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EU VAT: Adjustment of Input VAT

Case C-532/16 SEB bankas

Eleonor Kristoffersson*

The initial deduction of input VAT shall be adjusted where it is higher or lower than that to which the taxable person was entitled. In SEB bankas, the CJEU stated that the obligation to adjust undue VAT deductions set down in Article 184 of the VAT Directive also applies to cases where the initial deduction could not be made lawfully because the transaction giving rise to that deduction was exempt from VAT. In contrast, the adjustment system for capital goods does not apply to undue VAT. It is up to the Member States to determine the date on which the obligation to adjust the undue VAT deduction arises and the time period within which that adjustment must be made, in accordance with the EU law principles, in particular the principles of legal certainty and legitimate expectations.

1 Introduction

This case note offers a helicopter view of the CJEU\(^1\) case SEB bankas.\(^2\) It is a preliminary ruling which was submitted to the CJEU from the Lithuanian Supreme Court.\(^3\) The case deals with issues regarding the adjustment of input VAT.

The deduction of input VAT is fundamental to the system of VAT. In fact, the right of deduction is what gives VAT its character as a tax on the value added. The right of deduction is immediate. Hence, a system is needed that ensures that the original deduction can be changed retrospectively. The adjustment of input VAT is described in Articles 184–192 of the VAT Directive.\(^4\) Under the general rule in Article 184, the initial deduction shall be adjusted where it is higher or lower than that to which the taxable person was entitled.

Articles 187–189 provide a special adjustment system for capital goods. Capital goods are not defined in the VAT Directive. Instead, it is stated explicitly that it is up to the Member States to define capital goods.\(^5\) In the case of capital goods, adjustment shall be spread out over five years including that in which the goods were acquired or manufactured.\(^6\) For immovable property, the adjustment period may be extended to up to twenty years.\(^7\) Adjustment shall be made if the capital goods are used for other purposes than what they were originally acquired for and that influences the right to deduct input VAT in a positive or negative way. Furthermore, adjustment should be made if the goods are sold during the adjustment period. In such a case, the goods shall be treated as if they had been applied to an economic activity of the taxable person up until the end of the adjustment period.\(^8\) The business activity shall be presumed to be fully taxed in cases where the supply of the capital goods is taxed.\(^9\) The business activity shall be presumed to be fully exempt in cases where the supply of the capital goods is exempt.\(^10\)

2 The dispute before the national court and the questions referred to the CJEU

In the case before the Lithuanian court, a company had issued an invoice including VAT for a plot of land, which

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* Professor Dr of Tax Law, Örebro University, Sweden. Email: eleonor.kristoffersson@oru.se.
1 Court of Justice of the European Union.
3 Lietuvos vyriausiasis administracinis teismas.
5 Art. 189 (a) of the VAT Directive.
6 Art. 187, para. 1, subpara. 1 of the VAT Directive.
7 Art. 187 para. 1, subpara. 3 of the VAT Directive.
8 Art. 188 para. 1, subpara. 1 of the VAT Directive.
9 Art. 188 para. 1, subpara. 2 of the VAT Directive.
10 Art. 188 para. 1, subpara. 3 of the VAT Directive.
was actually exempt from VAT. At the time when the invoice was issued, the tax authorities and the company were of the opinion that it was building land that was being supplied, which was subject to VAT. The purchaser paid the invoice and deducted the input VAT.\textsuperscript{13}

Due to the fact that the land was not to be built on, the supplier credited the original invoice, since it was no longer a taxable supply of building land, but a tax-exempt supply of a plot of land. The credit note stated that, no VAT being due, the price including VAT shown on the initial invoice was the price excluding VAT. The supplier issued a new invoice, which stated that the price to be paid was the same as the previous price including VAT. This invoice did not mention any VAT.\textsuperscript{12}

The purchaser did not accept the credit note and the new invoice. After a tax inspection, the tax authorities found that the transaction was in fact tax-exempt. Consequently, they decided that the purchaser should pay unduly deducted input VAT as well as interest. They also imposed a fine on the purchaser. The purchaser challenged the tax authorities’ decision before the national court. Subsequently, the case reached the Lithuanian Supreme Court.\textsuperscript{15}

In essence, the Lithuanian Supreme Court asked the CJEU the following questions:

(1) Whether Article 184 of the VAT Directive must be interpreted as meaning that the obligation to adjust undue VAT deductions set down in that article also applies in cases where the initial deduction could not be made lawfully, because the transaction that led to it being made was exempt from VAT and whether Articles 187–189 of the VAT Directive must be interpreted as meaning that the mechanism for adjusting undue VAT deductions provided for in those articles is applicable in such cases, in particular in situations such as that at issue in the main proceedings, where the initial VAT deduction was unjustified inasmuch as it concerned a VAT-exempt transaction relating to the supply of land. This question includes the potential impact of (i) the fact that, in the dispute in the main proceedings, the VAT on the purchase price of the land had been paid and deducted wrongly owing to the flawed practice of the tax authorities and (ii) the fact that the supplier of that land sent a credit note to the purchaser amending the amount of VAT mentioned on the initial invoice.\textsuperscript{14}

(2) Whether the provisions of the VAT Directive on the adjustment of deductions must be interpreted as meaning that, in cases where the initial VAT deduction could not be made lawfully, they serve to determine the date on which the obligation to adjust the undue VAT deduction arises and the period for which that adjustment must be made.\textsuperscript{15}

3 **Adjustment under Articles 184 and 187–189 of the VAT Directive**

The CJEU states initially that a distinction must be made between the extent of the obligation to make an adjustment as laid down in Article 184 of the VAT Directive and the scope of the adjustment mechanism described in Articles 187–189 of that Directive. Article 184 is defined broadly and its wording does not exclude undue transactions. According to the CJEU, the general obligation to adjust unjustified VAT deductions also derives from the fiscal neutrality of VAT, which is a fundamental principle of the common VAT system put in place by the EU legislature. Only input VAT on goods or services used by a taxable person for its taxable business may then be deductible. Consequently, Article 184 of the VAT Directive must be interpreted as meaning that the obligation to adjust undue VAT deductions also applies in cases where the initial deduction could not be made lawfully, as is the case when the transaction which has given rise to that deduction has then proved to be amongst those which are exempt from VAT.\textsuperscript{17}

The adjustment system for capital goods as provided under Articles 187–189 does not, however, apply to an undue VAT adjustment where the initial deduction could not be made lawfully. It follows from the wording of Article 185(1) that this adjustment system relates to a change, subsequent to the VAT return, in the factors used to determine the amount to be deducted. Therefore, the adjustment system for capital goods cannot be used to adjust a deduction made in the absence of any initial right of deduction. Accordingly, the fact that the VAT on the purchase price of the land was paid and deducted erroneously because of a flawed practice on the part of the tax authorities and that the supplier of that land sent the purchaser a credit note amending the amount of VAT mentioned on the initial invoice has no impact on the inapplicability of that mechanism.\textsuperscript{18}

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**Notes**

13 SEB bankas, (C-532/16), supra n. 2, para. 18.
14 SEB bankas, (C-532/16), supra n. 2, para. 20.
15 SEB bankas, (C-532/16), supra n. 2, paras 21–22.
16 SEB bankas, (C-532/16), supra n. 2, paras 30–31.
17 SEB bankas, (C-532/16), supra n. 2, para. 46.
18 Deemed taxable transactions also open a deduction right such as exports.
19 SEB bankas, (C-532/16), supra n. 2, paras 32–33 and 37–39.
20 SEB bankas, (C-532/16), supra n. 2, para. 44.
To summarize, what can be learnt from SEB bankas is that Article 184 of the VAT Directive applies to undue VAT deductions where the initial deduction could not be made lawfully, whereas Articles 187–189 do not.

Before this judgment, it was put forward in the literature that Article 184 should not allow for corrections to the VAT deducted initially, where the right of deduction was exercised in breach of national or EU VAT law.\textsuperscript{19} For example, Article 184 should not cover a situation where it turns out that the taxable person deducted all input VAT even though the goods and services were used for supplies that were originally exempt.\textsuperscript{20} In SEB bankas, VAT was deducted even though the underlying transaction was exempt, which is not the same situation, but it is still a deduction exercised in breach of EU law. The CJEU stated that Article 184 did indeed apply in such a situation. The SEB bankas case, therefore, provides us with important information on the area of application of Article 184.

The fact that the special adjustment system for capital goods in Articles 187–189 is not applicable to an undue VAT deduction is nothing new. This was already stated by the CJEU regarding the corresponding provisions in the Sixth Directive\textsuperscript{21} in the case Uudenkaupungin kaupunki.\textsuperscript{22} The aim of this special system is to take into account the long economic life of the capital goods. The correction of undue VAT deduction where the initial deduction could not be made lawfully is already dealt with under Article 184.

