Case C-227/21

Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice

Date lodged:

9 April 2021

Referring court:

Lietuvos vyriausiasis administracinis teismas (Lithuania)

Date of the decision to refer:

31 March 2021

Applicant and appellant:

‘HA.EN.’ UAB

Defendant and respondent:

Valstybinė mokesčių inspekcija

Subject matter of the main proceedings

Tax dispute regarding the refusal to recognise the applicant’s right to deduct input VAT where the applicant, when acquiring immovable property, knew or should have known that the supplier, due to its insolvency, would not pay the output VAT into the State budget.

Subject matter and legal basis of the request for a preliminary ruling

Interpretation of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax and of the principle of fiscal neutrality.

Paragraph 3 of Article 267 of the Treaty on the Functioning of the European Union.

Question referred for a preliminary ruling

Is Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, in conjunction with the principle of fiscal neutrality, to be interpreted as prohibiting or not prohibiting a practice of national authorities under which the right of a taxable person to deduct input VAT is denied where that person, when acquiring items of immovable property, knew (or should have known) that the supplier, due to his insolvency, would not pay (or would not be able to pay) the output VAT into the State budget?

Provisions of EU law cited

Article 168(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax ('the VAT Directive').

Provisions of national law cited

Article 58(1), point 1, of the Lietuvos Respublikos pridėtinės vertės mokesčio įstatymas (Law on Value Added Tax of the Republic of Lithuania) (in the version of Law No IX-751 of 5 March 2020):

'A VAT payer shall have the right to deduct input and/or import VAT in respect of goods and/or services acquired and/or imported, if those goods and/or services are intended to be used for the following activities of that VAT payer: … the supply of goods and/or services on which VAT is chargeable …'

Article 719(1) of the Lietuvos Respublikos civilinio proceso kodeksas (Code of Civil Procedure of the Republic of Lithuania) (as amended by Law No XII-889 of 15 May 2014):

'If an auction is declared void due to the absence of any bidder …, the property shall be transferred to the person seeking enforcement, for the initial price of sale of the property at the auction.'

Succinct presentation of the facts and procedure in the main proceedings

1 By a credit agreement of 21 September 2007, 'Medicinos bankas' UAB ('the bank') granted a loan to 'Sostinės būstai' UAB ('the borrower') to carry out real estate development activities, and, for the purpose of securing due performance of the agreement, the borrower granted a contractual mortgage over a plot of land in the city of Vilnius together with a building under construction located on it.

2 By an assignment of claim agreement of 27 November 2015, the applicant acquired from the bank for consideration all the financial claims arising from the credit agreement concluded by the latter with the borrower, together with all the rights established to secure the performance of obligations, including the

aforementioned contractual mortgage. By entering into that arrangement, the applicant, inter alia, confirmed that it had become acquainted with the borrower's economic and financial situation and legal status and was aware that the borrower was insolvent and subject to restructuring proceedings.

3 By order of a bailiff of 23 May 2016, the auction of a part of the borrower's immovable property was announced but no purchaser showed an interest in that immovable property.

4 Following the auction's failure to take place, the offer to take over that property of the borrower ('the immovable property') was made to the applicant, thereby meeting a part of the latter's claims. The applicant exercised the right and took over the property.

5 For this purpose, an instrument for the transfer of property to a person seeking enforcement was drawn up on 21 July 2016, whereby the bailiff transferred to the applicant the immovable property with a value of EUR 5 468 000.

6 On 5 August 2016, the borrower drew up a VAT invoice, stating that the immovable property was being transferred for EUR 4 519 008.26 and VAT of EUR 948 991.74. The applicant entered the VAT invoice in its accounts, deducted the input VAT and declared the VAT in the VAT declaration for November 2016.

7 The borrower entered the VAT invoice in its accounts, declared the output VAT that was indicated in the VAT invoice in the VAT declaration for August 2016, but did not pay that output VAT into the State budget. On 1 October 2016, the borrower acquired the status of a company subject to insolvency proceedings.

