European Union - ECJ Decisions in the *Skellefteå Industrihus AB* and *Vittamed* Cases: A Severe Blow to the Neutrality of the VAT System

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In this Column, the author analyses the ECJ's decisions in the *Skellefteå Industrihus AB* and *Vittamed* cases, which concerned the issue whether or not a taxable person should adjust the VAT deductions made in connection with a project that was abandoned.

In May 2021, the Court of Justice of the European Union (ECJ) delivered a surprising Order in the *Skellefteå Industrihus AB* case. [1] In this case, a taxable person intended to erect new buildings with a view to sell them subject to VAT, but the project was eventually abandoned. The ECJ decided, by Order, that this taxable person should have adjusted the VAT deductions made in connection with that project (mostly consisting in the VAT incurred on the architect services that were not "used" since the project was abandoned). The ECJ, now, confirmed this position in its decision rendered on 6 October 2022 in the *Vittamed* case. [2]

This new line of case law is surprising (to say the least) because, since *INZO*, [3] it is undisputed that deductions made by a taxable person cannot be revoked on the ground that the economic activity envisaged has not given rise to taxable transactions. Surprisingly, the ECJ now "clarified" that this principle must be combined with the VAT Directive [4] rules on adjustments.

Vittamed was a Lithuanian company that acquired goods and services in 2012 and 2013 with a view to developing and marketing a prototype of a medical diagnostic and monitoring device. It deducted EUR 87,987 of VAT paid in respect of those inputs and used them to produce intangible capital goods (licences) and tangible capital goods (prototype devices). However, Vittamed operated at a loss in 2014 and 2015, and the previous losses recorded by that company increased continually. In view of those loss-making years and the absence of orders and potential income, Vittamed's sole shareholder decided to place the company in liquidation and submitted its last VAT return in September 2015.

The ECJ decided that if Vittamed no longer had any intention of using the capital goods produced for the purposes of taxed transactions,

> the close and direct relationship which must exist between the right to deduct the input VAT paid and the carrying out of the planned taxed transactions was broken, and that the adjustment mechanism provided for in articles 184 to 187 of the VAT Directive [5] should be applied.

In other words, Vittamed should reimburse the VAT deducted on the goods and services acquired to obtain the licences and build its prototypes. The ECJ added that there would have been no obligation to proceed to adjustments had the company resold the prototypes and the licences, but who would want to buy prototypes and licences related to a failed project? And, in the *Skellefteå Industrihus AB* case, how could they have resold unused architect services to avoid the adjustment?

In the author's opinion, this new line of case law is difficult to reconcile with the fundamental principles underlying the VAT system. VAT is a tax on private consumption and it should be neutral on businesses who engage into a taxable economic activity, whether or not that activity is successful. To that end, taxable persons should keep the right to deduct VAT on their inputs, whatever the result of the economic activity they engaged in.

In this connection, it should be pointed out that, in the Vittamed decision, the Court began by recalling that the outcome of the *INZO* case (i.e. that the right of deduction, once it has arisen, is retained even if, subsequently, the intended economic activity was not carried out and, therefore, did not give rise to taxable transactions) guarantees the neutrality of the VAT system and that:

> Any other interpretation would be contrary to the principle that VAT should be neutral as regards the tax burden on a business. It would be liable to create, as regards the tax treatment of the same investment activities, unjustified differences between businesses already carrying out taxable transactions and other businesses seeking by investment to commence activities which will in future be a source of taxable transactions. Likewise, arbitrary differences would be established between the latter businesses, in that the final acceptance of the deductions would depend on whether or not the investment resulted in taxed transactions. [6]

According to the Court, therefore, revoking the right to deduct of a taxable person who has not been able to carry out taxable transactions would be contrary to the principle of neutrality, whereas imposing (potentially full) adjustments on the same taxable person would not. Admittedly, the rejection of the deduction does not have exactly the same result as the obligation to proceed to an adjustment (since, in the event of rejection of the deduction, fines and interest for late payment are in principle applicable). The obligation to adjust the VAT nevertheless results in a definitive tax burden, and therefore in a difference in treatment between successful and unsuccessful companies!

