Obligation to adjust input VAT if company is deregistered for VAT and liquidated 3/45/22

Deducting input VAT, particularly on capital goods, is based on their intended use for taxable supplies. Intentions sometimes fail to materialise, raising the question of whether the taxable person becomes liable to repay the VAT deducted earlier. This question was handled by the Court of Justice of the European Union (CJEU) in Ruling C-293/21 of 6 October 2022. This time the CJEU examined the need for adjustment if the taxable person did not use the acquired goods and services for making taxable supplies because the shareholder decided to liquidate the company. This article explores the CJEU's findings and their practical implications.

The main proceedings and preliminary questions

A Lithuanian-registered company planning to conduct scientific research and put it into practice had made no taxable supplies since 2012. In 2012 and 2013, EU financing helped the company purchase goods and services in order to develop a prototype for a diagnostic and monitoring medical device (high-value assets). Input VAT was deducted on those goods and services. The acquired goods were capital assets (worth over EUR 350,000).

On completion of the project, the company was operating at a loss and kept making losses. Since there were no potential orders or income, the shareholder decided to wind the company up. The company was deregistered for VAT, without adjusting the input VAT deduction.

During a check, the Lithuanian tax authority claimed the taxable person was liable to adjust the input VAT deduction, and assessed additional VAT on the acquired goods and services that were not used for making taxable supplies.

The company challenged the tax authority's decision and said the expenses were incurred in preparation for business.

The case landed in the Supreme Court, which then asked the CJEU whether the taxable person is liable to adjust the input VAT deducted earlier on goods and services acquired for capital investment if those goods and services are no longer intended for making taxable supplies? And does the cause of liquidation matter?

The CJEU's findings

When hearing the case, the CJEU referred to the VAT system's neutrality: a taxable person has the right to deduct VAT on goods and services acquired for business purposes regardless of the aim or result of such activities if they are in principle subject to VAT. The CJEU also pointed out that the initial amount of deduction depends on the purpose of acquiring the goods and services, but this does not preclude possible adjustments going forward.

The CJEU also mentioned Ruling C-249/17 Ryanair, in which it held that the right to deduct VAT remains even if the intended business was not carried out and no taxable supplies were made because of circumstances beyond the taxable person's control.

However, the CJEU states that the mechanism of adjustment forms an integral part of the VAT system, and input VAT adjustments – particularly on fixed assets – must be made if there are no plans to use the acquired goods or services for taxable supplies, or if they are used for exempt supplies. For example, it is not sufficient that the taxable person still intends to use real estate for taxable supplies if it has been unoccupied since a lease was terminated. In that case, too, there is an obligation to adjust the input VAT deducted earlier for the period in which the real estate was not used for taxable supplies.

The CJEU finds that in this case, when the decision was made to deregister the company for VAT and liquidate it, the taxable person no longer had any intention to use the capital investment goods for taxable supplies, and that intention was final, giving rise to an obligation to adjust the input VAT deduction. The CJEU states that an adjustment might not be necessary if the taxable person's liquidation resulted in taxable supplies, such as asset sales to settle his debts even if this has no bearing on the business the taxable person originally intended to do. Also, the CJEU finds it irrelevant what the circumstances were around making the decision on VAT deregistration and liquidation because that decision per se indicates a change of intention – not to use the acquired goods for future taxable supplies.

Law and practice in Latvia

The Latvian VAT Act, too, states that for fixed assets worth EUR 70,000+ (ex VAT) on which input VAT has been deducted, the taxable person is liable to adjust the deduction for five years if the asset is not used for making taxable supplies only, or if the ratio of use for taxable and exempt supplies has changed. Input VAT adjustments are generally made through the annual VAT return, but in the case of liquidation (and VAT deregistration) an adjustment must be made by filing a statement of tax payment.