

Deducting input VAT in chain of consecutive supplies (3/33/19)

On 10 July 2019, the Court of Justice of the European Union (CJEU) ruled on Case C-273/18 Kursu Zeme SIA vs the Latvian State Revenue Service (SRS), which examined the question of whether in a chain of consecutive cross-border supplies of goods with one transportation, the end customer – a Latvian entity – had the right to deduct the input VAT appearing on another Latvian entity's tax invoices if Kursu Zeme SIA received the goods in Lithuania (at the original supplier's warehouse) and itself ensured transportation to Latvia. This article explores the CJEU findings.

Facts and circumstances of the main proceedings

According to the CJEU ruling, Kursu Zeme, a taxable person registered for Latvian VAT, had deducted input VAT on the basis of a tax invoice issued by KF Prema, another Latvian VAT registered taxable person, for a supply of goods made in Latvia.

On a tax audit, the SRS found that the acquisition made by Kursu Zeme occurred at the end of a chain of consecutive supplies between multiple companies. Initially, Lithuanian-registered company Baltfisher UAB sold goods to two Latvian-registered companies, who sold them on to another Latvian-registered company, who sold them on to KF Prema, who finally sold them to Kursu Zeme. Kursu Zeme itself ensured transportation from Klaipeda to its factory in Latvia.

Being unable to find a reasonable explanation for this chain of supplies, the SRS claimed that the intermediary companies in fact performed no activity for making the acquisition of goods, and Kursu Zeme should have been aware of the artificial nature of the chain. The SRS claimed that Kursu Zeme in fact acquired the goods directly from the Lithuanian entity, and the SRS reclassified the acquisitions as intra-Community acquisitions of goods from Baltfisher UAB, a taxable person registered for Lithuanian VAT. As a result, Kursu Zeme's VAT returns were adjusted to increase the output VAT and simultaneously reduce by this amount the domestic input VAT reported by Kursu Zeme on the grounds that the supplies did not take place in Latvia.

In this case the SRS had not found that Kursu Zeme or any of the chain companies had obtained any unlawful tax advantage.

Kursu Zeme took the SRS to court over this decision. During the litigation, the Supreme Court of Latvia asked the CJEU to establish whether the VAT directive permits the tax authority to deny the input VAT deduction right if an acquisition of goods occurred at the end of a chain of consecutive supplies between multiple persons and if the taxable person acquired goods at a warehouse of a person that is involved in the chain but is not the person appearing as supplier on the invoice. The Supreme Court wished to establish whether this is sufficient for finding an abuse by the taxable person or other persons involved in the chain, or whether the court needs to prove what unlawful tax advantage the taxable person or other persons obtained.

In hearing the case, the CJEU stated that the fact that goods have not been received directly from the person who issued the invoice does not automatically mean that the real supplier was fraudulently

concealed, nor does it necessarily constitute an abuse, as this may have some other reasons, such as the existence of two consecutive sales of the same goods, which the first seller is ordered to transport directly to the second buyer. The CJEU stated that a supply of goods under the VAT directive is a transfer of the right to deal with the goods as their owner, and it is not necessary for the first buyer to have become owner of the goods at the time of transportation because a transfer of title to goods is not a precondition for the existence of a supply.

Since no tax advantage was found in the case, the CJEU stated that the existence of a chain of supplies and the fact that Kursu Zeme physically received the goods at the warehouse of Lithuanian company Baltfisher UAB per se cannot lead to the conclusion that Kursu Zeme has not acquired the goods from Latvian company KF Prema.

However, the CJEU calls attention to a question the Supreme Court has not asked, namely which of the supplies/acquisitions in the chain is the one to which the carriage from Lithuania to Latvia relates and which is the only one to be considered an intra-Community supply/acquisition of goods. The CJEU has stated that the Supreme Court should make a general assessment of all the circumstances of the case and particularly check when the right to deal with the goods as their owner passed to Kursu Zeme. The timing of that transfer, i.e. before or after the carriage, will determine which of the chain supplies/acquisitions is considered an intra-Community supply/acquisition of goods.

If a chain of consecutive supplies with one transportation had the intra-Community transportation occurring in the final supply, then that will be an intra-Community supply/acquisition of goods. In this case, the transaction between KF Prema and Kursu Zeme is not a domestic supply of goods and there are no grounds for charging Latvian 21% VAT. As a result, Kursu Zeme has no right to deduct the input VAT on the basis of an erroneous invoice issued by the supplier.

The CJEU stated that in this case Kursu Zeme should ask the supplier to refund the VAT through civil proceedings. Only if the supplier has in fact paid the VAT to the government and it turns out that a refund is either impossible or excessively difficult, including the event of the supplier's insolvency, the efficiency principle dictates that a refund request could be made directly against the tax authority, not the supplier.

It is important to note that if title to the goods in this chain of consecutive supplies passes to the end customer before transportation begins from Lithuania, all the previous sellers (Latvian companies) in the chain should be aware that the goods are treated as supplied in Lithuania and Lithuanian VAT should be charged on the supplies because no transportation occurs in those stages of the chain and the goods are in Lithuania at the time of the supply.