8 On 20 December 2016, the applicant submitted a request to the Valstybinė mokesčių inspekcija (State Tax Inspectorate; 'the Inspectorate' or 'the tax authority') for refund of the overpaid amount of VAT that resulted from the declared deductible input VAT. After conducting a tax inspection in respect of the applicant, the Inspectorate found that the applicant – in that it entered into transactions for the acquisition of the immovable property and knew or should have known that the borrower would not pay VAT for such a transaction – acted dishonestly and abused rights, and therefore did not acquire the right to deduct VAT. For this reason, by decision of 12 July 2017, the applicant was refused the right to the VAT deduction of EUR 948 980, was charged interest of EUR 38 148.46 for late payment of VAT, and a VAT fine of EUR 284 694 was imposed upon it.

9 The applicant brought a complaint against that decision of the Inspectorate before the Mokestinių ginčų komisija prie Lietuvos Respublikos Vyriausybės (Tax Disputes Commission under the Government of the Republic of Lithuania; 'the Tax Disputes Commission') which, by decision of 22 January 2018, set aside the parts of the decision of the Inspectorate in respect of the interest for late payment that was charged and the fine that was imposed, but, after stating that the applicant

abused rights, upheld the decision of the tax authority not to recognise the right of that taxable person to deduct VAT.

10 The applicant brought an action against the latter part of the decision of the Tax Disputes Commission before the Vilniaus apygardos administracinis teismas (Regional Administrative Court, Vilnius), which dismissed the action as unfounded by judgment of 14 November 2018.

11 Partially upholding the applicant's appeal, the Lietuvos vyriausiasis administracinis teismas (Supreme Administrative Court of Lithuania), by order of 13 May 2020, set aside the aforementioned judgment of the court of first instance and referred the case back to that court for fresh examination, stating, inter alia, that it was necessary for that court to assess the conditions for, and indications of, the presence of abuse of rights in the case in point.

12 The Regional Administrative Court, Vilnius, after re-examining the tax dispute, found by judgment of 3 September 2020 that the applicant abused rights, and therefore the Inspectorate was justified in refusing to recognise its right to deduct input VAT. The applicant again appealed to the Supreme Administrative Court of Lithuania.

Succinct presentation of the reasons for the request for a preliminary ruling

Preliminary observations

13 In the present case, the tax authority first of all denied the applicant's right of deduction after deciding that it, when acquiring the immovable property and seeking to deduct input VAT, abused rights because it knew or should have known that the borrower would not pay the output VAT into the State budget, that is to say, it knew or should have known that it was contributing to failure to pay taxes but, notwithstanding this, carried out such a transaction.

14 For these reasons the tax authority also found the applicant to be 'dishonest', holding that it had participated in a transaction entailing tax avoidance or fraud.

15 The facts of the case justify the finding that the applicant knew or should have known that, after it took over the immovable property, the borrower would not be able to fulfil the obligation to pay VAT into the State budget, because:

(1) in concluding the aforementioned agreements with the bank, the applicant became acquainted with the financial situation of the borrower, and was informed about the restructuring proceedings instituted and the bank's previous intentions to institute insolvency proceedings on account of the borrower's insolvency;

(2) when settling up for the immovable property, the consideration for that property consisted of the setting off of a claim and the borrower did not actually receive any monetary funds;

(3) at the time of the acquisition of the immovable property, one of the applicant's shareholders was a separate creditor of the borrower and the chairman of the meeting of the creditors of the borrower undergoing restructuring, and he undoubtedly knew that the borrower had no other assets and that, once the applicant took over its sole asset, it would no longer be possible to pay VAT into the State budget or to satisfy the claims of other creditors.

16 It should also be stated that the borrower made the supply of the immovable property knowing that it would not pay VAT into the State budget due to its insolvency.

