

VAT DEDUCTION ADJUSTMENT IN CASE OF THEFT

Case C-550/11 PIGI – Pavleta Dimova ET v NRA

SUMMARY

The adjustment to the VAT deduction enjoyed at the acquisition of goods, where those goods have been stolen, does not run contrary to the provisions of Directive 2006/112/EC.

INTRODUCTION

The basic principle of neutrality of the VAT system is found on the deduction of input tax. The deduction system is designed to relieve the taxable persons of the tax burden and in principle may not be limited. However, the VAT deduction is subject to one major condition – the goods or services whose acquisition have given rise to the deduction must be used for the purposes of the person's taxable supplies.

This raises the question what happens if the link between the input VAT and the output supplies is broken because the goods no longer exist or are not in the possession of the taxable person due to theft?

FACTS AND QUESTIONS REFERRED FOR A PRELIMINARY RULING

The Bulgarian sole trader ET PIGI – Pavleta Dimova ("PIGI") operates in *inter alia* the manufacture, purchase and marketing of agricultural products, the manufacture and sale of alcoholic and non-alcoholic drinks and trade in foodstuffs.

On 3 January 2007 packaged products and cigarettes for a total amount of BGN 6 417.16 were stolen from PIGI's premises. The Public Prosecution launched a criminal investigation against an unknown perpetrator which did not result in the identification and indictment of the offender.

Following a tax audit for the period 01.08.2005 – 30.09.2010 the Bulgarian tax authorities found that the input VAT deducted by PIGI upon the acquisition of the stolen goods must be adjusted pursuant to the provisions of the Bulgarian VAT Act¹. The revenue authorities also held that PIGI could not rely on any of the exceptions to the adjustment rule, including *force majeure*².

¹ Under Art. 79 (3) of the Bulgarian VAT Act a taxable person who has wholly or partly deducted input tax in respect of any goods produced, purchased, acquired or imported by him shall calculate and be liable for tax in the amount of the deduction made, where the goods have been destroyed, a shortfall has been established or the goods have been classified as wastage, or their intended use has been altered and the new intended use no longer gives entitlement to deduction.

² Art. 80 of the VAT Act provides for a number of cases where no VAT deduction adjustment is required. Those exception include destruction, shortfalls or wastage caused by force majeure and destruction, shortfalls or wastage caused by accidents or disasters which the person can prove were not caused through his fault.

PIGI appealed the tax assessment act before the administrative appeals instance arguing that the shortfall of the stolen goods was caused by force majeure and that, therefore, the input VAT deduction should not be adjusted.

When the administrative appeals instance dismissed the appeal, PIGI lodged an appeal with Varna Administrative court. In those circumstances, the Administrative court decided to stay the proceedings and to refer the case to the Court for a preliminary ruling and to ask the Court whether Directive 2006/112/EC³ must be interpreted as precluding national tax provisions, such as Articles 79 and 80 of the Bulgarian VAT Act, which require, where a shortfall of goods subject to VAT has been established, that an adjustment be made to the input tax deduction made at the time of acquisition of those goods where the taxable person has been the victim of theft of those goods and the perpetrator has not been identified.

JUDGMENT OF THE COURT

As a starting point of the Court's interpretation serves the decisive criterion for VAT deduction - the actual or intended use of the goods or services concerned for the purposes of the person's taxable transactions. According to the Court the taxable person must enjoy his right to VAT deduction as long and insofar as there is a direct and close relationship between the right to deduct input VAT and the use of the goods and services concerned for taxable transactions.

Therefore, should any change to the factors which were taken into consideration for the determination of the amount of the VAT deduction occur subsequently, the neutrality of VAT should be restored by making the respective and corresponding adjustment to the initial VAT deduction. And theft should be generally considered as such a change that could give rise to adjustments, as the stolen property could be clearly no longer used for any taxable output transactions by the respective person.

At the same time Directive 2006/112/EC provides for an express derogation from the VAT deduction adjustment rule stating in its Art. 185 (2) that no adjustment is to be made, *inter alia*, in the event of 'theft of property duly proved'. The important proviso, however, being that the derogation is made optional to Member States.

It follows that Member States may provide for compulsory adjustment of the input VAT deduction for goods which have been stolen, irrespective of whether the theft has been duly proved.

As Bulgaria has availed itself of the possibility provided for in Art. 185 (3) of the Directive to require adjustments of input VAT deductions in case of theft, the Court found that Directive 2006/112/EC does not preclude national provisions such as Articles 79 and 80 of the Bulgarian VAT Act which require, where a shortfall in the goods subject to value added tax has been established, that an adjustment be made to the deduction of that input tax at the time of acquisition of those goods, where the taxable person was the victim of a theft of those goods and the perpetrator has not been identified.

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³ Article 185 of the Directive reads as follows:

'1. Adjustment shall, in particular, be made where, after the VAT return is made, some change occurs in the factors used to determine the amount to be deducted, for example where purchases are cancelled or price reductions are obtained.

2. By way of derogation from paragraph 1, no adjustment shall be made in the case of transactions remaining totally or partially unpaid or in the case of destruction, loss or theft of property duly proved or confirmed, or in the case of goods reserved for the purpose of making gifts of small value or of giving samples ...

However, in the case of transactions remaining totally or partially unpaid or in the case of theft, Member States may require adjustment to be made.