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Forum

Order in Skellefteå Industrihus AB: A Reversal of the INZO, Ghent Coal Terminal and Breitsohl Jurisprudence?

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The Order issued by the Court of Justice of the European Union on 18 May 2021 in Skellefteå Industrihus AB may have escaped the attention of most VAT scholars and practitioners. In my opinion, however, it is either based on a wrong interpretation of the Court's case law in the ITH and Stichting Schoonzicht cases, or constitutes nothing less than a reversal of the CJEU landmark INZO and Breitsohl decisions.

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1 Introduction

In accordance with Article 99 of the Rules of Procedure of the Court of Justice of the European Union ('the Court'):

> *Where a question referred to the Court for a preliminary ruling is identical to a question on which the Court has already ruled, where the reply to such a question may be clearly deduced from existing case-law or where the answer to the question referred for a preliminary ruling admits of no reasonable doubt, the Court may at any time, on a proposal from the Judge Rapporteur and after hearing the Advocate General, decide to rule by reasoned order.*

Orders, therefore, only 'repeat' what has already been decided in previous similar case(s), which is why they usually attract very little attention. This implies, however, that the Court makes a correct interpretation of its own case law.

In *Skellefteå Industrihus*,[1] the Court decided that adjustments of previously deducted input VAT may be imposed by the national legislation of a Member State when a taxable person does not make any use of input goods and services acquired for a project that was eventually abandoned. In my opinion, this decision is either based on a wrong interpretation of the Court's own case law in *ITH*[2] and *Stichting Schoonzicht,*[3] or constitutes nothing less than a reversal of its landmark decisions in *INZO,*[4] *Ghent Coal terminal'*[5] and *Breitsohl.*[6]

2 Landmark decisions confirming that VAT is a tax that should not burden businesses even when they fail to carry out a taxable activity

In *INZO* (1996), an association of municipalities had envisaged to develop and exploit processes for the treatment of sea and brackish water, with the objective to turn them into drinking water and to distribute it. Before launching the project, the association commissioned a profitability study. The VAT that was due on this study was immediately deducted. The study identified profitability issues and the project was eventually abandoned. The association was subsequently put into liquidation. In *Ghent Coal Terminal* (1998), the taxable person had acquired a plot of land and started carrying out investment work. It immediately deducted the VAT paid on the goods and services relating to that work. The taxable person then exchanged the land in question for another plot of land in the same area. Accordingly, it never used the land in respect of which it had carried out the investment work giving rise to the deduction. In *Breitsohl* (2000), an entrepreneur was willing to start a car repair and sales business. To that end she acquired a plot of land and commissioned a building company to build a workshop on the plot of land. Excavation and building works had begun when it became apparent that extra costs were to be expected. Since the bank refused

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1 CJEU, 18 May 2021, C-248/20 *Skatteverket v. Skellefteå Industrihus AB*, ECLI:EU:C:2021:394.

2 CJEU, 12 Nov. 2020, C-734/19 *ITH Comercial Timişoara SRL v. Agenţia Naţională de Administrare Fiscală*, ECLI:EU:C:2020:919.

3 CJEU, 17 Sep. 2020, C-791/18 *Stichting Schoonzicht v. Staatssecretaris van Financiën*, ECLI:EU:C:2020:731.

4 CJEU, 29 Feb. 1996, C-110/94 *INZO v. Belgium*, ECLI:EU:C:1996:67.

5 CJEU, 15 Jan. 1998, C-37/95 *Ghent Coal Terminal NV*, ECLI:EU:C:1998:1.

6 CJEU, 8 Jun. 2000, C-400/98 *Breitsohl*, ECLI:EU:C:2000:304.

to finance those additional costs, the works stopped and Mrs Breitsohl sold the building works already completed.

In all these cases the tax authorities were of the opinion that the deduction of input VAT was no longer justified in view of the absence of taxable output transactions and that – as a consequence – the deducted VAT should be reimbursed. The Court however decided that if the parties qualified as taxable persons when acquiring the input goods and services,[7] this status and the related right to deduct could not be revoked, even if the envisaged economic activity had not given rise to taxable transactions. In other words, the Court confirmed that when a taxable person acquires input goods and services in the context of an economic activity and with the purpose to use them to carry out taxable transactions, a right to deduct the VAT incurred on these input goods and services immediately arises and cannot be revoked even when the taxable person eventually does not use the input goods and services for the envisaged purpose.[8] In *INZO* the Court held that deciding otherwise would create *'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'*.[9]

This line of case law is logical considering the purpose of the value-added-tax, i.e., taxing consumption, and the objective of the deduction mechanism which is intended to relieve the taxable person entirely of the burden of the VAT payable or paid in the course of all his/her economic activities.

3 The Need to Adjust Deduction in Specific Situations

The need to adjust deductions arises in specific cases where the initial deduction is higher or lower than that to which the taxable person was entitled. Articles 184 and 185 of the VAT Directive provide for general adjustments rules while Articles 187 to 190 of the VAT Directive provide for specific adjustment rules applicable to capital goods (according to which adjustments must be spread over a number of years).

