



VAT NEWSLETTER

1 Background

If one of the participants in a chain of supplies evades VAT, the other participants in the chain are also at risk of having their input VAT deduction or VAT exemption for intra-Community supplies refused. According to the jurisprudential and administrative view, this applies, in any case, to those who knew or ought to have known about the fraud. Corresponding circumstances were and are repeatedly the subject of court decisions. In its decision of 21.09.2021 (2 K 345/20), the Fiscal Court of Nuremberg sought clarification from the ECJ concerning the question of whether the refusal of the right to deduct input VAT, in terms of amount, should be limited to the actual tax loss caused by the evasion. The Fiscal Court of Nuremberg wanted to limit the damage to be compensated to the amount that could be determined as tax loss due to unpaid VAT, when considering the supply chain as a whole. On 24.11.2022, the ECJ issued its judgment (C-596/21 *Finanzamt M*).

2 Facts

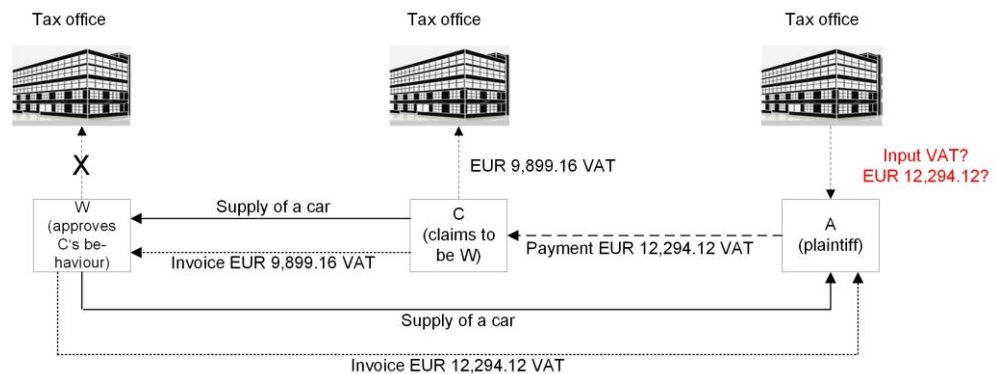
C (who claimed to be W) sold a used car to A (plaintiff). W knew that C was pretending to be him and consented to this. C issued an invoice to W for the supply of a car and, in this invoice, showed VAT in the amount of EUR 9,899.16. C paid this VAT to the tax office. W issued an invoice to A showing EUR 12,294.12 VAT. W gave this invoice to C, who passed it on to A. A paid the invoiced amount, including EUR 12,294.12 VAT, to C. C only paid EUR 9,899.16 VAT to the tax office and kept the rest of the money for himself. W did not record the transactions in his bookkeeping and did not pay VAT. The tax office then denied A the input VAT deduction, as he ought to have known about C's tax evasion. The Fiscal Court was of the opinion that two separate supplies were carried out. The first, by C to W and the second by W to A. A was basically entitled to input VAT deduction from W's invoice in accordance with sec. 15 para. 1 no. 1 of the German VAT Act. In the Fiscal Court's view, C had evaded VAT in the amount of EUR 2,394,96 and A ought to have known about the evasion, so



Dr. Thomas Streit, LL.M. Eur.
Lawyer

+49 (0) 89 217 50 12-75
thomas.streit@kmlz.de

that at least part of the input VAT deduction was to be denied. The actual amount of the input VAT deduction to be refused was unclear.



3 Reasons for the ECJ Decision

From the ECJ's point of view, A's input VAT deduction had to be denied in its entirety. The refusal of the right to deduct input VAT is not to be limited to the amount, that results from an overall view of the supply chain, as the unpaid amount:

- If A purchases goods, despite the fact he ought to have known of C's evasion, he participates in the tax evasion by virtue of the act of purchasing the goods. A is to be denied input VAT deduction, regardless of whether another person in the chain, besides W, knew of C's tax fraud.
- A is to be denied the input VAT deduction regardless of whether or not he profits from a possible resale of the goods.
- It is an implied material condition of the right to deduct input VAT that the taxable person A was not aware of any tax evasion, despite checks which could reasonably be required. Otherwise, the input VAT deduction must be entirely denied.
- Only a refusal of input VAT deduction, in its entirety, would encourage taxable persons to exercise the necessary due diligence. To deny input VAT deduction only in the amount actually evaded would not sufficiently motivate taxable persons to exercise this necessary amount of caution.

4 Consequences for the practice

If taxable persons knew or ought to have known of the existence of tax evasion in the chain, they will be forced to face harsh consequences, namely the denial of tax advantages. Therefore, the crucial question is under which circumstances will a taxable person be considered to be aware or in a position where he ought to have been aware of the fraud. In the present decision, the ECJ only referred to the fact that this must be examined by the national authorities. With effect from 01.01.2020, sec. 25f of the German VAT Act has served to regulate the refusal of tax advantages in Germany. In its letter of 15.06.2022, the Federal Ministry of Finance provided a catalogue of criteria and defined characteristics that are regarded as being indicators of irregularities or tax evasion. These include: the taxable person being offered supplies at a price below the market price; cash payments that are not customary in the industry; frequent changes to company contact persons, etc. Ultimately, the outcome depends on the overall circumstances of the individual case. Even if the significance of some of these criteria is doubtful, taxable persons should establish certain control mechanisms as part of their tax compliance management systems. In a serious case, this can, from a VAT and criminal law perspective, offer invaluable assistance.

KMLZ Rechtsanwaltsgesellschaft mbH | www.kmlz.de | office@kmlz.de
D-80331 München | Unterer Anger 3 | Tel.: +49 89 217501220 | Fax: +49 89 217501299
D-40221 Düsseldorf | Speditionstraße 21 | Tel.: +49 211 54095320 | Fax: +49 211 54095399