\section{Dates and adjustment periods}

Time periods are set out in Article 187 of the VAT Directive for adjustment under Articles 187–189. As mentioned above, these provisions are not applicable to undue VAT deductions. There are no rules in the VAT Directive regarding dates and adjustment periods for input VAT under Article 184. Even though there are no particular rules in the VAT Directive, the Member States have to comply with the fundamental principles of EU law when they implement the VAT Directive. Hence, the question of whether it is contrary to the principles of legal certainty and the protection of legitimate expectations to make an adjustment of a VAT deduction concerning a transaction which took place in 2007 when, up until 2013, the tax authorities defended the view that the transaction was subject to VAT\textsuperscript{23} is a relevant one.

The CJEU recalled that legitimate expectations could not be founded on an unlawful practice of the tax authorities. A misunderstanding of law by the tax authorities cannot constitute any legitimate expectations. Furthermore, the principle of legal certainty does not preclude an administrative practice on the part of the national tax authorities consisting in revoking, within a mandatory time limit, a decision in which they acknowledged that the taxable person had a right to a VAT deduction, by demanding that he pays that tax.\textsuperscript{24}

According to the CJEU, the principle of legal certainty requires the tax position of the taxable person not to be open for an indefinite period of time. For that reason, the fact that the starting point of the mandatory time limit depends on the fortuitous circumstances in which the unlawfulness of the deduction came to light, is likely to breach the principle of legal certainty, a matter which it is for the national court to assess. In particular, such a breach is likely to be recognized in the case the starting point of the mandatory time limit, as the Lithuanian Government claims, is set at the date of receipt by the purchaser of the credit note whereby the vendor unilaterally adjusted the price, net of VAT, of the land several years after the sale. Hence, it was up to the national court to determine whether the principles of legitimate expectations and legal certainty had been complied with in that particular case.\textsuperscript{25}

The most important statement of the CJEU in this respect is, in my opinion, that a misunderstanding of the law by the tax authorities cannot constitute legitimate expectations. In the Member States, it is not uncommon for the tax authorities to change their practice due to the fact that the CJEU has clarified the content of law through its case law. You may easily think that when the tax authorities state, for example, that an activity is exempt from VAT and the taxpayers treat the activity as exempt that everything would be fine. However, this judgment shows us that we cannot simply rely on the administrative practice of the tax authorities; instead we have to evaluate it from an EU law perspective. If it turns out that the tax authorities and the taxpayers were both wrong regarding the interpretation of the harmonized VAT provisions, the mistake on the part of the tax authorities does not excuse the taxpayer. Instead, as long as the taxpayers’ tax position is not open for an indefinite period of time, and there is a reasonable time limit, the tax charge can

\begin{notes}
\item\textsuperscript{20} van Doozen, van Kesteren & van Norden, supra n. 19, at 597.
\item\textsuperscript{22} CJEU 30 Mar. 2006, C-184/04, Uudenkaupungin kaupunki, ECLI:EU:C:2006:214.
\item\textsuperscript{23} SEB bankas, (C-532/16), supra n. 2, paras 46–49.
\item\textsuperscript{24} SEB bankas, (C-532/16), supra n. 2, paras 50–51.
\item\textsuperscript{25} SEB bankas, (C-532/16), supra n. 2, paras 52–53.
\end{notes}
be amended retrospectively in accordance with the national procedural rules. The reason for this is that the CJEU does not create new law in its preliminary rulings but interprets existing law.

5 Concluding remarks

To summarize, the CJEU case SEB bankas provides important information on the adjustment of input VAT in Articles 184–192 of the VAT Directive. There are two different adjustment systems in the Directive; a general adjustment system in Article 184 and a specific one for capital goods in Articles 187–189. From this case we learn that the former but not the latter applies to undue VAT deductions. If a taxable person has treated a transaction as taxable and the acquirer has deducted input VAT, but the transaction was in fact exempt from VAT, the deduction can be recalled under Article 184 but not adjusted under the capital goods system laid down under Articles 187–189.

A taxpayer cannot rely on a decision from the tax administration based on a misunderstanding of EU VAT law. A misunderstanding of the law does not give rise to any legitimate expectations. The tax authorities can amend a decision retrospectively. This conflicts, however, with the principle of legal certainty if the taxpayer's tax position is open for an indefinite period of time.