

Questions and Answers
Cases and Solutions

ADJUSTMENT OF DEDUCTION

Preliminary Remarks:

- ▶ The following are a series of situations that could occur in day to day practice. The answers given are in accordance with the amended VAT Act, as applicable from the 1st of May 2004. **However, while the VAT Department has made every effort to ensure that the content of this document is as legally accurate as possible, it should not be used as a substitute for the provisions of the VAT Act 1998, of the Act No X of 2003, of any other Act and of the relevant Legal Notices as published in the Malta Government Gazette, which are the only ones that have legal value.**
- ▶ Any reference in the examples/cases/situations described in this document to a particular European Union member state, to a specific country outside the European Union or to a specific product brand name is by way of example only. Answers remain valid when the name of the member state mentioned is substituted by the name of any other member state, when any outside country is substituted by any other outside country and when any brand name is substituted by any other brand name.
- ▶ As from the 1st of May 2004, European Union member states (besides Malta) are Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden and the United Kingdom.

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- Q.** *In June 2005, a Maltese company A, registered under art. 10, purchased office furniture in Malta to be used as investment good. A only deducted a part of the Maltese VAT since it used the office furniture also for exempt without credit activities. In September 2006, A supplies the goods in Malta to B charging Maltese VAT as the goods stay in Malta. Is there any case for an adjustment?*
- A.** A can perform an adjustment in its favour and recover part of the previously not deducted VAT
- Q.** *Maltese company A is registered under art. 10 but part of its business consists of exempt without credit activities. In June 2005 A purchased a photocopier in France to be used as investment good for its entire business. A only deducted 60 % of the Maltese VAT it paid on the intra-community acquisition of the copier. In November 2006, A supplies the goods to B, a company established in Lybia, not charging Maltese VAT as the goods are exported to Lybia. Is it correct to say that A should make an adjustment of part of the VAT not deducted in his favour?*
- A.** Yes, A should make an adjustment of part of the VAT not deducted in his favour

Q. *In June 2006, a Maltese company A, registered under art. 10, makes an intra-Community acquisition of office furniture in Malta to be used as investment good. A deducts 50% of the Maltese VAT paid on these goods. In September 2008, A supplies the goods to B in Italy charging no Maltese VAT as the goods are transported to Italy and as B provides A with a valid IT VAT number. Is it correct to say that A should make an adjustment of part of the VAT not deducted in his favour?*

A. Yes, A should make an adjustment of part of the VAT not deducted in his favour

Q. *In June 2006, a Maltese company A, registered under art. 10, purchases office furniture in Malta to be used as investment good. A deducts entirely Maltese VAT paid on these goods. In September 2007, A supplies the goods in Malta to B charging Maltese VAT as the goods stay in Malta. Is there any case for an adjustment?*

A. No adjustment, nor self-supply have to be made

Q. *A, a Maltese taxable person, registered under art. 10 as from August 2004, purchased in February 2005 a computer in Malta. A deducted the entire VAT charged by the supplier. In December 2007, A changes his economic activity and becomes a taxable person only performing activities that are exempt without credit. Does A have to perform an adjustment in favour of the State of the previously deducted VAT?*

A. Yes, a one-off adjustment of 2/5 of the previously deducted VAT, because:

- The Period of reference is: 1 November year X -> 31 October year X+1
- Period 1 (period of acquisition): 1 November 2004 -> 31 October 2005 (taken into account)
- Period 2: 1 November 2005 -> 31 October 2006 (taken into account)
- Period 3: 1 November 2006 -> 31 October 2007 (taken into account)
- Period 4 (period of change of activity): 1 November 2007 -> 31 October 2008 (not taken into account)
- Period 5: 1 November 2008 -> 31 October 2009 (not taken into account)

2/5 of the previously deducted VAT has to be reimbursed to the State

Remark: If, due to the change of activity, the VAT registration under art. 10 is effectively cancelled, the rules with respect to the self-supplies will apply (and as a consequence the adjustment rules do *not* apply) (see item 14 (2) Second Schedule).

