



KMLZ VAT NEWSLETTER

Invoice correction with retroactive effect!

From the fiscal authorities' perspective, invoices that do not meet the strict requirements of sec. 14 para. 4 German VAT Act, are not entitled to VAT deduction. If such faulty invoices are subsequently found during the course of a tax audit, the taxpayer is required to pay back any input VAT unjustifiably claimed. Furthermore, the repayment amount is interest bearing at the rate of 6% p.a. The fiscal authorities, supported by case law, have extremely high standards regarding correct invoices. Service descriptions, for example, need to be very precise so that there is no risk of charging for the same service twice. Case law denied VAT deduction even in cases where all parties involved were aware of the supply carried out and there was no intention whatsoever to commit tax fraud.

The ECJ has expressly confirmed (judgment of 15 September 2016, C-516/14 – *Barlis 06*; judgment of 15 September 2016, C- 518/14 – *Senatex*), that it is possible to correct invoices with retroactive effect. The principle of neutrality is of profound importance in these decisions. Entrepreneurs are to be completely relieved of the obligation to pay VAT. The ECJ identifies an infringement of this principle of neu-

Invoice correction with retroactive effect!

On 15 September 2016 the ECJ published two fundamental judgments. As a result, the German fiscal authorities, as well as the tax courts, now need to rethink many cases. The previous formalism associated with the issuing of invoices will be considerably reduced in the future. The requirement to pay interest as a result of formal invoice errors will become a thing of the past. Companies, that were denied VAT deduction in the past, due to formal invoice errors, now have the chance to reclaim the interest paid. However, these judgments do not mean a carte blanche approach to invoices. Rather, they will assist in containing the excessive formalism. It may take some time before an official reaction from the fiscal authorities is forthcoming. However, taxpayers should immediately seize the opportunities afforded them by the judgments.

trality due to the resulting interest burden (sec. 233a German General Fiscal Code). It is only relevant, for VAT deduction purposes, that the recipient is an entrepreneur who has received the supply for his company. However, the existence of an invoice is only a formal requirement.

The ECJ does not comment on which minimum requirements need to be fulfilled in order for an invoice amendment to be granted with retroactive effect. In the cases at hand, it was clear that the relevant invoices were properly corrected. This is what the ECJ refers to. According to sec. 31 para. 5 German VAT Implementation Code, it is possible to correct any missing or wrong information within the meaning of sec. 14 para. 4 German VAT Act. One can conclude from this that there are no minimum requirements for a document that needs to be corrected. The only cases that need to be



differentiated are cases with facts similar to those in *Terra Baubedarf* (C-152/02). In this case, there was no invoice at all. However, this leads to an important conclusion for practice. It is essential to create an amendment in the case of invoice corrections. Therefore, the solution favored by most accounting departments, namely to cancel the invoice completely and issue a new one, still remains critical. In this case, the fiscal authorities may argue that, due to the cancellation of the invoice, a similar situation, as in the case of *Terra Baubedarf* (C-152/02), arises.

These are the arguments that the ECJ brought up as an explanation in *Senatex*:

- VAT deduction is not to be generally restricted. The principle of neutrality is infringed due to the additional interest to be paid within the meaning of sec. 233a German General Fiscal Code.
- VAT deduction is to be granted if the material requirements are fulfilled. According to the ECJ's case law, invoices are merely formal requirements.
- It is vital that the taxpayer is in possession of an invoice. There will be no VAT deduction without an invoice.
- Member States may themselves establish penalties if formal requirements are not fulfilled. Thus, it would be possible for a faulty invoice to lead to a fine. The proportionality principle is relevant for the calculation of the said fines.
- The ECJ did not comment on the question as to when an invoice needs to be corrected (in the tax audit, before the commencement of the objection procedure, etc.). This question was irrelevant in the preliminary ruling procedure. All parties agreed that the documents were corrected before the tax audit took place.

