

# Can input tax deduction be restricted on grounds of unreasonable costs and inefficiency? 3/51/21



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The Court of Justice of the European Union (CJEU) has examined a question that often faces Latvian taxable persons. May an excessive price of advertising services and the fact that they are not clearly necessary for the company's business give the tax authority grounds for denying a deduction of input tax on the advertising expenses? This article explores the court findings and their practical implications.

## The circumstances of case C-334/20

Amper Metal, a Hungarian company dealing in electrical appliances, had entered into a contract with another Hungarian-registered taxable person for advertising services that involved placing advertising stickers with the Amper Metal brand on racing cars at autocross championships in Hungary. The transaction amounted to around EUR 133,230 plus VAT (27%), which Amper Metal claimed as input tax on its VAT return.

The Hungarian tax authority denied this input tax and imposed a late fee and a penalty for wrongful deduction of input tax. The tax authority based this treatment on an expert opinion that the advertising services were too expensive and were not useful. The tax authority claimed that the stickers placed on the racing cars could in no way affect decisions made by the company's customers (producers of paper and similar goods). So those expenses cannot be accepted as reasonable, profitable or useful because the services were too expensive and could in no way increase the company's revenue.

## The court assessment

What instructions did the CJEU give the Hungarian court in hearing the case?

The court stated that deduction rights arise and cannot be restricted to the extent a taxable person, acting as such, uses the acquired goods or services for making taxable supplies. Input tax paid on expenses that are not closely related to business (such as luxury, amusement and entertainment expenses) is not deductible.

According to the CJEU, first of all, there must be a taxable supply on which the taxable person wishes to deduct input tax. So there must be a legal relationship between the supplier and the customer involving reciprocal performance, and the service provider's fee is the actual payment for the service supplied to the customer.

On the question of whether an excessive service fee per se may be a reason for restricting input tax deduction rights, the CJEU stated that when it comes to classifying a transaction made for a consideration it does not matter whether business is conducted for a price that is above or below the cost price and thus for a price that is above or below the normal market price. The parties to the transaction agree on a consideration that is the taxable amount for the supplier. The consideration cannot be an amount set by the tax authority. The CJEU also states that the anti-fraud rule, which provides that the taxable amount is

the transaction's market value, applies only to recipients of goods and services that have family ties or other close personal ties, or management, ownership, participation, financial or legal ties as defined by the relevant member state. In Latvia an arm's length (market) value applies to a transaction between related parties within the meaning of the [Taxes and Duties Act](#) and only if one of the parties has its input tax deduction rights restricted. So an excessive price per se cannot be a reason for restricting input tax deduction.

As for the fact that the taxable person's revenue failed to increase, which suggests that the services supplied to him earlier were not useful, the CJEU states that the condition for input tax deduction requires the taxable person to use the acquired goods and services for making taxable supplies. Any expenses that are not closely related to business (such as luxury, amusement and entertainment expenses) are clearly excluded from deduction rights. Yet deduction rights are not subject to the taxable person's revenue growth condition or the transaction's profitability condition.

According to the CJEU, to assert that goods and services were acquired for making taxable supplies, those goods and services must have a direct and immediate link to a supply made later. This means the acquisition cost must form part of the price of supplies on which VAT is payable in the future, or at least the acquisition cost must form part of general costs which therefore constitute the price of taxable supplies made later. So the tax authorities and national courts should observe all the circumstances surrounding the supplies in question, and only supplies that are objectively related to the taxable person's taxable business should be taken into account when determining the deductible amount of input tax. In conducting this objective assessment, the fact that the taxable person's revenue has not increased cannot affect the exercise of deduction rights.

The CJEU recommendation that the national court should evaluate expenses is generally consistent with Latvian established case law, i.e. this type of expenditure could be recognised as:

- Expenses related to raising the company's profile and thus treated as representation expenses (with restricted input tax deduction rights); or
- Expenses related to making taxable supplies; or
- Non-business expenses.

It all depends on what evidence the taxable person presents.