Case C-108/20

Request for a preliminary ruling

Date lodged:

27 February 2020

Referring court:

Finanzgericht Berlin-Brandenburg (Germany)

Date of the decision to refer:

5 February 2020

Applicant:

HR

Defendant:

Finanzamt Wilmersdorf

F I N A N Z G E R I C H T (FINANCE COURT)

B E R L I N — B R A N D E N B U R G

ORDER

[…]

In the case between

HR

applicant,

Legal representative: …,

and

Finanzamt Wilmersdorf (Tax Office, Wilmersdorf)

defendant,

in the matter of Value added tax 2009, 2010

the Fifth Chamber of the Finance Court, Berlin-Brandenburg

made the following order on 5 February 2020 […]:

I. The following question is referred to the Court of Justice of the European Union ('the Court') for a preliminary ruling:

Are Articles 167 and 168(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive') to be interpreted as precluding the application of national law under which input tax deductions are not to be allowed where, when turnover tax fraud about which a taxable person knew or should have known was committed at a preceding stage, the taxable person, through the transaction carried out with him or her, did not participate in and was not connected to the turnover tax fraud and did not encourage or facilitate the turnover tax fraud committed? [Or. 2]

II. The proceedings are stayed pending a ruling on the question referred for a preliminary ruling above.

G r o u n d s:

I.

1. The applicant and her husband operated a wholesale drinks business in 2009 and 2010 ('the relevant years'), in […]. On her turnover tax returns for the relevant years, she claimed input tax on invoices raised by P GmbH in the amounts of EUR 993 164.00 (2009) and EUR 108 417.87 (2010). The drinks listed on the invoices (mainly spirits and Red Bull) were actually delivered to the applicant by P GmbH. The applicant paid the sums invoiced to P GmbH and both P GmbH and the applicant reported the transactions in their accounts. Neither the applicant nor P GmbH committed tax fraud in connection with the supply relationship between them. The invoices raised by P GmbH fulfilled the statutory requirements enacted in Paragraphs 14 and 14a of the Umsatzsteuergesetz (Law on Turnover Tax, 'the UStG'). The applicant resold the drinks purchased from P GmbH; no turnover tax fraud was committed in connection with those onward sales.

2. As is apparent from two judgments delivered in criminal proceedings, which have now become final, P GmbH committed several counts of turnover tax fraud in connection with the purchase of the drinks supplied to the applicant. According to the findings by the criminal court, the facts of those crimes can be summarised as follows: The applicant's husband supplied P GmbH with large quantities of spirits, coffee and Red Bull (the transactions as at September 2010 totalled approximately EUR 80 million) and, in doing so, incurred criminal liability. No invoices were raised for those supplies. Instead, an employee of P GmbH raised fictitious invoices for the purchases. P GmbH then unlawfully claimed the input

tax on them. At the same time, the applicant's husband provided P GmbH with price lists and lists of potential buyers for the goods. The goods were then resold to various buyers, including the applicant. Once the facts of the case had come to light, the Finance Office refused to allow P GmbH to deduct the input tax charged on the fictitious invoices.

3. The defendant also refused to allow the applicant to made deductions in so far as they related to input tax amounts paid on purchases from P GmbH. The main reason given for this was that the applicant and her business formed part of the **[Or. 3]** chain of supply connected with the turnover tax fraud. With the involvement of the applicant's husband, P GmbH had avoided paying input tax on purchases of various drinks subsequently resold to the applicant and other customers.

4. The applicant argues that it was wrong in this case to refuse to allow her to deduct the input tax paid in respect of purchases made from P GmbH. She claims that she fulfils the statutory requirements governing the right to deduct input tax.

5. The defendant contends that, given the involvement of her husband and the unusual business conduct, the applicant must have known that she and her business formed part of a chain of supply being used to evade turnover tax. The defendant argues that, according to the case-law of the Court, it was therefore justified in refusing to allow her to make the deductions.

II.

6. The Chamber referred the question set out in the operative part to the Court for a preliminary ruling in accordance with the second paragraph of Article 267 in combination with point (a) of the first paragraph of Article 267 of the Treaty on the Functioning of the European Union (TFEU).

1. Legal context

a) EU law

7. Article 167 of the VAT Directive states:

'*A right of deduction shall arise at the time the deductible tax becomes chargeable.*'

8. Article 168(a) of the VAT Directive states:

'*In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:* **[Or. 4]**

a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person.'

