on prepayments, deducting input tax on prepayments, and adjusting any deducted input tax.

## Charging VAT on a prepayment

- VAT becomes chargeable when goods or services are supplied (Article 63 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ("VAT directive")). VAT on a prepayment becomes chargeable when it is received (Article 65 of the VAT directive).
- Charging VAT on a prepayment is an exception to the basic rule and should therefore be applied strictly. In other words, if VAT is to become chargeable on receipt of a prepayment, all the essential elements of a supply, in particular accurate details of the goods or services, should be known beforehand.
- Where there is any doubt that a taxable supply will take place, VAT is not chargeable.
- The missing date of supply in the contract does not mean that not all of the essential elements of an expected supply are known or that this is questionable, and so this is no reason for not charging VAT on the prepayment.

## Deducting input VAT on a prepayment

- The right to deduct input tax arises when the deductible VAT becomes chargeable (Article 167 of the VAT directive).
- Input tax is deducted according to the initial purpose for which the acquired goods or services are to be used. The actual use may create an obligation to make adjustments in future periods.
- The CJEU points out the buyer's liability for becoming a party to the transaction. It should be assessed whether the buyer had information at the time of entering into the transaction about the seller's intention of perpetrating fraud and whether there were any signs that the seller never intended to honour the contract. This supports the practice of the tax authorities of member states

(including Latvia) to prevent fraud, including by emphasising the buyer's liability for becoming a party to the transaction.

- If the buyer was not, and could not have been, aware of the seller's fraudulent intentions, there is no objective reason for denying the buyer's deduction of input tax on the prepayment.

#### Adjusting deducted input VAT if prepayment is not refunded

- The CJEU has earlier ruled that input tax should generally be adjusted for any wastage, theft or destruction of goods where this is confirmed by documentary evidence. Member states have the option of adopting restrictions on adjusting deducted input tax for thefts (section 106 of the Latvian VAT Act).
- The circumstances of the case in which the seller perpetrated a non-tax fraud of which the buyer was not and could not have been aware are consistent with a property theft. Thus, although the prepaid goods will not be supplied, and the taxable person cannot use them for making taxable supplies, the deducted input tax cannot be adjusted unless the seller refunds the prepayment.
- Input tax should be adjusted where it is obvious that the prepaid goods will not be eventually supplied, whether or not the VAT payable by the seller has been adjusted (Ruling of 13 March 2014 on C 107/13 Firin, paragraphs 52-53).

In the light of this ruling it is important to remember the need to adopt a tax risk management policy and regularly check that it works in practice. If you need any help in developing or auditing your risk management policy, please let us know.