



Update on the scope and limits of input VAT recovery

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In brief

On 12 November 2020, the ECJ issued its judgement for two interesting cases in relation to the scope and limits of input VAT recovery. The first case (C-42/19 Sonaecom) relates to input VAT recovery on a potential acquisition of shares and restructuring which did not ultimately materialise. The second case (C-734/19 ITC Comercial Timișoara) relates to input VAT recovery on the acquisition of services or goods which are not used for their intended use for reasons beyond the taxpayer's control.

In detail

C-42/19 Sonaecom

Background

Sonaecom is a mixed holding company which, in addition to its business of acquiring, holding and managing shareholdings, provides strategic management and coordination services to companies operating in the telecommunications, media, software and systems integration markets. During 2005, Sonaecom purchased consultancy services in the form of a market study with a view to acquiring shares in a company in the telecommunications industry. Sonaecom intended to carry out the economic activity of providing the acquiring subsidiary with management services subject to VAT. However, the share acquisition did not ultimately materialise. Furthermore, Sonaecom engaged an investment bank for the issue of bonds in return for a commission with the intention to use the capital for the acquisition of the shares. Since the acquisition did not materialise, Sonaecom used the capital acquired to provide an interest-bearing loan to its parent company. Sonaecom claimed in full the input VAT incurred on the consultancy services received and the commission fee paid to the bank.

Judgement

The deduction system is intended to relieve the traders entirely of the burden of the VAT payable or paid in the course of their economic activities. The common system of VAT consequently ensures neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT.

The right to deduct, once it has arisen, is retained even if the intended economic activity was not carried out and, therefore, did not give rise to taxed transactions or the taxable person was unable to use the goods or services which gave rise to a deduction in the context of taxable transactions by reason of circumstances beyond his or her control.

However, the actual use of goods and services takes precedence over the initial intention. According to the opinion of the Advocate General on the same case, the nature of the transactions actually carried out by the taxable person should also be taken into account in cases where the former intention does not materialise. Otherwise, the right to deduct would afford him or her a competitive advantage over other undertakings which have carried out similar transactions. As a consequence, this would be contrary to the principle of fiscal neutrality.

On this basis, the ECJ ruled that:

- A mixed holding company whose involvement in the management of its subsidiaries is recurrent is entitled to deduct the input VAT paid on the purchase of consultancy services relating to a market study carried out with a view to acquiring shares in another company, including where that acquisition did not ultimately take place.
- A mixed holding company whose involvement in the management of its subsidiaries is recurrent is not entitled to deduct input VAT paid on the commission paid to a credit institution for organising and putting together a bond loan, which was intended for making investments in a given sector, where those investments did not ultimately take place and the capital obtained by means of that loan was paid in full to the parent company of the group in the form of a loan.

C-734/19 ITC Comercial Timișoara

Background

In 2006, the applicant (hereafter referred to as “ITC”) purchased a factory from a lift company with the view to demolish the existing building in order to construct a shopping centre and a building with offices. At the same time, ITC intended to construct a new factory in another plot of land and lease that factory to the lift company for a period of ten years. Various preparatory expenses were incurred by ITC for the construction of the buildings and the relevant permits for both projects. Input VAT incurred on such expenses was claimed. Due to the economic crisis of 2008 and some complications with the discussions for the permits with the public authorities, the projects were suspended. In a tax inspection, the tax authorities took the position that ITC has incorrectly claimed the input VAT on the expenses incurred for the construction of the buildings because the company did not ultimately proceed with the projects. The tax authorities argued that ITC was aware of the risks that may impact the completion of the projects from the beginning. In addition, they took the position that any services received by ITC on behalf of the lift company should have been recharged in order for the input VAT to be recoverable.

Judgement

Similarly with C-42/19, the ECJ supported the position that the right to deduct input VAT on goods and services purchased with the intention of carrying out taxable activities for VAT purposes is retained even when the intention was not materialised due to circumstances which are beyond the control of the taxable person.

Once again, the Court stated that it is not required by the tax authorities to assess the validity of the reasons leading a taxable person to abandon an economic activity as the purpose of the common system of VAT is to ensure neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject in principle to VAT.

In particular, the ECJ ruled that:

- The right to deduct input VAT on goods, in this case on real estate, and services acquired with a view to carrying out taxed transactions is maintained when the investment projects initially planned have been abandoned due to circumstances beyond the control of the taxable person and that there is no need to adjust this VAT if the taxable person still intends to use the said goods for the purposes of a taxed activity.
- In the absence of an agency contract without representation, the undisclosed agent mechanism is not applicable when a taxable person carries out a construction of a building in accordance with the needs and requirements of another person expected to lease that building.

The takeaway

It is apparent from the judgement of the ECJ in the above cases that input VAT incurred on an intended taxable activity, such as the potential acquisition of shares in a company with the view to provide management services which are subject to VAT, is recoverable even in cases where the intended taxable activity did not ultimately materialise for reasons which are beyond the control of the taxpayer. However, input VAT incurred on services or goods which were acquired with the intention to be used in a taxable activity and they are subsequently used in an exempt activity is not recoverable.

Let's talk

For a deeper discussion of how this case might affect your business and your input VAT recovery right, please contact:

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