The author is also wondering how to reconcile this decision with other decisions, such as *Fini H*, [7] in which the ECJ decided that a person who has ceased an economic activity but who, because the lease contains a non-termination clause, continues to pay the rent and charges on the premises used for that activity, is to be regarded as a taxable person and is entitled to deduct the VAT on the amounts thus paid. In this case, too, it was clear that the taxable person would no longer carry out taxable supplies; yet the ECJ confirmed that this person had a right to deduct the VAT and it did not mention the need to proceed to adjustments …

Two concrete questions now arise:

(1) Should we update all EU VAT textbooks and clarify that even if the right to deduct cannot be challenged when a taxable person must abandon a project, this person might still be required to proceed to adjustments (and that the conclusions drawn from landmark cases such as *INZO* and *Fini H* must therefore be nuanced)?

(2) Should we warn innovative companies against the potential weight of a VAT that would have to be repaid to the Treasury if a project is abandoned?

Let us conclude on a third (more positive) question: can we hope that the ECJ will clarify in a subsequent judgment that adjustments [8] are only required when the risk of abuse or personal use of the goods and services acquired in the context of an aborted project cannot be ruled out? Such a clarification would be a relief for entrepreneurs, who know that failure is always part of the bargain.

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1.
SE: ECJ, Order of 18 May 2021, Case C-248/20, *Skatteverket v. Skellefteå Industrihus Aktiebolag*, Case Law IBFD (accessed 10 Mar. 2023). On this decision, *see* M. Lamensch, *Order in Skellefteå Industrihus AB: A reversal of the INZO, Ghent Coal Terminal and Breitsohl jurisprudence?*, 31 EC Tax Review 31 (2022).

2.
LT: ECJ, 6 Oct. 2022, Case C-293/21, *'Vittamed technologijos' UAB, in liquidation v. Valstybinė mokesčių inspekcija*, Case Law IBFD (accessed 10 Mar. 2023).

3.
BE: ECJ, 29 Feb. 1996, Case C-110/94, *Intercommunale voor zeewaterontzilting (INZO) v. Belgian State*, Case Law IBFD (accessed 10 Mar. 2023). This case law has been confirmed several times, for example in cases BE: ECJ, 15 Jan. 1998, Case C-37/95, *Belgische Staat v. Ghent Coal Terminal NV*, Case Law IBFD (accessed 10 Mar. 2023), DE: ECJ, 8 June 2000, Case C-400/98, *Finanzamt Goslar and Brigitte Breitsohl*, Case Law IBFD (accessed 10 Mar. 2023) and IE: ECJ, 17 Oct. 2018, Case C-249/17, *Ryanair Ltd v. The Revenue Commissioners*, Case Law IBFD (accessed 10 Mar. 2023). It goes without saying that if the inputs are eventually used to make exempt transactions, an adjustment is required (*see,* for example, NL: ECJ, 17 Sept. 2020, Case C-791/18, *Stichting Schoonzicht v. Staatssecretaris van Financiën*, Case Law IBFD (accessed 10 Mar. 2023), DE: ECJ, 9 July 2020, Case C-374/19, *HF v. Finanzamt Bad Neuenahr-Ahrweiler*, Case Law IBFD (accessed 10 Mar. 2023) and PT: ECJ, 12 Nov. 2020, Case C-42/19, *SONAECOM, SGPS S.A. v. Autoridade Tributária e Aduaneira*, Case Law IBFD (accessed 10 Mar. 2023).

4.

Council Directive 2006/112/EC of 28 November 2006, on the common system of value added tax, art. 16 and 26, OJ L347/1(2006), Primary Sources IBFD [hereinafter VAT Directive].

5.

The ECJ thus here refers to all the provisions related to adjustments and not only those related to capital goods.

6.

Vittamed technologijos (C-293/21), para. 44, with references to the following judgments: *INZO v. Belgische Staat* (C-110/94), para. 22, and *Ryanair* (C-249/17), para. 25.

7.

DK: ECJ, 3 Mar. 2005, Case C-32/03, *I/S Fini H v. Skatteministeriet*, Case Law IBFD (accessed 10 Mar. 2023).

8.

Or a deemed supply under the VAT Directive.

M.C.S. Lamensch, ECJ Decisions in the Skellefteå Industrihus AB and Vittamed Cases: A Severe Blow to the Neutrality of the VAT System, 34 Intl. VAT Monitor 2 (2023), Journal Articles & Opinion Pieces IBFD.