In *Breitsohl* and *Ghent Coal Terminal*, the Court explicitly decided that although the right to deduct should be retained when a project is abandoned (see above, section 2), provisions governing adjustments might be applicable. Since Mrs Breitsohl had resold the (unfinished) building with VAT, no adjustment was to be made (since the inputs were in fact used for the purpose of a taxed transaction). In contrast, Ghent Coal Terminal exchanged the plot of land without VAT (exempt supply) and in this case the Court decided that: '*a supply of investment goods during the adjustment period, such as occurred in the main proceedings in this case, may give rise to an adjustment of the deduction (…)*'.

Other decisions were adopted in the following years that further clarified the exact contours of the adjustment provisions laid down in the VAT Directive. In the context of this article the most relevant are the cases *Imofloresmira, Stichting Schoonzicht and HF*, in which the Court systematically referred to either *INZO, Breitsohl* or *Ghent Coal Terminal*, or to all of them.

In all these cases the taxable person had incurred input costs in relation to immovable properties (acquisition or building costs) that they had deducted, because they planned to use these immovable properties to carry out taxable transactions. In all these cases, however, things did not go as planned for the taxable person. In *Imofloresmira* the taxable person could not find any customer to rent the property (and the property remained empty for more than two years). In *Stichting Schoonzicht* the taxable person could not rent any of the seven apartments it had built subject to VAT and decided to rent four of them without VAT (while the three others remained empty). In *HF* the taxable person had built a cafeteria as an annex to a retirement home and expected to serve both residents from the retirement house (exempt supplies) and external visitors (taxed supplies). In the end access could not be offered to external visitors and only exempt supplies could take place in the cafeteria.

From the Court decisions in these cases it should now be clear to everyone that:

- A taxable person retains the right of deduction where that right has arisen, even if that taxable person could not, for reasons beyond its control, use the goods or services giving rise to the deduction in the context of taxed transactions.
- If the taxable person eventually uses the input goods and services for exempt transactions, the right to deduct is not revoked but adjustments are to be made, even if the change of use results from circumstances beyond the taxable person's control. In this respect the Court highlighted that:

> *the situation of an undertaking which makes investments for the purpose of an economic activity giving rise to both taxed and exempt transactions and which continues to carry out exempt*

[7] In the three cases the Court referred to its previous decision in the *Rompelman* case in which it already confirmed that preparatory acts constitute economic activity for VAT purposes.

[8] Recently the Court confirmed once more this principle in the Ryanair case, in which a company intended to acquire all the shares of another company in order to pursue an economic activity and had incurred expenditure relating to consultancy services in relation to that acquisition. The deal was eventually aborted and the Court confirmed that the right to deduct could not be challenged, provided that the exclusive reason for the expenditure was to be found in the intended economic activity'. C-249/17 *Ryanair*, 17 Oct. 2018, ECLI:EU:C:2018:834.

[9] *Inzo*, para. 22.

> *transactions is different from that of an undertaking which makes investments for the purpose of an economic activity giving rise to only taxed transactions without that activity ultimately resulting in such transactions.*[10]

– In the case of capital goods, if the change of use occurs at the moment when the goods are used for the first time, the adjustment is to be made in one step (and not spread over several years) as the general provisions on adjustments apply to such a situation and not the specific provisions on capital goods.

4 The CJEU Order in the case *Skatteverket v. Skellefteå Industrihus AB*

In *Skellefteå Industrihus AB* the taxable person intended to construct an office building and to let it out, subject to VAT, to clients who already had confirmed an interest in the project. It therefore applied for, and obtained, the right to benefit from an optional tax liability scheme and deducted the input VAT charged in relation to the planned building (from the application it appears that these inputs mostly consisted in architectural services). One of the clients eventually announced that it was no longer interested in renting office space. The reassessment of the costs showed that the project was not financially profitable and the taxable person therefore decided to abandon the project, thereby bringing the optional tax liability scheme to an end. It subsequently reimbursed the input VAT initially deducted. However, three years later, it argued that the deduction right should have been maintained and asked for a reimbursement. The request was rejected by the tax authorities. The taxable person lodged a claim before the Administrative Court which upheld that action on the ground that the applicable national legislation was not compatible with EU law. The tax authorities therefore reimbursed the amount of the VAT initially repaid. The latter brought an appeal before the referring court, who asked the following preliminary question to the Court:

> *Is it compatible with the VAT Directive, in particular with Articles 137, 168, 184 to 187, 189 and 192 thereof, that a property owner, who opted for taxation of the construction of a building and who has deducted the input tax paid on the acquisitions relating to the building project, must immediately repay the total amount of input tax, together with interest, on the ground that the liability for tax ceases by reason of the discontinuance of the construction project before the building is completed and that there is therefore no letting?.*

In its request, the referring court stressed that there was no suspicion of abuse or fraud.

