

News Flash

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**Judgement of the ECJ concerning
the adjustment of deductions of
input VAT**

Adjustment of deductions of input VAT paid based on the final approval of an arrangement with creditors

In the judgement of the court C-396/16 T-2 of 12 October 2017, the EJC dealt with the question of adjustment of deductions of the VAT concerning acquisition of goods and supply of services in respect of which the final approval of an arrangement with creditors (hereinafter „ the arrangement with creditors“) has been confirmed.

Description of the situation of the Slovenian company

The Slovenian company T 2 (hereinafter „the Company“) operating within sector of the electronic communications, became due an arrangement with creditors liable to pay 44% of its liabilities within a period of nine years, which is a special procedure designed to alleviate the liabilities of insolvent debtors.

At the request of the tax authority, company drew up a list of its suppliers' invoices which underlied the arrangement with creditors and from which it had deducted input VAT. The Slovenian tax authority concluded that **the company must adjust its VAT deduction according to the amount corresponding to the reduction of its debts resulting from the arrangement with creditors.**

As a consequence of this, the Slovenian tax authority asked the company to pay VAT in the amount of EUR 7 362 080.27, which was be deducted initially. The Company appealed against this decision to ministry of finance, after rejection of the appealed filed a court complaint at Administrative Court, which rejected the complaint, and so the Company appealed to the Supreme Court.

The Supreme Court turned to the EJC in search of **determination, whether Slovenian tax authorities are entitled to demand a reduction of the deduction of input VAT**, as a result of the approval of the arrangement with creditors due which the company reduced its liabilities towards to its suppliers.

VAT deduction according to Slovenian law

According with the Slovenian law the taxable person shall adjust the initial VAT deduction, when it is higher or lower than VAT deduction to which the taxable person was entitled.

The adjustment shall be done also when sometime after the VAT deduction, some change in the factors, used to determine the amount to be deducted, occurs, for example when purchases are cancelled or price reductions are obtained.

The Slovenian law determines also situations when the taxable person shall not adjust the initial VAT deduction, such as **in the case of destruction of goods duly proved or loss of goods, or in the case of goods used as samples.**

Judgment of ECJ in the respective case

ECJ in this judgment decided that, the Article 185(1) of the VAT Directive must be interpreted to the effect that the reduction of a debtor's obligations resulting from the final approval of an arrangement with creditors constitutes a change in the factors used to determine the amount of VAT to be deducted, for the purposes of that provision.

It follows that the final approval an arrangement with creditors decreased liabilities of the company in relation to its suppliers, therefore the customer is obliged to adjust the amount of tax deduction to maintain the principle of tax neutrality.

The question, whether mentioned arrangement with creditors, which reduced liabilities, shall be regarded as a total or partial non-payment of a transaction, in which it is not possible to adjust the initial deduction of tax, the ECJ decided as follows.

The article 185 (2) of the VAT Directive is to be interpreted as meaning that a reduction in the liabilities of an insolvent debtor resulting from a procedure for reaching an arrangement with creditors **does not represent a total or partial non-payment of a transaction, in which it is not possible to adjust the initial deduction of tax, if this reduction is final.**

Adjustment of the VAT deduction in the case of a totally or partially unpaid transaction or in the case of the theft

The last question, which the Supreme Court asked the ECJ was related to the article Article 185(2) of the VAT Directive according to which member states may require an adjustment of the VAT deduction in the case of a totally or partially unpaid transaction or in the case of the theft.

The Slovenian law does not expressly require this adjustment, but simply does not include those cases in the list of derogations from the adjustment obligation. In that regard the ECJ has made it clear that member states is not required to provide an express provision for an obligation to adjust the deductions in the case of transactions remaining totally or partially unpaid, it is sufficient, that these cases are not included in the list of derogations from the adjustment obligation.

Slovak law

Under the Slovak law, the Slovak Republic applies an exception from the article 90 (2) of the VAT Directive, according to which in the case of total or partial non-payment after supply of goods or services, **the tax base and the amount of the tax shall not be corrected.**

However, as is clear from the ECJ decision, a reduction of liability of debtor following from restructuring shall be considered as a circumstance for the correction of the tax base according to the § 25 of the VAT Act, both on the the debtor's side as well as on the creditor's side.

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