VAT EUROPEAN CASE·LAW

On the affection to the economic activity and the VAT deduction (cases C-45/20 and C-46/20)

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FACTS (I)

In its judgment of 14-10-2021, C-45/20 and C-46/20, the ECJ has dealt with the always complex issue of the **affection to the economic activity** of the acquired goods and their necessary accreditation as regards the **VAT deduction**.

In Case C-45/20, E operated a scaffolding business and in 2014 commissioned an architectural firm to draw up the **construction** plans for a **single-family house**. These plans indicated that the house would have a total useful area of 149.75 m2 and would include on the ground floor a room called **"office"**, of 16.57 m2. The issued invoices for the construction corresponded to the period between October 2014 and November 2015. In his 2015 annual VAT return (received by the Tax Office on 9-28-2016), E requested by the first time the deduction of the VAT borne by the construction of the aforementioned office, a deduction that was denied by the tax authorities because the allocation of the asset in question to the assets of the company took place after 31-5-2016, which is when the deadline for submitting the annual turnover tax return for the year 2015 expired.

FACTS (II)

In Case C-46/20, Z acquired in 2014 a **photovoltaic installation**. Of the generated electricity, Z consumed a part and resold the remaining to an energy supplier, resulting in said **resale** subject to VAT. On 29-2-2016, Z presented his VAT return for 2014, deducting in it for the first time a series of amounts, which essentially coincided with the input VAT quota, documented in an invoice dated 11-9-2014, issued for the delivery and installation of the photovoltaic system. The tax authorities denied the deduction, understanding that as of 31-5-2015 Z had not adopted a decision on the allocation of the asset to the assets of its activity, that being the date on which the deadline for submitting the annual VAT return corresponding to 2014.

REASONING (I)

It has been raised before the ECJ whether the VAT Directive opposes national provisions to which a national court gives the interpretation that, when the taxable person is free to affect an asset to the economic activity and has not done what is necessary by means of an **express decision** or by means of sufficient indications, at the latest **after the expiration of the legal deadline for filing the VAT annual return**, so that the competent national tax administration is in a position to verify that such damage has occurred, that tax Administration may consider that the aforementioned asset has been so affected and deny the right to deduct the input VAT.

The ECJ has started from the **basic nature of the right to deduction**, its material requirements (both those who buy and those who sell the goods and services must be taxable persons and must be used in the needs of its own taxed operations) and formal (accounting, invoicing and tax declaration), principles all of them established in reiterated case-law.

REASONING (II)

Regarding **mixed-use goods**, which can be used at the same time for professional and for private purposes, the ECJ has also appealed to its well settled case-law, according to which the taxpayer has the possibility to choose, for the purposes of the deduction VAT, between including them in their entirety in the assets of the economic activity, keeping them entirely in its private activity or integrating them into the economic one only in proportion to their effective business or professional use (among others, judgments of 07-14-2005, Charles and Charles -Tijmens, C-434/03, and of 16-2-2012, Eon Aset Menidjmunt, C-118/11, based on the traditional decision of 4-10-1995, Armbrecht, C-291/92).

In the event that the taxpayer chooses to treat investment goods used at the same time for professional and private purposes as business goods, the VAT borne on the acquisition of said goods is, in principle, fully deductible. However, and here an important nuance is introduced, in the case of real estate, article 168a of the VAT Directive, in force since 2010, specifies that the deduction of VAT on expenses related to them heritage must be made proportional to its use in the economic activities. If the **affection is partial**, the **deduction of input VAT is also partial**.

REASONING (III)

On the date of acquisition of the goods, which is when the right to deduct VAT arises, the taxpayer must decide whether or not to act as such, which will determine whether or not he has the right to deduct input VAT (judgment of 22-3-2012, Klub, C-153/11). It follows that said option is a material requirement of the right to deduct.

The **accreditation** of whether or not the taxable person acted as such on the date of purchase is a **matter of fact** that must be proven by the competent national court, based on **objective factors** and after examining all the data of the case that is known to it (judgments of 2-14-1985, Rompelman, 268/83, and of 25-7-2018, Gmina Ryjewo).

In view of the above, which does not seem controversial, the ECJ has added that although an **unequivocal and explicit declaration** of the intention to affect the good to an economic use, formulated at the time of acquiring it, may be enough to conclude that the good was acquired by a taxable person who acted as such, the absence of that declaration does not exclude that **such an intention may be expressed implicitly** (judgment of 25-7-2018, Gmina Ryjewo, C-140/17), being able to admit, among others, elements such as the nature of the assets in question, the condition in which the interested party acts and the period elapsed between the acquisition of the asset and its use for the economic activities of the taxpayer.

REASONING (IV)

This part of the decision can lead to some confusion, since it mixes the **taxpayer's statement**, which indicates his intention to affect the assets to his economic activity by deducting the VAT thus borne, of an evident subjective character as an expression of his will, with the **objective elements**, more difficult to somehow be “manipulated”, to which he refers when he appeals to the implicit manifestation of the will to affect.

