



# Fact sheet

## THE DEDUCTION OF VALUE ADDED TAX

Value added tax (VAT) has been a feature of EU law for almost five decades.<sup>1</sup> VAT is a consumption tax that applies generally to transactions carried out by taxable persons for the purposes of their economic activities and is intended to tax only the final consumer. It is also characterised by the principle of neutrality which applies to the imposition of the tax and which also entails that there is in principle a right of deduction. Thus, the deduction system is meant to relieve the trader entirely of the burden of VAT in respect of all his or her transactions, which themselves give rise to the right to deduct. In its case-law on VAT, the Court of Justice has frequently pointed out that the right to deduct (and, therefore, the right to the refund of VAT paid) forms an integral part of the VAT mechanism and in principle cannot be limited.

However, while the right of deduction should, a priori, apply in every instance in order to achieve neutral taxation, certain restrictions on that right are necessary. The Court has made clear in its case-law that it is necessary for there to be a direct and immediate link between the acquisition of goods or services and a downstream taxable transaction. In other words, the acquisition should, according to objective criteria, be made for the purposes of the taxable person's economic activity. On the other hand, when goods or services are acquired for the purposes of carrying out exempt transactions or transactions which fall outside the scope of VAT, no output VAT is chargeable and so no input VAT may be deducted.

The Court has also made clear in its case-law that EU law may not be relied on for fraudulent or abusive ends. Where abusive practices are detected in the exercise of the right of deduction, the right to deduct input VAT may be refused, with retroactive effect. Accordingly, national authorities may refuse the benefit of the right of deduction where it is established, on the basis of objective evidence, that the taxable person knew, or ought to have known, that by means of his or her acquisition he or she was participating in a transaction connected with VAT fraud, even if the transaction in question meets the objective criteria on which the concepts of a

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<sup>1</sup> Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1) and Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

'supply of goods effected by a taxable person acting as such' and an 'economic activity' are based.

The following is a selection of judgments, arranged under specific subject headings, which provide an overview of the Court's recent case-law on the deduction of VAT.

## I. The principle of neutrality

As mentioned above, the Court has consistently held that the deduction system established by Directive 77/388 and Directive 2006/112 is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his or her economic activities. The common system of VAT thereby seeks to ensure complete neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT.<sup>2</sup>

The Court has also emphasised that, while the Member States may adopt measures under Article 273 of Directive 2006/112 to ensure the correct collection of VAT and to prevent evasion, such measures must not undermine the neutrality of VAT.<sup>3</sup>

The Court has also consistently held that the principle of fiscal neutrality — which was intended by the EU legislature to reflect, in matters relating to VAT, the general principle of equal treatment — requires, inter alia, that different situations must not be treated in the same way, unless such treatment is objectively justified.<sup>4</sup>

### [Judgment of 1 March 2012, \*Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz\* \(C-280/10, EU:C:2012:107\)](#)

Two individuals, the future partners of a partnership governed by Polish law, acquired a property in December 2006. The acquisition was confirmed by a court official who issued an invoice to the future partners. The partnership was not founded, however, until four months later, in April 2007. On that occasion, a notary issued an invoice to the partnership for drawing up a notarial act and extracts relating to its setting up. The partnership consequently declared an amount of input VAT on the basis of the two invoices.

The tax authority refused the deduction requested on the ground that the acquirer of the immovable property, under the first invoice, was not the partnership itself, but the natural persons who, after the partnership had been set up, had transferred the property, as a contribution in kind, to the partnership. As regards the second invoice, the tax authority concluded that it had been issued before the partnership was registered in the companies register and had therefore been issued to a non-existent entity. In addition, the future partners

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<sup>2</sup> [Judgment of 14 February 1985, \*Rompelman\* \(268/83, EU:C:1985:74, paragraph 19\).](#)

<sup>3</sup> [Judgment of 22 March 2012, \*Klub\* \(C-153/11, EU:C:2012:163, paragraph 50\).](#)

<sup>4</sup> [Judgment of 19 July 2012, \*Lietuvos geležinkeliai\* \(C-250/11, EU:C:2012:496, paragraphs 44 and 45 and the case-law cited\).](#)

could not rely on a right to deduct VAT on investment expenditure because the contribution of the capital goods at issue was an exempt transaction under the applicable national legislation.

In an action brought against the tax authority's refusal to allow the deduction, the national court requested a preliminary ruling of the Court of Justice on the questions of whether a partnership, in the person of its future partners, which incurred investment expenditure prior to its formal registration as an entity governed by commercial law and its registration for the purposes of VAT, was entitled, following registration of the partnership as an entity governed by commercial law and its registration for the purposes of VAT, to exercise, pursuant to Article 9 and Articles 168 and 169 of Directive 2006/112, the right to deduct input tax paid in connection with investment expenditure which was incurred for taxable activities carried out within the framework of the partnership, and whether exercise of the right to deduct input tax could be precluded by the fact that the invoice for the acquisition of the immovable property had been issued to the partners and not to the partnership.

As it had pointed out in the cases of *Rompelman* (263/83)<sup>5</sup> and *INZO* (C-110/94),<sup>6</sup> the Court held that preparatory acts taking the form, for example, of the purchase of immovable property, must themselves be treated as constituting economic activities, as referred to in Article 4(1) of Directive 77/388 and the first subparagraph of Article 9(1) of Directive 2006/112, which may consist in several consecutive transactions (paragraph 28). In addition, the principle that VAT should be neutral as regards the tax burden on a business requires that the first investment expenditure incurred for the purposes of and with a view to commencing a business must be regarded as an economic activity. In this connection, it would be contrary to that principle if such an activity did not commence until the property was actually exploited, that is to say until it began to yield taxable income (paragraph 29). Accordingly, anyone who carries out such investment transactions which are closely connected with and necessary for the future exploitation of immovable property must be regarded as a taxable person within the meaning of Directive 77/388 (paragraph 30) and is therefore entitled to exercise the right to deduct input tax (paragraph 31). Furthermore, under the principle of neutrality of VAT, a taxable person whose sole object is to prepare the economic activity of another taxable person and who has not effected any taxable transaction may exercise a right to deduct in relation to taxable transactions carried out by the other taxable person (paragraph 33). Therefore, in so far as, under national legislation, the partners, even though they may be considered taxable persons for the purposes of VAT, are unable to rely on the taxable transactions effected by the partnership in order to relieve the cost of the VAT on investment transactions effected for the purposes of and with a view to the activity of that partnership, the latter must, in order to ensure the neutrality of taxation, be entitled to take account of those investment transactions when deducting VAT (paragraph 35).

According to the Court, the principle of VAT neutrality also requires that deduction of input tax be allowed if the substantive requirements of the law applying to input VAT are satisfied, even if certain formal obligations are not complied with (paragraph 43). Thus, the fact that the invoice — issued before the partnership was registered and identified for the purposes of VAT — was addressed to the future partners and not to the partnership itself does not remove

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<sup>5</sup> This case gave rise to the [judgment of 14 February 1985, \*Rompelman\* \(268/83, EU:C:1985:74\)](#).

<sup>6</sup> This case gave rise to the [judgment of 29 February 1996, \*INZO\* \(C-110/94, EU:C:1996:67\)](#).

the right of deduction, provided that those who paid the input tax and those who make up the partnership in question are one and the same. Any other approach would have the effect of rendering the right of deduction ineffective, and therefore call into question the neutrality of VAT.

**[Judgment of 22 March 2012, Klub \(C-153/11, EU:C:2012:163\)](#)**

In May 2009, a Bulgarian company which operated a hotel in Varna (Bulgaria) purchased a maisonette for residential use in Sofia (Bulgaria). The VAT on that purchase was deducted without any tax declaration concerning the payment of local taxes for the maisonette being submitted. Since the company in question did not alter the use of the property or open accounts in its own name for the supply of water and electricity, the tax authorities concluded that the maisonette was intended for residential use, not for business use, and that, consequently, its acquisition had not given rise to a right to deduct the input VAT.

In an action which it brought against the Administrativen sad Varna (Administrative Court, Varna, Bulgaria), the company took issue with that approach, submitting that the immovable property at issue was intended for business use, since it intended to use it for meetings for negotiations with tour operators. As Article 70(1)(2) of the Zakon za danak varhu dobavenata stoynost (Law on value added tax) (DV No 63, 4 August 2006) had been the subject of contradictory interpretations in Bulgarian law, the national court asked the Court of Justice, inter alia, whether, under Directive 2006/112, the right of deduction arises in the tax period in which the tax became due, regardless of the fact that the capital goods were not immediately used for business purposes.

The Court pointed out, first of all, that it is the acquisition of the goods by a taxable person acting as such that determines the application of the VAT system and therefore of the deduction mechanism (paragraph 39) and that a taxable person acts as such where he or she acts for the purposes of his or her economic activity within the meaning of Directive 2006/112 (paragraph 40). Next, the Court pointed out that, if a taxable person were to be denied deduction of input VAT payable for subsequent taxable business uses, despite his or her initial wish to allocate the capital goods in their entirety to his or her business, with future transactions in mind, he or she would not be relieved entirely of the burden of the tax relating to the asset which he or she uses for the purposes of his or her economic activity and the taxation of his or her business activities would lead to double taxation contrary to the principle of fiscal neutrality inherent in the common system of VAT (paragraph 42). The Court explained that the principle of the neutrality of VAT requires, with regard to the taxation of the business, that the investment expenditure incurred for the needs and objectives of a business be regarded as economic activity giving rise to an immediate right of deduction of the input VAT due (paragraph 43). Consequently, an individual who acquires goods for the purposes of an economic activity within the meaning of the second subparagraph of Article 9(1) of Directive 2006/112 does so as a taxable person even if the goods are not used immediately for that economic activity (paragraph 44).

[Judgment of 6 February 2014, E. ON Global Commodities \(C-323/12, EU:C:2014:53\)](#)

The company in this case had been active in the energy sector of the Romanian market since October 2005. In order to meet the obligations imposed on taxable persons established in a State other than Romania by Legea nr. 571/2003 privind Codul fiscal (Law No 571/2003 on the Tax Code) of 22 December 2003 (*Monitorul Oficial al României*, Part I, No 927 of 23 December 2003), it had designated a tax representative in Romania who was identified for VAT purposes in that country. The obligation to designate a tax representative having been abolished when Romania became a member of the European Union, the tax representative stopped issuing tax invoices on behalf of the company on 1 January 2007, albeit it continued to represent the company in Romania, in particular in dealings with the tax authorities. Between 1 January and 31 August 2007, the company sought to deduct the VAT which it had paid on the basis of invoices issued by its trading partners — which were Romanian legal persons — as suppliers of services. The tax authorities refused to allow the company's representative to make the deductions relating to transactions carried out from 1 January 2007 onwards on the ground that the company had ceased to be a taxable person for VAT purposes in Romania in respect of energy supplies, which meant that it had ceased to invoice and collect VAT in respect of those supplies in Romania, that obligation falling, as from 1 January 2007, on the recipient of those supplies.

Following that refusal, the company made an application for a refund on the basis of Directive 79/1072/EEC<sup>7</sup> and the provision of national law transposing that directive into Romanian law. Its application for a refund was refused on the ground that the directive concerned taxable persons not identified for VAT purposes and under no obligation to be identified for VAT purposes in Romania, whereas the company had continued to be represented for tax purposes in Romania and, consequently, had, in fact, continued to be identified for VAT purposes in Romania. The company's administrative action for review of that decision was dismissed, and it then brought proceedings before the Curtea de Apel Bucureşti (Court of Appeal, Bucharest, Romania), which made a reference to the Court of Justice for a preliminary ruling.

In this case concerning the interpretation of Directive 79/1072, the Court considered whether the provisions of that directive must be interpreted as meaning that the fact that a taxable person established in one Member State and carrying out supplies of electricity in another Member State designates a tax representative identified for VAT purposes in that second State means that the taxable person cannot rely on the directive in the latter State in order to obtain a refund of input VAT. The Romanian Government argued that the company in question, by maintaining its tax representative, had created a legal vacuum, thereby depriving it of any possibility of obtaining a refund of VAT.

The Court of Justice pointed out that Directive 79/1072 establishes two cumulative conditions that must be satisfied before a taxable person can be regarded as not being established in the territory of the country, and therefore entitled to a refund. It then examined the second of those conditions — which is that the taxable person must not have made any supplies of goods or

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<sup>7</sup> Eighth Council Directive 79/1072/EEC of 6 December 1979 on the harmonisation of the laws of the Member States relating to turnover taxes — Arrangements for the refund of value added tax to taxable persons not established in the territory of the country (OJ 1979 L 331, p. 11).

services in respect of which the place of supply is deemed to be in the Member State from which reimbursement is sought (paragraph 42) — and stated that, if the effect of the supplies of electricity concerned is to render Directive 79/1072 inapplicable, the deduction of input VAT must, as a rule, be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with certain formal requirements. The principle of fiscal neutrality precludes a penalty consisting in a refusal of the right to a refund or of the right to deduct (paragraph 55). That right is not precluded merely by the designation of a tax representative who is identified for VAT purposes in the latter State (paragraph 57 and operative part).

**[Judgment of 13 March 2014, Malburg \(C-204/13, EU:C:2014:147\)](#)**

In this case, Mr Malburg had held a 60% share in a partnership governed by German law, while the other two partners had each held 20% shares. That partnership was dissolved on 31 December 1994, with a portion of the client base being transferred to each of the partners. On 31 December 1994, Mr Malburg founded a new partnership in which he held a 95% share and to which he made available free of charge, for use in its business, the client base which he acquired following the dissolution of the old partnership. The old partnership having been dissolved by division of assets, the tax authority subsequently, in 2003, assessed the old partnership as liable for payment of VAT for 1994 based on the transfer of the client base. After Mr Malburg paid the tax due, the old partnership, represented by Mr Malburg, issued an invoice to Mr Malburg in respect of the 1994 division of assets, itemising the VAT separately. In his VAT returns for 2004, Mr Malburg deducted the VAT which had been invoiced to him in respect of the acquisition of the client base and declared turnover from his activities as managing partner of the new partnership. As the economic asset which that client base constituted had been used by the new partnership, an undertaking to be distinguished from Mr Malburg, the tax authority took the view that Mr Malburg was not entitled to deduct input VAT.

The appellant in the main proceedings argued that the principles established by the Court in its judgment in *Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz*,<sup>8</sup> concerning the recovery of input VAT in respect of transactions carried out for the purpose of future economic activity to be carried out by a partnership, the future partners of which have paid the input tax, did not apply in this case since it concerned the deduction of input VAT paid by a founding partner and not the deduction of input VAT paid by a partnership. The Bundesfinanzhof (Federal Finance Court, Germany) then referred a question on the issue to the Court of Justice for a preliminary ruling.

The Court began by examining the provisions of Directive 77/388 defining ‘taxable person’ and the right of deduction, having regard to the principle of tax neutrality, in order to determine whether, despite the fact that the client base in question had not become part of the capital assets of the newly founded partnership, Mr Malburg was entitled to deduct the input VAT paid on the acquisition of that client base. In this connection, the Court held that its findings in *Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz*<sup>9</sup> were not applicable, by

<sup>8</sup> [Judgment of 1 March 2012, Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz \(C-280/10, EU:C:2012:107\)](#). This judgment is discussed earlier in this part of the fact sheet.

