

Tax authority's guidance on topical VAT issues in emergency situation (1/20/20)

As we wrote earlier in our article [Tax solutions to deal with COVID-19 consequences](#), both the VAT Act and the case law permit taxable persons to avoid adjusting their input tax deduction if they have acquired goods or services with VAT but for objective reasons have stopped doing business, implementing projects, and supplying goods or services to their customers. This article explores guidance the State Revenue Service ("SRS") published on 24 April to analyse VAT treatment in certain situations facing many businesses.

Comments published by the SRS on VAT treatment in three cases

1. Input tax deduction rights where a prepayment is not returned for goods or services acquired for any cancelled events the taxable person was planning to attend (cancelled business trips or exhibitions).

According to the SRS comment, where prepayments including Latvian VAT have been made for cancelled events (e.g. on hotel services or participation at an exhibition), and the money paid is not returned, a registered taxable person may deduct input tax on those expenses if they are incurred in the course of business for making taxable supplies, if the person can provide documentary evidence of the need for those expenses, and if their use can be traced.

It follows from the SRS comment that the basic principle of VAT deduction must be followed in this situation: input tax is deductible if goods or services are acquired for making taxable supplies. The person's original intention is likely to be valid and provable. Yet the SRS remark about use being traceable is confusing. It is clear that in the example mentioned by the SRS, the prepaid services (including VAT) have not been received, so there is no use to trace.

Many taxpayers would like to hear the SRS opinion, for example, on whether their input tax deduction needs adjusting in this case. On what conditions? What documents must the taxable person hold to prove that no adjustment is required? The SRS has yet to answer these questions, but for now, all the taxable person can do is assess the particular situation in the light of their documents, contract terms and other circumstances capable of affecting their input tax deduction rights.

In the VAT Act, it is section 106 which lays down the requirement for adjusting the input tax deduction: the input tax deduction needs adjusting if its amount changes. And the VAT directive provides that the originally deducted amount of input tax must be adjusted if it is higher or lower than what the taxable person was entitled to. Accordingly, if a supply has not taken place, the service has neither been received nor used for making taxable supplies, so the input tax deduction must be adjusted.

Yet could this rule qualify for a concession in this external crisis, which is beyond the control of taxpayers? As for goods, the VAT Act provides that the input tax deduction does not need adjusting if goods have been destroyed by a natural disaster or any other force majeure. Accordingly, the input tax deducted on goods that have perished in any force majeure does not need adjusting.

The VAT directive lays down detailed rules for adjusting input tax deductions, so taxpayers would benefit from some guidance on circumstances in which the input tax deduction does not need adjusting if a prepaid service is not received and the prepayment is not returned.

2. The right to deduct input tax on food additives, vitamins and over-the-counter medicines a company has acquired for its workers to protect them during the COVID-19 outbreak, and where the company provides, for safety reasons, regular meals to any workers unable to work remotely.

The SRS finds that the goods and services acquired for the stated purposes were not received and used for making taxable supplies, so the amounts of input tax appearing on the tax invoices are not deductible. The SRS comment is based on paragraph 159 of the Cabinet of Ministers' Rule No. 17, which provides that the input tax appearing on a tax invoice for goods and services acquired for a registered taxable person's staff recreation, private purposes (including transport, fuel and telecommunications), catering, health improvement or entertainment events is not deductible. No concession is made even in the crisis.

3. The right to deduct input tax on preventive items a company has purchased to protect the health of its workers and visitors during the COVID-19 outbreak.

The SRS does not give a detailed answer to the question but merely cites the general rules. In other words, if the company has received those preventive items in the course of business for making taxable supplies and is able to provide documentary evidence of the need for such expenses, the company will have the right to deduct the input tax on those goods. In practice, this means uncertainty and the risk that the SRS might challenge whether the preventive items acquired by the company were received in the course of business for making taxable supplies, so the SRS will have the power to restrict the right to deduct the input tax on those transactions. Accordingly, the input tax deduction rights will depend on evidence provided by the taxable person.

Undoubtedly, when analysing how inputs incurred are linked to taxable supplies and input tax deduction rights, we need to assess whether there is a direct and immediate link between the acquired goods or services and one or more supplies made later giving input tax deduction rights. The Court of Justice of the European Union states that a direct and immediate link exists if the cost of the acquired goods and services is a cost component of future taxable supplies giving the right to deduct input tax.

However, the taxable person is recognised to have the right to deduct input tax even without a direct and immediate link between an input incurred initially and one or more outputs made later that provide input tax deduction rights, as long as the costs of such services form part of the taxable person's general costs.

In summary, we feel that the answer to this question can be given only by assessing all the facts and circumstances of the situation in correlation with the supporting documents, while bearing in mind a fairly high risk that the input tax deduction rights may be denied in a potential tax dispute with the SRS.

In these confusing situations, we encourage you to carefully consider the validity of your input tax deductions and we offer our assistance in assessing these situations and protecting your legal interests.