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Denial of the right to deduct VAT in case the right is exercised after the expiry of the limitation period or in case of omitted prior registration of the taxable person

VAT Alert

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Judgments of the European Court of Justice no. C-429/23 dated 12 September 2024, Nare BG case, and no. C-624/23 dated 21 November 2024, Sem Remont case

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1. Introduction

With judgment no. C-429/23 dated 12 September 2024 – ***Nare BG*** case – and judgment no. C-624/23 dated 21 November 2024 – ***Sem Remont*** case – the European Court of Justice (hereinafter, also CJEU) analyses the case concerning the possibility that a Member state could deny the right to deduct VAT, if such right is exercised after the expiry of the limitation period or in case the service provider, which is not established within the Member state in which the transaction is relevant, has not been registered for VAT purposes in order to charge VAT levied on taxable client established in that Member state. Both judgments concern cases occurred in Bulgaria, in which the concerned taxable persons committed some imprudence with reference to the correct fulfilment of their obligations. The CJEU showed concerns on the possibility that the omitted recognition of the right to deduct VAT by a Member state could contrast with the principles of tax equivalence, effectiveness, and neutrality and, more precisely, with the principle of legal certainty, emerging from the provisions of Directive 2006/112/EC (VAT Directive).

2. The case analysed by the CJEU

Both cases, even though not identical, led to the denial of the right to deduct VAT, in relation to the time within which such right was exercised and to the operating procedure used by the taxable persons to reach such result.

In Nare BG case, the right to deduct VAT was exercised beyond the twelve-months term provided by the Bulgarian Tax Authorities, "for the taxable transactions carried out before (the) registration for VAT" by the concerned taxable persons. In fact, the Romanian company, despite having met the term for registration, did not deduct VAT within the following twelve months, as provided by the domestic regulation, through a new VAT return aimed at amending the previous one, to be submitted before the expiry of such term. In this regard, some problems were identified, which were related to COVID-19 emergency, for which some extensions for the compliance of other tax-related fulfilments were issued.

On the other hand, in Sem Remont case, the provider of goods and services (Russian company, not established in Bulgaria) did not register for VAT purposes when its taxable turnover exceeded the threshold provided by the Bulgarian regulation (and registered later) and, therefore, issued invoices to its customer without charging VAT. Moreover, during the preparation of minutes by the Bulgarian Tax Administration, which imposed the payment of the tax due, the supplier company appeared both as creditor and debtor of the same amount.

3. Analysis of the Court of Justice

The complicated case was analysed by the CJEU, which identified a series of principles that should be observed for a correct application of the VAT deduction system.

Firstly, the Court affirmed that "*according to settled case-law, the right of taxable persons to deduct the VAT due or paid on goods purchased and services received as inputs from the VAT which it is liable to pay is a fundamental principle of the common system of VAT established by EU legislation*" (point 45, Nare BG). Such principle is "*intended to relieve the taxable person entirely of the burden of the VAT due or paid*", ensuring neutrality of taxation, but this "*cannot [...] have the effect of allowing a taxable person to adjust a deduction entitlement which it did not exercise before the expiry of a limitation period and which it has therefore lost*" (point 65, Nare BG). However, the extension of "*the time limits for the filing of returns and payment concerning certain direct taxes*", without providing for any special scheme for VAT (with reference to filing, payment or deduction), "*is not sufficient to render that legislation incompatible with the principle of equivalence*" (point 55, Nare BG).

As for the other dispute, Sem Remont case, the CJEU specifies that "*the right to deduct (...) is an integral part of the VAT scheme and may not, in principle, be limited. In particular, the right to deduct is exercisable immediately in respect of all the taxes charged on input transactions*" (point 33, Sem Remont). However, this assumption is subject to the meeting of specific requirements, including the condition requiring VAT claimed for deduction to be actually due or paid (principle already explained in judgment no. C 156/20 dated 13 January 2022, Zipvit case, point 22). Moreover, also when the price is agreed by the parties "*without any reference to VAT and the supplier is the taxable person for the VAT owing on the taxed transaction, the price agreed must be regarded (...) as already including VAT*" (point 35, Sem Remont).

In the case at issue, however, the Russian company omitted the amount of the tax due in the invoices issued to the Bulgarian company (Sem Remont) and, in fact, such invoices "*referred only to the taxable amount exclusive of VAT, that tax having been indicated only in the report issued by the supplier, namely Gidrostroy – Russia, during the tax inspection*" (point 36, Sem Remont). Such behaviour, consisting in the omitted indication of VAT in the invoice, did not allow the customer (Sem Remont) to deduct the relevant tax, since it did not have the document justifying the possibility to deduct input VAT paid.