<sup>9</sup> [Opinion of Advocate General Cruz Villalón in Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz \(C-280/10, EU:C:2011:592\)](#).

analogy, to the situation at issue in the main proceedings, the facts which had given rise to the two disputes being substantially different.

The Court observed that the provision of the client base for use by the new partnership free of charge could not be considered to constitute an 'economic activity' within the meaning of Directive 77/388. It also found that there was no direct and immediate link between a particular input transaction and an output transaction giving rise to entitlement to deduct, in accordance with Article 17(2)(a) of the directive (paragraphs 32 to 37). As regards the principle of fiscal neutrality, the Court pointed out that that principle manifests itself through the deduction system which is meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his or her economic activities. The common system of VAT therefore ensures that all economic activities, whatever their purpose or results, provided that they are themselves subject to VAT, are taxed in a wholly neutral way. However, the provision of a client base for the use of a partnership free of charge is not a transaction falling within the scope of VAT, and so the principle of fiscal neutrality does not apply to such a situation (paragraphs 40 to 42).

**[Judgment of 17 July 2014, Equoland \(C-272/13, EU:C:2014:2091\)](#)**

During the month of June 2006, the company Equoland imported into Italy a consignment of goods from a third country. On the customs declaration, it was stated that the goods were destined for the tax warehouse for the purposes of VAT. On the following day, the manager of the warehouse registered the goods in the warehouse register, even though the goods were never physically stored in the warehouse, but were placed there 'virtually', by means of their inclusion in the register. The goods were then immediately withdrawn from the tax warehouse arrangements and the VAT paid by Equoland under the reverse charge mechanism. As the goods in question were not physically placed in the warehouse, the Italian customs authority took the view that the necessary conditions for the postponement of payment of VAT on importation had not been met. The customs authority consequently concluded that the taxable person had not paid the tax allegedly due on importation and that the payment under the reverse charge mechanism constituted late payment of the VAT.

An action was brought and the referring court asked the Court of Justice whether, in accordance with the principle of neutrality of VAT, Directive 77/388 precludes national legislation under which a Member State requires the payment of VAT on importation even though that VAT has already been settled under the reverse charge mechanism through self-invoicing and entry in the sales and purchases register of the taxable person.

The Court pointed out in this connection that, where, to exercise the powers assigned under Article 16(1) of Directive 77/388, Member States adopt measures, such as the obligation to physically place imported goods in a tax warehouse, those Member States are also empowered, in the absence of legislation in relation to penalties, to choose the penalties which seem to them to be appropriate (paragraph 32). It is therefore legitimate for a Member State, in order to ensure the correct collection of VAT on importation and to prevent evasion, to provide, in its national legislation, for appropriate penalties for failure to observe the obligation to physically place imported goods in the tax warehouse (paragraph 33).



However, with regard to the methods for determining the amount of the penalty, the Court found that the requirement that the taxable person must again pay the VAT on importation, with no consideration being given to the payment already made, amounts, in essence, to depriving that taxable person of his or her right to deduct. To make a single transaction subject to double imposition of VAT, while only allowing that tax to be deducted once, leaves the taxable person liable to pay the remaining VAT (paragraph 40). In that context, the Court recalled that, in view of the preponderant position which the right to deduct has in the common system of VAT, a penalty consisting of a refusal of the right to deduct is not compatible with Directive 77/388 where no evasion or detriment to the budget of the State is ascertained (paragraph 41). The Court also pointed out that the reverse charge mechanism provided for under Directive 77/388 itself enables authorities to counter the tax evasion and avoidance observed in certain types of transactions (paragraph 42). However, in so far as there is neither evasion nor attempted evasion, the part of the penalty consisting of requiring a new payment of VAT already paid, without that second payment giving rise to a right to deduct, cannot be regarded as consistent with the principle of VAT neutrality (paragraph 43).

**[Judgment of 28 July 2016, Astone \(C-332/15, EU:C:2016:614\)](#)**

In the course of a tax audit in 2013, the Guardia di Finanza (tax and financial police, Italy) found that the legal representative of an Italian company subject to VAT was unable to produce accounts. The tax audit also revealed that the company had issued invoices, but, because it had failed to submit the related VAT return, it had evaded VAT. The tax audit further revealed that the company's representative had not complied with the registration obligation in respect of the invoices issued. In the course of criminal proceedings against him, the legal representative produced invoices issued to the company by third party undertakings, which had been paid, inclusive of VAT, but had not been entered into the company's accounts.

In that context, the court seised of the criminal proceedings asked the Court whether the provisions of Directive 2006/112 preclude Member State rules which exclude the possibility, including for the purposes of criminal law, of taking account, for the purposes of the deduction of VAT, of purchase invoices which the taxable person has paid but has failed to register. The referring court pointed out, in this connection, that the national legislation made the right to deduct VAT contingent on compliance with formal obligations relating in particular to the submission of the relevant returns when the taxable person claimed the tax credit and on the recording of the invoices concerned in the relevant register. In the view of the referring court, the taxable person was not entitled to deduct input VAT which had not been recorded in accordance with the law, even though it had been paid. It stated, in this connection, that, according to Italian law, where no VAT return had been filed, tax evaded meant the entire tax due, without it being possible to take into account, in the case of VAT, the VAT paid to suppliers, if the formal obligations provided for by law had not been complied with.

The Court of Justice first of all considered whether Directive 2006/112 precludes national legislation which provides for a two-year limitation period for exercising the right to deduct. Weighing the rule established in the case-law that the right to deduct laid down in Directive 2006/112 forms an integral part of the VAT mechanism and in principle cannot be limited, on the one hand, against the principle of legal certainty, which excludes the possibility of a right to deduct without any temporal limit, on the other, the Court held that a limitation period the



expiry of which has the effect of penalising a taxable person who has not been sufficiently diligent and has failed to claim deduction of input tax, by making him or her forfeit his or her right to deduct, cannot be regarded as incompatible with the regime established by Directive 2006/112, provided that, first, that limitation period applies in the same way to analogous rights in tax matters founded on domestic law and to those founded on EU law (the principle of equivalence) and, secondly, that it does not in practice render impossible or excessively difficult the exercise of the right to deduct (the principle of effectiveness) (paragraph 34). The Court also pointed out that the right to deduct is a fundamental element of the system of VAT, that it seeks to ensure complete neutrality of taxation of all economic activities, that it cannot, in principle, be limited and that it must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (paragraph 44).

## II. Origin and scope of the right of deduction

As regards the origin and scope of the right of deduction, the Court generally refers to its settled case-law in accordance with which the existence of a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to entitlement to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement.<sup>10</sup> However, the Court has made clear that a taxable person also has a right to deduct, even where there is no direct and immediate link between a particular input transaction and an output transaction or transactions giving rise to the right to deduct, where the costs of the services in question are part of the taxable person's general costs and are, as such, components of the price of the goods or services which he or she supplies. Such costs have a direct and immediate link with the taxable person's economic activity as a whole.<sup>11</sup>

### [Judgment of 16 February 2012, Varzim Sol \(C-25/11, EU:C:2012:94\)](#)

The company in this case operated a casino on the basis of a contract, concluded on 14 December 2001, granting a concession to operate games of chance in the permanent gaming area of Póvoa de Varzim (Portugal). Under that contract, the company carried out activities in the gaming sector, which are exempt from VAT, in the sectors of catering and entertainment, where they are subject to VAT, and in the administrative and finance sector, with partial deduction of VAT. In the sectors subject to VAT, the tax paid was deducted under the method of actual use, in accordance with the Código do Imposto sobre o Valor Acrescentado (VAT Code). Under the applicable rules and the concession contract, the company in question was bound to pay to the Portuguese State an initial consideration, but also an annual consideration calculated on the basis of income from the gaming sector. It was authorised to deduct from that annual consideration a part of the expenses incurred to fulfil its entertainment and tourism promotion obligations. The amount of that deduction depended on the amount of

<sup>10</sup> See, inter alia, judgments of 8 June 2000, *Midland Bank* (C-98/98, EU:C:2000:300, paragraph 24); of 22 February 2001, *Abbey National* (C-408/98, EU:C:2001:110, paragraph 26); and of 8 February 2007, *Investrand* (C-435/05, EU:C:2007:87, paragraph 23).

<sup>11</sup> See, inter alia, judgments of 8 June 2000, *Midland Bank* (C-98/98, EU:C:2000:300, paragraph 31), and of 26 May 2005, *Kretztechnik* (C-465/03, EU:C:2005:320, paragraph 36).

the expenses incurred and on the amount of the income from the gaming activity. Following an inspection by the tax authorities, the company received demands for additional payment in respect of the years 2002 to 2004. Those corrections were based on a challenge to the method used by the company to calculate the deductible amount of VAT paid for the catering and entertainment sectors. The Portuguese authority took the view that, since the deduction made from the annual consideration to compensate for the entertainment and promotion expenses constituted an operating subsidy for the purposes of the VAT Code, that subsidy was not subject to VAT, and that the catering and entertainment activities had to be treated as mixed activities. It maintained that the VAT paid in those sectors had to be deducted on the basis of a proportion that allowed both exempt and taxable activities to be taken into account.

In proceedings which it brought before the Supremo Tribunal Administrativo (Supreme Administrative Court, Portugal), the company claimed, inter alia, that the reasoning of the tax authority led to a distortion in the deduction of VAT, in breach of Directive 77/388 as interpreted by the Court of Justice in its judgments in *Commission v Spain*<sup>12</sup> and *Commission v France*.<sup>13</sup> That claim led the national court to refer questions to the Court of Justice for a preliminary ruling.

The Court found to be incompatible with the directive a system applied by a Member State under which, where the Member State authorises mixed taxable persons to make the deduction provided for in the provisions in question on the basis of the use of all or part of the goods and services, the Member State calculates the deductible amount, for sectors in which such taxable persons carry out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion (paragraph 43 and operative part).

The Court pointed out that, as regards mixed taxable persons, Directive 77/388 provides that the right to deduct is calculated according to the proportion determined in accordance with Article 19 thereof. The Court explained, however, that the third subparagraph of Article 17(5) of the directive permits Member States to provide for one of the other methods for determining the right to deduct that are listed in that paragraph, in particular, determination of a separate proportion for each sector of business or deduction on the basis of the use of all or part of the goods and services for a specific activity (paragraph 38). The Court also noted that, in accordance with Article 11A(1)(a) of Directive 77/388, subsidies directly linked to the price of goods or services are taxable in the same way as those goods or services. As regards subsidies which are not directly linked to price, Article 19(1) of the directive allows the Member States to include them in the denominator for calculating the proportion applicable where a taxable person carries out, at the same time, transactions in respect of which VAT is deductible and others which are exempt (paragraph 39). Given that the taxable person in question had been authorised to make the deduction according to a method other than the method whereby a proportion is determined under Article 19 of Directive 77/388, namely on the basis of the use of all or part of the goods and services for a specific activity (paragraph 40), and given that its activities in the catering and entertainment sectors were subject to VAT, the right to deduct on the basis of the method of actual use relates to all the taxes charged on the input transactions (paragraph 41). Since the taxable person had been authorised to make the deduction on the basis of the method of actual use, the provisions of Article 19 of Directive 77/388 were not

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<sup>12</sup> [Judgment of 6 October 2005 \(C-204/03, EU:C:2005:588\)](#).

<sup>13</sup> [Judgment of 6 October 2005 \(C-243/03, EU:C:2005:589\)](#).

applicable and could not limit the right to deduct in those sectors as provided for in the directive (paragraph 42).

Lastly, with regard to the nature of the 'direct and immediate link' which must exist between an input and an output transaction, the Court has held that it would not be realistic to attempt to be more specific in that regard. In view of the diversity of commercial and professional transactions, it is impossible to give a more appropriate reply as to the method of determining in every case the relationship which must exist between the input and output transactions in order for input VAT to become deductible.

**[Judgment of 22 March 2012, Klub \(C-153/11, EU:C:2012:163\)](#)**

As mentioned above in Part I, entitled 'The principle of neutrality', this case concerned a refusal of the right to deduct VAT on the acquisition of a maisonette (paragraph 2).

In its judgment, the Court observed that a taxable person acts as such where he or she acts for the purposes of his or her economic activity within the meaning of the second subparagraph of Article 9(1) of Directive 2006/112 (paragraph 40). Where that is so, the VAT on the item allocated entirely to his or her business assets can be deducted immediately and in full, even if it is not used immediately for the purposes of the economic activity (paragraph 45). Once it has arisen, the right of deduction is retained, in the absence of fraud or abuse. The right of deduction is therefore retained where the taxable person has been unable to use the goods or services which gave rise to a deduction in the context of taxable transactions by reason of circumstances beyond his or her control, because, in such a situation, there is no risk of fraud or abuse capable of justifying subsequent repayment of the sums deducted (paragraph 47).

Accordingly, the Court held that a taxable person who has acquired capital goods while acting as such and has allocated the goods to the assets of the business is entitled to deduct the VAT on the acquisition of those goods in the tax period in which the tax became due, regardless of the fact that the goods are not immediately used for business purposes (paragraph 52).

**[Judgment of 21 June 2012, Mahagében and Dávid \(C-80/11 and C-142/11, EU:C:2012:373\)](#)**

In the first of these two joined cases, pursuant to a contract concluded between two Hungarian companies for the supply of unprocessed acacia logs, a supplier issued 16 invoices to a purchaser, 6 of which were accompanied by delivery notes. The supplier declared all of the invoices in its tax return, stating that the deliveries had taken place. The supplier paid the related VAT and the purchaser deducted the corresponding sums. However, during an inspection of the purchases and deliveries made by the supplier, the tax authority concluded that it did not have any reserves of acacia logs and that the quantity purchased during the year in question had been insufficient to make the deliveries for which it had invoiced the purchaser. As a result, the tax authority adopted a decision establishing a tax debt on the part of the purchaser and imposed a fine on it together with a late payment surcharge, on the basis that it had had no right to deduct the input VAT, since the invoices could not be regarded as authentic.

The purchaser's administrative appeal against that decision was rejected by the tax authority, inter alia, on the grounds that the supplier had been unable to produce any documents evidencing the corresponding transactions and that the purchaser had not acted with due diligence, within the meaning of Article 44(5) of the általános forgalmi adóról szóló 1992. évi LXXIV. törvény (Law No LXXIV of 1992 on value added tax) (*Magyar Közlöny* 1992/128), having failed to check that the supplier was a taxable person and possessed the relevant goods.

The purchaser brought legal proceedings before the Baranya Megyei Bíróság (Regional Court, Baranya, Hungary) seeking the annulment of the tax debt, fine and late payment surcharge. That court requested a preliminary ruling of the Court on whether Article 167, Article 168(a), Article 178(a), Article 220(1) and Article 226 of Directive 2006/112 preclude a national practice whereby the tax authority refuses a taxable person the right to deduct from the VAT which he or she is liable to pay the VAT due or paid in respect of services supplied to him or her on the ground that the issuer of the invoice relating to those services, or one of his or her suppliers, acted improperly, without that authority establishing that the taxable person concerned was aware of that improper conduct or colluded in that conduct him or herself.