In the case *Barlis 06*, questions as to how detailed a service description has to be and questions regarding the service period were addressed. The ECJ made it clear that Member States are not permitted to require further criteria other than those stated in Art. 226 VAT Directive. We believe that, in doing so, the ECJ indicated its rejection of the German Federal Fiscal Court's case law. The German Federal Fiscal Court has always cited, as a further explanation for a detailed service description, that this is the only way to prevent the risk of charging for the same service twice. The German Federal Fiscal Court will now have to rethink its case law as Art. 226 no. 6 VAT Directive contains no trace of this said explanation. The ECJ emphasizes that stating the service period and description are sufficient for the fiscal authorities to determine whether tax was paid in a timely manner.

However, what is even more important is the fact that the ECJ expressively states that VAT deduction may not only be denied due to an invoice's failure to fulfil formal requirements. This applies, in particular, where the tax authorities have all of the information at hand to examine and to determine themselves whether the right to deduct VAT should be granted. The tax authorities also have to take into consideration any further information provided by the taxpayer. The burden of proof rests with the taxpayer. This means that the taxpayer needs to provide the necessary documents. In these cases, it may even be possible to obtain a waiver with respect to an invoice correction.

It depends, to a large extent, on the German General Fiscal Code as to how positively these decisions may affect each individual taxpayer. The question arises as to how past interest payments can be reclaimed. A crucial issue in this case will be whether the interest assessed at that time can still be changed. If necessary, it can be determined whether there is a retroactive effect within the meaning of sec. 175 para. 1 sentence 1 no. 2 German General Fiscal Code.



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However, this may, on the other hand, also affect the interest assessment (see sec. 233a para. 2a in connection with para. 7 German General Fiscal Code). However, this seems rather unlikely due to the explanation of the ECJ. The ECJ sees an infringement of the principle of neutrality. Insofar, the ECJ's judgments can only be taken into account if one rejects sec. 233a para. 7 German General Fiscal Code.

Example:

The taxpayer received faulty invoices for 2008 – 2010. The taxpayer claims a VAT deduction. In 2014, the VAT deduction is denied in a tax audit. The amendment assessments, including the interest assessments, are obtained in 2014. In 2014, the taxpayer receives corrected invoices. The taxpayer claims VAT in 2014 based on the corrected invoices and receives a VAT refund.

Solution:

Based on the two latest ECJ judgments, VAT deduction is to be granted for 2008 – 2010. The assessments are to be amended. The interest assessment is to be amended. At the time of payment, (when in doubt offsetting) of the additional taxes, interest in favor of the taxpayer begins to accumulate in accordance with sec. 233a para. 3 sentence 3. At the same time, VAT deduction is to be denied for the taxpayer in 2014. In this case, interest begins only after 15 months of the end of the calendar year in accordance with sec. 223a para. 2 sentence 1 German General Fiscal Code. This results in a potential windfall profit for the taxpayer.

In conclusion, the following can be summarized:

Faulty invoices should be corrected immediately. The ECJ was not required to comment on the question as to when an

invoice needs to be corrected. It is also important to correct an invoice immediately as one cannot be sure whether an invoice correction will still be possible after several years. Suppliers may have been liquidated, have merged or no longer be traceable for other reasons.

Companies would act with gross negligence if they failed to conduct invoice corrections or examine invoice formalities with regard to the latest case law. It will take the fiscal authorities and German courts years to implement these decisions. If one bears in mind the development in another area of formal requirements of proof, namely the documentary evidence for intra-Community supplies, it must be feared that, especially the German Federal Fiscal Court, will find ways and means to restrict this positive case law. The German Federal Fiscal Court did the same regarding intra-Community supplies.

The German General Fiscal Code will play a vital role in all this. To what extent can legitimate expectation be granted? If a taxpayer claims VAT deduction from corrected invoices at a later period in time, this would be the wrong time, from a VAT law perspective.

If there have been interest assessments in past tax audits due to formal invoice errors, every individual case should be examined in order to determine if and to what extent the interest paid can be reclaimed.

There is a lot to be done, but it will be worth it.