

CJEU ruling on reduction of taxable amount for VAT (1/49/17)

In November 2017, the Court of Justice of the European Union (CJEU) announced its ruling on a case concerned with a member state's power to restrict the right to reduce the taxable amount where a customer fails to pay, that is, on bad debts. This article explores CJEU findings.

Background

An Italian court asked the CJEU preliminary questions about whether national provisions of law are consistent with Article 90(1-2) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax. Among other things, Article 90(1-2) allows member states to lay down conditions that restrict the taxable person's ability to reduce the taxable amount if a debtor fails to make some or all of the payment due.

This provision has been passed into Latvian legislation and allows entities to adjust input tax on bad debts.

Circumstances of the main proceedings and CJEU findings

Case C-246/16 involved a dispute over whether the condition laid down by national legislation that the taxable amount cannot be reduced until the insolvency procedure has been completed is in line with provisions of the directive.

The CJEU stated that VAT is a consumption tax paid by the end consumer. The taxable person merely acts as a tax collector for the government, with the result that the taxable amount essentially cannot be higher than the price actually paid by the end consumer. Therefore, if the end consumer fails to pay the taxable person, the latter is not required to pay VAT because goods or services cannot then be considered to have been supplied for a consideration.

Under Article 63 of the directive, VAT becomes chargeable when a supply of goods or services has actually taken place. On conditions determined by member states, Article 90(1) of the directive allows the taxable person to adjust the taxable amount if the transaction is cancelled or refused, or if the price is not paid in whole or in part, or if it is reduced after the supply has taken place.

Article 90(2) of the directive has been adopted as an exception to Article 90(1) and applies to cases where payment for goods or services is outstanding in whole or in part. This provision allows member states to lay down conditions in order to ensure that the taxable amount is not reduced where payment of the consideration is quite possible but might be only delayed.

The CJEU stated that those conditions should be reasonable, they must not exceed such conditions as are necessary for achieving the purpose of the provision, they should be treated as an exception, and they must not restrict the core principles of VAT, especially its neutrality.

As stated by advocate general Juliane Kokott, any condition that causes the taxable person to pay over several years any VAT he has been unable to collect is a substantial encumbrance, violates the principle of

VAT neutrality, and puts the taxable person in circumstances of unfair competition. In that case the principle of proportionality is also violated because the encumbrance placed on the taxable person is disproportionate and not necessary for achieving the stated aim.

In this particular case the CJEU found that an identical result could also be achieved if the taxable person were given the right to reduce the taxable amount as soon as he sees a reasonable likelihood that the debt will not be paid off. This does not, however, exclude the possibility of having to revise the taxable amount upwards if payment is made at a later date. The CJEU states that such a condition would be likewise effective, only less burdensome for the taxable person.

As a result, the CJEU decided that a condition that allows the taxable person to reduce the taxable amount only when the debtor has completed his insolvency procedure is not permissible.

The Latvian VAT Act

Latvia has passed these provisions of the directive into section 105 of the VAT Act. This section defines a bad debt and explains the conditions a Latvian taxable person should meet in order to adjust the VAT charged on such a debt. It is important to note that like Italian legislation, section 105(5) of the Latvian VAT Act provides that VAT on a bad debt may be adjusted if that debt is recognised according to the register of creditor claims when the court has confirmed completion of the customer's insolvency procedure (or bankruptcy procedure if the customer is an individual).

In the context of this CJEU ruling, it would be useful to assess whether the concept of bad debt and the conditions on which a reduction of the taxable amount is permitted are in line with the CJEU findings.