Moreover, in the opinion of the Court, it is clear that "*the fundamental principle of VAT neutrality requires that the deduction or refund of input VAT be allowed even if the taxable person has failed to comply with some of the formal requirements, that is subject to the condition that the substantive requirements have otherwise been satisfied*" (point 48, Sem Remont). This does not mean, though, that invoices cannot be retroactively adjusted in relation to deduction. Indeed, the VAT directive provides for the deduction adjustment cases, in order to make this right as consistent as possible with the factual reality.

However, the de facto situation occurred in the case under analysis must be considered, which led to the non-recognition of the right of deduction for Sem Remont and to the subsequent impossibility to adjust deduction, since "*the mechanism for the adjustment of undue VAT deductions provided for by the VAT Directive is not applicable when the deduction was initially made in the absence of any right of deduction*" (point 55, Sem Remont).

4. Conclusions

The issues raised, for which the Tax Authorities denied the right for the service receiver to deduct VAT (in both cases), led the CJEU to recognise the validity of the regulations and/or Bulgarian domestic practice issued in this regard.

On the one hand, it was declared that "*the principles of equivalence, effectiveness and neutrality of VAT must be interpreted as not precluding national legislation and administrative practice under which a taxable person is denied the right to deduct input VAT paid prior to that taxable person's registration for VAT, on the ground that that person requested that deduction after the expiry of the limitation period laid down by the applicable national legislation, by means of a return seeking to correct a VAT return filed before the expiry of that period, notwithstanding the fact that national measures linked to the COVID-19 pandemic were adopted in order to extend the time limits for the filing and payment of certain taxes, without including VAT among those taxes*" (point 66, Nare BG).

On the other hand, the CJEU stated that the "*legislation of a Member State under which the recipient of a supply subject to VAT is denied the right to deduct that tax*" is not contrary to EU provisions, "*where the supplier, first, has failed to fulfil its obligation, laid down by that legislation, to submit an application for registration for VAT purposes and issued for the recipient invoices not stating VAT, and, second, issued, during a tax inspection, a report stating that VAT and in which that supplier was put forward as also being the recipient of that supply*" (point 44, Sem Remont).

Moreover, with reference to the possibility to adjust deduction, the CJEU underlined that "*the VAT Directive and the principle of neutrality of VAT must be interpreted as not precluding legislation of a Member State which excludes the possibility of correcting an invoice where, first, the invoice which the supplier has provided to the recipient of a supply subject to VAT did not state that tax and, second, during a tax inspection of that supplier, the supplier drew up a report stating the VAT and putting forward the supplier as also being the recipient of that supply*" (point 61, Sem Remont).

Both judgments of the CJEU concern particular situations related to the Bulgarian legislation, which is substantially different from the Italian one. In fact, as concerns the Italian system, the existing limits to VAT deduction are not in contrast with EU provisions, but underline that the right to deduction can be granted if VAT related to the transaction/provision received by the customer is due and the receiver has the relevant justifying document (ref. circular letter no. 1/E dated 17 January 2018). Moreover, again with reference to the Italian provisions, some limits are set to the possibility to extend the terms to deduct VAT, considered that the abovementioned circular letter admits the exercise of the right to deduct VAT paid on purchases or importations at the latest with the VAT return referring to the year in which such right arose (i.e., when the tax became due) and subject to the registration of the invoice in the purchase register (as provided under art. 25 of Presidential Decree no. 633 dated 26 October 1972).
In relation to the above, the judgment under analysis dictates some principles, which must in any case be considered by the taxable persons who intend to deduct VAT.
In particular, as indicated under point 51 of Nare BG judgment, "*the possibility of exercising the right to deduct VAT without any temporal limit would be contrary to the principle of legal certainty*". Therefore, it appears clear that "*a limitation period the expiry of which has the effect of penalising a taxable person who has not been sufficiently diligent*" cannot be considered as being in contrast with EU rules on VAT, provided that it does not prejudice the principles of equivalence and effectiveness, introducing, on the one hand, different systems and, on the other hand, making the right to deduction excessively onerous or difficult (point 52, Nare BG).
Lastly, as stated under point 57 of Sem Remont judgment, "*the harmonised VAT system does not preclude national legislation under which the right to deduct VAT may be refused to taxable persons who are recipients of services and are in possession of invoices which are incomplete, even if those invoices are supplemented by the provision of information seeking to prove the occurrence, nature and amount of the transactions invoiced after such a refusal decision was adopted*".

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