

# News Flash

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**ECJ judgment: Right to deduct input VAT, in case the seller is subject of bankruptcy proceedings**

## ECJ judgment: Right to deduct input VAT, in case the seller is subject of bankruptcy proceedings

In this issue of our News Flash, you will learn about a case concerning the right to deduct value-added tax (VAT) paid on input in case the seller is in bankruptcy.

The European Court of Justice (ECJ) addressed the question in judgment C-227/21 of September 15, 2022, whether the acquirer of a bankruptcy estate should be **denied the right to deduct input VAT paid, on the grounds that the seller, who was in bankruptcy proceedings at the time, subsequently did not remit the VAT** from the sale of the bankruptcy estate to the state budget.

### Lithuanian tax office rejected VAT deduction claim

The judgment concerns a **Lithuanian bank UAB**, which provided a loan to a third party (hereinafter referred to as the "seller") for real estate development. To ensure the proper performance of the contract, **the seller established a contractual mortgage right on the real estate with the bank.**

Subsequently, the seller encountered financial difficulties and was forced to **sell the mortgaged property in bankruptcy** to the UAB bank. Since no one showed interest in the property during the bankruptcy proceedings, in accordance with Lithuanian Civil Code, the property was acquired at the auction price by the UAB Bank.

In this transaction, the seller issued an invoice with VAT, which was accepted by UAB Bank and the entire amount including the VAT was paid. UAB deducted the paid VAT through the tax return, however **the seller duly reported the invoice in the VAT return, but never remitted the output VAT to the state budget.**

### The EU legal framework and preventing the tax evasion

As evident from the nature of the transaction, this is a **highly risky transaction**, since the seller is a person in financial distress and there is a reasonable concern that the VAT received as consideration for the sale of the bankruptcy estate might not be remitted to the state budget.

In this context, we draw attention to Directive 2006/112/EC on the common system of value added tax, where in Article 193 it is stated *"VAT shall be payable by any taxable person carrying out a taxable supply of goods or services, except where it is payable by another person in the cases referred to in Articles 194 to 199 and Article 202."*

Article 199 par. 1 letter g) of the Directive states that *"Member States may provide that the taxable person liable for payment of VAT is the taxable person to whom any of the following supplies have been made: **the supply of immovable property sold by a debtor in proceedings for the compulsory sale thereof by order of a court.**"*

As evident from the Directive, **the aim of such transactions is to transfer the tax liability to the buyer or the acquirer of the bankruptcy estate in order to minimize potential issues with non-remittance of VAT to the state budgets.**

In this context, it is necessary to emphasize that the lawmakers in Lithuania have decided not to adopt this exception into their tax legislation and the reason for this is unclear.

## Application to the Slovak Value Added Tax Act

The Slovak lawmakers decided to **transpose the above-mentioned exception into the Slovak Value Added Tax Act**, namely in § 69 par. 12 letters e), which states that *"The taxpayer who is the recipient of a supply from another taxpayer shall be obliged to pay the tax attributable to the supply of goods that constitute a collateral securing of a creditor's receivable in the exercise of the right arising from that receivable; in the case of a collateral assignment, the recipient of the transaction means the taxpayer whose receivable has been secured and the taxpayer who has acquired the collateral."*

In case that the similar situation arises in the Slovak Republic, the respective provision ensures that the seller of the bankruptcy estate **transfers the tax liability** (the reverse charge mechanism) **to the acquirer of the bankruptcy estate, who will self-assess the acquisition, and at the same time deducts the VAT in their VAT return, thus preserving the neutrality of the VAT system.**

At the same time, there is no possible evasion of VAT, which is one of the objectives of the Directive itself and of the tax authorities throughout the European Community.

Are you interested in another case where the ECJ decided on exemption from VAT payment? Read our article on [financial services provided based on a sub-participation agreement](#).

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