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Case Alert

Is VAT reclaimable?

Advocate General Kokott issues an opinion arguing that VAT incurred by a developer cannot be reclaimed!

Summary

The issue in this case was whether a developer could reclaim VAT incurred on the supply of repair and renovation works carried out on infrastructure belonging to a third party.

The developer had been granted permission to develop a holiday park by the local Municipality. However, the development would need to use the existing water treatment works owned and operated by the Municipality. The developer undertook to upgrade the plant at its own expense and reclaimed the VAT charged to it by its sub-contractor.

AG Kokott has said that, in her view, the VAT incurred by the developer is not reclaimable.

Court of Justice Advocate General's opinion

Advocate General Kokott has, once again, issued a somewhat controversial opinion. The case involved a Bulgarian developer (Iberdrola) which was granted permission by a local Municipality in Bulgaria to develop a holiday complex. However, the development would need to connect to and use the waste water treatment works and pumping station and, as the existing infrastructure was not adequate, Iberdrola agreed with the Municipality that it would upgrade the plant at its own expense and it sub-contracted that work. The sub-contractor raised VAT invoices in relation to the work and Iberdrola reclaimed the VAT on its Bulgarian VAT return as input tax.

Unfortunately, the Bulgarian tax authority took the view that the VAT incurred was not input tax and could not be reclaimed. In her opinion, AG Kokott has, somewhat surprisingly, agreed with the tax authority. Iberdrola argued that the cost of upgrading the water works was an overhead of its taxable business and that, as a consequence, under general VAT rules it should be entitled to reclaim the VAT charged. In essence, it argued that the costs incurred were overheads of the business as a whole and as such had a direct link to the supplies made by the business. The AG disagrees. In her view, the clear immediate link is between the costs and the free supply of upgrading services made to the Municipality. If these services were provided for no payment, there was no economic activity let alone a taxable activity. As such, in her view, the VAT incurred is not reclaimable.

AG Kokott sought to distinguish the recent case of Sveda (where the taxpayer similarly incurred costs on the construction of a trail on behalf of the Lithuanian State) on the basis that in Sveda, it was clear that the trail was to be used in the course of Sveda's taxable activities. Here, there was a simple supply of services free of charge to the Municipality with no economic use of the water works by anyone other than the Municipality.

This is a somewhat surprising opinion with which the full court may (or may not) agree when it issues its judgment in due course. The argument that such development costs ought to be considered as an overhead of the business is well established in the UK and is accepted by HMRC. If the full Court agrees with AG Kokott - she has been overruled by the Court in other cases – UK developers will need to consider the VAT treatment of s106 agreements afresh.

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