Contribution in kind and VAT: Limited and general partnerships (3) 3/42/22

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To pick up where we left off about “contributions in kind” and VAT last week, this article explores a less common form of business – limited and general partnerships that make a “contribution in work” under a partnership agreement.

Limited and general partnerships are partnerships that aim to carry on a business under a joint name combining two or more persons (partners) under a partnership agreement. In a limited partnership, the liability of at least one of the partners (a limited partner) towards the partnership’s creditors is limited by the amount of his contribution. In a general partnership, the partners’ liability towards its creditors is unlimited. Each partner has to take part in the partnership with a contribution – they can contribute cash, assets, receivables, or work.

A “contribution in work” has yet to be publicly examined for VAT purposes. So we find it important to call our MindLink subscribers’ attention to Ruling C-98/21 issued by the Court of Justice of the European Union (CJEU) on 8 September 2022.

The case involves a limited partnership set up by two persons under a partnership agreement for the purpose of developing real estate. According to the background, the partnership’s business was mainly exempt from VAT (it was making exempt supplies).

One partner’s contribution was in cash and the other’s in work. The contribution in work took the form of architect services, statistical calculations, planning and other services supplied to the limited partnership free of charge. As part of his contribution, the partner used his own staff to supply some of the services, while others were supplied through acquiring goods and services from other vendors. The partner had also entered into an agreement with the partnership that provided for supplies of accounting and management services to it for a consideration.

The dispute in the case was not over the contribution in work being chargeable to VAT, but rather over the partner’s right to deduct the input VAT on services he had acquired from third parties to secure his contribution and then supplied to the partnership in exchange for a share in its profits.

As stated earlier, for input VAT deduction purposes the first thing we need to assess is whether the person acted as a taxable person in acquiring those goods and services, and whether they were used for making taxable supplies. Of course, we also need to assess whether a tax invoice was issued, whether the supplier is a taxable person, whether the transaction did in fact take place, and whether this was with the person named on the invoice. Yet none of these questions was on the CJEU’s radar this time.

There was no doubt that in making his contribution, the partner acted as a taxable person (this follows from the fact that the purpose of his contribution is a direct or indirect intervention in the running of the partnership by supplying it with management and financial services for a consideration).

The dispute was over whether the goods and services the partner had acquired can be treated as used for making taxable supplies, since his contribution is not a taxable supply.

In its ruling, the CJEU states that the partner acquired the services to carry out his obligation as a contributor. There is no doubt that the acquired services (and goods) were not used for supplying accounting and management services (they were not part of the price of those services). Also, the acquired services cannot be treated as representing the partner's general costs, since they were performed to help him secure a share and their sole reason was his contribution.

Accordingly, the CJEU found that the partner has no right to deduct the input VAT on architect services, statistical calculations and planning services acquired from third parties, since the partnership would use those services in its business. The services had a direct and immediate link with the partnership's own supplies, which were mainly exempt from VAT.

The CJEU referred to its earlier rulings, stating that expenses associated with a third party's supplies, rather than the taxable person's own taxable supplies, do not give him the right to deduct input VAT.

Interestingly, would the CJEU's ruling be different if the partnership were in a taxable business? What are the indications of how it could recover the input VAT on services it used in its taxable business?

For traders who find themselves in a similar situation to the facts and circumstances of this CJEU case, it is advisable to assess their input VAT deductions. If you have any questions, we are happy to help.