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## Deduction of input VAT on costs borne on third-party property

**The Court of Justice of the European Union (CJEU) has established that an enterprise may be entitled to deduct VAT on costs borne in respect of the renovation of a third party's infrastructure even though the service was carried out free of charge.**

The purpose of levying value added tax on goods and services is to ensure that the final consumers bear VAT (the final consumption) and not the taxable enterprise. Accordingly, a taxable enterprise is, as a main rule, entitled to deduct VAT on costs incurred in order to generate taxable income or incurred as part of the taxable person's economic activity (general costs). In both cases, the deduction of VAT tax is subject to the costs constituting components of the enterprise's output transactions.

### Facts of the case

The case before the CJEU dealt with a Bulgarian property developer and whether the property developer was entitled to recover VAT on costs relating to renovation services provided free of charge to a waste-water pumping system, which was owned and operated by a Bulgarian municipality.

The property developer had built a holiday village to be leased on a taxable basis in the future. However, in order to connect the holiday village to the existing municipal waste-water pump station, the pumping system had to be extensively renovated. As a result, the property developer concluded an agreement with the municipality that the property developer undertook to carry out the repair of the municipal waste-water infrastructure at its own expense. The developer then employed a contractor to carry out the renovation and deducted VAT on costs incurred. The Bulgarian tax authorities refuse to recognise the property developer's right to deduct the VAT levied on the renovation costs, and the case was heard before the Bulgarian courts, which decided to refer the case to the CJEU.

### The opinion of the Advocate General

In his opinion, the Advocate General found that the property developer could not deduct the VAT on the renovation costs even if they were motivated for business reasons. According to the Advocate General, the costs incurred had no necessary link to the property developer's taxable activity (the leasing of the holiday village). Instead the costs were to be deemed to be directly allocated to the renovation of the municipal waste-water pumping system supplied free of charge, which is an activity not liable to VAT.

### The CJEU judgment

However, contrary to the Advocate General, the CJEU found that the property developer was entitled to deduct VAT as it was documented that the costs of renovating the waste-water pumping system had been incurred for services necessary to allow the developer carry out its property project. The fact that the Bulgarian municipality would benefit from the renovation services did not alter this situation. The right to deduct VAT was, according to the CJEU, solely subject to the costs being allocated to the property developer's taxable activity. Moreover, the CJEU established that deduction of VAT was limited to the VAT levied on the part of the costs incurred for the reconstruction of the pump station which were objectively necessary to allow the property developer to carry out its taxable activity.

According to the CJEU, the deduction in this case could be documented by the following objective circumstances:

- The renovation of the waste-water pumping system was a condition for the construction of the holiday village, which was to be used for leasing transactions, as the property developer would not be able to perform its economic activity without incurring such costs.
- The costs incurred constituted components of the price of the output transactions supplied by the property developer.

### Bech-Bruun's comments

The CJEU judgment is in line with the Danish Tax Council's practice. In a ruling by the Danish Tax Council (SKM2013.51 SR), it was confirmed that the applicant, which was involved in the sale of taxable construction sites, had a right to deduct VAT levied on costs incurred for the construction of infrastructure on land owned by a third party when such costs had been incurred for the purpose of increasing the value of the applicant's own land.

The clear presumption is that a taxable enterprise is entitled to deduct VAT when such VAT is deemed to be necessary for the enterprise's activity liable to VAT. The CJEU has now established that this presumption applies even if such costs are linked to a transaction free of charge that may benefit a third party.

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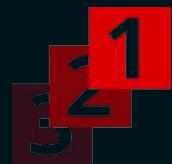
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