The Court observed, first of all, that the right to deduct provided for in the directive is an integral part of the VAT scheme and cannot, in principle, be limited. The question of whether or not the VAT payable on prior or subsequent transactions relating to the goods or services concerned has been paid to the public exchequer is irrelevant to the right of the taxable person to deduct input VAT (press release). Member States may, however, refuse the benefit of the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent or abusive ends. That is the case, inter alia, where the taxable person to whom were supplied the goods or services which served as the basis on which to substantiate the right to deduct knew, or ought to have known, that that transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction. The Court observed that it is for the tax authority to establish that the taxable person was or ought to have been aware of such fraud (press release).

In the second of the two joined cases, Mr Dávid had undertaken, under a works contract, to carry out various construction works, for which he used subcontractors (paragraph 24). After the contract had been performed, tax inspections were carried out that showed that neither Mr Dávid nor his subcontractor, nor the subcontractor's subcontractor, had the necessary employees or equipment to carry out the work in respect of which the invoices had been issued. The tax authority consequently concluded that the invoices received by Mr Dávid did not reflect a genuine economic transaction and were therefore fictitious. Also, Mr Dávid had not acted with due diligence, within the meaning of the relevant national legislation. In those circumstances, the tax authority refused to allow Mr Dávid the right to deduct the input VAT on the transactions which it considered to be suspicious (paragraph 27) inasmuch as the invoices could not adequately establish that the economic transactions detailed in them had taken place. It therefore decided that Mr Dávid had incurred a VAT debt and it imposed on him a fine and a late payment surcharge (paragraph 29).

Mr Dávid brought an action for the annulment of that decision before the Jász-Nagykun-Szolnok Megyei Bíróság (Regional Court, Jász-Nagykun-Szolnok, Hungary). That court asked the Court of Justice whether Article 167, Article 168(a) and Article 273 of Directive 2006/112 preclude a national practice whereby a tax authority refuses a taxable person the right to deduct from the

VAT which he or she is liable to pay the VAT due or paid in respect of services supplied to him or her on the ground that he or she has failed to satisfy him or herself that the issuer of the invoice relating to the goods in respect of which the exercise of the right to deduct is sought has the status of a taxable person and has acted properly (press release) (paragraph 51 of the judgment).

The Court considered the obligation of the taxable person to satisfy him or herself as to the propriety of the conduct of his or her trading partner and held that, when there are indications pointing to an infringement or fraud, a reasonable trader could, depending on the circumstances of the case, be obliged to make enquiries about another trader, in order to ascertain the latter's trustworthiness. However, the tax authority cannot, as a general rule, require the taxable person wishing to exercise his or her right to deduct VAT to satisfy him or herself that there were no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction (press release).

It is for the tax authorities to carry out the necessary inspections of taxable persons in order to detect VAT irregularities and fraud and to impose penalties on the taxable person who has committed them. Consequently, those authorities cannot transfer their own investigative tasks to taxable persons and refuse the latter the right to deduct if they do not carry out those tasks (press release).

In those circumstances, the Court held that Directive 2006/112 precludes the practice of the Hungarian tax authority of refusing to allow a taxable person the right to deduct VAT paid on the ground that the issuer of the invoice on the basis of which the deduction is sought acted improperly, without proof that the taxable person knew, or ought to have known of fraud committed earlier in the chain of supply. Equally, the directive precludes a national practice whereby the tax authority refuses the right to deduct on the ground that the taxable person, being in possession of no material justifying the suspicion that irregularities or fraud had been committed, failed to satisfy him or herself that his or her trading partner had fulfilled his or her legal obligations, in particular those relating to VAT, or on the ground that the taxable person did not have in his or her possession, in addition to the invoice, other documents capable of demonstrating that his or her commercial partner had acted with propriety (press release).

#### [Judgment of 6 September 2012, Portugal Telecom \(C-496/11, EU:C:2012:557\)](#)

In this case, a holding company regulated in Portugal provided technical administrative and management services to companies in which it had a shareholding. In the course of its business, the company acquired, under the VAT regime, certain services from consultants, for which it invoiced its subsidiaries at the same price as it had paid for them, plus VAT. In one financial year, the holding company deducted all the VAT it had paid from the VAT it had passed on, taking the view that the taxed transactions were in fact covered by the use of the corresponding services acquired.

The holding company was subsequently issued with a notice of assessment in which a deductible percentage of input VAT was set by the tax authority, which, following an inspection, had concluded that the holding company could not deduct all the VAT on the input services and should instead use the pro-rata method of deduction. The company brought an action

challenging the notice of assessment before the Tribunal Administrativo e Fiscal de Lisboa (Administrative and Tax Court, Lisbon, Portugal), which dismissed the action.

The holding company brought an appeal against the decision at first instance before the Tribunal Central Administrativo Sul (Southern Administrative Court of Appeal, Portugal), which asked the Court of Justice whether Article 17(2) and (5) of Directive 77/388 must be interpreted as meaning that a holding company which, in addition to its main activity of holding all or part of the shares in subsidiary companies, acquires goods and services which it then invoices to those companies is authorised to deduct the entire amount of input VAT paid, pursuant to Article 17(2) of the directive, or as meaning that it may be required by the tax authorities to deduct only that proportion of the VAT which is attributable to the taxed transactions, in accordance with Article 17(5) of the directive.

The Court of Justice began by recalling that, according to its settled case-law, a holding company whose sole purpose is to acquire holdings in other undertakings and which does not involve itself directly or indirectly in the management of those undertakings, without prejudice to its rights as a shareholder, does not have the status of taxable person and has no right to deduct tax. However, the involvement of a holding company in the management of companies in which it has acquired a shareholding constitutes an economic activity within the meaning of Directive 77/388 where it entails carrying out transactions subject to VAT (paragraph 34).

The Court then emphasised that, according to its well-established case-law, the right to deduct is an integral part of the VAT scheme and in principle cannot be limited. The right to deduct is exercisable immediately in respect of all the taxes charged on transactions relating to inputs (paragraph 35). However, in order for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction (paragraph 36) or the costs of the services in question must be part of the taxable person's general costs and, as such, components of the price of the goods or services which he or she supplies (paragraph 37).

The Court identified three possible scenarios. First, there is the case where the input services should be regarded as having a direct and immediate link with the output economic transactions giving rise to a right to deduction. Secondly, there is the case where the input services are used in order to perform both transactions in respect of which VAT is deductible and transactions in respect of which VAT is not deductible. Thirdly, there is the case where the input services are used for both economic and non-economic activities. In the first case, the taxable person is entitled to deduct all the VAT chargeable on the relevant inputs purchased, and that right to deduct cannot be limited simply because, on account of the purpose or general activity of the company in question, the national legislation treats the taxed transactions as ancillary to its main activity. In the second case, the deduction is allowed only for the part of the VAT which is proportionate to the amount attributable to the VAT-deductible transactions and Member States are authorised to provide for one of the methods of determining the right to deduction. In the third case, Directive 77/388 is not applicable and the methods of deduction and apportionment are defined by the Member States, which, when exercising that discretion, must have regard to the aims and broad logic of Directive 77/388 and, on that basis, provide for a method of calculation which objectively reflects the portions of the input expenditure actually to be attributed, respectively, to those two types of activity (paragraphs 45 to 47). In conclusion,



the Court held that the extent of a holding company's right to deduct input VAT depends on the case or cases which apply to the holding company's activity.

**[Judgment of 21 February 2013, Becker \(C-104/12, EU:C:2013:99\)](#)**

A businessman, who was a sole trader and the majority shareholder in a limited company governed by German law which carried out for consideration construction works subject to VAT, had criminal proceedings brought against him in his capacity as managing director and main shareholder of the company. The businessman and the company were linked by an *Organschaft* under which they were treated as one single taxable person. The businessman, as a so-called 'controlling entity', took responsibility for the fiscal obligations of the group of undertakings consisting of his sole-trader undertaking and the limited company. In the context of the performance of a construction contract awarded to the company, suspicions of corruption were aroused and the competent prosecuting authority brought criminal investigation proceedings against the businessman, in the course of which he was represented by a lawyer. Under the terms of the lawyer's fee agreement, the businessman, as accused, and the limited company were represented by the lawyer. The invoices for the lawyer's fees were addressed to the company. The businessman, as controlling entity, deducted, for the year in question, the VAT charged on those invoices.

The Finanzamt Köln-Nord (Tax Office, Cologne-North, Germany) subsequently issued an additional assessment against the businessman, taking the view that the VAT in question was not deductible. The objection which the businessman then lodged before the Finanzamt was rejected, and he initiated proceedings challenging the additional assessment before the competent court of first instance, the Finanzgericht Köln (Finance Court, Cologne, Germany), which upheld his action.

Hearing an appeal on a point of law brought by the Finanzamt, the referring court, the Bundesfinanzhof (Federal Finance Court, Germany), had doubts as to whether a direct link existed between the input and output transactions, as is required by the Court's case-law in order for the right to deduct to be exercised. Consequently, it asked the Court of Justice, first, whether the existence of a direct link, for the purposes of Article 17(2)(a) of Directive 77/388, depends on the objective content of the supply acquired or rather on the reason for the acquisition of that supply and, secondly, whether, in the event that it is the reason which has given rise to the supply that is decisive, a taxable person who has commissioned a supply together with an employee is entitled to deduct input tax in full or only in part.

Referring to its earlier case-law on the requirement for a direct link to exist, the Court observed that the application of the direct-link test requires that all the circumstances surrounding the transactions at issue must be considered and account must be taken only of the transactions which are objectively linked to the taxable person's taxable activity (paragraph 22). The obligation to take account only of the objective content of the transaction at issue is the most compatible with the aim pursued by the common system of VAT, which seeks to ensure legal certainty and to facilitate the application of VAT (paragraph 23). It is also in the light of their objective content that it is necessary to determine whether there is a direct and immediate link between the supply of goods or services utilised and a taxable output transaction or, exceptionally, a taxable input transaction (paragraph 24). The Court also explained that the fact



that the existence of the direct and immediate link between a supply of services and the overall taxable economic activity must be determined in the light of the objective content of that supply of services does not preclude that the exclusive reason for the transaction at issue can also be taken into account, since that reason must be considered as a criterion for determining the objective content. Where it is clear that a transaction has not been performed for the purposes of the taxable activities of a taxable person, that transaction cannot be considered as having a direct and immediate link with those activities within the meaning of the Court's case-law, even if that transaction would, in the light of its objective content, be subject to VAT (paragraph 29).

The Court held that, in the light of their objective content, the costs relating to the lawyer's services could not be considered as having been incurred for the purposes of the company's economic activities as a whole, inasmuch as, according to the information provided by the referring court, the supply of the lawyer's services sought directly and immediately to protect the private interests of the accused who was charged with offences relating to his personal behaviour, and the criminal proceedings had been brought against the accused solely in a personal capacity, and not against the company, even though proceedings against the company would also have been legally possible (paragraph 30).

The Court added that the fact that domestic civil law obliges an undertaking such as that at issue in the main proceedings to bear the costs relating to the defence, in criminal proceedings, of its representatives' interests is not relevant for the interpretation and application of provisions relating to the common system of VAT. In the light of the objective scheme of VAT set up by that system, only the objective relationship between the supplies performed and the taxable economic activity of the taxable person is decisive (paragraph 32). Therefore, the supplies of lawyers' services the purpose of which is to avert criminal penalties against natural persons, managing directors of a taxable undertaking, do not give that undertaking the right to deduct as input tax the VAT due on the services supplied (paragraph 33).

**[Judgment of 18 July 2013, PPG Holdings \(C-26/12, EU:C:2013:526\)](#)**

In this case, PPG set up a pension fund, in accordance with national pensions legislation, in the form of a legally and fiscally separate entity, in order to safeguard the pension rights of its current and former employees. A subsidiary of PPG entered into contracts with suppliers of services relating to the administration of the pensions and the management of the assets of the pension fund, the costs of which were paid by the subsidiary, rather than being passed on to the pension fund. PPG deducted the VAT relating to the costs thus incurred over a certain period as input tax.

PPG was then issued with an additional assessment to VAT for the period in question. After its complaint to the Inspecteur van de Belastingdienst Noord/Kantoor Groningen (Inspector of Taxes for the North, Groningen Office, Netherlands) had proved unsuccessful, PPG brought an action against the inspector's decision before the Rechtbank Leeuwarden (District Court, Leeuwarden, Netherlands), which was dismissed.

In an appeal against that first instance judgment, the Gerechtshof te Leeuwarden (District Court of Appeal, Leeuwarden, Netherlands) sought to establish whether Article 17 of Directive 77/388

permits a taxable person that has set up a separate pension fund to deduct the tax which it has paid on services supplied to it for the implementation and operation of the pension fund.

After reviewing the conditions, as established in its case-law, under which a taxable person is accorded the right to deduct input VAT, the Court held, with regard to the existence of a direct and immediate link, that whether or not such a link exists will depend on whether or not the cost of the input services is incorporated either into the cost of particular output transactions or into the cost of the goods or services supplied by the taxable person as part of his or her economic activities (paragraph 23).

In order to ascertain whether, despite the fact that the fund set up by PPG was an entity legally separate from PPG, the existence of such a link was apparent from all the circumstances of the transactions in question in the main proceedings, the Court first of all noted that PPG acquired the services in question for the purpose of the administration of its employees' pensions and the management of the assets of the pension fund set up to safeguard those pensions. By setting up the fund, PPG complied with a legal obligation imposed on it as an employer and, in so far as the costs of the services acquired by PPG in that connection formed part of its general costs, they were, as such, component parts of the price of PPG's products (paragraph 25).

The Court then concluded from that that the sole reason for the acquisition of the input services lay in the taxable person's taxable activities and that there was a direct and immediate link (paragraph 26). The Court went on to observe that, if there were no right to deduct the input tax paid, not only would the taxable person be deprived — by reason of the legislature's decision to protect pensions by means of a legal separation between employer and pension fund — of the tax advantage resulting from the application of the deduction system, but the neutrality of VAT would also no longer be guaranteed.

Accordingly, the Court held that a taxable person who has set up a pension fund in the form of a legally and fiscally separate entity, in order to safeguard the pension rights of his or her employees and former employees, is entitled to deduct the VAT he or she has paid on services relating to the management and operation of that fund, provided that the existence of a direct and immediate link is apparent from all the circumstances of the transactions in question (operative part).

#### **[Judgment of 6 February 2014, Fatorie \(C-424/12, EU:C:2014:50\)](#)**

Two taxable persons concluded a framework contract relating to works for the building and fitting out of pigpens and the modernisation of a pig-rearing farm. Under that contract, the service provider issued several invoices for advance payments, under the reverse charge scheme. Subsequently, the service provider issued a single invoice, applying the normal VAT rules, restating the total value of the work carried out, including VAT. The recipient of the services, Fatorie, paid the VAT stated on the invoice to the service provider, which was later declared insolvent and was unable to pay the VAT to the tax authorities.

The tax authorities granted, by decision, the application made by Fatorie for the repayment of the VAT relating to that final invoice. Following a second tax investigation, however, the Romanian tax authorities found that the simplification measures governing the reverse charge

system had not been observed. Fatorie was consequently sent a tax assessment notice and a decision for the recovery of the VAT relating to the invoice, together with default interest. The Tribunalul Bihor (Regional Court, Bihor, Romania) dismissed as unfounded an action for the annulment of the decision to recover the tax and of the tax assessment. An appeal against that judgment was dismissed as unfounded and an application for its revision was then dismissed as inadmissible. Fatorie brought an appeal against that last judgment before the Curtea de Apel Oradea (Court of Appeal, Oradea, Romania).

