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Spain’s New VAT Bad Debt Relief Rules Remain Open to Challenge

By Joanna Norland

- Spain relaxed VAT bad debt relief in 2023
- Restrictions may be subject to further challenges

Spain relaxed its restrictions on VAT relief for customer default in 2023, but the new rules may not go far enough to meet EU requirements and are therefore open to taxpayer challenge.

The importance of bad debt relief stems from a mismatch between the time when suppliers must remit VAT to tax authorities and the time they receive it from recipients, which is often much later. Suppliers generally remit VAT to the tax authorities in the period of invoicing. The supplier then collects VAT from the customer to preserve “neutrality,” the EU legal principle that the final customer, rather than the supplier, shoulders the ultimate burden for VAT expense. If a customer defaults on payment, tax leakage can be significant, given that VAT is imposed at rates of 17%-27% across the EU.

To prevent this leakage, all EU member states are required to provide for VAT relief in case of nonpayment or refusal to pay. The conditions countries may impose on this relief are limited under a long line of EU cases, e.g., *E. Sp. z o.o. Sp. k. v. Minister Finansów* (C-335/19). In practice, domestic requirements vary widely from country to country.

Spain Relaxes Rules

In 2022, the Spanish Supreme Court ruled that Spain’s requirements were excessive and contradicted the EU principle of neutrality. Following this decision, Spain amended its rules, effective starting 2023.

Previously, a creditor had to support the claim for relief with a court claim or notarial demand. Now, any reliable evidence is sufficient. Furthermore, once a debt is written off as “bad,” the window for VAT recovery is extended from three to six months. According to Fernando Matesanz, managing director of Spanish VAT Services, the prior strictures were impractical for many businesses, including some he advises, which often lacked the resources to monitor invoice timelines closely or pursue expensive claims procedures.

Spain also reduced the minimum bad debt amount for consumer debt from 300 euros to 50 euros ($326-$54). Under the prior minimum, “it was impossible for companies in sectors such as telecoms, with large numbers of small consumer defaults, to recover significant amounts of VAT,” said Jorge Gómez Alguacil, special counsel, tax, with Baker McKenzie Madrid, an adviser to Spanish and multinational companies.

“Now there is a possibility. For those companies, this is a huge impact,” he said.

In relaxing its rules, Spain follows the trend set by Bulgaria, Poland, Italy, and Greece.

EU Member States Expand Bad Debt Recovery Provisions

Country	Date In Force	Key Amendments
Spain	January 1, 2023	Expanded access by amending thresholds, deadlines, procedural requirements and providing relief for bankruptcies filed throughout the EU, not just in Spain.
Bulgaria	January 1, 2023	Enacted VAT bad debt relief provisions, subject to various conditions.
Poland	October 1, 2021	Extended claim period and amendment of requirements relating to the VAT registration status of the debtor and creditor.
Italy	May 26, 2021	Accelerated the claim procedure
Greece	November 28, 2019	Extended conditions under which debt relief can be claimed.

Source: Bloomberg Tax

Bloomberg Tax

Is It Enough?

Although these changes enable recoveries that were previously not allowed, Spanish restrictions may remain incompatible with the neutrality principle, according to Alguacil. He questions the basis for the 50-euro threshold and the six-month window. “When you miss a deadline, you are unable to recover by any means,” he said. Furthermore, unless the recipient is insolvent, bad debt relief is only available if the recipient is established in Spain or certain autonomous regions, a requirement which may be incompatible with EU rules.

Alguacil said that litigation may be an impractical means of shifting the law further because Spanish courts are reluctant to refer matters the Court of Justice of the European Union for a preliminary ruling on compatibility. Therefore, a more effective route may be to negotiate with the tax authorities for additional flexibility. Taxpayers may also seek alternative means of recovery, such as renouncing the receivable altogether. Effectively, this means that some companies give up the right to legal recourse, particularly on small debts, such as 10 euros, as a mitigation strategy.

Objection, Your Honor

In other EU member states, advisers see litigation as the way forward.

Bulgaria amended its law to allow bad debt relief starting in 2023, but doesn't provide for retroactive relief for pre-existing bad debts. Taxpayers who have suffered such debts should be encouraged to try to recover the VAT based on their rights under EU law, "as there are arguments in support of such VAT refund claims," Ivan Punev, a senior associate with the Bulgarian business law firm Djingov, Gouginski, Kyutchukov & Velichkov, told Bloomberg Tax.

The Greek VAT Code doesn't provide procedures for bad debt relief. However, the Greek Supreme Administrative Court has allowed such relief if the debtor has been declared bankrupt or has been placed under special administration or under a rehabilitation procedure.

Alex Karopoulos, a partner with the Greek law firm Zepos & Yannopoulos, is currently litigating to establish that the law must go further and provide for bad debt relief in other circumstances where the debt will likely not be repaid. He anticipates resolution in 2024.