REASONING (V)

This issue is resolved in the following paragraphs of the judgment:

a) Noting that the **mere name of office** granted to a stay in a home, constituting a relevant indication for these purposes, is not decisive, being necessary that other objective factors corroborate the will to allocate said stay to economic activity (for example, a contract for the resale of the electricity generated, which may constitute an indication to this effect if the conditions of said resale correspond to those offered to professionals and not to individuals).

b) Clarifying that the **aforementioned deduction** of input VAT constitutes an **indication** that, when acquiring the asset, the taxpayer intended to affect it to its economic activity, and in such a case it must be presumed that the acquired asset has been so affected (judgment of 11-7-1991, Lennartz, C-97/90). On the other hand, the mere fact that no deductions were made in the declaration of the period in which the property was acquired does not allow to conclude that the taxable person chose not to affect his company.

c) Finally, and regarding its mandatory **communication** to the tax authorities, which is admitted, it is clarified that, although the adoption of a decision on the affectation is a material requirement to exercise that right, its communication to the tax administration is only a **formal requirement**. According to settled jurisprudence, the mere failure to comply with formal requirements cannot, by itself, imply the loss of the right to deduct, unless the failure to comply with such formal requirements had the effect of preventing the provision of certain proof that the material requirements have been (judgment of 28-7-2016, Astone, C-332/15).

REASONING (VI)

This breach by E and Z of the period given to them to transmit their decision on the affectation could not prevent them from providing certain proof that they adopted said decision at the time of the acquisition of the investment goods that are controversial in the main litigation. Furthermore, it did not appear that the German legislator established such a deadline in order to avoid tax fraud or abusive.

This relative flexibility has been completed with the **reference** to certain **general principles of EU law**, such as:

a) **legal certainty**, contrary to the right to deduction being exercised without any time limit,

b) **equivalence**, in such a way that the provisions in this way apply in the same way to similar rights in tax matters based on national law and those based on Union law,

c) **effectiveness**, so that it does not make it impossible or excessively difficult in practice exercise of the right to deduct, and

d) **proportionality**, aimed at minimizing the impairment of the principles established by the EU law, such as the fundamental principle of the right to deduct VAT, indicating the possibility of imposing sanctions regarding the latter less harmful than the complete denial of the right to deduct, as well as the fact that, at first glance, a term that expires beyond May 31 of the year following the decision on the affectation does not seem incompatible with compliance with the principle of legal certainty and the preponderant place that corresponds to the right to deduct in the common VAT system.

RELATED TOPICS (I)

Already included in some way in the previous paragraphs, there are two additional elements that are worth insisting on:

1st. The effect of the entry into force of the **Dir 2009/162** and the incorporation into the **VAT Directive** of its **art.168a**, which is expressly referred to in the judgment.

The option, which the ECJ itself had already recognized, to fully deduct VAT on items of partial use in economic activity and subsequently pay the part corresponding to private use in the form of a free supply, no longer exists. In light of the decision we are now commenting on, it does not appear that the ECJ pays more attention to this issue.

RELATED TOPICS (II)

2nd. The **relevance given to the deduction**, by the taxpayer, of input VAT on the purchase of mixed-use goods, which is admitted as a formal element, such that its non-compliance should not prevent a subsequent exercise, at the same time as its actual performance constitutes no more than a presumption.

This is where the main discussion arises:

a) Once the **presumption** is constituted, is it incumbent on the tax authorities to prove otherwise? It could well be considered that this is the case, but it does not make sense, since we would be facing a diabolical proof, the accreditation of a negative element - there was no intention of business use -, which would be imposed on who does not have more elements of proof than those provided by taxpayers.

RELATED TOPICS (III)

2nd (it continues):

b) Rather, once the deduction is made, the **primary requirement** in which the right is specified is fulfilled, constituting an appearance of affectation to the activity; however, and in the event of any control action, it is up to the taxpayer to provide the other objective elements with which to justify their right, as, on the other hand, the ECJ itself has indicated in other judgments on evidence in tax control procedures (judgments of 7-7-1981, Rewe/Hauptzollamt Kiel, C-158/80, 5-5-1982, Gaston Schul, C-15/82, 6-9-2012, Mecsek-Gabona, C-273/11, or of 27-9-2012, VSTR, C-587/10).

c) The latter is **consistent** with the conclusion of 14-2-1985, C-268/83, Rompelman, in which the ECJ stated that the acquisition of a right to the future transfer of property rights in part of a building yet to be constructed with a view to letting such premises in due course may be regarded as an economic activity within the meaning of the Sixth Directive. However, it does not preclude the tax administration from requiring the declared intention to be supported by objective evidence such as proof that the premises which it is proposed to construct are specifically suited to commercial exploitation (in the same line, as regards the effect of the submission of VAT returns, conclusion of 27-9-2007, Teleos and others, C-409/04).