The Curtea de Apel Oradea (Court of Appeal, Oradea), as referring court, asked the Court of Justice whether Directive 2006/112 and the principle of fiscal neutrality preclude, in a transaction subject to the reverse charge regime, the recipient of the services from being deprived of the right to deduct the VAT not due which he or she paid to a service provider on the basis of an incorrectly drawn up invoice, even where the correction of that error is impossible because of the service provider's insolvency.

The Court pointed out that a taxable person who is liable, as the recipient of services, for the VAT relating thereto is not obliged to hold an invoice drawn up in accordance with the formal requirements of Directive 2006/112 in order to be able to exercise his or her right to deduct, and has only to fulfil the formalities laid down by the Member State concerned in the exercise of the option conferred by Article 178(f) of Directive 2006/112 (paragraph 33). The scope of the formalities laid down by the Member State concerned, which must be complied with by a taxable person in order to be able to exercise the right to deduct VAT, should not exceed what is strictly necessary for the purposes of verifying the correct application of the reverse charge procedure and ensuring that the VAT is collected (paragraph 34).

The Court held in this instance that, contrary to the requirement of the relevant national legislation, the invoice in question did not contain the words 'reverse charge procedure', and that the recipient of the services had not taken the measures necessary to put that omission in order, as provided for in the national legislation. Furthermore, Fatorie had incorrectly paid the VAT, wrongly referred to in that invoice, to the service provider, whereas, under the reverse charge regime, it should, as the recipient of the services, have paid the VAT to the tax authorities in accordance with Directive 2006/112. Thus, besides the fact that the invoice at issue did not meet the formal requirements provided for by the national legislation, a substantive condition of the reverse charge regime had not been satisfied (paragraph 37).

According to the Court, that situation led to a risk of the loss of tax revenue for the Member State concerned (paragraph 38). Moreover, since the VAT paid by Fatorie to the service provider had not been due and that payment had been made in breach of a substantive requirement of the reverse charge regime, Fatorie could not claim the right to deduct that VAT (paragraph 40). Accordingly, the Court held that the refusal of the right to deduct in this case was not contrary to EU law (operative part).

### **[Judgment of 27 June 2018, SGI and Valériane \(C-459/17 and C-460/17, EU:C:2018:501\)](#)**

In these cases, two French companies with registered offices in Réunion (France) were active in the execution of investments eligible for tax reductions under a provision of national law. The French tax authorities challenged their right to deduct the VAT appearing on various invoices for

the purchase of equipment, inter alia, on the ground that the invoices did not correspond to any actual delivery. Additional VAT assessments were consequently addressed to them, in respect of various periods.

The cour administrative d'appel de Bordeaux (Administrative Court of Appeal, Bordeaux, France) upheld two judgments of the tribunal administratif de la Réunion (Administrative Court, Réunion, France) dismissing their actions contesting the additional VAT assessments, whereupon the two companies brought an appeal on a point of law before the Conseil d'État (Council of State, France).

The Conseil d'État (Council of State), as referring court, sought to establish whether Article 17 of Directive 77/388 must be interpreted as meaning that, in order to deny a taxable person in receipt of an invoice the right to deduct the VAT appearing on that invoice, it is sufficient that the authorities establish that the transactions covered by that invoice have not actually been carried out or whether those authorities must also establish that taxable person's lack of good faith.

The Court of Justice first of all observed that the right to deduct arises at the time when the deductible tax becomes chargeable, which occurs when the goods are delivered or the services are performed (paragraph 34). The right to deduct is therefore connected to the actual delivery of the goods or performance of the services at issue (paragraph 35). The Court stated in this connection that the exercise of the right to deduct does not extend to a tax which is due solely because it appears on an invoice (paragraph 37). The good or bad faith of a taxable person seeking deduction of VAT has no bearing on the question whether there has been a delivery, for the purposes of Directive 77/388. The concept of 'supply of goods' is objective in nature and must be interpreted without regard to the purpose or results of the transactions concerned and without it being necessary for the tax authorities to carry out inquiries to determine the intention of the taxable person or for them to take account of the intention of an economic operator other than that taxable person involved in the same chain of supply (paragraph 38).

Accordingly, the Court held that, in order to deny a taxable person in receipt of an invoice the right to deduct the VAT appearing on that invoice, it is sufficient that the authorities establish that the transactions covered by that invoice have not actually been carried out (operative part).

#### **[Judgment of 5 July 2018, Marle Participations \(C-320/17, EU:C:2018:537\)](#)**

A holding company, whose objects included the management of shareholdings in several subsidiaries of the group, to which it also let a building, carried out a restructuring operation, which led it to make sales and acquisitions of securities. It deducted in full the VAT charged on various expenses connected with that restructuring operation. That deduction was called into question by the tax authorities on the ground that the expenditure in respect of which the company had claimed deduction of VAT was attributable to capital transactions which fell outside the scope of the right of deduction. The company was accordingly issued with additional VAT assessments, which it challenged, unsuccessfully, at first instance and on appeal.

The company brought an appeal on a point of law before the Conseil d'État (Council of State, France), which, as referring court, sought to establish whether the letting of a building by a holding company to its subsidiary constitutes involvement in the management of that subsidiary

which must be considered to be an economic activity, within the meaning of Directive 77/388, giving rise to the right to deduct the VAT on the expenditure incurred by the company for the purpose of acquiring shares in that subsidiary and, if so, under what conditions.

The Court observed, first of all, that, as regards a holding company's right of deduction, where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, that involvement constitutes an economic activity, within the meaning of Article 9(1) of Directive 77/388, in so far as it entails carrying out transactions subject to VAT by virtue of Article 2 of that directive (paragraphs 29 and 30). It also pointed out that the examples of activities constituting involvement of a holding company in the management of its subsidiaries set out in its case-law are not exhaustive (paragraph 31).

The Court noted that the only services that the holding company had supplied to the subsidiaries in whose regard it had incurred expenditure for the purpose of acquiring their securities related to the letting of a building used by an operational subsidiary as a new production site (paragraph 33). It pointed out that the taxation of leasing and letting transactions is left to the discretion of the Member States (paragraph 34). It then held that the letting of a building by a holding company to its subsidiary amounts to involvement in the management of that subsidiary, which must be considered to be an economic activity giving rise to the right to deduct the VAT on the expenditure incurred by the company for the purpose of acquiring securities of that subsidiary, on condition that that supply of services is made on a continuing basis, that it is carried out for consideration and that it is taxed (meaning that the letting is not exempt) and that there is a direct link between the service rendered by the supplier and the consideration received from the beneficiary (paragraph 35).

Concerning, more specifically, the scope of the right of deduction, the Court pointed out that expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in the management of those subsidiaries and which, on that basis, carries out an economic activity must be regarded as belonging to its general expenditure and the VAT paid on that expenditure must, in principle, be deducted in full (paragraph 36). However, that unlimited right of deduction does not apply to expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in the management of only some of its subsidiaries and which, with regard to the other subsidiaries, does not, by contrast, carry out an economic activity. In such case, the expenditure must be regarded as only partially belonging to its general expenditure, with the result that the VAT paid on that expenditure may be deducted only in proportion to the expenditure which is inherent in the economic activity, in accordance with the apportionment criteria defined by the Member States following a method of calculation which objectively reflects the proportion of the input expenditure actually to be attributed, respectively, to economic and to non-economic activities (paragraph 37).

**[Judgment of 17 October 2018, Ryanair \(C-249/17, EU:C:2018:834\)](#)**

In this case, a company, Ryanair, launched a takeover bid for all the shares in another company. In connection with that planned acquisition, it incurred expenditure for consultancy and other services. However, it proved impossible to carry out that transaction fully, and Ryanair was able to acquire only a part of the share capital of the target company (paragraph 8). Ryanair

requested the deduction of input VAT paid on that expenditure, stating that its intention, after gaining control of the target company, had been to involve itself in its management by providing management services subject to VAT. The competent tax authority refused the deduction of VAT and Ryanair brought an appeal against that refusal. The Supreme Court (Ireland), hearing a further appeal by Ryanair, then asked the Court of Justice whether Directive 77/388 permits deduction where there is an intention to acquire all the shares of another company in order to pursue an economic activity consisting in the provision of management services subject to VAT to the latter company.

The Court first considered the conditions for acquiring the status of taxable person, referring to the findings made, *inter alia*, in *Larentia + Minerva and Marenave Schiffahrt*<sup>14</sup> and pointing out the need for direct or indirect involvement in the management of the company in which the holding is acquired in order for the right of deduction to arise (paragraphs 16 and 17). Next, it stated that preparatory acts must themselves be treated as constituting economic activity and that, accordingly, any person with the intention, as confirmed by objective elements, of independently starting an economic activity and who incurs the initial investment expenditure for those purposes must be regarded as a taxable person (paragraph 18). The Court concluded from that that a company which carries out preparatory acts which are part of a proposed acquisition of shares in another company with the intention of pursuing an economic activity consisting in involvement in the management of that other company by providing management services subject to VAT must be considered a taxable person, within the meaning of Directive 77/388.

The Court went on to add that, in accordance with the judgment in *INZO*,<sup>15</sup> the right to deduct, once it has arisen, is retained even if the intended economic activity was not carried out and, therefore, did not give rise to taxed transactions. By virtue of the judgments in *Midland Bank*<sup>16</sup> and *Ghent Coal Terminal*,<sup>17</sup> the same applies where the taxable person was unable to use the goods or services which gave rise to a deduction in the context of taxable transactions by reason of circumstances beyond his or her control (paragraph 25).

Furthermore, the VAT paid can be deducted in full only if the exclusive reason for the expenditure incurred is to be found, in principle, in the intended economic activity, namely the provision to the target company of management services subject to VAT. If the expenditure is attributed in part also to an exempt or non-economic activity, VAT paid on that expenditure may only be deducted in part (paragraph 30).

In conclusion, the Court held that Directive 77/388 confers on a company which intends to acquire all the shares of another company in order to pursue an economic activity consisting in the provision of management services subject to VAT to that other company the right to deduct, in full, input VAT paid on expenditure relating to consultancy services provided in the context of a takeover bid, even if ultimately that economic activity was not carried out, provided that the exclusive reason for that expenditure is to be found in the intended economic activity (operative part).

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<sup>14</sup> [Judgment of 16 July 2015 \(C-108/14 and C-109/14, EU:C:2015:496\)](#).

<sup>15</sup> [Judgment of 29 February 1996 \(C-110/94, EU:C:1996:67\)](#).

<sup>16</sup> [Judgment of 8 June 2000 \(C-98/98, EU:C:2000:300\)](#).

<sup>17</sup> [Judgment of 15 January 1998 \(C-37/95, EU:C:1998:1\)](#).

[Judgment of 18 October 2018, Volkswagen Financial Services \(UK\) \(C-153/17, EU:C:2018:845\)](#)

This case concerned a financing company that provided finance solely for the purchase, including by way of hire purchase, of motor vehicles of the brands of the group to which it belonged. Under hire purchase arrangements, it purchased a vehicle from a dealer and supplied it to a customer, albeit that ownership of the vehicle did not pass to the customer until all payments due under the terms of the agreement had been made. The price received by the financing company in respect of the purchase of a vehicle was such as to leave no profit margin. However, when setting the interest rate relating to the 'finance' aspect of the transaction, the company applied a margin for overheads, a profit margin and an allowance for bad debts to its own cost of financing the vehicle. For that reason, the part of the repayments corresponding to interest was included in the company's turnover, unlike the part corresponding to the repayment of the purchase price of the vehicle.

Pursuant to the national VAT law applicable to hire purchase transactions, although a hire purchase agreement was a single commercial transaction, it comprised a number of separate supplies, including, on the one hand, a taxable supply of a vehicle and, on the other, exempt supplies of credit. As regards the input VAT incurred by the financing company on its entire business, some of it was used only for making taxable or exempt supplies and some of it was used for both types of supplies. This latter VAT was described as 'residual'. Specifically, that residual VAT concerned general costs relating to everyday administration.

In the light of the financing company's status as a partially exempt trader, the parties disagreed on the extent to which it was entitled to deduct that residual VAT. The financing company proposed apportioning the residual VAT between its business sectors in particular in proportion to the turnover of each sector, with no account being taken of the value of vehicles sold. Then, to quantify the deductible residual VAT for each sector, it proposed a particular methodology, based on the proportion of the number of taxable transactions to the total number of transactions in each sector. In the retail sector, that was not, according to the financing company, the number of hire purchase contracts, but the number of payments. For its part, the tax authority argued for the apportionment of the residual VAT between taxable and exempt supplies on the basis of the value of those supplies, excluding the initial value of vehicles at the time of their supply, thus substantially reducing the deductible proportion of the residual VAT, given that the bulk of the value was attributable to the grant of finance (an exempt supply).

A reference for a preliminary ruling was made by the Supreme Court of the United Kingdom, before which a final appeal had been brought. The Court of Justice then considered whether Article 168 and Article 173(2)(c) of Directive 2006/112 must be interpreted as meaning, first, that, even where the general costs relating to supplies of moveable goods by hire purchase are passed on not in the amount payable by the customer in respect of the supply of the goods concerned, that is to say the taxable part of the transaction, but in the amount of the interest due in respect of the 'finance' part of the transaction, that is to say the exempt part thereof, those general costs must nonetheless be considered, for the purposes of VAT, to be a component of the price of that supply and, secondly, that Member States may apply a method of apportionment which does not take account of the initial value of the goods concerned when they are supplied (paragraph 27).



After emphasising the requirement for a direct and immediate link between a particular input transaction and a particular output transaction or transactions giving rise to the right to deduct, the Court pointed out that a taxable person nevertheless has a right to deduct even in the absence of such a direct and immediate link where the costs of the services in question are part of his or her general costs and are, as such, components of the price of the goods or services which he or she supplies (paragraph 42). The Court noted that the financing company had decided to include the general costs at issue not in the price of the taxable transactions, but solely in the price of the exempt transactions. Nevertheless, in so far as those general costs were in fact incurred, at least to a certain extent, for the purpose of the supply of vehicles, which are taxed transactions, those costs are, as such, components of the price of those transactions (paragraph 44).

The Court pointed out that the extent of the right to deduct varies according to the intended use of the goods and services at issue (paragraph 47) and stated that general costs relating to goods and services used to effect both transactions giving rise to a right to deduct and transactions not giving rise to a right to deduct require that a deductible proportion be established, in accordance with the relevant provisions of Directive 2006/112. The general rule that turnover should be used as the basis for determining the deductible proportion is open to exceptions permitting the use of a method or allocation key other than one based on turnover (paragraph 51). However, that option requires that a more precise method be used, even if not necessarily the most precise possible (paragraph 53). In that context, the Court stated that, in the light of the fundamental nature of the right to deduct, where the method by which the deduction is calculated does not take account of an actual and non-negligible allocation of a share of the general costs to transactions giving rise to a right to deduct, such a method cannot be regarded as objectively reflecting the actual share of the expenditure resulting from the acquisition of mixed use goods and services that may be attributed to those transactions. Consequently, such a method is not capable of ensuring a more precise apportionment than that which would arise from the application of the turnover-based allocation key (paragraph 57).