The right to deduct input VAT where the supplier has not paid the output VAT into the State budget

17 According to settled case-law of the Court of Justice, the right of taxable persons to deduct the VAT due or already paid on goods purchased or services received as inputs from the VAT which they are liable to pay is regarded as a fundamental principle of the common system of VAT established by EU legislation (see judgment of 11 December 2014, *Idexx Laboratories Italia*, C-590/13, EU:C:2014:2429, paragraph 30 and the case-law cited). The Court of Justice has repeatedly held that that right is an integral part of the VAT scheme and in principle may not be limited (see judgments of 15 September 2016, *Senatex*, C-518/14, EU:C:2016:691, paragraph 37, and of 16 October 2019, *Glencore Agriculture Hungary*, C-189/18, EU:C:2019:861, paragraph 33 and the case-law cited).

18 The common system of VAT ensures the neutrality of taxation of all economic activities, whatever their purpose or results, provided that they are themselves subject, in principle, to VAT (see judgments of 3 July 2019, *The Chancellor, Masters and Scholars of the University of Cambridge*, C-316/18, EU:C:2019:559, paragraph 22 and the case-law cited, and of 18 March 2021, *A. (Exercise of the right of deduction)*, C-895/19, EU:C:2021:216, paragraph 33 and the case-law cited). Therefore, if an assessment of the transactions discloses that the supplies of goods at issue have actually been carried out and that those goods were used by the person claiming the deduction for the purposes of his own taxed output transactions, that person cannot, in principle, be refused the right of deduction (judgment of 6 December 2012, *Bonik*, C-285/11, EU:C:2012:774, paragraph 33).

19 In the opinion of the chamber, in the light of the arguments of the parties to the proceedings and the objective data available in the case, the aforementioned conditions for the right to deduct VAT are satisfied in the present case.

20 Nonetheless, the prevention of tax evasion, avoidance and abuse is an objective recognised and encouraged by the VAT Directive and the Court of Justice has repeatedly held that EU law cannot be relied on for abusive or fraudulent ends. It is therefore for the national authorities and courts to refuse the right of deduction, if it is shown, in the light of objective factors, that that right is being relied on for fraudulent or abusive ends (see judgment of 16 October 2019, *Glencore Agriculture Hungary*, C-189/18, EU:C:2019:861, paragraph 34 and the case-law cited).

21 It has been mentioned that the applicant's right to deduct VAT was denied, in essence, following a finding both of abuse of rights and of dishonesty on the part of the applicant.

22 With regard to abuse of rights, the Court of Justice has explained that, in the sphere of VAT, an abusive practice can be found to exist only if two conditions are satisfied, namely, first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the VAT Directive, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions and, secondly, it is apparent from a number of objective factors that the essential aim of the transactions concerned is solely to obtain that tax advantage (see judgment of 10 July 2019, *Kuršu zeme*, C-273/18, EU:C:2019:588, paragraph 35 and the case-law cited). The principle that abusive practices are prohibited bars wholly artificial arrangements which do not reflect economic reality and are set up with the sole aim of obtaining a tax advantage (see, to that effect, judgment of 17 December 2015, *WebMindLicenses*, C-419/14, EU:C:2015:832, paragraphs 35 and 36 and the case-law cited).

23 In the present case, first, it is uncertain whether the aim of exercising the right to deduct input VAT is incompatible with the objectives of the provisions of the VAT Directive establishing that right because the VAT sought to be deducted was not paid into the State budget as a result of the supplier's insolvency, even if the taxable person knew or should have known that.

24 In that regard, the Court of Justice has repeatedly held that whether the VAT payable on prior transactions relating to the goods concerned has or has not been paid into the State budget *is irrelevant to the right to deduct VAT* (order of 3 September 2020, *Vikingo Fővállalkozó*, C-610/19, EU:C:2020:673, paragraph 62; and judgments of 12 January 2006, *Optigen and Others*, C-354/03, C-355/03 and C-484/03, EU:C:2006:16, paragraph 54; of 6 December 2012, *Bonik*, C-285/11, EU:C:2012:774, paragraph 28; and of 9 November 2017, *Wind Innovation 1*, C-552/16, EU:C:2017:849, paragraph 44). That has also been confirmed by the Court of Justice in interpreting the terms 'due or paid' used in Article 168(a) of the VAT Directive (see, to that effect, judgments of 29 March 2012, *Véleclair*, C-414/10, EU:C:2012:183, paragraph 25, and of 22 October 2015, *PPUH Stehcemp*, C-277/14, EU:C:2015:719, paragraph 45).