Considering that the reply to this question could be clearly deduced from existing case-law, the Court ruled by reasoned Order that (emphasis added):

> *Articles 137, 168, 184 to 187, 189 and 192 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as precluding national legislation which requires a property owner who was granted the right to benefit from the optional tax liability scheme during the construction of a building that he or she intended to let out, and who deducted the input value added tax (VAT) charged on the purchases relating to that building project, to repay immediately all that VAT, plus any applicable interest, on the ground that the planned project that gave rise to the right of deduction did not result in any taxed activity, but as not precluding national legislation which, in such a situation, establishes an obligation to adjust the input VAT paid.*

In other words, while the Court confirms that the right to deduct cannot be revoked (and therefore that a repayment of VAT with interest could not be required), it nevertheless holds that adjustments can be imposed.

In its Order the Court refers to its decisions in the *INZO, ITH, Ryanair, Imofloresmira* and *Stichting Schoonzicht* cases summarized above.

Quoting paragraph 44 of its decision in *ITH*, the Court held that (emphasis added):

> *if the taxable person no longer plans to use the goods and services in question in order to carry out taxed output transactions or uses them to carry out exempt transactions, the close and direct relationship, for the purposes of the case-law referred to in paragraph 42 above, which must exist between the right to deduct the input VAT paid and the carrying out of the planned taxed transactions is broken.*[11]

Based on this finding drawn from *ITH*, the Court decided that if the taxable person in *Skellefteå Industrihus AB* does indeed not carry out output taxed transactions, adjustments are in order[12]. The two cases are however not similar. In *ITH* the taxable person eventually carried out exempt transactions (like in the INZO case, it was the exempt output supply that justified the adjustment and not the fact that the project was being abandoned). In contrast, in *Skellefteå Industrihus AB*, it seems that the taxable person did not use the input services at all (as already indicated above, from the request it appears that most of the inputs consisted in architectural services and nothing in the description of the facts nor in the decision of the Court suggests that the taxable person would have been able to use or to enjoy any undue advantage from the incurred inputs). If that is indeed the case, in my opinion, these two situations are not comparable, irrespective of the wording of paragraph 44 of the Court's decision in *ITH*. In fact, paragraph 44 of the Court's decision in *ITH* is quite

[10] *HF*, para. 34.

[11] *Skellefteå Industrihus*, *supra* n. 1, para. 45.
[12] *Ibid.*, para. 46.

imprecise and should probably be understood as putting in the same basket a taxable person using inputs to make exempt supplies and a taxable person using inputs to make out-of-scope supplies, but not as comparing a taxable person using inputs to make exempt supply with a taxable person not using the inputs at all. Hence, in my view, paragraph 44 of the Court's decision in *ITH* was not relevant to provide an answer to the question raised in *Skellefteå Industrihus* (unless in this case also the taxable person used the inputs to carry out an exempt or an out-of-scope supply or made a personal use of the inputs, which does not seem to be the case).

The Court then added that a one-off adjustment of the deducted VAT was needed, quoting paragraph 48 of *Stichting Schoonzicht:*

> *The determination of the rules for the adjustment of the initial deduction at the time the capital goods in question are first used, where it becomes apparent at that time that that deduction was higher than that which the taxable person was entitled to deduct on account of the actual use of the goods, does not fall within the scope of Article 187 of the VAT Directive but within that of Articles 184 and 185 of that directive, the latter of which the Member States are responsible for determining pursuant to Article 186 of the VAT Directive.*

Based on this finding drawn from *Stichting Schoonzicht*, the Court concludes that the general adjustment rules apply (and therefore that the adjustment may not be spread over several years). Again, in my opinion, the situation of the taxable person in *Stichting Schoonzicht* (i.e., making exempt supplies while the initial intention was to make taxable supplies) is not comparable to the situation of the taxable person in *Skellefteå Industrihus* (i.e., not being able to use inputs because the project for which the inputs were acquired has been abandoned) and therefore paragraph 48 of *Stichting Schoonzicht* is also not relevant in this case.

In my opinion the Court should, based on its own case law, have decided that in a situation where a taxable person purchases input goods and services that it intends to use for the purpose of carrying out taxable supplies under a specific taxation scheme but eventually abandons the project, rescinds the special taxation scheme, and does not use the inputs at all (as it seems to be the case here), the right to deduct initially exercised should not be revoked and that no adjustments are to be made. The decision that adjustments can be imposed indeed jeopardizes the benefit of the deduction which was legitimately acquired by someone who had the intention to carry out an economic activity and cannot be justified on the basis of existing case law.

5 Where do we go from here?

Based on the above I conclude that, *either* the Court clarifies its position in a future decision (and confirms that adjustments are only in order if the input goods and services are used for exempt or out of scope transactions, or for personal use), *or* all VAT textbooks should be updated and their description of the *INZO, Ghent Coal Terminal* and *Breitsohl* cases should include a caveat that although the right to deduct cannot be revoked, the deducted VAT might nevertheless have to be reimbursed by way of adjustments. The latter option would – without a doubt – be a major setback for neutrality.