Q. *A, a Maltese taxable person, registered under art. 10 as from February 2005, purchased in February 2005 a computer in Malta. A deducted the entire VAT charged by the supplier. In January 2007, A changes his economic activity and becomes a taxable person only performing activities that are exempt without credit. Has A to perform an adjustment of the previously deducted VAT?*

A. Yes, a one-off adjustment of 4/5 of the previously deducted VAT in favour of the State is due:

- From February 2005 up to January 2006: first year (taken into account)
- From February 2006 up to January 2007: second year (not taken into account as the change of activity is taking place during this year).
- As VAT has been deducted entirely and as there is no self-supply possible (A continues an economic activity), 4/5th of the VAT previously deducted must be repaid to the State

Q. *A, a Maltese taxable person, registered under art. 10 as from August 2004, purchased in February 2005 a computer in Malta. A deducted the entire VAT charged by the supplier. In December 2007, A changes his economic activity and becomes a mixed taxable person performing also activities that are exempt without credit. The computer previously used for taxable activities will as from that moment only be used for activities that are exempt without credit. A has to perform an adjustment in favour of the State of the previously deducted VAT.*

A. Yes, a one-off adjustment of 2/5 of the previously deducted VAT has to be performed because:

- As A is registered in August, the first period of reference will be one tax period in 2004, that is to say August, September and October.
- Afterwards, the period of reference will be: 01/11 to 31/10
- We have to consider the following periods:
 - **01/11/04 to 31/10/05: purchase of the computer (this period is taken into account)**
 - **01/11/05 to 31/10/06: use of the computer (this period is taken into account)**
 - **01/11/06 to 31/10/07: use of the computer (this period is taken into account)**
 - 01/11/07 to 31/10/08: the computer is wholly used for an activity not opening right to deduct VAT (this period is not taken into account)
- As the adjustment period is five reference periods and as the computer has been used for an activity opening the right to deduct VAT during only three reference periods, 2/5th of the VAT deducted must be repaid to the State.

Q. *A, a Maltese taxable person, registered under art. 10 as from August 2004, purchased in February 2005 a machine in Malta. A deducted the entire VAT charged by the supplier. In December 2008, the machine gets broken, cannot be repaired and goes to the scrap-yard. Is it correct to say that A must perform an adjustment in favour of the State of the previously deducted VAT.*

A. No, as the machine got broken and is beyond repair, it is considered to be destroyed and therefore no adjustment of deducted VAT has to be made. It goes without saying that the taxable person must be able to prove that the machine stopped to exist in the enterprise because it was beyond repair.

CASE 1 - DATA

A Maltese company X (a normal taxable person) is registered for VAT purposes (art. 10) as from 1 October 2004. On 7 October 2004, X buys a computer (Lm 2,788 + 500 VAT). He deducts Lm 500. On 6 August 2008, he stops his taxable economic activity, but continues an economic activity without right to deduct VAT.

Is there any adjustment to be made by X? If yes, to what extent?

CASE 1 - SOLUTION

Preliminary remark: In case due to the change of activity, the VAT registration art. 10 is effectively cancelled, the rules with respect to self-supply will apply (and as a consequence the adjustment rules do *not* apply).

When hereafter the solution is dealing with the adjustments, it is for the purpose of this study case assumed that the VAT registration art. 10 has not been cancelled

Case 1 - Solution self-supply

Solution: A-A

1. Taxable person: YES
2. Operation in the scope of VAT: YES (self-supply of goods)
3. Place of supply: Malta (where the goods are when they are placed “at the disposal of the customer A” - Item 1 (a) Third Schedule)
4. Exemption: NO
5. Person liable to pay VAT: A (Art. 20 (1) (a) VAT Act)

Taxable basis = the purchase price (or cost price) determined at the time of the supply

Case 1 - Solution adjustment

The **period of reference** is:

- For period 1: 10/04 -> 12/04
- For period 2, 3, 4 and 5: calendar year

- Period 1 ends on 31/12/2004 (taken into account)
- Period 2 ends on 31/12/2005 (taken into account)
- Period 3 ends on 31/12/2006 (taken into account)
- Period 4 ends on 31/12/2007 (taken into account)

The loss of the right to deduct VAT appears in period 5 (not taken into account)

Adjustment in favour of the State: 500 Lm x 1/5th = 100 Lm (box 40 VAT return)

CASE 2 - DATA

A Maltese company X (a mixed taxable person) is registered for VAT purposes (art. 10) as from 1 October 2004. On 7 October 2005, X buys a computer (Lm 2,788 + 500 VAT).