The Court concluded, first, that, even where the general costs relating to supplies of moveable goods by hire purchase are passed on not in the amount payable by the customer in respect of the supply of the goods concerned, that is to say the taxable part of the transaction, but in the amount of the interest due in respect of the 'finance' part of the transaction, that is to say the exempt part thereof, those general costs must nonetheless be considered, for the purposes of VAT, to be a component of the price of that supply and, secondly, that Member States may not apply a method of apportionment which does not take account of the initial value of the goods concerned when they are supplied, since that method is not capable of ensuring a more precise apportionment than that which would arise from the application of the turnover-based allocation key (operative part).

## **1. Direct and immediate link**

### **[Judgment of 30 May 2013, X \(C-651/11, EU:C:2013:346\)](#)**

Company X held 30% of the shares in company A and carried out management work for A in return for remuneration. In 1996, X and the other shareholders sold their shares to company D and the management work for A came to an end. A number of services were supplied to X in

conjunction with that sale of shares, and the invoices provided for VAT to be charged. X deducted that VAT in its VAT returns, on the basis that the disposal of its shareholding constituted a transfer of a totality of assets and of services and that the costs which it incurred in connection with that transaction had to be considered part of the general costs associated with its entire economic activity and were, therefore, fully deductible.

The referring court asked the Court of Justice, in essence, whether the disposal of 30% of the shares in a company — to which the transferor supplies services that are subject to VAT — constitutes a transfer of a totality of assets or services or part thereof within the meaning of Directive 77/388. If not, the referring court wishes to know whether the fact that the other shareholders transfer all the other shares in that company to the same person at practically the same time and that the disposal is closely linked to management activities carried out for that company has any bearing on the matter.

The Court of Justice first of all explained that the mere acquisition, holding and sale of shares in a company do not, in themselves, amount to an economic activity within the meaning of Directive 77/388, since the mere acquisition of financial holdings in other undertakings does not amount to the exploitation of property for the purpose of obtaining income therefrom on a continuing basis (paragraph 36). Consequently, the transfer of shares in a company cannot, irrespective of the size of the shareholding, be regarded as equivalent to the transfer of a totality of assets or part thereof, unless the holding is part of an independent unit which allows an independent economic activity to be carried out, and that activity is carried on by the transferee. The mere disposal of shares, unaccompanied by the transfer of assets, does not allow the transferee to carry on an independent economic activity as the transferor's successor (paragraph 38). Shareholders are not owners of the assets of the undertaking in which they hold their shares; they are owners of the shares and, as such, are entitled to a dividend and to the communication of information, and are involved in the adoption of important decisions for the management of the undertaking. Accordingly, the Court held that a 30% shareholding in a company represents only a limited entitlement in respect of that company (paragraph 39) and that the transfer of 30% of the shares in a company cannot be regarded as equivalent to the transfer of a totality of assets or part thereof within the meaning of Directive 77/388 (paragraph 40). The Court however observed that each transaction must be assessed individually and independently (paragraph 47).

Next, the Court observed that there is a right to deduct where the input transactions effected have a direct and immediate link with output transactions giving rise to the right to deduct. If that is not the case, it is necessary to examine whether the costs incurred to acquire the input goods or services are part of the general costs linked to the taxable person's overall economic activity. In either case, whether there is a direct and immediate link will depend on whether the cost of the input services is incorporated into either the cost of particular output transactions or the cost of goods or services supplied by the taxable person as part of his or her economic activities (paragraph 55).

In conclusion, the Court held that the disposal of 30% of the shares in a company to which the transferor supplies services that are subject to VAT does not amount to the transfer of a totality of assets or services or part thereof within the meaning of Directive 77/388, irrespective of the fact that the other shareholders transfer all the other shares in that company to the same

person at practically the same time and that that disposal is closely linked to management activities carried out for that company (operative part).

**[Judgment of 8 November 2018, C&D Foods Acquisition \(C-502/17, EU:C:2018:888\)](#)**

C&D Foods was the parent company of Arovit Holding A/S, which owned Arovit Petfood. Prior to 1 March 2007, the main activity of C&D Foods was to act as the parent company of Arovit Holding. On that date, it entered into a management agreement with its sub-subsidiary Arovit Petfood, relating to the supply of management and IT services. In August 2008, a credit institution assumed ownership of the Arovit group for the sum of EUR 1, on account of the failure of the former owner of the Arovit group to repay a loan which had been granted to it. Over the period from December 2008 to March 2009, the credit institution entered into a number of consultancy agreements on behalf of C&D Foods in preparation for the sale of all the shares which it held in Arovit Petfood, which it proposed to carry out so as no longer to be the group's creditor. C&D Foods, having paid fees associated with that proposed sale, deducted the corresponding VAT. However, the sale process was brought to an end in 2009, as no potential buyer could be found.

The referring court asked the Court of Justice whether a holding company is entitled to deduct the VAT on expenditure relating to a disposal — envisaged but not completed — of shares in a sub-subsidiary to which that company provides management and IT services.

The Court began by observing that a company which has as its sole purpose the acquisition of holdings in other companies, without being directly or indirectly involved in the management of those companies, is neither a person entitled to deduct VAT nor a taxable person, since the mere acquisition and ownership of shares do not, in themselves, constitute an economic activity for the purposes of Directive 2006/112 (paragraph 30). However, the position is otherwise where a financial holding in another company is accompanied by direct or indirect involvement in the management of the company in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder or associate, in so far as involvement of that kind entails carrying out transactions subject to VAT, such as the supply of administrative, accounting and information-technology services (paragraph 32).

The Court then held that, in order for a share disposal transaction to be able to come within the scope of VAT, the direct and exclusive reason for that transaction must, in principle, be the taxable economic activity of the parent company in question, or that transaction must constitute the direct, permanent and necessary extension of that activity. That is the case where that transaction is carried out with a view to allocating the proceeds of that sale directly to the taxable economic activity of the parent company in question or to the economic activity carried out by the group of which it is the parent company (paragraph 38). Accordingly, the Court concluded that a share disposal transaction, envisaged but not carried out, such as that at issue, for which the direct and exclusive reason does not lie in the taxable economic activity of the company concerned, or which does not constitute the direct, permanent and necessary extension of that economic activity, does not come within the scope of VAT (paragraph 42 and operative part).

[Judgment of 22 October 2015, Sveda \(C-126/14, EU:C:2015:712\)](#)

In this case, Sveda, a for-profit legal person, undertook to create a recreational path in the context of an economic activity linked to rural and recreational tourism and to allow the public free access to the path for a period of five years. It deducted the VAT relating to the acquisition or production of certain capital goods as part of the construction work on the recreational path, and applied to the tax authority for the repayment of the VAT in question. The authority nevertheless found that there was no justification for such a repayment, since it was not established that the goods and services acquired were intended to be used for the purposes of an activity subject to VAT. On that basis, the tax authority refused deduction of the VAT.

In that context, the referring court questioned whether there was a direct and immediate link between the expenses associated with the construction work carried out and the economic activities planned by Sveda, on the ground that the recreational path was directly intended for use by the public free of charge.

The Court of Justice first observed that, in so far as a taxable person, acting as such at the time when he or she acquires goods, uses the goods for the purposes of his or her taxed transactions, he or she is entitled to deduct the VAT paid or payable in respect of the goods (paragraph 18). It stated, in this connection, that goods and services may be acquired by a taxable person for the purposes of an economic activity even if the goods are not used immediately for that economic activity (paragraph 19). A person who incurs investment expenditure with the intention, confirmed by objective evidence, of engaging in economic activity must be regarded as a taxable person. Acting in that capacity, he or she has the right immediately to deduct the VAT payable or paid on the investment expenditure incurred for the purposes of the transactions which he or she intends to carry out and which give rise to the right to deduct (paragraph 20). Whether a taxable person acted as such for the purposes of an economic activity was, however, a question of fact to be assessed by the referring court (paragraph 21). Nevertheless, the Court noted that it was apparent from the description given by the referring court that the recreational path could be regarded as a means of attracting visitors with a view to providing them with goods and services (paragraph 22). That suggested that Sveda had acquired or produced the capital goods concerned with the intention of carrying out an economic activity and, consequently, that it had acted as a taxable person (paragraph 23).

As regards the existence of a direct and immediate link, the Court pointed out that there is a right to deduct, even where there is no direct and immediate link, if the expenditure incurred is part of the taxable person's general costs and is, as such, a component of the price of the goods or services which he or she supplies (paragraphs 27 and 28). All the circumstances surrounding the transactions concerned must be considered, but account must be taken only of the transactions which are objectively linked to the taxable person's taxable activity (paragraph 29).

The Court held that the immediate use of the capital goods free of charge does not affect the existence of a direct and immediate link, since the making available of the recreational path to the public is not covered by any exemption under Directive 2006/112 and the expenditure incurred by Sveda in creating the recreational path can be linked to the economic activity planned by it (paragraphs 33 to 35).

[Judgment of 14 September 2017, Iberdrola Inmobiliaria Real Estate Investments \(C-132/16, EU:C:2017:683\)](#)

In the dispute in the main proceedings, a Bulgarian company, Iberdrola, purchased several parcels of land in a holiday village in order to construct apartments for seasonal use. It entered into a contract with the municipality, which had obtained a building permit for the reconstruction of a waste-water pumping station serving the holiday village, which was located in its territory. After purchasing the parcels of land, Iberdrola commissioned construction works from a third-party company. According to Iberdrola, there was a link between the expenditure it incurred in order to reconstruct the pumping station and the services which it was to supply after the construction of the authorised buildings on its parcels of land.

The referring court asked, in essence, whether a taxable person has the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and those services are used both by the taxable person and by the third party in the context of their economic activities.

The Court of Justice first of all pointed out that the existence of a direct and immediate link must be assessed in the light of the objective content of the transactions in question (paragraph 31). Where goods or services acquired are used for the purposes of transactions that are exempt or do not fall within the scope of VAT, no output tax can be collected or input tax deducted (paragraph 30).

Accordingly, it was necessary, in this case, to determine whether there was a direct and immediate link between, on the one hand, the reconstruction of the waste-water pumping station and, on the other hand, a taxed output transaction by Iberdrola or that undertaking's economic activity (paragraph 32). It was clear from the facts of the case that, without the reconstruction of the pumping station, it would have been impossible to connect the buildings which Iberdrola planned to build to the pumping station. In the absence of the reconstruction, Iberdrola would not have been able to carry out its economic activity (paragraph 33). The fact that the municipality also benefited from the reconstruction service could not justify the right to deduct being denied to Iberdrola if the existence of a direct and immediate link were established (paragraph 35).

The Court went on to explain that it was for the referring court to examine whether the reconstruction service had been limited to that which was necessary to ensure the connection of the buildings to the pumping station at issue in the main proceedings, or whether that service went beyond that which was necessary for that purpose (paragraph 37). In that connection, the Court held that a taxable person has the right to deduct input VAT in respect of a supply of services consisting of the construction or improvement of a property owned by a third party when that third party enjoys the results of those services free of charge and those services are used both by the taxable person and by the third party in the context of their economic activities, in so far as those services do not exceed that which is necessary to allow that taxable person to carry out the taxable output transactions and their cost is included in the price of those transactions (paragraph 40 and operative part). If the construction or improvement works exceed the needs created solely by the buildings constructed by the taxable person, a right to deduct would thus have to be recognised only for the input VAT levied on the part of the costs

incurred for the construction or improvement which is objectively necessary to allow the taxable person to carry out its taxed transactions (paragraph 39).

## 2. The effect of fraud on the right of deduction

### [Judgment of 6 December 2012, Bonik \(C-285/11, EU:C:2012:774\)](#)

In this case, the Bulgarian tax authorities found, following a tax investigation, that there was no evidence of the intra-Community supplies of wheat and sunflower which Bonik, a Bulgarian company, had declared as having been carried out for a company governed by Romanian law. The tax authorities also carried out checks with two of Bonik's suppliers and also with three of the latter's own suppliers. However, it was not possible by means of those checks to establish that the latter three suppliers had actually supplied goods to Bonik's two suppliers, and so the Bulgarian tax authorities concluded that Bonik's suppliers had not had a sufficient quantity of goods to make the supplies to Bonik and that no actual supplies had been made from those companies to Bonik. In that context, questions were referred for a preliminary ruling concerning the definition of the concept of 'tax evasion' and the scope of that concept.

The Court of Justice first of all pointed out that, according to its settled case-law on the matter — namely its judgments in *Halifax and Others*,<sup>18</sup> *Kittel and Recolta Recycling*<sup>19</sup> and *Mahagében and Dávid*<sup>20</sup> — a taxable person who knew, or should have known, that, by his or her purchase, he or she was taking part in a transaction connected with VAT fraud must, for the purposes of Directive 2006/112, be regarded as a participant in that fraud, whether or not he or she profits from the resale of the goods or the use of the services in the context of the taxable transactions subsequently carried out by him or her (paragraph 39).

On the other hand, the Court held that it is incompatible with the rules governing the right of deduction under Directive 2006/112 to impose a penalty, in the form of refusal of that right, on a taxable person who did not know, and could not 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 (paragraph 41).

Consequently, since the refusal of the right of deduction is an exception to the application of the fundamental principle constituted by that right, it is incumbent upon the competent tax authorities to establish, to the requisite legal standard, the objective evidence needed to substantiate the conclusion that the taxable person knew, or should have known, that the transaction relied on as a basis for the right of deduction was connected with fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply (paragraph 43).

<sup>18</sup> [Judgment of 21 February 2006 \(C-255/02, EU:C:2006:121\)](#).

<sup>19</sup> [Judgment of 6 July 2006 \(C-439/04 and C-440/04, EU:C:2006:446\)](#).

<sup>20</sup> [Judgment of 21 June 2012 \(C-80/11 and C-142/11, EU:C:2012:373\)](#). Regarding this judgment, see, also, Part II above, 'Origin and scope of the right of deduction' and Part V below, 'Rules governing exercise of the right of deduction'.

[Judgment of 13 February 2014, Maks Pen \(C-18/13, EU:C:2014:69\)](#)

The applicant in the main proceedings, Maks Pen, was a company registered under Bulgarian law. Maks Pen was the subject of a tax inspection which led the Bulgarian tax authorities to contest the validity of the VAT deduction made on the basis of the tax included in the invoices of seven of the company's suppliers. In respect of some of the suppliers themselves, or their subcontractors, it was not possible to establish from the information requested of them during the tax inspection that they had had the necessary resources to make the supplies invoiced. Taking the view that either it was not proven, in respect of some of the subcontractors, that the transactions in question had actually been carried out, or that those transactions were not carried out by the service providers referred to on the invoices, the tax authorities drew up an amended tax assessment notice contesting the deductibility of the VAT included in the invoices of those seven undertakings.

Referring to its judgment in *Bonik*,<sup>21</sup> the Court of Justice held, first of all, that, if it were simply to be the case that a supply made to Maks Pen was not actually made by the supplier mentioned on the invoices or by its subcontractor, inter alia, because they did not have the personnel, equipment or assets required, there was no record of the costs of making the supply in their accounts or the identification of persons signing certain documents as suppliers was shown to be inaccurate, that would not, in itself, constitute sufficient grounds to exclude the right to deduct (paragraph 31). Excluding the right to deduct is subject to the twofold condition that such facts constitute fraudulent conduct and that it is established, in the light of objective evidence provided by the tax authorities, that the taxable person knew or should have known that the transaction relied on to give entitlement to the right to deduct was connected with fraud, which it was for the referring court to determine (paragraph 32).

