VAT eLearning module 10

RIGHT TO DEDUCT

Course takeaways

This is a handy summary of the most relevant course information.

This eLearning course is based on EU VAT Legislation as it stands on 01.01.2020 (valid for the EU VAT Directive, the EU VAT Refund Directive and the EU VAT Implementing Regulation).

This module is a part of a VAT broader course which is made up of the following units:

- Introduction
- Territory
- Taxable person
- Transactions
- Place of taxable transactions
- Digital Services and Mini One-Stop Shop (MOSS)
- Chargeable Event & Taxable Amount
- Rates
- Exemptions
- **Right to deduct**
- Refund
- Obligations

This course addresses the questions "**Who can deduct?, What can be deducted?, When can it be deducted? Where can it be deducted?"**

1. Learning objectives

At the end of the training you will know:

- **who can deduct:** only taxable persons carrying out taxed transactions, and some exempt transactions, can deduct input VAT;
- **what to deduct:** only input VAT can be deducted and adjustments to the input VAT originally deducted are required to reflect the change of taxed use within a specified period;
- **when to deduct:** the right to deduct arises when the VAT becomes chargeable;
- that the combination of transactions with and without the right to deduct leads to **proportional deduction** for the proportion attributable to the transactions carrying a right of deduction;
- how to distinguish between **deductible** and **non-deductible input VAT** in exempt and taxed transactions and the associated right to deduct input tax;

- other **restrictions** on the right of deduction;
- about the necessity **to adjust** deductions;
- how to exercise the right of deduction through **subtraction** or **refund**.

2. Definitions

Input tax: Input VAT is the tax paid by a taxable person on goods and services purchased for his business activities. For the system of the net value added tax it is important for a taxable person to have the right to deduct the input VAT which was incurred on the prior transaction.

Output tax: Output VAT is the VAT that the taxable person charges to his customers on the sale of goods and services. Only input tax may be deducted.

Taxed transactions: are taxable transactions for which VAT has been imposed.

Deductible exempt transactions: Exempt transactions like the supply of goods for exportation and intra-Community supply of goods give the right to deduct the input VAT relating to these transactions.

Non-deductible exempt transactions: Exempt transactions linked to certain activities in public interest, for example, hospital and medical care or other activities like gambling or supply of postage stamps at face value or supply of fiscal stamps do not give the right to deduct the input VAT relating to these.

Taxable person: anyone who regularly and independently carries out an economic activity

Non-taxable legal persons: some categories of legal persons such as public bodies and holdings with no economic activity.

Person liable for payment: person legally obliged to handle the VAT payment to the Tax Authorities

Final consumer: the ultimate consumer of a finished product who bears the full burden of the tax

3. Who can deduct?

- <u>**Taxable persons** who carry out taxed transactions and some exempt transactions **can deduct VAT** related to these transactions:</u> The purchase of goods or services
- The acquisition of goods, and
- The importation of goods

The <u>net VAT</u> principle ensures that tax is only calculated on the value added, and that taxable persons along the supply chain may deduct the tax paid on previous transactions.

There are **two types of exempted transactions**:

- those that carry the right to deduct (**taxed transactions and deductible exempt transactions**) and
- those that do not (**Non-Deductible exempt transactions**).

4. On What to deduct?

The VAT on goods or services, which the taxable person purchased, acquired or imported and that are **used for taxable transactions**, **can be deducted.**

In case of:

- Supply of goods or services: the VAT that is due or paid;
- Intra-Community acquisition of goods: the VAT that is due
- Importation of goods the VAT that is due or paid

VAT deduction **apply also** on those **exempt transactions that carry a right of deduction**, but only those mentioned in Art. 169.
If they are used for private consumption or for exempt transactions without right to deduct, then there is no right to deduct the VAT.

In the case of immovable property forming part of the business assets of a taxable person and used both for purpose of the taxable person's business and for his private use, VAT expenditure related to this property shall be deductible in accordance with the principles set out in Articles 167a, 168, 168a, 169, 173. VAT is deductible only up to the proportion of the property's use for purposes of the taxable person's business.

5 When to deduct?

The right to deduct VAT basically arises at the time **the deductible tax becomes chargeable**.

As a general principle, the chargeable event occurs when all legal conditions for VAT to become chargeable are fulfilled. Member States may provide within an optional scheme so the right of deduction of a taxable person, whose VAT solely becomes chargeable in accordance with Art. 66 (b), be postponed until the VAT on the goods or services supplied has been paid to the supplier. (Art. 167, 167a).

6 Where to deduct?

The right to deduct input VAT can only be exercised in the Member State **where** the taxable **transaction** for which the VAT has been charged, **was carried out.**

Therefore, **the deduction of VAT** will cause **no problems** if **the taxable perso**n in charged with VAT **in the Member State in which he is established** or identified for VAT purposes.
Example: a taxable person in Member State A purchases goods to sell them to his customers an receives an invoice with VAT. In this case the taxable person can submit a VAT return in that Member State in which he is established. With that return he can claim his right to deduct the input VAT.

For taxable persons who **are not established in the Member State in which they had to pay VAT**, a special Directive has been issued establishing rules for the refund of VAT (Directive 2008/9/EC and 86/560/EEC). This Directive applies to refund applications submitted from 2010 onwards.
For more information refer to the"VAT Refund" course

7 What amount can be deducted?

The equation to calculate the amount of VAT actually due to the Tax Authorities incorporates the deductible VATIs: The output VAT minus the input VAT equals the net amount due or refundable.

Output VAT – Input VAT = net amount to pay or to be refunded
Output VAT= Taxable amount of taxed transactions * VAT rate
Input VAT= Sum deductible VAT

In the case of **supply of goods or services** the VAT to pay to Tax Administrations is the net amount obtained from **output VAT minus input VAT**.

In the case of **Intra-Community acquisition** the buyer **may deduct input VAT**. This means the tax position is neutral. This system ensures that the transaction is taxed in the Member State where the goods are consumed or used.
Example: Furniture is sent from Latvia to Lithuania. Furniture cost € 1.000. The buyer must pay the VAT on the acquisition. The VAT rate is 20%. The buyer may deduct € 200 input VAT. At the same time, he may deduct the VAT due on the acquisition as input VAT, which is € 200. This means the tax position is neutral: € 1.000 x 20% (€ 200) - € 200 = 0.

However, sometimes the buyer does not have the right to deduct, which will result in a tax liability.

In the case of **Importation of goods** the buyer has to pay import VAT. At the same time, **he may deduct the VAT paid on import as input VAT**. (Note that if you import clothes you are still liable to pay import VAT, but you will have no right to deduction).

In order to exercise the right of deduction, a taxable person must have or hold a document, such as an invoice or an import document or comply with other formalities (art. 178 describes the conditions).

In some situations, deduction of VAT will **need to be adjusted** if the use of a capital good changes within a certain period. The adjustment has to **be spread over a minimum adjustment period of five years** as defined in the VAT Directive or for immovable property, over an extended period decided by the Member States but not beyond 20 years.
Adjustments might become necessary by changes in price or changes in use.

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