Unlocking import VAT: the role of ownership

Indirect Tax

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The ability of a taxable business to deduct the VAT that it has incurred is supposed to be sacrosanct, but has the case law of the CJEU and now the UK courts called that into question when it comes to import VAT?

Key Points

What is the issue?

The precise wording of the Principal VAT Directive Article 168 requires that for a taxable business to deduct the VAT it has incurred, the relevant 'goods and services' are used in the taxpayer's downstream supplies, not simply that a taxpayer incurs import VAT in the course of making supplies.

What does it mean to me?

There is a subtle difference between the Principal VAT Directive and the UK's VAT Act 1994 when it comes to the right of deducting import VAT: the former places the emphasis on the relevant 'goods and services', whereas the latter refers directly to the 'VAT paid or payable'.

What can I take away?

Discrepancies between UK law and the Principal VAT Directive, such as appear to exist when it comes to import VAT, could well be a subject of interest for businesses, their advisers and HMRC in the years to come.

Articles 167 and 168 of the Principal VAT Directive are in some ways the crux of the whole VAT system, the legal provisions which ensure that a taxable business should be placed in a fiscally neutral position when it comes to charging and deducting VAT. As the CJEU is wont to remind us:

'The right to deduct stipulated in that provision constitutes a fundamental principle of the common system of VAT established by EU law, so that that right is an integral part of the VAT scheme and in principle may not be limited.'

(*Vos Aannemingen BVBA* (Case?C-405/19), [23] *inter alia*).

Article 167, of course, states that 'a right of deduction shall arise at the time the deductible tax becomes chargeable'. Article 168 – in well-known terms – provides that 'in so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled … to deduct' the VAT that he has incurred, defined in five scenarios.

For the majority of those scenarios – which concern goods and services consumed with the taxpayer's member state of establishment, and intra-Community acquisitions – the case law of the CJEU has developed gradually over the years. We may derive the following principles from this jurisprudence:

- Goods or services acquired for the purpose of non-economic activity will give rise to the right to deduct where they are consumed for the benefit of a taxpayer's taxable economic activity in general (*Kretztechnik* (Case C-465/03)).
- The relevant goods or services must constitute a cost component of the taxpayer's downstream taxable supplies (*University of Cambridge* (CaseC-316/18)).
- The taxpayer's intention to make taxable supplies at the time of acquiring the relevant goods or services is a necessary consideration, although the actual use of those inputs will take priority in the analysis (*Sonaecom* (Case C-42/19)).

When it comes to the fifth scenario contemplated by Article 168, however, the case law appears to have taken a different turn. This provision, Article 168(e), concerns 'the VAT due or paid in respect of the importation of goods into that member state', and here the CJEU has articulated a different set of conditions.

VAT on the importation of goods

In *DSV Road* (Case C-187/14), the court considered the case of a business which had been contracted to import goods on behalf of its customer from a freeport into the territory of the member states. The taxpayer paid the import VAT that was due to the Danish authorities, but the authorities rejected the taxpayer's claim for the recovery of that VAT.

When the court ruled on the taxpayer's entitlement to recover the disputed VAT, it found that:

'Under the wording of Article 168(e) … a right to deduct exists only in so far as the goods imported are used for the purposes of the taxed transactions of a taxable person … [and] that condition is satisfied only where the cost of the input services is incorporated either in the cost of particular output transactions or in the cost of goods or services supplied by the taxable person as part of his economic activities.' [49]

It followed that even though bearing the burden of the import VAT was an essential aspect of the taxpayer's taxable business of freight services, he was not entitled to recover it because the relevant goods themselves were not cost components of those freight supplies.

Indeed, the CJEU appears to have considered this interpretation of the Principal VAT Directive as '*acte clair*'; i.e. if the judgment or rule of law is clear enough, then a member state has no duty to refer a question for preliminary ruling to the CJEU.

