MAKSU- JA TOLLIAMET

Calculation and refund of VAT

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Reduction of tax liability in case of irrecoverable arrears

As of 1 January 2022, the VAT Act introduces provisions giving taxable persons the possibility to reduce their VAT liability due to irrecoverable arrears if certain conditions are met.

Until the end of 2021, purchaser's insolvency did not affect the amount of VAT payable on goods or services if the goods or services were actually transferred but the purchaser did not pay for them in full or at all. The amendment to the VAT accounting rules relating to invoices which are partially or fully unpaid follows from the **judgement of the Court of Justice in Case C-246/16**, which amended the principle set out in previous decisions concerning the treatment of Article 90(2) of the **VAT Directive 2006/112/EC of the EU**.

Taking into account this court judgement, **§ 29[1] of the VAT Act** was amended with the date of entry into force on 1 January 2022. From that date, taxable persons can reduce their VAT liability in the following circumstances:

1. an invoice has been issued for the transferred goods or the provided service pursuant to **§ 37 of the VAT Act**;
2. the amount of the VAT is calculated on the transaction and reflected in the VAT return for the taxable period of the transaction;
3. the claim has not been transferred;
4. at least 12 months have passed since the due date for payment of the invoice, but not more than three years, except in the case specified in clause 6;
5. the claim has been written off in accounting because it has not been possible to collect the claim despite the efforts of the taxable person to make every effort to collect the claim, or the expenses incurred for its recovery exceed the estimated income receivable (i.e. the claim has been removed from the balance sheet);
6. in the case of a claim containing VAT exceeding 30,000 euros, the claim has been certified by a court judgment which has entered into force;
7. the purchaser of goods or the recipient of services is not a related person within the meaning of the Income Tax Act;
8. the taxable person has notified the purchaser of the goods or the recipient of the service in writing of the write-off of the claim in the accounting in the month of the write-off, indicating the amount of the VAT related to the written-off claim.

If all of these conditions are met, the seller can reduce his VAT liability to the extent of the unpaid amount in the taxable period in which the claim is written off (removed from the balance sheet). Only if the transaction has been formalised in accordance with the requirements laid down in the VAT Act does a taxable person have the right to reduce the VAT liability. If the taxable person has not issued an invoice for the goods or services or has not declared the relevant supply during the relevant taxable period, the taxable person has no right to reduce his tax liability in respect of the goods or services unpaid. Once a

claim has been transferred, it is no longer a debt and the tax liability cannot be reduced, since the claim is essentially satisfied by the third party acquiring it.

If several invoices have been submitted to the same purchaser and the invoices are partially or fully unpaid, each invoice shall be deemed to be a separate claim for the purposes of § 29^1 of the VAT Act. This means that only claims containing VAT exceeding 30,000 euros related to that purchaser must be certified by a court judgement which has entered into force. If a person has already gone to court with a set of invoices, this set of invoices can be viewed as a single claim.

According to subsection 1 of § 29^1 of the VAT Act, in order to reduce tax liability, a taxable person must comply with **all** the conditions listed in clauses 1 to 8 of that subsection, **including the obligation laid down in clause 8 to notify the other party of the transaction in writing of the write-off of the claim in the accounting**. If the taxable person has not or is no longer able to do so, all the conditions laid down in § 29^1 of the VAT Act for the reduction of tax liability are not fulfilled. Although the explanatory memorandum to the draft resolution on amending the VAT Act and the Customs Act adopted by the Riigikogu on 10 February 2021 seems to allow the condition established in clause 8 to be excluded exceptionally in certain cases (transaction party has been liquidated) if the other conditions are met, it must be taken into account that if the debtor has been liquidated without having paid his or her debt to the taxable person, and the taxable person has not written the claim off in its accounting before the debtor's liquidation, it is doubtful that the taxable person has fulfilled the condition laid down in clause 5 of subsection 1 of § 29^1, i.e. made every effort to collect the claim (e.g. responded to a warning on deletion of a debtor from the commercial register, filed a claim before liquidation in liquidation proceedings, filed a bankruptcy petition concerning the debtor).

If, during one taxable period, several claims relating to the same purchaser are written off in the accounting, the claims can be the subject of a single written notification to the purchaser, provided that all claims written off and the related VAT are indicated separately.

If the conditions are met and tax liability is reduced due to irrecoverable arrears, but the claim on which the reduction is based on is subsequently paid in part or in full, that claim must be included in the taxable value of the period of taxation in which the claim is paid in part or in full.

Taxable purchasers who have, due to insolvency, failed to pay in part or in full for goods or services received but who have deducted the VAT included in the unpaid invoice as input VAT and have received a notification of the write-off of the claim in accounting from the seller, are required to increase their tax liability (reduce the deductible input VAT) by the amount of VAT related to that claim in the taxable period in which the notification is received. **If an irrecoverable claim is written off in the accounting, no credit note must be issued to the debtor.**

This provision can be implemented in case of irrecoverable arrears written off as of **1 January 2022**. If a claim is written off at a time when the new provision of the VAT Act does not yet apply (before 1 January 2022), then the seller cannot yet apply § 29^1 and reduce their tax liability on the basis of this new

provision.

If, after 1 January 2022, a taxable person reduces their VAT liability based on § 29[1] of the VAT Act, when filling in the VAT return for the tax period of writing off the claim, the reduction of the taxable value is recorded in the line of the VAT rate of the goods or services the taxable value of which is reduced (1, 1[1], 2 or 2[1]), which in turn reduces the amount of VAT in line 4. The taxable purchaser must record the reduction of input VAT in line 5 of the VAT return.

If the VAT liability is reduced pursuant to § 29[1]of the VAT Act and the invoices relating to the respective transaction partner have to be included in KMD INF (appendix to the VAT return) during the taxable period, the seller must declare in part A of the form KMD INF and the taxable purchaser in part B of the form KMD INF either again (if the corresponding invoices were declared in the form KMD INF during the taxable period of supply) or for the first time the invoice partially or fully paid in respect of which the irrecoverable claim was written off in the accounts. In both cases, the usual details of the invoice (invoice date, number, transaction partner data) and the figures of the outstanding part of the invoice with a minus sign are declared.

Additional information

Example on how to declare invoices related to irrecoverable arrears in form KMD INF part A (in Estonian)
Example on how to declare invoices related to irrecoverable arrears in form KMD INF part B (in Estonian)

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