25 Furthermore, it may be inferred from the assessment of the Court of Justice provided in the judgment of 29 March 2012, *Véleclair* (C-414/10, EU:C:2012:183), that the actions of a taxable person that have resulted in the non-payment of import VAT do not negate that person's right to deduct that import VAT at a later date, even though it ultimately was not paid into the State budget due to insolvency proceedings in respect of that person. In other words, it may be considered that that preliminary ruling recognised, in essence, the right to deduct import VAT even where it is sought to exercise that right in the knowledge that that VAT will not be paid.

26 Second, in the present case, the applicant, although it knew or should have known that the borrower would not be able to pay the output VAT into the State budget, chose a method of settling the claim which enabled the creation of its right to deduct input VAT, that is to say, led to a corresponding tax advantage. Nevertheless, it must be borne in mind that, according to the case-law of the Court of Justice, taxable persons are generally free to choose the organisational structures and the form of transactions which they consider to be most appropriate for their economic activities and for the purpose of limiting their tax burdens (see judgment of 17 December 2015, *WebMindLicenses*, C-419/14, EU:C:2015:832, paragraph 42) and they are not obliged to choose the transaction which involves paying the higher amount of VAT (see judgment of 22 December 2010, *Weald Leasing*, C-103/09, EU:C:2010:804, paragraph 27).

27 Third, the view is to be taken that in the present case *the mere fact* that the applicant, in realising part of its claim, acquired ownership of immovable property of high value from the debtor in accordance with the procedure established by law does not support the conclusion that the sole or main purpose of that transaction was to obtain a tax advantage.

28 So far as concerns the applicant's dishonesty as a precondition for denying its right to deduct VAT, it must be borne in mind that the right of a taxable person to deduct VAT must be denied, inter alia, when that person knew, or should have known, that, by his purchase, he was taking part in a transaction connected with VAT fraud (for example, see judgments of 21 June 2012, *Mahagében and Dávid*, C-80/11 and C-142/11, EU:C:2012:373, paragraph 46, and of 16 October 2019, *Glencore Agriculture Hungary*, C-189/18, EU:C:2019:861, paragraph 35).

29 It is, nevertheless, questionable whether VAT fraud (or tax avoidance) referred to in the case-law of the Court of Justice can be found when (1) items of immovable property are supplied in circumstances where a bailiff enforces recovery from the supplier's assets, (2) the supplier declares output VAT but (3) the supplier fails to pay output VAT due to his insolvency (that is to say, the supplier objectively does not have the funds to fulfil his obligation to the State).

30 On the other hand, in deciding what should be regarded as 'VAT fraud' in the present instance, it should be noted that the relevant provisions of the VAT

Directive do not reveal the content of the concept in question. Nor has the Court of Justice explicitly identified the elements of the content of that concept.

31 Given the objectives of the VAT Directive relating to the establishment of a common system of VAT, the view is to be taken that the concept of 'VAT fraud' used in the case-law of the Court of Justice is a concept of EU law; thus, a different interpretation of that concept under national law as a precondition for denying a taxable person the right to deduct VAT may be contrary to the objectives of that directive. Therefore, it is necessary to clarify how the situation in which a taxable supply of goods takes place and a VAT invoice is drawn up, where the supplier does not intend to pay the output VAT into the State budget due to insolvency and/or impending insolvency proceedings, is to be assessed.

32 It should be noted that the right of a taxable person to deduct input VAT has been repeatedly denied in the practice of the Lithuanian tax authority and in the case-law of national courts where that person knew or should have known that the supplier would not pay the output VAT into the State budget due to financial difficulties or impending insolvency, and/or would use the funds received for the supplied goods primarily to cover his operating costs and/or to settle up with other creditors.

33 The answer to the question referred for a preliminary ruling is of crucial importance for the present case because it will enable, while in particular ensuring the primacy of EU law, an unequivocal and clear decision on the applicant's right to deduct VAT in the present case.