Until such time as the law changes, however, he advises taxpayers who seek bad debt relief to gather convincing evidence of their defaulting customers' financial distress—for example, entry into bankruptcy proceedings.

Trust the Process?

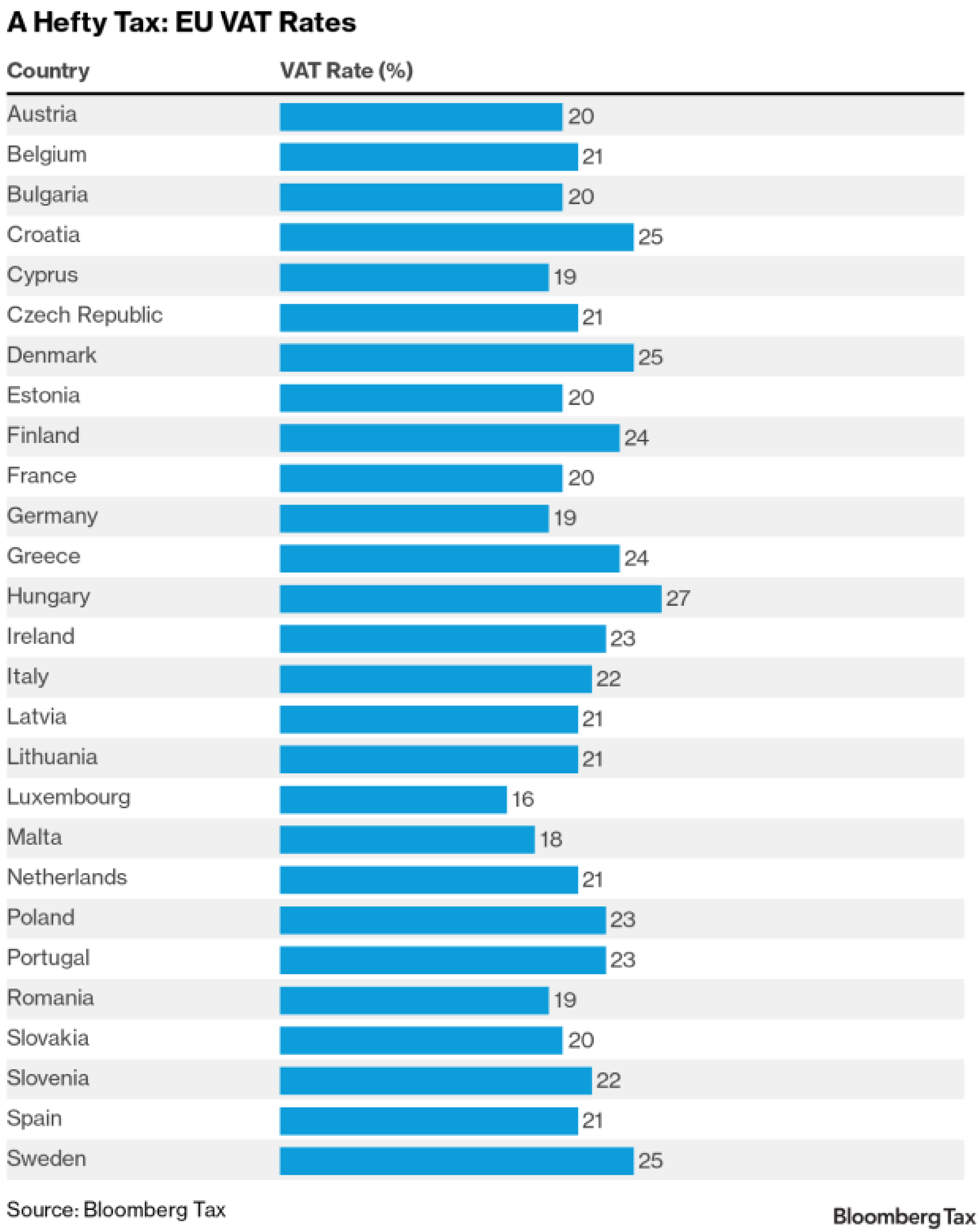
In Spain as well, whether taxpayers seek to recover VAT under current law or to extend access, advisers agree that sound processes are key to supporting a claim.

Alguacil recommends that suppliers implement internal processes or systems to track the status of receivables. Monitoring can be outsourced or delegated to a specified employee.

Further, companies should record all collection and debt enforcement efforts, as tax authorities may scrutinize the file. In Spain, a burofax seeking collection is more likely to prevail than an email, which may be insufficient, according to Matesanz and Alguacil.

While these procedures can be demanding, the sums often justify close attention, given the EU's high VAT rates.

Says Matesanz, "My opinion as an adviser is that it is a taxpayer's right to recover VAT on bad debt and everyone should find a way to do so."



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