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By PwC Deutschland | 20. September 2022

Input VAT in case of insolvency of the seller may be deductible

In a preliminary request from Lithuania the European Court of Justice has ruled that it is contrary to EU law for the local tax authority to deny an input VAT deduction on the grounds of alleged abuse of rights solely because the seller is insolvent, and the buyer was aware of this situation.

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Background

According to the case-law of the ECJ, the tax authorities should be entitled or even obliged to deny a taxable person the right to deduct input tax if it knew or should have known that a transaction in a chain of supplies was involved in VAT fraud. **According to the Advocate General (AG) in the present case** the sanctioning of fraud under tax law and apart from the criminal law intended for such crime, raises questions about the (fundamental) rights of taxpayers. Even more so if it is to be sufficient in that respect that the taxpayer knew or should have known that the contracting partner would not pay the VAT owed by him or her. On the one hand, the mere possibility of non-payment of a tax does not constitute tax fraud; second, that would make it practically impossible to do business with undertakings in financial difficulties (that is to say, those that are in or are close to insolvency).

Case of dispute (insolvency of the seller of immovable property)

An undertaking that takes over goods from its debtor, who is heavily indebted to it, to cover part of the debt, could always be accused to the effect that it should have known that the debtor might not (or might not be able to) pay the VAT incurred from the sale of the goods. That now seems to have become the established practice of the tax authorities in Lithuania. There, the acquisition of goods from an undertaking experiencing financial difficulties is regarded as an abuse and, therefore, the right to deduct input VAT is denied. The present case from Lithuania thus gave the ECJ the opportunity to shed light on the limits of its case-law on fraud.

In the case of dispute, the plaintiff (HA.EN.), who had purchased the loans granted to the seller by a bank, knew that insolvency proceedings against the seller were initiated. In the following, HA.EN. exercised its right to take over the immovable property at issue during an auction of the seller which would settle part of HA.EN.'s claims. The seller thus issued an invoice indicating that ownership of the immovable property had been transferred to HA.EN. for a total amount inclusive of the appropriate amount of VAT. HA.EN. deducted the input VAT set out on the invoice in its VAT declaration. The seller also recorded the sale in its accounts including the output VAT payable, but never paid that VAT to the Treasury. The tax authorities refused the input VAT deduction since HA.EN. had committed a fraud and an abuse of rights.

ECJ decision: No automatic VAT fraud

The ECJ decided that *"Article 168(a) of the VAT Directive, read in conjunction with the principle of fiscal neutrality, must be interpreted as precluding a national practice under which, in the context of the sale of an item of immovable property between taxable persons, the purchaser is denied the right to deduct input value added tax (VAT) merely because he or she knew or should have known that the vendor was in financial difficulty, or even insolvent, and that that circumstance could result in the vendor not paying or not being able to pay VAT into the public purse."*

The ECJ went on to say that - in the context of the sale of an immovable property between taxable persons because of legal foreclosure proceedings - the local tax authorities cannot legitimately take the view that an abuse of rights committed by the purchaser existed based on the mere fact that the purchaser knew or

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should have known that the seller was in financial difficulties and might not be able to pay the VAT to the Treasury.

A national practice of that kind would also be contrary to the principle of fiscal neutrality because it implies that purchasers are not allowed to deduct the input VAT that they have paid in the course of a compulsory sale procedure, which effectively makes them bear the burden of that tax, whereas the principle of fiscal neutrality is meant specifically to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his or her economic activities (recalling the ECJ judgment of 13 March 2014, **C-204/13** *Malburg*, paragraph 41 and the case-law referred there).

Such practice, by effectively depriving taxable persons who have acquired immovable property in a compulsory sale procedure of their right of input VAT deduction, could also contribute to restricting the scope of potential purchasers. Therefore, it is counter-productive to the objective pursued by that type of (insolvency) procedure, namely, to realize the debtor's assets in the best possible way. Such practice also tends to isolate economic operators faced with financial difficulties and to hamper their ability to carry out transactions, in a way which is not consistent with the principle of fiscal neutrality, as that principle precludes distinctions between taxable persons based on their financial situation.

Source:

The ECJ case reference is **C?227/21** *HA.EN.* judgment of 15 September 2022.

Schlagwörter

VAT fraud, input VAT deduction