

Is input VAT deductible after breach of industry rules? (1/45/19)

We have written earlier about the Supreme Court of Latvia asking the Court of Justice of the European Union (CJEU) to make a preliminary ruling on Altic SIA (the “Company”) vs the Latvian State Revenue Service (SRS) regarding a possible breach of food industry rules in relation to input tax deduction rights. This article explores CJEU Ruling C-329/18 (see our [Flash News edition of 19 September 2018](#) for background details).

In an appeal to the Supreme Court, the SRS stated that Regulation No. 178/2002 requires food business operators to be able to identify any substance intended or expected to be incorporated into a food or feed, so they should have systems and procedures in place for passing this information to competent authorities. The Company did not run even minimum checks on its suppliers and failed to verify that they are registered with the Food and Veterinary Service, as considered necessary by the SRS. According to the SRS, this omission suggests that the Company knew or should have known that it was involved in abusing the common VAT system.

The questions asked and CJEU findings

The first question was whether the VAT directive (2006/112) must be interpreted as preventing a taxable food business operator from being denied input tax deduction rights because he has failed to meet the supplier identification requirement laid down by the industry rules to ensure traceability of foodstuffs.

The CJEU stated that first of all, the VAT directive gives no legal grounds for denying input tax deduction rights to a taxable food business operator that has failed to meet the supplier identification requirement. In fact, this requirement is not related to the material and formal conditions for input tax deduction laid down by the VAT directive. And the information available to the CJEU does not imply that the reason for such denial could be based on the national VAT legislation.

Secondly, the Company as a food business operator must comply with the food industry rules, but the obligations imposed to ensure traceability of foodstuffs are not aimed at discovering VAT fraud. In other words, the food supplier identification requirement aims to make it possible to withdraw certain foods from the market in an accurately targeted manner and to provide consumers or controlling officers with relevant information. Failure to meet this requirement may form a basis for enforcing penalties under national law.

Accordingly, this obligation cannot be considered a step the taxable person may be reasonably expected to take for making sure that his transactions are not part of VAT fraud. A possible failure to meet this requirement alone cannot form a basis for denying the taxable person’s input tax deduction rights.

The contrary would be true only if it were duly found that because of special circumstances the buyer of food should have had serious doubts about the food supplier’s actual existence or true identity, which should be established convincingly under the food industry rules. This omission could be one of the elements that consistently suggest that the taxable person knew or should have known that he was taking part in a transaction involving VAT fraud.

The CJEU found that the VAT directive must be interpreted as preventing a taxable food business operator from being denied input tax deduction rights only because he has failed to meet the supplier identification requirement. This failure may be one of the elements which suggests, in combination with others, that the taxable person knew or should have known that he was taking part in a transaction involving VAT fraud.

PwC concludes from the above that a breach of industry rules cannot be the sole reason for denying input tax deduction rights, but it may only serve as an additional piece of evidence.

The second question was whether the VAT directive must be interpreted as meaning that a taxable food business operator's failure to verify that his suppliers are registered with competent authorities under article 6(2) of Regulation No. 852/2004 and under article 31(1) of Regulation No. 882/2004 is relevant for the purpose of determining whether the taxable person knew or should have known that he was taking part in a transaction involving VAT fraud.

The CJEU stated that those Regulations do not require a taxable food business operator to verify that his suppliers are registered in accordance with those Regulations. And such a duty of verification with respect to input tax deduction does not arise under the VAT directive.

The CJEU replied that the VAT directive must be interpreted as meaning that a taxable food business operator's failure to verify that his suppliers are registered with competent authorities in accordance with the Regulations is not relevant for the purpose of determining whether the taxable person knew or should have known that he was taking part in a transaction involving VAT fraud.