Secondly, the Court resolved the procedural issue of whether the national court is under an obligation to establish the existence of tax evasion of its own motion. The Court pointed out in this connection that, even if a rule of national law were to classify the tax evasion as a criminal offence, and only a criminal court could make that classification, it is not obvious that such a rule would preclude the court responsible for assessing the legality of an amended tax notice which contests a VAT deduction made by a taxable person from being able to rely on objective evidence submitted by the tax authorities to establish the existence, in the particular case, of tax evasion, where, pursuant to another provision of national law, VAT which is 'unlawfully invoiced' cannot be deducted (paragraph 38). EU law requires of the national courts and authorities that they refuse entitlement to the right to deduct where it is established, in the light of objective evidence, that that right is being relied on for fraudulent or abusive ends. Moreover, even if EU law is not relied upon by the parties, the national court must raise of its own motion points of law based on binding EU law rules where, under national law, the national courts must or may do so in relation to a binding rule of national law (paragraph 34).

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<sup>21</sup> [Judgment of 6 December 2012 \(C-285/11, EU:C:2012:774\)](#).



[Judgment of 22 October 2015, PPUH Stehcemp \(C-277/14, EU:C:2015:719\)](#)

In this case, the applicant in the main proceedings, a Polish company, made a number of purchases of diesel fuel which it used in the course of its economic activity. Subsequently, the company deducted the VAT paid in respect of those fuel purchases. Following a tax inspection, the tax authorities refused to allow the company to deduct that VAT on the ground that the invoices corresponding to those fuel purchases had been issued by a non-existent trader. The finding that the trader in question was a non-existent trader was based on the overall evidence, including the fact that the company in question was not registered for VAT purposes, did not submit a tax return and did not pay any taxes.

First of all, regarding the possible existence of fraud, the Court, after recalling its judgments in *Bonik*<sup>22</sup> and *Maks Pen*,<sup>23</sup> stated that, where the material and formal conditions laid down by Directive 77/388 for the creation and exercise of the right of deduction are met, it is incompatible with the rules governing the right to deduct under that directive to impose a penalty, in the form of refusing that right to a taxable person who did not know, and could not 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 prior or subsequent to the transaction carried out by the taxable person was vitiated by VAT fraud (paragraph 49).

According to the Court, it is for the tax authorities, having found fraud or irregularities committed by the issuer of the invoice, to establish, on the basis of objective factors and without requiring the recipient of the invoice to carry out checks which are not his or her responsibility, that that recipient knew, or should have known, that the transaction on which the right to deduct is based was connected with VAT fraud, this being a matter for the referring court to determine (paragraph 50).

### III. The deductible proportion

[Judgment of 16 February 2012, Varzim Sol \(C-25/11, EU:C:2012:94\)](#)

The facts of this case are described above in Part II, entitled 'Origin and scope of the right of deduction'. It therefore need only be repeated that the case concerns mixed taxable persons and their entitlement to deduct input VAT on the basis of the use of all or part of the goods and services, and the issue of the calculation of the deductible amount, for sectors in which such taxable persons carry out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion.

The Court referred to its judgment in *Commission v France*<sup>24</sup> and pointed out that, as regards mixed taxable persons, even if the right to deduct is calculated according to a proportion determined on the basis of a fraction having, as numerator, the total amount, exclusive of VAT,

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<sup>22</sup> [Judgment of 6 December 2012 \(C-285/11, EU:C:2012:774\)](#).

<sup>23</sup> [Judgment of 13 February 2014 \(C-18/13, EU:C:2014:69\)](#).

<sup>24</sup> [Judgment of 6 October 2005 \(C-243/03, EU:C:2005:589\)](#).

of turnover per year attributable to transactions in respect of which VAT is deductible in accordance with Article 17(2) of Directive 77/388 and, as denominator, the total amount, exclusive of VAT, of turnover per year attributable to transactions included in the numerator and to transactions in respect of which VAT is not deductible, the Member States are nevertheless permitted to provide for one of the other methods for determining the right to deduct that are listed in the third subparagraph of Article 17(5) of that directive, in particular, determination of a separate proportion for each sector of business or deduction on the basis of the use of all or part of the goods and services for a specific activity (paragraph 38). The Court explained, in this connection, that subsidies directly linked to the price of goods or services are taxable in the same way as those goods or services and that, as regards subsidies which are not directly linked to the price, the Member States may include them in the denominator for calculating the proportion applicable where a taxable person carries out, at the same time, transactions in respect of which VAT is deductible and others which are exempt (paragraph 39).

The Court concluded that, since the taxable person in the main proceedings had been authorised to make the deduction according to a method other than the method whereby a proportion is determined under Article 19 of Directive 77/388, namely on the basis of the use of all or part of the goods and services for a specific activity (paragraph 40), and since its activities in the catering and entertainment sectors were subject to VAT, the right to deduct on the basis of the method of actual use related to all the taxes charged on the input transactions (paragraph 41). The Court accordingly held that Directive 77/388 precludes a Member State, where it authorises mixed taxable persons to make the deduction provided for by that directive on the basis of the use of all or part of the goods and services, from calculating the deductible amount, for sectors in which such taxable persons carried out taxable transactions only, by including untaxed 'subsidies' in the denominator of the fraction used to determine the deductible proportion (paragraph 43).

**[Judgment of 8 November 2012, BLC Baumarkt \(C-511/10, EU:C:2012:689\)](#)**

In this case, the taxable person, BLC, a company governed by German law, commissioned the construction of a building that included both residential accommodation and commercial premises. After completion of the building, BLC let it, that letting being partly exempt from VAT and partly subject to VAT. In its VAT declaration, BLC made a partial deduction of the input tax in relation to the building, calculating the amount of deductible VAT by applying a proportion determined by reference to the ratio between the turnover in relation to the commercial letting and that arising from other letting transactions.

Following a tax inspection, the tax authority took the view that the amount of deductible input VAT had to be determined by reference to the ratio between the floor area of the commercial premises and that of the residential premises. This resulted in a downward revision of the amount of deductible VAT, to BLC's detriment.

In the dispute, the national court made a reference to the Court of Justice to establish whether the provision of Directive 77/388 governing the calculation of the deductible proportion of VAT permitted Member States, for the purposes of calculating the proportion of input VAT deductible for the construction of a mixed-use building, to give precedence to an allocation key other than that based on turnover.

The Court of Justice first of all pointed out that, in accordance with the general rule established by Directive 77/388, in the calculation of the deductible proportion, only such proportion of the VAT is deductible as is attributable to transactions covered by Article 17(2) and (3) of that directive, in respect of which VAT is deductible (paragraph 13). However, by way of derogation from that rule, the Member States are permitted to employ one of the other methods for determining the deductible amount, namely determination of a separate proportion for each sector of business, or deduction on the basis of the use made of all or part of the goods and services for a specific activity, or even to exclude the right of deduction, in certain circumstances (paragraph 15). In that regard, it is necessary for the Member States, in the exercise of the powers conferred on them, to ensure the effectiveness of the general rule in Directive 77/388 and to observe the principles which underlie the common system of VAT, in particular those of fiscal neutrality and proportionality (paragraph 16). National legislation that derogates generally from that rule would call into question the objective of Directive 77/388 according to which calculation of the deductible proportion must be carried out in a similar manner in all Member States (paragraph 17). In that context, the Court held that it is incumbent on the Member States to establish, within the limits of compliance with EU law and the principles on which the common system of VAT is based, methods and rules governing the calculation of the deductible proportion of input VAT and that, in exercising that power, the Member States are obliged to take account of the purpose and general system of that directive (paragraph 22).

According to the Court, the Member States are also required to ensure that the calculation of the deductible proportion of input VAT is as precise as possible (paragraph 23). Therefore, Directive 77/388 does not preclude the Member States from applying, for a given transaction, a method or allocation key other than the turnover-based method, such as, in particular, that based on the floor area at issue in the main proceedings, on condition that the method used guarantees a more precise determination of the deductible proportion of the input VAT than that arising from application of the turnover-based method (paragraph 24).

#### [Judgment of 12 September 2013, Le Crédit Lyonnais \(C-388/11, EU:C:2013:541\)](#)

This case concerned a bank which had its principal establishment in France and branches established in other EU Member States and third countries. Following an examination of its accounts, the tax authority refused to allow the bank, as a taxable person, to take account of the interest on loans granted by the principal establishment to its branches established outside France in the numerator and denominator of the deductible proportion.

The national court referred to the Court of Justice for a preliminary ruling four questions concerning the determination of the deductible proportion of VAT. The Court first of all examined whether Directive 77/388 must be interpreted as meaning that, in determining the deductible proportion of VAT, a company the principal establishment of which is situated in a Member State may take into account the turnover of its branches established in other Member States.

The Court held that, in so far as the calculation of the deductible proportion constitutes an element of the deduction system provided for by Directive 77/388, the manner in which that calculation must be carried out falls, along with that deduction system, within the scope of the national VAT legislation to which an activity or transaction must be linked for tax purposes

(paragraph 30). It is for the Member States' tax authorities to lay down the method for determining the right to deduct, inasmuch as they are permitted by the directive to provide for determination of a separate proportion for each sector of business, or deduction on the basis of the use made of all or part of the goods and services for a specific activity, or even to exclude the right of deduction in certain circumstances (paragraph 31). The method of repayment of VAT, by deduction or by refund, depends solely on the place where the taxable person is established (paragraph 32). The concept of the 'place of establishment' covers not only the taxable person's principal establishment, but also its fixed establishments (paragraph 33). Since a fixed establishment situated in a Member State and the principal establishment situated in another Member State constitute a single taxable person subject to VAT, it follows that a taxpayer is subject, in addition to the system which applies in the State of its principal establishment, to as many national systems of deduction as there are Member States in which it has fixed establishments (paragraph 34).

Since the methods of calculation of the proportion constitute a fundamental element of the deduction system, account cannot be taken, in calculating the proportion applicable to the principal establishment of a taxpayer established in a Member State, of the turnover of all of the taxable person's fixed establishments in the other Member States, without seriously jeopardising both the rational allocation of the spheres of application of national legislation in VAT matters and the rationale of the deductible proportion (paragraph 35). Indeed, first, such a method of calculating the deductible proportion cannot guarantee better observance of the principle of neutrality of VAT than a system which provides for a separate deductible amount for each Member State in which there is a fixed establishment (paragraph 37). Secondly, the amount of the applicable deductible proportion would be distorted (paragraph 38). Thirdly, such a method of establishing the deductible proportion is liable to impair the effectiveness of Directive 77/388 (paragraph 39).

**[Judgment of 16 July 2015, Larentia + Minerva and Marenave Schiffahrt \(C-108/14 and C-109/14, EU:C:2015:496\)](#)**

This case concerned two holding companies. The first deducted in full the input VAT which it had paid in procuring capital from a third party which it then used to fund the acquisition of its shareholdings in its subsidiaries and its services. The second company deducted in full the input VAT which it had paid on the issue costs connected with an increase in its capital. As regards the first company, the tax authority allowed the deduction only in part, on the ground that the mere holding of shares in the subsidiaries did not give rise to a right of deduction. As regards the second company, the tax authority refused the deduction of the input VAT.

The national court hearing the disputes referred to the Court of Justice questions concerning, inter alia, the situation where the deduction of input VAT is permitted only to the extent that the expenses incurred by the taxable person may be attributed to its economic activity. More specifically, the national court had doubts about the methods of calculation according to which input VAT thus paid by a holding company for the acquisition of capital intended for the purchase of shares must be apportioned between the economic and non-economic activities of that company.

The Court first of all observed that a holding company whose sole purpose is to acquire shares in other undertakings and which does not involve itself directly or indirectly in the management of those undertakings does not have the right to deduct tax under Directive 77/388 (paragraph 18). However, the expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involves itself in their management and which, on that basis, carries out an economic activity, must be regarded as attributed to that company's economic activity, and the VAT paid on that expenditure gives rise to the right to full deduction (paragraph 25).

Next, the Court explained that the system for the deduction of a proportion of the VAT covers only cases in which the goods and services are used by a taxable person to carry out both economic transactions giving rise to a right to deduct and economic transactions which do not (paragraph 26). That system concerns the input tax chargeable on expenses relating exclusively to economic transactions. On the other hand, the determination of the methods and criteria for apportioning input VAT between economic and non-economic activities falls within the discretion of the Member States (paragraph 27). Given that the holding companies in question were subject to VAT in respect of the economic activity consisting of the supplies which they provided for consideration to their subsidiaries, the VAT paid on the costs of acquiring those services had to be regarded as general expenditure and deducted in full, unless the output economic transactions were exempt, in which case the right of deduction was determined by the method used for calculating the deductible proportion (paragraph 28).

**[Judgment of 9 June 2016, Wolfgang und Dr. Wilfried Rey Grundstücksgemeinschaft \(C-332/14, EU:C:2016:417\)](#)**

In this case, the taxable person, a property partnership governed by German civil law, demolished an old building on a plot of land owned by it and constructed a building there for both residential and commercial use. The building contained 6 residential and commercial units and 10 underground parking spaces. Some of the units and parking spaces were let.

The taxable person calculated its entitlement to deduct VAT paid for the demolition and construction works by applying an allocation key based on the ratio between the turnover generated by the activity, subject to VAT, of letting the commercial units and associated car parking spaces and the turnover arising from the other, VAT-exempt, letting transactions. However, some parts of the building which had originally been envisaged to be used for carrying out taxed transactions were ultimately let exempt from VAT. Taking the view that the deduction of VAT should be made using a more precise allocation key than the one based on turnover, namely one based on floor area, the German tax authority applied the latter allocation key and reduced the deduction percentage that the taxable person was allowed.

That difference of opinion led the national court to refer to the Court of Justice the question of whether, where a building is used in order to carry out some output transactions in respect of which VAT is deductible and others in respect of which it is not, the Member States are required to prescribe that the input goods and services used for the construction or acquisition of that building must, in a first stage, be assigned exclusively to one or other of those types of transactions in order that, in a second stage, only the deduction entitlement due in respect of those of the goods and services which cannot be so assigned is determined by applying a

turnover-based allocation key or, provided that this method guarantees a more precise determination of the deductible proportion, on the basis of floor area. The referring court also asked whether the answer which the Court would be called upon to give to this question also applies to the goods and services to which recourse is had for the use, conservation or maintenance of a mixed-use building.

The Court of Justice observed that the Member States are, in principle, required to lay down that taxable persons, in order to determine the amount that they are entitled to deduct, must, in a first stage, assign the input goods and services to the various output transactions which have been carried out and for the performance of which they were intended. It then went on to explain that, in a second stage, the competent authorities of the Member States have the task of applying, in respect of those goods or services, the deduction arrangement corresponding to their assignation; the proportional arrangement laid down in Directive 77/388 should, however, be applied so far as concerns goods and services which do not relate to a single type of transaction (paragraph 26).

