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Broad VAT deduction for unoccupied properties

Arts. 167, 168, 184, 185 and 187 of the VAT directive must be interpreted as meaning that "they prevent a national legal framework that provides for an adjustment of the value added tax initially deducted due to the fact that a property, for which the option for VAT application has been exercised, is deemed as no longer used by the taxpaying entity for purposes of its business operations subject to taxes, if the property has remained unoccupied for over two years, evn if it has been demonstrated that the taxpaying entity has attempted to lease it during such period".
These are, in a nutshell, the conclusions reached by the European Court of Justice in the judgment filed yesterday related to lawsuit C-672/16, Imofloresmira – Investimentos Imobiliários SA.

Retracing the facts of the case, it is worthwhile to recall that the claim was filed by a company having as its corporate purpose the purchase, sale, lease and managment of properties for residential, commercial and mixed use, whether owned by the company or by third parties.
Following a number of tax controls, the competent Portuguese tax authorities found that a number of lots, pertaining to two buildings owned by the claimant company and for which it had opted for application of the tax, had been vacant for over two years and that despite such failure to secure the occupancy of the buildings, the company had not made any adjustment of the tax deducted, in accordance with the corresponding Portughese legal framework settingforth the exemption waiver regime.

Based upon such findings, since the company is in disagreement with the legal reconstruction carried out by the inspectors, the issue was submitted to the competent Court which, while admitting the continuous commercial promotion by the company of the spaces available within such properties, for purposes of leasing them, found indispensable an interpretation of arts. 137, 167, 168, 184, 185 and 187 of the VAT directive.
To such end, the competent Court decided to suspend the proceedings and to submit specific preiminary issues to the European Court of Justice.

On the first issue, the judges of the European Court of Justice, after recalling the methods that dictate the "timeframes" and conditions for the deduction of VAT (see European Court of Justice, 30 March 2006, lawsuit C-184/04, Uudenkaupungin kaupunki) along with the

presence of the precondition set forth in art. 168 of the VAT directive or, in other words, that "in order for an interested party to be entitled to the deduction, it is necessary, on the one hand, that such party be «a party subect to taxation» within the meaning set forth in such directive and, on the other, that the goods and services in question be used for purposes of its business operations subject to taxation" (European Court of Justice, 15 December 2005, lawsuit C-63/04, Centralan Property), do not agree with the interpretation given by the Tax and customs administration, according to which "the fact that a property is not occupied for a given period interrupts the designated use of the property for purposes of the enterprise, obligating the party subject to taxation to proceed with the adjustment of the tax deducated, even if it has been demonstrated that such party still intends to continute to conduct a business subject to taxation".

To agree with such reasoning, the European Court of Justice points out:
– would end up limiting the right to a deduction pursuant to the provisions applicable to adjustments;
– would conflict with the principles of the common VAT system where it guarantees the perfect neutrality of the application of the tax for all economic ativities, regardless of the purpose or results of the same, as long as they are per se subject to VAT;
– would conflict with the principle that the right to deduct remains, generally speaking, acquired even if, subsequently, due to circumstances falling outside its control, the party subject to taxation does not use such assets and services which have given rise to the deductionin the context of the business operations subject to taxation.

The temporal limitation of the effects of the judgment was denied.

Lastly, the Portughese Government, in the event that the European Court of Justice were to find that the EU law prevents a national legal framework, such as that referred to in the main proceedings, requests the EU judges to limit, over time, the effects of the judgment.
The answer by the European Court of Justice is sharp and decisive.
In reality, the judges point out appropriately that any restriction in the right to deduct VAT imposed upon parties subject to taxation "constitutes an exceptionto a fundamental principle of the common VAT system, the lawfulness of which, according to unwavering case law, would be permitted only in exceptional circumstances" (European Court of Justice 19 October 2017, lawsuit C-101/16, Paper Consult).
Since, in this case, the Court does not find the conditions met for an objective uncertainty to

be found, it follows that the limitation over time of the effects of the judgment is denied.