

# New amendments to VAT Act take effect from 1 June (1/20/17)

New amendments to the VAT Act were published on 10 May, which Parliament had been debating since October 2016 but didn't pass until 20 April 2017. The amendments come into force on 1 June, except for those relating to the direct application of zero-rating to supplies of goods and services to Allied Headquarters staff members and US diplomats, which come into force on 1 January 2018. This article explores what we see as key changes.

## Input tax deduction point

Input tax is currently deductible only in one specified tax period when the criteria set by section 97(1) of the VAT Act are satisfied:

1. goods or services and a tax invoice have been received, or
2. a consideration for the supply of goods or services is paid before they are received.

This clause as amended allows a taxable person to deduct input tax on goods or services in the tax period when these conditions are satisfied or the following tax period.

For example, on 8 June Gem SIA receives goods from another Latvian-registered taxable person for making taxable supplies, and a tax invoice is issued on 5 June. The input tax appearing on the tax invoice can be reported by Gem SIA on its VAT return for June or July, assuming its tax period is one month. If it's one quarter, the input tax should be reported on the VAT return for the second or the third quarter.

## Input tax adjustment for bad debts

Very important amendments have been made to section 105 of the VAT Act, which prescribes input tax adjustments for bad debts with respect to age limitation. This section now has a new subsection (2.1) stating that the three-year condition will be treated as satisfied if within three years after the debt arose –

1. a court claim has been filed to recover the debt from the customer – with respect to the case mentioned in section 105(3), i.e. the debt is €430 or more;
2. the customer has gone into bankruptcy – with respect to the case mentioned in section 105(4); or
3. the customer has gone into insolvency – with respect to the case mentioned in section 105(5).

This will solve the problem taxpayers faced where debt recovery or insolvency proceedings lasted longer than three years.

## Construction services and alignment of terminology

Since the terms used in the VAT Act with respect to dealings in real estate, including construction services, aren't consistent with the terms used in the Construction Act (effective from 1 October 2014), the amendments substitute the term “renewal” for “renovation” and the term “rebuilding” for “reconstruction” throughout the Act. Paragraph 3 (“Zero Cycle Development”) has been deleted from section 142(4) of the VAT Act to make it consistent with Cabinet Regulation No. 500, *General Construction Rules*, because they don't use such a term.

Section 142(1) of the VAT Act, which lists the services attracting reverse-charge VAT, has been amended to read as follows: “For the purposes of this section, construction services shall mean the performance of construction work for the erection of a new building (or engineering structure) or for the renovation, simplified renovation, reconstruction, restauration, conservation or dismantling of an existing building or its part, and all types of design work included in a contract for construction services.”

Unfortunately it appears that Parliament hasn’t supported the version of this clause proposed by the Ministry of Economy (MOE), which provided for applying reverse-charge VAT to “...*the performance of any construction work and all types of design work included in a contract for construction services.*”

The MOE believes that section 142(1) refers to any type of construction work and design work: “...*this broad coverage isn’t altered by the separate reference to simplified construction processes. It was essentially construction work that was carried out as part of these simplified construction processes. The fact that renovation (renewal) and reconstruction (rebuilding) could in certain cases be carried out using a simplified construction process doesn’t alter the fact that renovation or reconstruction was carried out. Depending on the type of proposed construction work and the type of the building (or engineering structure), the current construction rules provide for various types of construction processes and specify cases where the person requires no permit of any type. Yet this doesn’t alter the fact that construction work of a particular type is carried out in all cases. Section 1 of the Construction Act names the types of construction work: renovation, installation, conservation, dismantling, placement, rebuilding, and restauration. Additionally, the building legislation uses the term “new construction” to indicate the creation of a new structure (one that didn’t exist before). All the types of construction work mentioned above are covered by the umbrella term “construction work” in section 1(2) of the Construction Act.*”

In our opinion, had the MOE proposal been adopted, the tax authorities and taxpayers would better understand this clause and avoid disputes over interpretation.

#### Other amendments

The following amendments have also been made to the VAT Act:

- Zero-rating will apply directly to domestic supplies of goods and services to staff members of an Allied Headquarters recognised in Latvia and their dependants, as well as domestic fuel supplies to the US Embassy in Latvia and its diplomatic and consular agents and back-office staff (from 1 January 2018);
- With respect to the new Customs Code, the terms used in the VAT Act have been clarified, and non-residents will have more opportunities to stay unregistered for Latvian VAT;
- An exemption will cover gambling games and lotteries organised through electronic communication services.