9. In accordance with Article 178(a) of the VAT Directive, in order to exercise the right of deduction in respect of supplies of goods and services, a taxable person must meet, *inter alia*, the following condition:

'*... he must hold an invoice drawn up in accordance with Sections 3 to 6 of Chapter 3 of Title XI*'.

b) National law

10. The first and second sentences of point 1 in Paragraph 15(1) of the UStG, as it applied in the relevant years, read as follows:

'[1]*A trader may deduct the following as input tax:*

1. the tax lawfully payable on goods and services provided to his business by another trader. [2]*Deduction of the input tax is subject to the condition that the trader holds an invoice drawn up in accordance with Paragraphs 14 and 14a.'*

2. Assessment on the basis of national law and the relevance of the question referred

11. The question that arises in the main proceedings and which needs to be answered in order to enable the referring court to give judgment is whether the applicant should not be allowed to make a deduction in respect of inputs from P GmbH as she must have known about the turnover tax fraud committed at a preceding stage.

12. The factual requirements for a deduction of input tax under the first sentence of point 1 of Paragraph 15(1) of the UStG are fulfilled for the turnover tax evidenced by the invoices raised by P GmbH. **[Or. 5]**

13. The sole question is whether the Tax Office is justified in refusing to allow the applicant to make the deductions on the grounds that the applicant must have known about the turnover tax fraud committed by P GmbH, that is to say the fraud committed at a preceding stage.

14. In the relevant years the law did not provide for the deduction of input taxes to be refused in the above circumstances. Nonetheless, national case-law established by the highest courts by reference to the case-law of the Court regards any such refusal as necessary where '*it is shown in the light of objective factors that the taxable person knew or should have known that the transaction concerned was connected with fraud committed by the supplier or that another transaction forming part of the chain of supply, downstream or upstream of the transaction carried out by the taxable person, was vitiated by VAT fraud*' […].

15. Thus, under national law, it is necessary to know, in order to give judgment, whether the fact that the applicant should have known about P GmbH's fraudulent attempt to deduct input tax means not only that P GmbH must not be allowed to deduct input tax, but also that the applicant must not be permitted to deduct input tax paid in the context of the downstream supply relationship between her and P GmbH. The interpretation given to the term 'chain of supply' is therefore crucial to the outcome in the main proceedings. If the transactions between P GmbH and the applicant are to be regarded as forming part of an overall chain of supply together with the fraudulent purchases of drinks by P GmbH at the preceding stage, it is right that the applicant be prevented from deducting input tax in this case. However, if they should not be regarded as such, the applicant must be allowed to deduct the input tax paid.

3. Assessment on the basis of EU law

16. The referring court has doubts as to the interpretation of the term 'chain of supply' under EU law and as to whether the supply relationship in the main proceedings can be included in that chain. As the term 'chain of supply' has been developed by the Court in connection with refusals to allow deductions of input tax, the problem lies in the interpretation of EU law. **[Or. 6]**

17. The Court has ruled, in what is now settled case-law, that the prevention of tax evasion, avoidance and abuse is an objective recognised and encouraged by the VAT Directive. It is therefore for the national courts and judicial authorities to refuse to allow deductions if it is shown, in the light of objective factors, that the right to deduct is being relied on for fraudulent or abusive ends. Although that is the position where tax fraud is committed by the taxable person him- or herself, it is also the case where a taxable person knew, or should have known, that, by his or her purchase, he or she was participating in a transaction connected with VAT fraud or that another transaction forming part of the chain of supply, downstream or upstream of the transaction carried out by the taxable person, was vitiated by VAT fraud (see judgments of 18 May 2017, *Litdana*, C-624/15 […], paragraph 35; of 22 October 2015, *PPUH Stehcemp*, C-277/14, […], paragraphs 47 to 49; of 13 March 2014, *FIRIN*, C-107/13, […], paragraph 42; of 18 July 2013, *Evita-K*, C-78/12, […], paragraph 41; of 31 January 2013, *Stroy trans*, C-642/11, […], paragraph 48; of 31 January 2013, *LVK-56*, C-643/11, […], paragraph 60; of 6 December 2012, *Bonik*, C-285/11, […], paragraph 41; and of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 47).