- *The definitive ratio for the tax period(s) ending on 31 December 2004 was 30 p.c.*
- *The definitive ratio for the four tax periods ending on 31 December 2005 was 40 p.c.*
- *The definitive ratio for the four tax periods ending on 31 December 2006 was 50 p.c.*
- *The definitive ratio for the four tax periods ending on 31 December 2007 was 30 p.c.*
- *The definitive ratio for the four tax periods ending on 31 December 2008 was 40 p.c.*
- *The definitive ratio for the four tax periods ending on 31 December 2009 was 70 p.c.*

Question: *Are there any adjustments to be made by X? If yes, to what extent?*

CASE 2 – SOLUTION ADJUSTMENT

The period of reference is a calendar year

► Adjustment first period

- VAT paid: 500 Lm
- Definitive ratio for tax periods ending on 31/12/2004 (and thus provisional ratio for tax periods ending on 31/12/2005) = **30%**
- Deduction of VAT = 30% x 500 Lm = **150 Lm**
- Definitive ratio for tax periods ending on 31/12/2005 = **40%**
- Taking into account this ratio, the taxable person could deduct 500 Lm x 40% = **200 Lm**
- Additional deduction allowed: X can make an adjustment in his favour of **50 Lm** (i.e. right to deduct 200 Lm – amount already deducted 150 Lm) (box 41 VAT return)

Remark: This adjustment concerns the entire amount provisionally deducted at the origin and it consequently also covers the adjustment related to the first 1/5th for capital goods

► Adjustment following periods: adjustment per year

- The adjustments for the periods 2, 3, 4 and 5 will this time concern only one fifth taking into account what follows:
 - VAT actually paid is divided by 5 → $500 : 5 = \underline{100}$
 - VAT actually deducted on basis of the definitive ratio of the first period is divided also by 5 → $200 : 5 = \underline{40}$
 - The result of **100** multiplied by the definitive ratio of each of the following periods will be compared with **40**
 - The difference will result in an adjustment either in favour of the State or in favour of the taxable person

► Adjustment second period

Adjustment for the second period 1/1 → 31/12/2006

The definitive ratio for the period calculated on the basis of the turnover is 50%

- Authorised deduction: **100** X 50% = 50
- Already deducted: **40**
- Additional deduction allowed: $50 - \mathbf{40} = 10$ (box 41 VAT return)

► **Adjustment third period**

Adjustment for the third period 1/1 → 31/12/2007

The definitive ratio for the period calculated on the basis of the turnover is 30%

- Authorised deduction: **100** X 30% = 30
- Already deducted: **40**
- To be repaid to the State: $\mathbf{40} - 30 = 10$ (box 40 VAT return)

► **Adjustment fourth period**

Adjustment for the fourth period 1/1 → 31/12/2008

The definitive ratio for the period calculated on the basis of the turnover is 40%

- Authorised deduction: **100** X 40% = 40
- Already deducted: **40**
- No adjustment: $40 - \mathbf{40} = 0$

► **Adjustment fifth period**

Adjustment for the fifth period 1/1 → 31/12/2009

The definitive ratio for the period calculated on the basis of the turnover is 70%

- Authorised deduction: **100** X 70% = 70
- Already deducted: **40**
- Additional deduction allowed: $70 - \mathbf{40} = 30$ (box 41 VAT return)

CASE 3 - DATA

In August 2005, a taxable person (A) sells a work of art (originally purchased to be put in A's reception hall of his premises) to B. This good has been purchased in July 2004. The taxable person was registered under art. 10 on 1st June 2004.

CASE 3 - Question

Determine the VAT treatment of the above operation (in order to determine whether an adjustment has to be made by A).

CASE 3 - SOLUTION

Preliminary remarks:

- This study case focuses on the question to determine whether or not an adjustment (or a self-supply) has to be made by A
- It is *assumed* that A is a regular taxable person registered under art. 10
- It is *assumed* that A is not a trader in works of art, nor a second-hand goods dealer falling under the profit margin regime
- It is *assumed* that the purchase by A of the work of art in July 2004 was subject to Maltese VAT
- It is *assumed* that (taking into account the above) the VAT deduction upon the purchase of the work of art was blocked (see item 3 (a) (iii) Tenth Schedule – or because the work of art was purchased under the profit margin regime)

Hypothesis 1: supply A-B is deemed to take place in Malta

Solution: A-B

1. Taxable person: YES
2. Operation in the scope of VAT: YES (supply of goods)
3. Place of supply: Malta (see assumption)
4. Exemption: YES (VAT deduction upon purchase of the work of art was blocked (see item 3 (a) (iii) Tenth Schedule) – item 13 Part Two Fifth Schedule)
5. Person liable to pay VAT: N/A

The exemption is an exemption without credit

Hypothesis 2: supply A-B is deemed to take place outside Malta

Solution: A-B

1. Taxable person: YES
2. Operation in the scope of VAT: YES (supply of goods)
3. Place of supply: outside Malta (see assumption)
4. Exemption: N/A
5. Person liable to pay VAT: N/A

IN BOTH HYPOTHESES:

A will not make any adjustment (nor a self-supply)!!