

Ecotrade – Different time-limits for taxpayers and tax authorities

The ECJ has today released its judgment in Ecotrade. Whilst the Court found in favour of the tax payer, the answers were not as expected. The Court went against the Commission's submission, finding that differing time limits for tax authorities and tax payers do not contravene the principle of equivalence. This means that it is possible for Member States to have different time limits. However, the court did rule that the corresponding restriction of Ecotrade's recovery of VAT due on the reverse charge did contravene European law.

Background

Ecotrade is an Italian company which receives shipping services from other Member States. Historically, it incorrectly treated these supplies as exempt. The tax authorities subsequently established that these supplies were taxable and that Ecotrade should have accounted for VAT under the reverse charge mechanism. As a fully taxable business Ecotrade would have been able to recover this VAT in full. As a result, despite applying the incorrect treatment, the same overall VAT result was achieved.

However, in 2004 the Italian tax authorities issued an output tax assessment for EUR 320,000 (plus penalties), and refused the corresponding input tax as being out of time. This resulted from different time limits as the tax authorities have four years to assess for the output tax but tax payers have only two years to recover VAT incurred. Ecotrade appealed through the Italian courts who referred the case to the ECJ.

The Decision

Unusually the court chose to reformulate the questions referred. The two questions it answered were essentially as follows.

- Does the Directive preclude the two year time limit in Italian legislation (Limitation period)?
- Does the Directive preclude penalising an irregularity, such as the omission of the reverse charge accounting, by restricting the corresponding input tax (Reassessment and recovery practice)?
- Limitation period

The court was quite clear that a two year limit does not contravene the principle of effectiveness as it does not render the right to deduct VAT virtually impossible or excessively difficult. The fact that a tax authority has a longer period does not change this position. The Court noted that the principle of equivalence had not been argued, but would not be contravened as the position of tax authority and tax payer are different. Tax authorities, for example, have to wait until a return is submitted until it is in a position to validate VAT treatment. This response confirms that different time limits are not precluded under European law.

Reassessment and Recovery practice

The court confirmed that, where a Member State establishes that a tax payer is liable to output VAT on reverse charge services, it cannot deny the right to corresponding input VAT. Such restriction is contrary to principle of fiscal neutrality. The Court added that Community law provides for Member States to apply proportional fines and penalties for non compliance but measures beyond this, such as a restriction of VAT recovery, go beyond the objective of the Directive.

Why is this important?

This is important as the Court has confirmed that Member States may enact different time limits for tax authorities and tax payers. It was interesting to see the Court disagreeing with the Commission who found the different time limits contravened equal treatment. The Court's view was that this is reasonable as the tax payer has immediate knowledge of his own affairs whilst the authorities have to wait until much later before being able to validate the VAT accounting. Whilst the UK has no significant mismatches in time limits, we may see HMRC considering implementing longer time limits for recovering under declared VAT, on the basis of the growing number of UK businesses and longer periods between compliance visits

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and they considered this briefly in 1996 when the three year cap was being introduced. We have recently seen changes to time limits in the Finance Bill 2008 which appears to shift more categories of assessment under the 20 year limit.

The recovery and assessment practice response is consistent with European case law. Even under the redefinition principles established in Halifax the recovery of input tax, even under abusive arrangements, must be offset by the output tax charged. This reinforces the importance of the principle of neutrality when calculating claims and assessments. This case relates to the self charging of VAT under the reverse charge procedure but may also support the netting off historic claims even where time limits may have passed.