18. Based on those principles of EU law, a refusal to allow a deduction of input tax in the main proceedings is permitted in the following three cases:

- the applicant herself committed tax fraud in connection with the contested supplies received by her from P GmbH;
- P GmbH evaded the turnover tax on the supplies to the applicant; or

- the contested transactions formed part of a chain of supply vitiated by tax fraud.

If none of those three scenarios applies, it is not permissible to refuse to allow the applicant to make the deductions, irrespective of whether she knew of any tax fraud at a preceding stage. **[Or. 7]**

19. As neither the applicant, through her deduction of input tax paid on the drinks supplied by P GmbH, nor P GmbH, as the supplier of those goods, evaded paying any tax in connection with the transactions contested in this case, the sole deciding factor in the main proceedings is whether the transactions in question formed part of a 'chain of supply' vitiated by tax fraud.

20. The Court uses the term 'chain of supply', but does not appear to date to have defined it in greater detail.

21. The referring court therefore considers that it is conceivable that a taxable person should not be permitted to deduct input tax where that person knew or should have known about tax fraud committed at (any) preceding stage. That would be the case if the term 'chain of supply' is to be understood as meaning that it suffices if several consecutive transactions were carried out in connection with the same goods. A link or connection with the tax fraud at a preceding stage would exist in that case simply by reason of the fact that the transaction concerned the same goods. Encouragement of or assistance with the tax fraud via the contested transaction (for example by concealing the supply relationships or similar) would, however, not be necessary.

22. Nonetheless, the referring chamber is of the opinion that any such interpretation of the term 'chain of supply' would be too broad in light of the principles of EU law of neutrality and proportionality.

23. It follows from the case-law of the Court that the right of deduction can be refused in the event of tax fraud and abuse in connection with a chain of supply only where the fraudulent nature of transactions taken together is the consequence of precisely the specific combination of several consecutive transactions (see judgment of 18 December 2014, *Italmoda*, C-131/13, C-163/13 and C-164/13, […], paragraph 67). That is to apply, for example, where the consecutive supplies form part of an overall plan devised in the aim of making the goods supplied difficult to track and, thus, the tax fraud committed in the chain of supply difficult to uncover. This includes, in particular, transactions forming part of 'carousel' fraud. This might, moreover, include serial transactions, where businesses which do not actually take delivery of goods **[Or. 8]** are interpolated in order to conceal supply relationships. Ultimately, based on that view, a 'chain of supply' would include only those transactions that specifically encouraged or facilitated the tax fraud at a preceding or subsequent stage.

24. The referring chamber states that this interpretation is supported by several judgments in which, when it refused to allow deductions to be made, the Court:

- required '*participation*' of the taxable person, via the transactions carried out by him or her, in the tax fraud committed at a preceding or subsequent stage (see judgments of 17 October 2019, *Unitel*, C-653/18, […], paragraph 33; of 28 March 2019, *Vins*, C-275/18, […], paragraph 33; of 8 November 2018, *Cartrans Spedition*, C-495/17, […], paragraph 41; of 25 October 2018, *Božičevič Ježovnik*, C-528/17, […], paragraph 35; of 19 October 2017, *Paper Consult*, C-101/16, […], paragraph 52; of 18 May 2017, *Litdana*, C-624/15, […], paragraphs 33 et seq.; of 9 February 2017, *Euro Tyre*, C-21/16, […], paragraph 40; of 2 June 2016, *Kapnoviomichania Karelia*, C-81/15, […], paragraph 42; and of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 54);

- assumed a '*connection*' between the taxable person's transactions and the fraud committed at another stage (see judgment of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 53); or

- required a '*link*' between the taxable person's transactions and the tax fraud committed at another stage (see judgments of 28 March 2019, *Vins*, C-275/18, […], paragraph 33; of 8 November 2018, *Cartrans Spedition*, C-495/17, […], paragraph 41; of 18 October 2018, *Božičevič Ježovnik*, C-528/17, […], paragraph 35; and of 9 February 2017, *Euro Tyre*, C-21/16, […], paragraph 40).

The referring court is of the opinion that it may not suffice for the purpose of substantiating any such 'participation', 'connection' or 'link' that the taxable person merely knew **[Or. 9]** or even simply should have known about the tax fraud committed. On the contrary, in order for 'participation' or a 'connection' or 'link' to be established, a contribution to the tax fraud, at least in the sense of encouraging or facilitating it, may be required. In the opinion of the referring court, bad faith as a purely subjective factor cannot replace the active involvement required for 'participation' or a 'connection' or 'link'.

