

Is input VAT deductible after breach of industry rules? (1/38/18)

The Administrative Division of the Supreme Court of Latvia has asked the Court of Justice of the European Union (CJEU) to give a preliminary ruling on a case involving Altic SIA (the “Company”) against the Latvian State Revenue Service (SRS). This article explores the main aspects of the dispute.

Background

The Company bought rapeseed from two entities, with delivery and storage at a third-party warehouse (grain elevator). The Company deducted input VAT on those transactions. The SRS conducted a VAT audit of the Company and found that its transactions with the two suppliers never took place. As a result, the SRS assessed additional VAT, a penalty, and late charges.

There is no dispute as to whether the goods (rapeseed) were actually supplied. Likewise, there is no dispute as to whether the Company’s suppliers have signs of fictitious entities and the origin of the goods cannot be identified. So in this case, to deny the Company’s right to deduct input VAT, the court should establish that the Company knew or was supposed to know that its transactions were part of VAT fraud.

The transactions in question took place as follows:

- The Company did not search for its suppliers – rapeseed dealers, who themselves contacted the Company in response to a business advert the Company had placed in the mass media and on the Internet. It follows that the Company’s possible prior agreement in selecting its suppliers is not confirmed in the case.
- The dealers take the goods to the agreed destination, a grain elevator, where their quality is assessed and weighing done.
- The Company checks the quality of the goods delivered.
- Payment is made after the goods have been received and their quality checked.
- Under the agreement the third party (elevator) is responsible for the validity of information given on the consignment note and is liable for the consequences.
- The carrier does not deny having performed the carriage services, and the case has documents describing the process of carriage. The consignment documents imply that the goods were actually carried by identifiable parties, i.e. by the carriers specified on documents accompanying the vehicles.

Such circumstances require special reasons why the company should have made more enquiries about its suppliers, to serve as a basis for accusing it of having knowingly taken part in illegal transactions.

Questions referred to the CJEU

When hearing the case, the Supreme Court had doubts about interpreting article 168(a) of the VAT directive¹ in conjunction with the requirement for the registration of food companies in article 6 of Regulation No. 852/2004 and in article 31 of Regulation No. 882/2004. The court questioned whether verifying a food supplier’s registration with the Food and Veterinary Service makes a difference to assessing whether the Company knew or was supposed to know it was dealing with a fictitious entity,

given the nature of the transactions in question, including the fact that the Company checked the quality of the goods supplied.

In view of this, the following preliminary questions were referred to the CJEU:

1. Should article 168(a) of the VAT directive be read as implying that it is consistent with denying input VAT deduction if a taxable person involved in the distribution of food products, given the aim of Regulation No. 178/2002 to ensure that food is harmless, which is achieved *inter alia* by making food products traceable, has not, in selecting its suppliers, exercised a higher level of diligence that exceeds the ordinary course of business, which essentially includes an obligation to check its supplier, but has at the same time checked the quality of the food, thereby achieving the aim of the Regulation?
2. Does the requirement for registering an entity involved in the distribution of food products as laid down by article 6 of Regulation No. 852/2004 and by article 31 of Regulation No. 882/2004, interpreted in conjunction with article 168(a) of the VAT directive, place the company's service provider under an obligation to verify such registration? And does the verification make a difference to assessing whether the provider knew or was supposed to know he was dealing with a fictitious entity, given the nature of the transactions described?

We should point out that the CJEU has already addressed the question of how the legislation governing the industry affects the VAT treatment.

In the other case, a taxable person acquired by another trader was denied a VAT exemption only because the acquirer did not have the necessary licence to continue the previous business activity. The CJEU stated that the acquirer could not be denied an exemption only for that reason (case C-497/01 *Zita Modes Sarl*, paragraph 54).

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax