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The MIT VAT Practitioners Forum - Report 9 April 2024

This Report sets out an overview of the matters discussed and the salient points raised at the MIT VAT Practitioners Forum held on 9 April 2024 at The Hyatt Regency Malta, St. Julian's. It is for information purposes only. The contents of this report do not constitute official guidance, nor advice, and should not be relied upon as such.

Any comments or queries concerning the contents of this Report should be addressed to the Chief Technical Officer on CTO@maintax.org or MIT@maintax.org

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Panel 1: A Spotlight on...Input Tax Recovery

The first panel discussion was moderated by Sarah Cassar Torregiani (Chief Technical Officer of the Malta Institue of Taxation) and featured panelists from the MIT's Indirect Tax Technical Committee: Graziella Demanuele Bianco and Matthew Zampa, as well as guest panellists Nico Sciberras from the Malta Tax & Customs Administration and Mirko Gulic (PWC)

During the panel discussion, particular emphasis was placed on the fact that input VAT recovery can be limited in certain situations depending on the nature of the expenses incurred. For instance, if the expenses are for non-business purposes, such as personal use, then input VAT cannot be recovered. Similarly, if the expenses are attributable to exempt (without credit) supplies, such as financial services, then input VAT cannot be recovered. In cases where expenses are incurred for both business and non-business purposes, input VAT can only be recovered for the portion of expenses used for business purposes (i.e. partial recovery). Additionally, input VAT can be limited if the taxpayer fails to meet certain requirements, such as the need for a valid tax invoice.

1.1 The requirement for a Tax Invoice to support input tax deductions

Reference was made to the EU VAT Directive 2006/112/EC (the 'EU VAT Directive') which effectively sets out two criteria for determining the eligibility of input VAT recovery: the substantive criterion and the formal criterion.

The substantive criterion is based on the nature of the goods or services acquired. It requires that the goods or services be supplied to a taxable person and used for the purposes of their own taxable transactions. This means that if the goods or services are used for non-business purposes or for exempt supplies, input VAT cannot be recovered. This criterion is defined in Article 168 of the EU VAT Directive. The formal criterion, on the other hand, is based on administrative requirements. It requires that the taxpayer has met certain formal requirements, such as the need for a valid tax invoice. The formal criterion is used to ensure that the taxpayer has met the necessary administrative requirements to claim input VAT recovery. This criterion is defined in Article 178 of the EU VAT Directive.

In relation to this matter, the Court of Justice of the European Union (CJEU) has established through various cases the principle that the substantive criterion must invariably be met for the recovery of input VAT, and that the formal criterion is secondary to the substantive criterion. The CJEU in the *Senatex (C-518/14)* and *Barlis (C-516/14)* cases held that the tax authorities cannot deny the right to deduct input VAT solely on the basis that some of the invoice content requirements are not met (e.g. no VAT number specified or insufficient description of the supply), when they have sufficient information to ascertain that the substantive conditions to exercise the right to deduct are satisfied. The CJEU emphasised that the substantive criterion must be satisfied in order for input VAT to be

eligible for recovery, and that the formal criterion, such as the need for a valid VAT identification number, is secondary to the substantive criterion.

During the panel discussion, it was highlighted that from a local perspective the MTCA in practice does tend to place considerable emphasis on the satisfaction of the formal criterion when determining the eligibility of input VAT recovery. The panellists further highlighted that the MTCA often initiates inquiries through credit control exercises and that, in the past, input VAT recovery has been denied in cases where local invoices lacked certain details. Additionally, it was noted that invoices from Non-EU suppliers often lack the necessary details.

However, there appears to have been a shift in approach in recent times, and the MTCA has acknowledged that the absence of certain criteria on an invoice should not prevent the recovery of input tax. It was explained that the necessary training is being provided within the MTCA to ensure that the CJEU's decisions are followed. It was recognised however that ultimately it would be simpler for both the taxable person and the MTCA if tax invoices are issued in line with the requirements in the VAT Act from the outset.

Panellists further shared their experience of VAT being denied in an "Eighth Directive" VAT refund claim process, when invoices were not in line with the Malta VAT requirements. It was agreed that whilst the same principles should apply to Eighth Directive refund claims, in practice the formal requirements specified in Directive 2008/9/EC must be met in such cases (and for example, if an invoice has an incorrect invoice date, the input VAT refund would typically not be granted).

On a separate but related note, it was pointed out that it is also important to identify who is actually receiving the supply. In the case of supplies of goods, for example, it is important to ensure that the recipient has the right to dispose of the goods as the owner. If this right has not been acquired, then the recipient does not have the right to recover input VAT, even if they possess a tax invoice in their name. The *Vega* case (Case C-235/00) and *Autolease* case (Case C-185/01) are examples where deduction was refused because the 'customer' did not acquire the right to dispose of the goods as the owner. Therefore, even if an invoice has all the relevant details, input VAT recovery can still be denied.

The main takeaway from the panel discussion was that there has been clarification from the CJEU around the right or otherwise of the tax authorities to deny an input tax deduction based on an incomplete tax invoice, and that these CJEU principles are followed by the MTCA. It was further concluded that the tax invoice serves as evidence that tax was incurred by the taxable person, and therefore accuracy and completeness are important, but there should also be flexibility to ensure compliance with EU VAT principles.

1.2 Item 6 and 8 of the Tenth Schedule to the Malta VAT Act - Partial Attribution and Alternative Methods of Partial Attribution

The VAT Directive (and our law – item 6 of the Tenth Schedule) establishes the general pro rata method (based on turnover) for recovery of input tax on general overheads. Art 173(2) permits Member States to authorise or require taxable persons to apply a different methodology: a sectoral method or one based on use. Item 8 of the Tenth Schedule of the VAT Act gives the possibility, upon the approval of the CfTC, of the attribution of inputs using a methodology other than the turnover based method where that does not lead to a fair or reasonable result.

The panel discussed the fact that 'revenue' may not always be the most appropriate indicator to use. Other indicators, such as square meterage or the number of transactions executed, may be more suitable. For example, the number of transactions might be relevant when providing loans. Since 2015, there has been some use of different partial attribution methods locally, however there is no guidance on possible / accepted methods. Formally established sectorial or segmental methods, as well as the option to tax for property, may be potential solutions to make it easier for taxable persons to apply partial attribution in the future.

Whilst there are currently no plans to establish tax authority approved methods / guidance on possible methods, it was agreed that the key is to ensure that the alternative method applied reflects how expenses are attributed to and used in the business. It is important to identify the best method for attributing expenses to supplies that allow for input VAT recovery and those that do not. The MTCA had considered issuing guidelines, however, typically in practice these are specific to the circumstances of each business, and any guidance setting parameters may result in creating undue limitations for businesses and the MTCA. Therefore a uniform approach may not necessarily be the best solution.

Another question which arises in practice with applying the partial attribution on recovery of input VAT on general expenses is around the process for the first year of operation, when there is no prior year on which to base the provisional ratio. The VAT Act is silent on this and there is no guidance. It was observed that in such cases, the VAT Directive allows the provisional ration to be based on forecasts, which are to be submitted to the tax authority for approval. It was noted that this approach has become more common in recent years.

1.3 Capital Goods Scheme

The Capital Goods Scheme (CGS) is an aspect of input tax deductions which in practice is complex, and the lack of clarity around the interpretation of the provisions in the law, has led to varying approaches. The panelists were asked for their view on the application of the EUR 1,160 threshold in the definition of Capital Goods - is this per invoice or per item? The wording of the law suggests that the intention is to exclude low-value items from the scheme to reduce the burden. However, one of the panellists

mentioned that in practice she has seen different interpretations being applied. For example, if desks and chairs are purchased together and the total value exceeds the threshold, they would be regarded as a Capital Good (collectively). This suggests a categorised approach rather than an invoice line item-based approach. This is one of the areas in which guidance would be helpful.

The panelists noted that to address the mismatch between the Balance Sheet and the CGS, it is advisable to maintain a register. Taxable persons who have full right of recovery of input tax do not pay much attention to the CGS. However, if circumstances change, they may find themselves in a difficult situation when calculating the CGS adjustment.

One of the panellists pointed out a common error arises where practitioners fail to recognised that what is a capital asset for the purposes of the VAT CGS is independent of how an expense is treated under accounting standards (i.e. as a capitalized expense or not).

For instance, if machinery is purchased and attachments are subsequently added, which fall below the threshold, it might appear odd to exclude those attachments from the CGS adjustment. Similarly, architect fees to improve a yacht are in practice not included in the CGS.

The interaction of the CGS with the rule for deemed supplies was also discussed. In this respect, the panellists were asked whether a taxpayer can freely use an asset for private purposes once they are out of the reference period. The answer is NO. The purpose of the CGS is to adjust the input VAT throughout the reference period. After the lapse of the 5 / 20 year period, as the case may be, if there is a change in the use of an asset for which input VAT was recovered, e.g. from business use to private use, it is important to determine if there is a deemed supply. If a deemed supply exists, output VAT must be accounted for on it. Beyond the reference period, nothing changes as the asset still belongs to the business. The only aspect that does not apply beyond the reference period is the CGS itself.

The panellists also discussed the interaction between Transfer of a Going Concern (TOGC) and the CGS. The need for guidance in this area was highlighted. While a TOGC is not an adjustment event for the CGS, if capital goods are transferred under a TOGC, it is essential to provide the necessary information around the adjustments already made, reference period lapsed etc to the transferee to ensure they are aware of their responsibilities. Creating awareness in this regard helps to avoid any unexpected issues or complications.

Panel 2: Input Tax deductions in practice

This second panel was moderated by Chris Borg, Chairperson of the MIT's Indirect Tax Technical Committee, with panellists Saviour Bezzina, Efrem Debono and Louise Grima who also form part of MIT's Indirect Tax Technical Committee, and Brian Debono from the Office of the MTCA.

During the panel discussion, the following points were discussed:

2.1 Failure to provide documents

One of the main issues that the MTCA encounters, which has a significant impact on the right to claim input VAT, is the failure of taxpayers to provide requested documents. This can occur due to various reasons, including negligence on the part of the taxpayer and a lack of communication with the MTCA. This is relevant for the purposes of Article 48(5) of the Malta VAT Act, which states that documents cannot be produced at a later stage.

2.2 The attribution of expenses between economic and non-economic activity

This is an important consideration for taxpayers. When seeking to claim input VAT, taxpayers must assess whether the VAT incurred is fully for the furtherance of their economic activity. If not, only a proportionate amount of the input VAT can be claimed. However, this aspect can sometimes be overlooked. For example, let's consider Company A, which owns a yacht used for commercial chartering. However, the directors agree that the ultimate beneficial owner can use the yacht for three to four weeks without any payment. In this case, we have a non-economic activity, which is the gratuitous use of the yacht. If this intention is known at the time of acquisition, the input VAT cannot be fully claimed. It becomes necessary to limit the input VAT recovery, the question then arises: how should the limitation of input VAT recovery be determined? Should turnover be used as a basis? These are questions that need to be discussed with the MTCA on a case-by-case basis. Other factors to consider include the time when the yacht is berthed, the period when it is traveling between chartering, and the idle time. Applying these considerations in practice can be challenging and complex.

2.3 Input tax relating to future supplies (e.g. related to setting up of a business)

If there is an intention to make future supplies, in principle, taxpayers are entitled to recover input VAT on purchases. However, in practice, this can sometimes present challenges. The MTCA acknowledges that it is common for businesses to incur input VAT before commencing trading. On this basis, they assess the intention and analyse the proportion of allowable input VAT based on the evidence of contracts and transactions. If the MTCA is not convinced that the intention is genuine, they may challenge the input VAT recovery.

2.4 Tax in Danger provisions

As regards the Tax in Danger procedure, which primarily applies to construction activities (business-to-business transactions), it is crucial to maintain proper invoices and documentation. Furthermore, in such procedure, the MTCA must verify that the taxpayer has a legitimate right to recover input VAT. From a practical standpoint, providing comprehensive information to the MTCA increases the likelihood of expediting the process.

2.5 Partial Attribution – Provisional Ratio during the first year

In relation to the question of how to handle the first year when applying the standard partial attribution method, one approach suggested was not to claim any input VAT in the first year and then claim it in the first VAT return of the following year. However, this could be overly conservative and results in a VAT cash flow disadvantage for the taxpayer. Alternatively, it was suggested to potentially consider working out a budgeted sales ratio or apply a quarter-by quarter VAT basis for the first year. It was emphasised that the most prudent approach would be to consult with the MTCA regarding the chosen approach for the first year. This ensures alignment with MTCA requirements and reduces the risk of potential disagreements or assessments by the MTCA. It was acknowledged that there might be specific reasons why consulting the authorities might not be feasible or desirable. However, in such cases, there is a risk of disagreement with the MTCA if they are not in agreement with the chosen approach, potentially leading to assessments or other consequences.

2.6 Blocked expenses

The misconception that any business-related expenses can be claimed for VAT purposes was also addressed. It was emphasised that certain expenses, such as the cost of a car, are specifically blocked and cannot be claimed. When it comes to the blocked items, the potential subjectivity involved in certain instances was also highlighted e.g. "team building" events. It was advised to exercise caution, especially when dealing with significant amounts. When making a case with the MTCA, it is important to provide supporting documentation to justify the treatment of expenses. The question of whether certain expenses, such as free lunches or canteen services, should be considered as receptions or entertainment was raised. The general position was that these expenses should be treated as blocked for VAT purposes.

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Event Rapporteurs: Samantha Agius and Sarah Cassar Torregiani