25. The referring court is of the opinion that, if bad faith is not accompanied by action to encourage or facilitate tax fraud, there is good cause to think that a taxable person must be allowed to make deductions in respect of his or her inputs. This is especially so where the supply relationships are fully disclosed by raising invoices and reporting them in the accounts and on the turnover tax returns filed with the tax authorities, as is the case in the main proceedings. Supply relationships and suppliers have not been concealed in the present case. The tax fraud committed at a preceding stage (in this case, deduction of input tax on drinks purchased by P GmbH) had been fully completed and it was no longer possible to encourage or facilitate it via the transactions at the next stage (in this case, the onward sale of the drinks by P GmbH to the applicant). On the contrary, the transaction between P GmbH and the applicant represents a further supply relationship independent of the transaction connected with the tax fraud committed at a preceding stage. In that sense, there was no overall plan in which these supplies were supposed to

form part of tax fraud across several transactions. Based on that understanding of the term ‘chain of supply’, in circumstances such as those in the main proceedings, the chain of supply may have ended at P GmbH. In that case, supplies by P GmbH downstream of the turnover tax fraud, whether to the applicant or to other third parties, must therefore be new supply relationships which are regarded as being independent of the preceding tax fraud, rather than as part of a chain of supply vitiated by tax fraud.

26. In the opinion of the referring court, therefore, whether or not the applicant’s husband specified the buyers of the goods to P GmbH may also be irrelevant. Its reasoning is that this cannot change the fact that supplies from P GmbH to the applicant have no effect on the tax fraud previously committed by P GmbH. It is no longer possible for the wholly transparent supply relationship between P GmbH and the applicant to encourage tax fraud that has already been completed. Nor, **[Or. 10]** given that transparency, is it possible subsequently to conceal supply relationships.

27. This conclusion may be supported by the case-law of the Court, according to which deductions may be refused in cases of abusive conduct only where allowing the contested deduction would result in the accrual of a tax advantage the grant of which would be contrary to the purpose of the VAT Directive (see judgment of 10 July 2019, *Kuršu zeme*, C-273/18, […], paragraph 35). According to the case-law of the Court, that may be the case, for example, where the taxable person conducts the transactions in the aim of concealing the true suppliers and frustrating taxation of the transactions, or if the real objective of the contested transaction is to obtain an undue tax advantage (see judgment of 10 July 2019, *Kuršu zeme*, C-273/18, […], paragraphs 36 and 37). However, in circumstances such as those in the main proceedings, there may not have been such abusive conduct. As the supplier of the drinks (P GmbH) is named on the invoices, the tax authorities are fully able to check the turnover tax charged on the goods. The referring court cannot find that the transactions between P GmbH and the applicant concealed suppliers. Nor, furthermore, was tax fraud the objective of the transactions contested in the main proceedings. On the contrary, as stated previously, any tax fraud committed by P GmbH had already been completed when the drinks were supplied to the applicant. Therefore, from a purely logical point of view, the applicant cannot possibly have purchased the drinks for the purpose of the tax fraud committed by P GmbH at a preceding stage.

28. Furthermore, the transactions contested here did not give rise to any loss of turnover tax revenue, as P GmbH had to pay the turnover tax invoiced. Consequently, no tax advantage accrued from those transactions that might be contrary to the purpose of the VAT Directive. On the contrary, it may be necessary to allow the input tax deductions in the main proceedings in light of the fundamental decision to base the common system of VAT on turnover tax neutrality. In the opinion of the referring court, were tax fraud at a preceding stage to impact all downstream transactions simply because the fraud was known or should have been known, that would be a disproportionate restriction of that

principle of neutrality. In that regard, it should be noted that a refusal to allow deductions to be made should not ultimately have a punitive aspect. The principle of VAT neutrality cannot be suspended **[Or. 11]** simply because the goods concerned by the transactions may, for example, have been obtained illegally. Deductions should be precluded only where the supply concerned directly facilitates or encourages abusive conduct.

