



# KMLZ VAT NEWSLETTER

## Federal Fiscal Court: No VAT deduction concerning criminal defence expenses

### 1. Background

Mr. B was an individual entrepreneur and, at the same time, majority shareholder and controlling company of a limited company (controlled company). This limited company performed construction work subject to VAT. Furthermore, he was the CEO of this limited company. Criminal proceedings were pending against B as he was suspected of having granted money in exchange for confidential information. Criminal proceedings were subsequently halted and a fine was imposed in accordance with sec. 153a of the Criminal Procedural Code. B and the limited company were the contracting entities negotiating the fee agreements with the defence lawyer handling the case. The lawyer issued his invoices to the limited company. B, as the controlling company of this limited company, claimed a VAT deduction concerning these invoices.

### VAT deduction only if there is a legal connection between the criminal proceeding and the company

A limited company is not permitted to deduct VAT regarding the expenses incurred with respect to the criminal defence of its CEO even if the criminal charges are connected to his operating activities (Federal Fiscal Court, judgment of 11 April 2013, V R 29/10). The same applies for individual entrepreneurs. It only does not affect VAT deduction if proceedings are also taken against the company.

### 2. Referral for preliminary ruling / European Court of Justice: legal case Becker

On 22 February 2011 (V R 29/10), the Federal Fiscal Court submitted the following question to the European Court of Justice (ECJ) for a preliminary ruling: Is the objective purpose of the lawyer's services primarily decisive for the right to deduct VAT – in this case, these services were intended for the protection of B's private interests – or is it sufficient if there is a mere causal connection between the economic activity of the limited company and the expenses arising for the criminal defence? The ECJ ruled that a mere causal connection is insufficient and what is required is an immediate and direct connection between the economic activity of the limited company and the expenses for the criminal defence (ECJ, judgment of 21 February 2013, C-104/12, legal case Becker). These requirements were not fulfilled in the



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main proceedings. In fact, the criminal defence served to protect B's private interests. Also, the criminal proceedings were directed at B personally and not at the company.

### 3. The Federal Fiscal Court's judgment

The Federal Fiscal Court followed the ECJ and denied the VAT deduction for the limited company by arguing that the services of the criminal lawyer did not have an immediate and direct connection with the economic activity of the limited company. Furthermore, the criminal proceedings were only directed at B personally and not at the company. The Federal Fiscal Court expressly declared that the principles of its jurisdiction do only apply concerning the CEO of a limited company but also concerning individual entrepreneurs.

### 4. Practical tip

The Federal Fiscal Court's judgment expressly refers to:

- the denial of a VAT deduction concerning a limited company if it claims a VAT deduction concerning expenses for the criminal defence of its CEO even if the criminal charges are connected to his operating activities as well as to
- the denial of a VAT deduction for an individual entrepreneur if he seeks a VAT deduction concerning expenses for a criminal defence which is also connected to the company.

The reasons given by the Federal Fiscal Court can also be applied to criminal offences committed by employees within the company level who are not working as CEOs. In contrast, if proceedings are also taken against the company, it does not prevent the VAT deduction (i.e. proceedings according to sec. 30 of the Code of Administrative Offence). In this case, the company is still permitted to deduct VAT due to the legal connection between the expenses for the criminal defence and the company.

### 5. Additional fee agreement with the company necessary?

If proceedings are taken both against a natural person and a company due to accusations at company level, a fee agreement should not only be concluded by the accused individual person but also by the company. However, according to the Federal Fiscal Court's judgment, if proceedings are only taken against a natural person, it is no longer necessary (regarding VAT matters) that the company also concludes a fee agreement. However, the signing of a contract with the company can facilitate the right to deduct the expenses for the criminal defence at company level for corporate tax reasons (operational expenses). Furthermore, the fact that the claim for remuneration is guaranteed also by the company is another argument for signing an additional contract with the company.