

Deducting input VAT on preparations for making taxable supplies (2) (2/17/19)

In an earlier article we explained some of the aspects a taxable person should consider when deducting input tax on preparations for making taxable transactions. This article explores a few examples from case law.

The tax authority denies input tax deduction

To build a spa hotel for a proposed business activity, a company had entered into a land lease and an asset management agreement, but the construction project was put on hold. The State Revenue Service (SRS) prevented the company from recovering a VAT overpay on the grounds that no business was being conducted at the registered address and there was nothing to suggest that the commercial intention could be carried out on the site. The SRS ruled against the company in the absence of proof for preparations the company had made and how that work was linked to its proposed business. On a tax audit, the company presented an architecture and planning task and a preliminary design, as well as mentioning the land lease and the asset management agreement, without presenting those documents to the court.

In another case, the SRS denied a link between a Latvian company's business and acquired services because they related to a property development owned by its subsidiaries. The ruling says there must be a consecutive (uninterrupted) chain of transactions to qualify for deducting input tax according to amounts of VAT that will be actually paid by the consumer of the goods or services. Before Latvia adopted the VAT grouping facility, related companies could not be considered a single entity for VAT purposes, and the intention of reorganising a group of companies to merge their liabilities is not sufficient for treating one company's liabilities as another company's liabilities before a reorganisation takes place.

The court upholds the right to deduct input tax

An unfavourable SRS ruling was based on a company's inability to prove a credible intention to operate as a credit institution in Latvia by registering a commercial bank for this purpose at the request of third parties, or the company's link to that intention. The SRS also found that some of the company's leased office space was not used in its business, so the company was denied an input tax deduction on transactions linked to that part of its office lease and utility services. However, the court disagreed with the SRS because the case materials implied that it was the foreign company who intended to operate as a credit institution in Latvia, not the Latvian company, whose intention was to provide the newly established bank with ancillary services, i.e. the necessary infrastructure. So the company's transactions linked to leasing, adjusting and equipping offices for banking needs are recognised as preparations generally consistent with the company's intention to conduct a business. Although the foreign company failed to obtain a Latvian banking licence, the Latvian company subleased the equipped offices to other credit institutions. The fact that the company's registered line of business (legal and management consulting services) was originally inconsistent with its proposed business is no basis for dismissing those preparatory activities.

In another case, the SRS rejected a company's intention of property development because the company had not prepared a construction design, had not obtained a construction permit, had not entered into

agreements for architecture, construction or construction oversight, had not built the property, and had not signed preliminary contracts with prospective apartment owners. The court again disagreed with the SRS because there was no basis for questioning a number of designs (such as a preliminary design, a plan for dismantling buildings, a preliminary design for road reconstruction, and a technical design for external power supply grids). Before starting construction work, the company might have made a number of necessary preparations that are aimed at property development but do not guarantee that the company will be able to start and complete the proposed construction or to sell the new apartments. A person's right to deduct input tax on preparations is based on a sufficiently credible and provable intention, rather than on reaching any specified stage, such as starting construction.

In yet another court case, some of the evidence a Latvian company had presented was its internal documents, including a progress report and a presentation to its parent company, which were not prepared for filing with any government agency. The court found that those documents objectively demonstrate the company's intention to develop the land. The SRS had wrongly alleged that such internal documentation was weaker proof than other types of evidence.