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Adjusting VAT on capital goods: who is liable for unmet non-adjustment conditions (1/50/20)

In its ruling C-787/18 (Sögård Fastigheter AB) of 26 November 2020 the Court of Justice of the European Union ("CJEU") looked into an obligation to adjust input tax on capital goods in a supply of real estate ("RE") and which party is liable. This article explores some of the CJEU findings.

Latvian legislation

Latvia has not adopted an option to tax that would allow a taxable person selling RE free of VAT not to adjust the input tax deducted on refurbishments on the sole condition that the new owner intends to use it for taxable supplies. However, no adjustment is required if RE changes hands in a transfer of business as a going concern or in an asset contribution. Accordingly, we could use the CJEU assessment of which party is required to adjust the input tax if the buyer is to blame for failing to meet the conditions for non-adjustment.

The issue under dispute

In 2012 a Swedish company acquired RE from a person that had taken a Swedish option to tax rental services. This option allowed the previous owner to deduct input tax on refurbishments to the building. VAT was not charged on the sale.

The Swedish VAT Act provides that on a sale of RE the buyer still has an option to pay VAT from the date of taking possession and replaces the previous owner in all his statutory rights and obligations.

The company rented the RE with VAT and sold it in 2013 to two individuals who did not plan to use it for taxable supplies. The Swedish tax authority asked the company to adjust the input tax deducted by the previous owner and repay VAT on the remaining adjustment period.

The company disagreed with the tax authority's decision and took the dispute to court. The Swedish Supreme Administrative Court suspended litigation and referred a preliminary question to the CJEU.

The basis for the CJEU assessment

The CJEU mentions the VAT directive's conditions for adjusting input tax on capital goods and the right to stop this adjustment before the time limit expires only if the goods are sold. In this situation, if the sale is taxed, no adjustment is required. If the sale is not taxed, then a single adjustment must be made to the input tax and VAT on the remaining adjustment period must be repaid to the government.

The CJEU points out that member states may allow non-adjustment of input tax deduction if capital goods are sold to a taxable person that uses them exclusively for supplies on which VAT is deductible. If the buyer stops this exclusive use, the conditions for non-adjustment are no longer met.

The CJEU states that a member state is not permitted to impose an obligation to adjust input tax deducted on goods and services on another taxable person that has not deducted that input tax. The CJEU invokes an earlier ruling of 10 October 2013 (Pactor Vastgoed, C-622/11, paragraphs 36 and 37) stating that input tax must be adjusted by the taxable person that deducted it. The CJEU finds that if the seller's obligation to adjust the input tax deduction were placed on the buyer, he would be required to pay a tax debt associated with a transaction he was not a party to and which was carried out in the course of another taxable person's business. And the seller that deducted the input tax would be taking a deduction that exceeds what he is entitled to given the actual use of the RE. This approach would destroy VAT neutrality.

The CJEU dismisses the argument put forward by other member states that it would be contrary to the principle of legal certainty and legitimate expectations to demand that input tax be adjusted by the taxable person that deducted it, i.e. the seller, if the buyer has changed the use of the RE, with the seller having no influence on that use.

Conclusion

As stated above, Latvia has not adopted an option to tax that would allow a taxable person not to adjust input tax deducted on construction, renovation or refurbishment where used RE is sold free of VAT on the sole condition that the new owner intends to use it for taxable supplies. Yet a dispute over the obligation to adjust the input tax deduction may arise on a transfer of business as a going concern or on an RE contribution to another company's capital. It is important to consider the details of this issue early on, that is, by reaching agreement on the transfer of RE (defining the parties' responsibility and obligations, and possibly the selling price). PwC offers assistance in handling this issue.