The Court explained, in this connection, that national legislation may authorise taxable persons not to assign those goods and services, irrespective of the use to which they will be put, where they relate to the acquisition or construction of a mixed-use building and their assignation is, in practice, difficult to carry out (paragraph 28). On the other hand, if the assignation is easy to carry out in practice, a Member State cannot be authorised to provide that taxable persons do not have to assign the goods and services to the various output transactions carried out by means of the building (paragraph 30).

As regards the calculation of the deduction, the Court pointed out, with reference to goods and services assigned both to transactions in respect of which VAT is deductible and to transactions in respect of which it is not, that the deductible amount is, in principle, calculated on the basis of a proportion determined, for all the transactions carried out by the taxable person, by applying a turnover-based allocation key (paragraph 31). Nevertheless, the Member States may provide for a different calculation method, provided that the method used guarantees a more precise determination of the deductible proportion of the input VAT than that resulting from the first method (paragraph 32).

The Court held that the Member States are not required to prescribe that the input goods and services used for the construction, acquisition, use, conservation or maintenance of the building must, in a first stage, be assigned to those various transactions when such assignation is difficult to carry out, in order that, in a second stage, only the deduction entitlement due in respect of those of the goods and services which are used both for certain transactions in respect of which VAT is deductible and for others in respect of which it is not is determined by applying a turnover-based allocation key or, provided that this method guarantees a more precise determination of the deductible proportion, on the basis of floor area (paragraph 36).

#### **IV. Limitations on the right of deduction**

The limitations discussed in the present part are broader in scope than the restrictions provided for in Article 176 of Directive 2006/112. They are in fact limits on the right of deduction.

Three judgments will be covered, namely the judgments in *Maks Pen*,<sup>25</sup> *Gemeente Woerden*<sup>26</sup> and *Iberdrola Inmobiliaria Real Estate Investments*.<sup>27</sup>

#### **[Judgment of 13 February 2014, Maks Pen \(C-18/13, EU:C:2014:69\)](#)**

In this case, the Court pointed out that the option granted to the Member States, under the first paragraph of Article 273 of Directive 2006/112, to impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion may not, as the second paragraph of Article 273 states, be relied upon in order to impose additional invoicing obligations over and above those laid down in the directive (paragraph 42). The Court also stated that any failure by the service provider to complete certain accounting requirements cannot call into question the right of deduction to which the recipient of services supplied is entitled in respect of the VAT paid for those services where the invoices relating to the services supplied contain all the information required by Article 226 of Directive 2006/112 (paragraph 47). Accordingly, the Court held that Directive 2006/112 precludes a national provision according to which a service is deemed to have been supplied at the time when the conditions governing recognition of the revenue arising from that service are satisfied (paragraph 48 and operative part, point 3).

#### **[Judgment of 22 June 2016, Gemeente Woerden \(C-267/15, EU:C:2016:466\)](#)**

In this case, a municipality in the Netherlands, classified as a taxable person for the purposes of Directive 2006/112, commissioned the construction of two buildings which it then sold for a price below the cost of construction to a purchaser which subsequently allowed a third party to use parts of the buildings free of charge. Leases over the other parts were granted for consideration to various tenants. The referring court asked the Court of Justice whether, in such a situation, the taxable person is entitled to deduct all of the VAT invoiced in respect of the construction of the buildings, or only a part thereof, in proportion to the parts of the buildings which the purchaser uses for economic activities, that is to say the grant of a lease for consideration.

The Court of Justice observed that Directive 2006/112 does not make the right of deduction subject to any condition relating to the use made of the goods and services at issue by the person who receives those goods and services from the taxable person, since that would imply that every transaction of a taxable person with a purchaser or a lessee who does not carry out an economic activity, such as private individuals, would limit the taxable person's right to deduct input tax (paragraph 36).

Moreover, according to the Court, a condition pursuant to which the use of the goods or services at issue by their purchaser or lessee determines whether a supplier has the right to

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<sup>25</sup> [Judgment of 13 February 2014 \(C-18/13, EU:C:2014:69\)](#). See, also, in Part II above, 'Origin and scope of the right of deduction', Section 2, 'The effect of fraud on the right of deduction'.

<sup>26</sup> [Judgment of 22 June 2016 \(C-267/15, EU:C:2016:466\)](#).

<sup>27</sup> [Judgment of 14 September 2017 \(C-132/16, EU:C:2017:683\)](#). See, also, in Part II above, 'Origin and scope of the right of deduction', Section 1, 'Direct and immediate link'.



deduct input tax would mean that the taxable person's right to deduct would depend on the subsequent actions of the purchaser or lessee, who would always be capable of changing the use of the property in the short or long term (paragraph 37).

The Court held that the result of an economic transaction is irrelevant for the right to deduct, provided that the activity itself is subject to VAT, and, consequently, the taxable person in question is entitled to deduct all of the VAT paid in respect of the construction of the buildings, and not only a part of that tax in proportion to the parts of the buildings which the purchaser uses for economic activities (paragraphs 40 and 42).

**[Judgment of 14 September 2017, Iberdrola Inmobiliaria Real Estate Investments \(C-132/16, EU:C:2017:683\)](#)**

This case principally concerned the requirement for there to be a direct and immediate link.<sup>28</sup>

So far as concerns restrictions within the meaning of Article 176 of Directive 2006/112, the Court held in its judgment that, even if the relevant provision of Bulgarian law were to provide for an exception to the right to deduct in place at the date of accession of the Republic of Bulgaria to the European Union, Article 176 allows for such exclusions to be maintained only in so far as they do not provide for general exclusions from the right to deduct established by that directive and in particular by Article 168 thereof. It should be noted that the provision of Bulgarian law in question provided that the right to deduct did not apply if the goods or services were intended to be supplied free of charge or for activities other than the economic activity of the taxable person (paragraph 21).

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<sup>28</sup> See, also, Part II above, 'Origin and scope of the right of deduction', Section 1 'Direct and immediate link'.

## V. Rules governing exercise of the right of deduction

### [Judgment of 21 June 2012, Mahagében and Dávid \(C-80/11, EU:C:2012:373\)](#)

This case, already mentioned above, also presents aspects concerning the rules governing exercise of the right of deduction.<sup>29</sup>

In this regard, the Court held in particular in this judgment that tax authorities cannot, as a general rule, require the taxable person wishing to exercise the right to deduct VAT, first, to ensure that the issuer of the invoice relating to the goods and services in respect of which the exercise of the right to deduct is sought has the capacity of a taxable person, that he or she was in possession of the goods at issue and was in a position to supply them and that he or she has satisfied his or her obligations as regards the declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction or, secondly, to be in possession of documents in that regard (paragraph 61).

According to the Court, while it is not contrary to EU law to require a trader to take every step which could reasonably be required of him or her to satisfy him or herself that the transaction which he or she is effecting does not result in his or her participation in tax evasion, the option provided for by the first paragraph of Article 273 of Directive 2006/112 may not, according to the second paragraph of that article, be relied upon in order to impose additional invoicing obligations over and above those laid down in Chapter 3, headed 'Invoicing', of Title XI, headed 'Obligations of taxable persons and certain non-taxable persons', of that directive and, in particular, Article 226 thereof (paragraph 56).

It is, in principle, for the tax authorities to carry out the necessary inspections of taxable persons in order to detect VAT irregularities and fraud as well as to impose penalties on the taxable person who has committed those irregularities or fraud (paragraph 62), and they may not transfer their own investigative tasks to taxable persons.

### [Judgment of 6 February 2014, Fatorie \(C-424/12, EU:C:2014:50\)](#)

This case involved the reverse charge mechanism.<sup>30</sup> In it, the question arose of whether, under EU law, the company that was the applicant in the main proceedings and had received the services in question could be deprived of the right to deduct the VAT not due which it had paid to a service provider on the basis of an incorrectly drawn up invoice, even where the correction of that error was impossible because of the service provider's insolvency.

The Court pointed out, first, that, under the reverse charge regime, no VAT payment takes place between the supplier and the recipient of the services, the recipient being liable, in respect of

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<sup>29</sup> See, also, Part II above, 'Origin and scope of the right of deduction'.

<sup>30</sup> See, for the facts of the case, Part II above, 'Origin and scope of the right of deduction'.

the transactions carried out, for the input VAT, while being able, in principle, to deduct that tax so that no amount is payable to the tax authorities (paragraph 29).

As regards, secondly, the rules governing exercise of the right of deduction listed in Article 178 of the VAT Directive, the Court held that only Article 178(f) of Directive 2006/112 is applicable where a reverse charge procedure under Article 199(1)(a) of that directive is at issue (paragraph 32).

A taxable person who is liable as the recipient of services for the VAT relating thereto is not obliged to hold an invoice drawn up in accordance with the formal requirements of Directive 2006/112 in order to be able to exercise his or her right to deduct, and only has to fulfil the formalities laid down by the Member State concerned in the exercise of the option conferred by Article 178(f) of that directive (paragraph 33). The scope of the formalities laid down by the Member State concerned, which must be complied with by a taxable person in order to be able to exercise the right to deduct VAT, should not exceed what is strictly necessary for the purposes of verifying the correct application of the reverse charge procedure and ensuring that the VAT is collected (paragraph 34).

Accordingly, the Court pointed out that, in the context of the reverse charge procedure, the principle of fiscal neutrality requires deduction of input tax to be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements (paragraph 35).

Nevertheless, the Court held, with regard to the case in the main proceedings, that, besides the fact that the invoice at issue did not meet the formal requirements provided for by the national legislation, a substantive condition of the reverse charge regime had not been satisfied. Since the VAT paid by the applicant in the main proceedings to the supplier of the services had not been due and that payment had been made in breach of a substantive requirement of the reverse charge regime, it could not claim the right to deduct that VAT (paragraph 40).

#### **[Judgment of 15 September 2016, Senatex \(C-518/14, EU:C:2016:691\)](#)**

In this case, the German tax authority refused to allow the applicant in the main proceedings, a wholesale textile business, to deduct the input VAT it had paid, for the years in which the invoices held by it had been issued, on the ground that, in their original form, they did not satisfy the requirements of national tax legislation. Under that legislation, the correction of an invoice in relation to a detail which must be mentioned, namely the VAT identification number, did not have retroactive effect, so that the right to deduct VAT exercised on the basis of the corrected invoice related not to the year in which the invoice was originally drawn up, but to the year in which it was corrected.

The commission statements which the company had issued to its commercial agents and the invoices of an advertising designer for 2009 to 2011 failed to include the tax number or VAT identification number of the addressee, a situation which was rectified in 2013 during an on-the-spot check carried out by the tax authority.

Nonetheless, the tax office issued amended tax notices for 2008 to 2011 in which, on the basis of the findings made in its on-the-spot check, it reduced the sums which the company was entitled to deduct as VAT, on the ground that the conditions for deduction had not been satisfied for those years, but had only been met from the time of correction of the invoices, in 2013.

Consequently, the Court was required in this case to decide the issue of the temporal effect of the rectification of incorrect invoices on the exercise of the right to deduct VAT.

The Court pointed out, first, that it follows from the first paragraph of Article 179 of Directive 2006/112 that the right to deduct VAT must in principle be exercised in respect of the period during which (i) the right has arisen and (ii) the taxable person is in possession of an invoice (paragraph 35). Secondly, the Court pointed out that the right to deduction of VAT is an integral part of the VAT scheme and in principle may not be limited, and that the right is exercisable immediately in respect of all the taxes charged on transactions relating to inputs. The deduction system is meant to relieve the operator entirely of the burden of the VAT due or paid in the course of all his or her economic activities. However, according to the Court, national legislation which applies interest for late payment on the amounts of VAT it considers to be due before correction of the invoice originally drawn up imposes a tax burden deriving from VAT on those economic activities, even though the common system of VAT guarantees the neutrality of that tax (paragraph 37).

Next, the Court observed that the fundamental principle of the neutrality of VAT requires deduction of input VAT to be allowed if the substantive requirements are satisfied, even if the taxable persons have failed to comply with some formal conditions. Holding an invoice showing the details mentioned in Article 226 of Directive 2006/112 is, however, a formal condition, not a substantive condition, of the right to deduct VAT (paragraph 38).

Consequently, the Court held that several provisions of Directive 2006/112, in particular the rules governing exercise of the right of deduction, preclude national legislation such as that at issue (paragraph 43).

**[Judgment of 15 September 2016, Barlis 06 — Investimentos Imobiliários e Turísticos \(C-516/14, EU:C:2016:690\)](#)**

In this case, the applicant in the main proceedings, a company established in Portugal, contested the refusal of the Autoridade Tributária e Aduaneira (Tax and Customs Authority, Portugal) to allow the deduction of input VAT paid by the company as the recipient of legal services rendered by a firm of lawyers, on the ground that the invoices issued by the firm did not satisfy the formal requirements laid down by national legislation. The question referred by the national tribunal concerned, first, certain details which must appear on invoices, such as the extent and nature of the services rendered and the date of supply of the services and, secondly, whether or not tax authorities can refuse the right to deduct VAT on the sole ground that an invoice does not contain such information.

First of all, the Court, after acknowledging that invoices mentioning only 'legal services rendered from [a date] until the present date' do not, a priori, comply with the requirements of

Article 226(6) of Directive 2006/112, and that invoices mentioning only 'legal services rendered until the present date' do not, a priori, comply either with the requirements of Article 226(6) or with those of Article 226(7), requested the referring tribunal to ascertain whether the annexes produced by the company provided a more detailed description of the legal services in question in the main proceedings and could be treated as invoices by virtue of Article 219 of that directive, as documents that amended the initial invoice and referred specifically and unambiguously to it (paragraph 34).

Next, the Court held that tax authorities cannot refuse the right to deduct VAT on the sole ground that an invoice does not satisfy the conditions required by Article 226(6) and (7) of Directive 2006/112 if they have available all the information to ascertain whether the substantive conditions for that right are satisfied (paragraph 43). According to the Court, the authorities cannot confine themselves to examining the invoice itself and must also take account of the additional information provided by the taxable person (paragraph 44).

### **[Judgment of 12 April 2018, Biosafe — Indústria de Reciclagens \(C-8/17, EU:C:2018:249\)](#)**

Finally, in this case, following a tax inspection carried out in 2011, the Portuguese tax authorities issued adjusted VAT notices concerning supplies of goods which had taken place between February 2008 and May 2010 and in respect of which the applicant in the main proceedings, Biosafe, had incorrectly applied a reduced VAT rate instead of the normal rate. Biosafe then made a VAT adjustment by paying the additional VAT and claimed reimbursement from its trading partner, by issuing debit notes to it. The trading partner, which had received the goods sold by Biosafe, refused to pay the additional VAT on the ground, in particular, that it could not make a deduction because the period of four years laid down by the national legislation had expired and that it was not for it to bear the consequences of an error for which Biosafe was solely responsible.

The Court of Justice held that a taxable person may be authorised to make a VAT deduction even if he or she did not exercise his or her right during the period in which the right arose, that is to say at the time when the tax became chargeable, subject, however, to compliance with certain conditions and procedures determined by national legislation (paragraph 35).

The Court pointed out that a limitation period the expiry of which has the effect of penalising a taxable person who has not been sufficiently diligent and has failed to claim deduction of input VAT, by making him or her forfeit his or her right to deduct VAT, cannot be regarded as incompatible with the regime established by Directive 2006/112, provided that the limitation period complies with the principles of equivalence and effectiveness (paragraph 37).

The Court noted, however, that it had been objectively impossible for Biosafe's trading partner to exercise its right of deduction prior to the VAT adjustment carried out by Biosafe, since it had not been in possession of the documents rectifying the initial invoices and had not known that additional VAT was due (paragraph 42).

It was only following that adjustment that the substantive and formal conditions giving rise to a right to deduct VAT were met and that the trading partner could therefore request to be relieved of the VAT burden due or paid in accordance with Directive 2006/112 and the principle

of fiscal neutrality. Accordingly, since the trading partner had not shown any lack of diligence before the receipt of the debit notes, and since there was no abuse or fraudulent collusion with Biosafe, a period which started to run from the date of issue of the initial invoices and which, for certain transactions, expired before this adjustment, could not validly be used to refuse the exercise of the right to deduct VAT (paragraph 43).

## VI. The adjustment of deductions

### [Judgment of 10 October 2013, Pactor Vastgoed \(C-622/11, EU:C:2013:649\)](#)

In this case, the defendant in the main proceedings, the company Pactor Vastgoed, purchased an immovable property and opted for taxation of that supply, as had the supplier when it acquired the property. Subsequently, Pactor Vastgoed let the property, that transaction being exempt from VAT, and thereafter sold it, that supply also being exempt from VAT. Taking the view that the supply made to Pactor Vastgoed did not satisfy the conditions laid down by national law and that, consequently, that supply should have been exempted from VAT, the Netherlands tax authority issued a notice of additional assessment in respect of VAT to Pactor Vastgoed for an amount corresponding to the amount due following adjustment of the VAT deduction applied by the supplier on the occasion of its acquisition of the immovable property subsequently supplied by it to Pactor Vastgoed.

The Hoge Raad der Nederlanden (Supreme Court of the Netherlands), hearing the ensuing dispute, questioned the Court of Justice as to whether amounts due following the adjustment of a VAT deduction may be recovered from a taxable person other than the taxable person who applied that deduction.

The Court of Justice pointed out that the adjustment mechanism is an integral part of the VAT deduction scheme (paragraph 33). The rules governing the adjustment of deductions are intended to enhance the precision of deductions so as to ensure the neutrality of VAT, with the result that transactions effected at an earlier stage continue to give rise to the right to deduct only to the extent that they are used to make supplies themselves subject to VAT. The aim is to establish a close and direct relationship between the right to deduct input VAT and the use of the goods and services concerned for taxable output transactions (paragraph 34).

The Court held that amounts due following the adjustment of a VAT deduction cannot be recovered from a taxable person other than the taxable person that applied the deduction (paragraph 47 and operative part). Any different interpretation would, according to the Court, be incompatible with the aims pursued by the rules governing the adjustment of deductions. The option of providing that a person other than the taxable person is to be held jointly and severally liable for payment of the tax cannot be interpreted as allowing the imposition of a separate tax liability on that other person (paragraph 39). Moreover, in the event of successive supplies of an immovable property, the fact that one of the taxable persons concerned did not, at the time of the supply in which it has participated, comply with the rules governing the exercise of the right to opt for taxation cannot have the consequence of requiring that taxable person to pay the tax debt due following the adjustment of a VAT deduction applied by another

taxable person in relation to one of those supplies in respect of which the first taxable person is extraneous (paragraph 40).

**[Judgment of 6 February 2014, Fatorie \(C-424/12, EU:C:2014:50\)](#)**<sup>31</sup>

In this case, the referring court asked the Court of Justice, essentially, whether the principle of legal certainty precludes an administrative practice of national tax authorities whereby they revoke a decision by which they granted a taxable person the right to deduct VAT and then, following a fresh investigation, order him or her to pay that VAT together with default interest.

The Court held that the principle of legal certainty did not preclude an administrative practice of the Romanian tax authorities whereby, within a limitation period, they revoked such a decision.

Admittedly, the principle of legal certainty requires that the tax position of a taxable person, having regard to his or her rights and obligations vis-à-vis the tax authorities, should not remain open to challenge indefinitely (paragraph 46). Nevertheless, national rules which allow, in exceptional circumstances, before the expiry of the limitation period, a new investigation to be carried out concerning a particular period, where additional information unknown to the tax investigators at the date of the investigation or errors in calculation having an effect on the results of that investigation come to light, comply with the principle of legal certainty (paragraphs 47 and 48).

As regards the default interest, the Court held that, in the absence of harmonisation of EU legislation in the field of the penalties applicable in cases where conditions laid down by arrangements under such legislation are not complied with, Member States retain the power to choose the penalties which seem to them to be appropriate. They must, however, exercise that power in accordance with EU law and its general principles, and, consequently, in accordance with the principle of proportionality (paragraphs 50 and 51 and operative part, point 2).

**[Judgment of 9 June 2016, Wolfgang und Dr. Wilfried Rey Grundstücksgemeinschaft \(C-332/14, EU:C:2016:417\)](#)**<sup>32</sup>

In this case, the referring court asked, in essence, with regard to the adjustment of VAT deductions, whether Directive 77/388 must be interpreted as precluding deductions made in respect of goods or services falling within Article 17(5) of the directive from being adjusted following the alteration, during the adjustment period in question, of the VAT allocation key used to calculate those deductions. It also asked whether the principles of legal certainty and of the protection of legitimate expectations preclude national legislation which does not expressly prescribe an input tax adjustment, within the meaning of Article 20 of Directive 77/388, following amendment of the VAT allocation key used to calculate certain deductions or lay down transitional arrangements.

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<sup>31</sup> For the facts of the case, see Part II above, 'Origin and scope of the right of deduction'.

<sup>32</sup> For the fact of the case, see Part III above, 'Deductible proportion'.



The Court held that Directive 77/388 requires VAT deductions made in respect of goods or services falling within Article 17(5) of that directive to be adjusted following the adoption, during the adjustment period in question, of a VAT allocation key used to calculate those deductions that departs from the method provided for by the directive for determining the deduction entitlement (paragraph 47 and operative part, point 2). Initial deductions must be adjusted where, after the return giving rise to the deduction is made, some change occurs in the factors used to determine the amount to be deducted (paragraph 38). The allocation key and, therefore, the method of calculating the amount of the deduction applied constitute factors used to determine the amount to be deducted (paragraph 42).

The Court also held that the principles of legal certainty and of the protection of legitimate expectations must be interpreted as not precluding national legislation which does not expressly prescribe an input tax adjustment following amendment of the VAT allocation key used to calculate certain deductions, or lay down transitional arrangements, although the input tax allocation applied by the taxable person in accordance with the allocation key applicable before that amendment had been recognised as generally reasonable by the supreme court (paragraph 65 and operative part, point 3).

According to the Court, the principles of legal certainty and of the protection of legitimate expectations cannot be interpreted as meaning that, in order for an adjustment of the deduction entitlement to be capable of being imposed in the event of the method of calculating that entitlement being amended, the national legislation by virtue of which that amendment was made must have expressly pointed out that such adjustment is mandatory (paragraph 54). Nevertheless, in particular situations, where the principles mentioned so require, it may be necessary to introduce transitional arrangements appropriate to the circumstances (paragraph 57). Thus, a national legislature may breach the principles mentioned when it suddenly and unexpectedly adopts a new law which withdraws a right that taxable persons enjoyed until then, without allowing them the necessary time to adjust, when the objective to be attained did not so require (paragraph 58). That is especially true where taxable persons need time to adapt when the withdrawal of the right which they enjoyed until then obliges them to carry out consequential economic adjustments (paragraph 59).

However, the Court noted that an amendment of the calculation method has the effect not of withdrawing the right to deduct possessed by taxable persons but of adapting its ambit (paragraph 61). The Court also observed that, in principle, such an amendment does not in itself mean that taxable persons carry out consequential economic adjustments, and so time to adapt does not appear strictly necessary (paragraph 62).

## VII. Refunds

The right of a taxable person established in a Member State to obtain a refund of VAT paid in another Member State, in the manner governed by Directive 2008/9/EC,<sup>33</sup> is the counterpart of such a person's right, established by Directive 2006/112, to deduct input VAT in his or her own Member State. According to the Court's settled case-law, the right of taxable persons to deduct the VAT due or already paid on goods purchased and services received as inputs from the VAT which they are liable to pay is a fundamental principle of the common system of VAT established by EU legislation.

**[Judgment of 21 June 2012, Elsacom \(C-294/11, EU:C:2012:382\)](#)**

In this case, the national tax authorities refused to refund the VAT which the respondent in the main proceedings, Elsacom, had paid in 1999. The refund application was submitted on 27 July 2000. The reason given by the tax authorities for refusing the application was that it was out of time, since the time limit for submitting it had expired on 30 June 2000.

The referring court asked the Court of Justice whether the time limit laid down in Directive 79/1072 for the submission by taxable persons not established in the territory of the country of applications for the refund of VAT is a mandatory time limit.

The Court observed that the period prescribed by the last sentence of the first subparagraph of Article 7(1) of Directive 79/1072 is not to be understood as a non-mandatory time limit. Indeed, having regard to the wording of the provision in question and to the objective pursued by Directive 79/1072, namely that of eliminating 'discrepancies between the arrangements currently in force in Member States, which give rise in some cases to deflection of trade and distortion of competition', the Court held that the six-month time limit laid down by the directive for submitting an application for a value added tax refund is a mandatory time limit (paragraphs 24, 28 and 34 and operative part).

**[Judgment of 25 October 2012, Daimler and Widex \(C-318/11 and C-319/11, EU:C:2012:666\)](#)**

In this case, the references for a preliminary ruling were made in the context of two disputes, one between an undertaking established in Germany and the Skatteverket (Swedish Tax Board) and the other between an undertaking established in Denmark and the same tax authority. The disputes concerned the lawfulness of the Skatteverket's decisions rejecting their applications for the refund of VAT paid in Sweden on the purchase of goods or services. The tax authority had decided not to grant the refunds on the ground that the two undertakings each had a fixed establishment in Sweden. The undertaking which had the seat of its economic activity in Germany carried out winter testing of cars at testing installations in Sweden, where it had a wholly owned subsidiary that provided it with premises, test tracks and services connected with the test activities. In the context of the testing of cars, it had made acquisitions. The undertaking which had the seat of its economic activity in Denmark had a research division in Sweden. It had also acquired goods and services, for the research activity which it carried out in that research

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<sup>33</sup> Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State (OJ 2008 L 44, p. 23).

division. Neither of the companies had carried out output taxable transactions in Sweden through their technical testing and research departments.

In that context, the referring court had asked the Court of Justice, in particular, whether a taxable person for VAT established in one Member State and carrying out in another Member State only technical testing or research work, not including taxable transactions, may be regarded as having in that other Member State a 'fixed establishment from which business transactions are effected' within the meaning of Directive 2008/9.

The Court first of all observed that the concept of 'fixed establishment from which business transactions are effected' includes two cumulative conditions, requiring, first, the existence of a 'fixed establishment' and, secondly, that 'transactions' be carried out from that establishment (paragraph 32). For the purposes of exclusion of a right to a refund, taxable transactions must actually be carried out by the fixed establishment in the State where the application for a refund is made and a mere ability to carry out such transactions does not suffice (paragraph 37).

Next, the Court observed that, in the main proceedings, it was not in dispute that the undertakings concerned did not carry out taxable output transactions in the Member State where the applications for a refund had been made through their technical testing and research departments (paragraph 38). It held that, in such circumstances, a right to refund of the VAT must be granted, without it being necessary to examine, moreover, whether the undertakings in question do actually have a 'fixed establishment', since the two conditions forming the criterion of a 'fixed establishment from which business transactions are effected' are cumulative (paragraph 39). That interpretation is not called into question by the fact that the taxable person has, in the Member State where it has applied for a refund, a wholly owned subsidiary the purpose of which is almost exclusively to supply it with various services in respect of its technical testing activity (paragraph 51 and operative part). Indeed, a wholly owned subsidiary is a taxable legal person on its own account (paragraph 48).

#### [Judgment of 21 March 2018, Volkswagen \(C-533/16, EU:C:2018:204\)](#)

In this case, between 2004 and 2010 a company established in Germany and two companies established in Slovakia ('the Hella Companies') supplied Volkswagen AG, a company established in Germany, with moulds for the manufacture of lights for motor vehicles. During this time, the Hella Companies did not include VAT on the invoices that they issued, as they regarded the transactions not as supplies of goods but as 'financial compensation' exempt from VAT. In 2010, the Hella Companies realised that the transactions had not been carried out in accordance with Slovak law. They then issued invoices charging the VAT payable by Volkswagen for the supply of the goods in question, filed supplementary tax returns for all years from 2004 to 2010 and paid the relevant VAT to the Treasury. On 1 July 2011, Volkswagen submitted to the Slovak tax authority an application for a refund of the VAT charged on the goods supplied.

The tax authority partially upheld Volkswagen's application and ordered a refund of VAT for the supplies of goods carried out from 2007 to 2010. However, it dismissed the application in so far as it related to the period from 2004 to 2006, due to the expiry of the limitation period of five years provided for by Slovak law. In this regard, it held that the entitlement to a refund of VAT had arisen on the date of delivery of the goods. The national court then asked the Court of

Justice whether EU law must be interpreted as precluding national legislation of a Member State under which, in circumstances in which the VAT was charged to the taxable person and paid by it several years after delivery of the goods in question, the benefit of the right to a refund of VAT is denied on the ground that the limitation period provided for by that regulation for the exercise of that right began to run from the date of supply of the goods and expired before the application for a refund was submitted.

The Court of Justice first of all pointed out that the right to deduct VAT is subject to compliance with both substantive and formal requirements or conditions (paragraph 40). Although the right to deduct VAT arises at the same time as the tax becomes chargeable, it can be exercised only once the taxable person holds an invoice (paragraph 43). A taxable person may be authorised to make a VAT deduction even if he or she did not exercise his or her right during the period in which the right arose, subject to compliance with the conditions and procedures determined by national legislation (paragraph 45).

The Court held that, in the circumstances of the case, it had been objectively impossible for Volkswagen to exercise its right to a refund before the VAT adjustment made by the Hella Companies, as, prior to that, it had neither been in possession of the invoices nor aware that the VAT was due (paragraph 49). Indeed, it was only following that adjustment that the substantive and formal conditions giving rise to a right to deduct VAT had been met and that Volkswagen could request to be relieved of the VAT burden. Accordingly, since Volkswagen had not demonstrated a lack of diligence, and in the absence of an abuse or fraudulent collusion with the Hella Companies, a limitation period which began on the date of supply of the goods and which, for certain periods, expired before this adjustment could not validly be relied on to deny Volkswagen the right to a refund of VAT (paragraph 50).

However, the possibility of exercising the right to deduct VAT without any temporal limit would, according to the Court, be contrary to the principle of legal certainty (paragraph 46). Any limitation period must apply in the same way to analogous rights in tax matters founded on domestic law and to those founded on EU law, and must not render in practice impossible or excessively difficult the exercise of the right to deduct VAT (paragraph 47). In addition, the Member States may impose other obligations which they deem necessary for the correct collection of VAT and for the prevention of evasion, but such measures must not go further than necessary to attain such objectives and cannot be used in such a way that they would have the effect of systematically undermining the neutrality of VAT (paragraph 48).

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*The judgments mentioned in this fact sheet are indexed in the Digest of the case-law, under sections xxx.*