When the question of deducting import VAT was next referred to the CJEU in the case of *Weindel Logistik* (Case C-621/19), it merely issued a reasoned order. Here, it reiterated that Article 168(e):

'…must be interpreted as precluding the grant of a right to deduct value added tax to an importer where he does not dispose of the goods as an owner and where the upstream import costs are non-existent or are not incorporated in the price of particular output transactions or in the price of the goods or services supplied by the taxable person in the course of his economic activities.'

Necessary conditions under EU law

As far as EU law is concerned, therefore, a taxpayer must satisfy three conditions in order to deduct the tax that it has incurred as import VAT:

1. The taxpayer bears the cost of importing the goods.
2. The taxpayer has the right to dispose of the goods as owner.
3. The goods are cost components of the taxpayer's downstream taxable supplies.

Although this interpretation may be unwelcome for taxpayers whose business concerns the importation of goods, it is entirely consistent with the precise wording of Article 168, which requires that the relevant 'goods and services' are used in the taxpayer's downstream supplies, not simply that a taxpayer incurs import VAT in the course of making supplies.

But has the UK transposed these provisions into domestic law in a way that is consistent with the Principal VAT Directive and its interpretation by the CJEU? Perhaps not.

The UK's interpretation

Section 24(1)(c) of the Value Added Tax Act (VAT Act) 1994, for instance, defines input tax as: 'VAT paid or payable by him on the importation of any goods, being … goods or services used or to be used for the purposes of any business carried on or to be carried on by him'.

And so, on one reading, there is a subtle difference between the Principal VAT Directive and the VAT Act 1994 when it comes to the right of deducting import VAT: the former places the emphasis on the relevant 'goods and services', whereas the latter refers directly to the 'VAT paid or payable'. It may therefore appear that a plain reading of UK law would permit the deduction of any import VAT incurred for taxable purposes, whereas the EU test is more stringent.

This analysis came to the fore in the recent case of *Piramal Healthcare UK Ltd* [2023] UKFTT 891 (TC), where the taxpayer had imported pharmaceutical ingredients for processing and paid the import VAT, but was denied the right of deduction by HMRC because it did not own the relevant goods.

Finding itself bound by the case law of the CJEU, the First-tier Tribunal dismissed the taxpayer's appeal, ruling that even though the goods were essential to the taxpayer's business, and even though the import VAT would have been a cost component of the prices charged to the taxpayer's customers, the relevant factor was whether *the goods themselves* – and not just the associated VAT – were components of the taxpayer's supplies.

What does the future hold?

Many businesses have resolved potential problems within their supply chains pursuant to the Revenue and Customs Briefs that HMRC issued on the subject (RCB 2/2019 and RCB 15/2020). However, the discrepancy between the right to deduct 'domestic' input tax and import VAT persists. So where does this leave taxpayers who are importing goods into the UK without taking ownership of them, such as businesses that are importing goods on hire?

On one view, there is a potential sense of injustice in circumstances where a taxpayer has imported goods for the purpose of its business and incurred import VAT accordingly, and where it has factored such import VAT into the prices that it charges to its customers, but where it is denied the right to recover the VAT because it did not own the goods that were – in any event – essential to the taxpayer's business activities. But might there be scope for businesses now to argue that the plain wording of VAT Act 1994 should take precedence over the case law of the CJEU?

The accounting periods that were relevant to the First-tier Tribunal's decision in *Piramal* all occurred before the UK's departure from the European Union, and so EU law was supreme. Moreover, the recently enacted legislation concerning the interpretation of VAT and excise law appears to provide for the ongoing supremacy of EU law, despite the provisions of the Retained EU Law (Revocation and Reform) Act 2023.

Even so, if *Piramal* were to come before the First-tier Tribunal again, and if the tribunal were to consider only the provisions of VAT Act 1994 and their effect after 1 January 2024, might it come to a different conclusion? Discrepancies between UK law and the Principal VAT Directive, such as appear to exist when it comes to import VAT, could well be a subject of interest for businesses, their advisers and HMRC in the years to come.