29. This legal argument may be further corroborated by the fact that the question whether the VAT payable on the prior or subsequent sales of the goods concerned has or has not been paid to the public purse is irrelevant to the right of the taxable person to deduct input tax (see order of 3 March 2004, *Transport Service*, C-395/02, EU:C:2004:118, paragraph 26, and judgments of 12 January 2006, *Optigen and Others*, C-354/03, C-355/03 and C-484/03, EU:C:2006:16, paragraph 54, and of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 40). The Court has consistently emphasised in this context that the measures adopted to protect the public exchequer, and thus protect tax revenue, must not go further than is necessary to ensure '*the correct levying and collection of the tax and the prevention of tax evasion*' (judgments of 29 July 2010, *Profaktor Kulesza, Frankowski, Jóźwiak, Orłowski*, C-188/09, […], paragraph 26; of 27 September 2007, *Téleos*, C-409/04, […], paragraph 46; and of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 48). The Court has held as follows in relation to measures within the meaning of Article 273 of the VAT Directive: '*Furthermore, the measures which the Member States may adopt under Article 273 of Directive 2006/112, in order to ensure the correct levying and collection of the tax and to prevent evasion, must not go further than is necessary to attain such objectives. Therefore, they cannot be used in such a way that they would have the effect of systematically undermining the right to deduct VAT and, consequently, the neutrality of VAT, which is a fundamental principle of the common system of VAT* (judgment of 21 June 2012, *Mahagében and David*, C-80/11 and C-142/11, […], paragraph 57).

30. In the opinion of the referring court, a broad interpretation of the term 'chain of supply' which allows input tax deductions to be refused in cases of abusive conduct may, however, result in such a systematic undermining of the right to deduct input tax and of the principle of VAT neutrality. If the chain of supply underlying a transaction for which the input tax deduction is refused were to include transactions that neither encouraged nor facilitated the tax fraud committed at a preceding or subsequent stage, that refusal to allow input tax deductions in cases of abusive conduct would ultimately have a broad and disproportionate punitive effect. Just as it is right to refuse to allow deductions to be made in respect of transactions directly connected with **[Or. 12]** abusive conduct and fraud relating to turnover tax so that tax evasion and abusive conduct can be countered effectively, it may equally be contrary to the system to accept, on the grounds of prevention of abusive conduct, that deductions at various subsequent or preceding stages that appear to be unconnected in terms of encouraging the tax fraud committed should also be refused. Were it to be affirmed that fraud or abusive conduct did have that effect, the result would be an

unwarranted increase in the turnover tax burden that exceeds the tax revenue lost as a result of the tax fraud by several times. A finding that such a transaction was 'vitiated by fraud' would ultimately have a punitive effect tantamount to a fine, for which there is no legal basis in the VAT Directive. In that regard, turnover tax should not be used as an instrument for punishing a taxable person's dishonest behaviour […].

31. Furthermore, the chamber considers that a broad interpretation of the term 'chain of supply' is also questionable, in that there is nothing to indicate that refusing to allow deductions at subsequent stages where the taxable person has not contributed by encouraging the tax fraud is remotely capable of achieving the objective assumed by the Court of preventing abusive conduct relating to turnover tax or turnover tax evasion. That is because where, as in the main proceedings, the turnover tax fraud committed at a preceding stage has already been completed and it is no longer possible for the subsequent transaction — in this case between P GmbH and the applicant — to facilitate or encourage the tax fraud, refusing the applicant's input tax deductions cannot prevent tax fraud.

32. The fact that it is wrong to refuse to allow input tax deductions in circumstances such as those in the main proceedings might ultimately also be substantiated by the settled case-law of the Court, which prevents any distinction between 'lawful' and 'unlawful' transactions with respect to turnover tax. Whether a transaction is legally reprehensible is irrelevant for the purposes of turnover tax, as the principle of VAT neutrality requires all sales to be included (see judgments of 6 July 2006, *Kittel and Recolta Recycling*, C-439/04 and C-440/04, […], paragraph 50, and of 12 January 2006, *Optigen and Others*, C-354/03, C-355/03 and C-484/03, […], paragraph 49). However, if a VAT system also includes 'unlawful' transactions, deduction should also be possible in respect of the unlawful transactions for reasons of neutrality. In circumstances such as those in the main proceedings, that may mean that, although a legally reprehensible transaction took place as a result of the participation of the applicant's husband in turnover tax fraud at a preceding stage **[Or. 13]**, the subsequent transactions cannot be disregarded under VAT law notwithstanding the reprehensible nature of the earlier transaction, and hence the deduction of input tax cannot be ruled out.

4. Stay of proceedings

33. […] [explanations relating to national procedure]

34. […] [explanations relating to national procedure]

[…]