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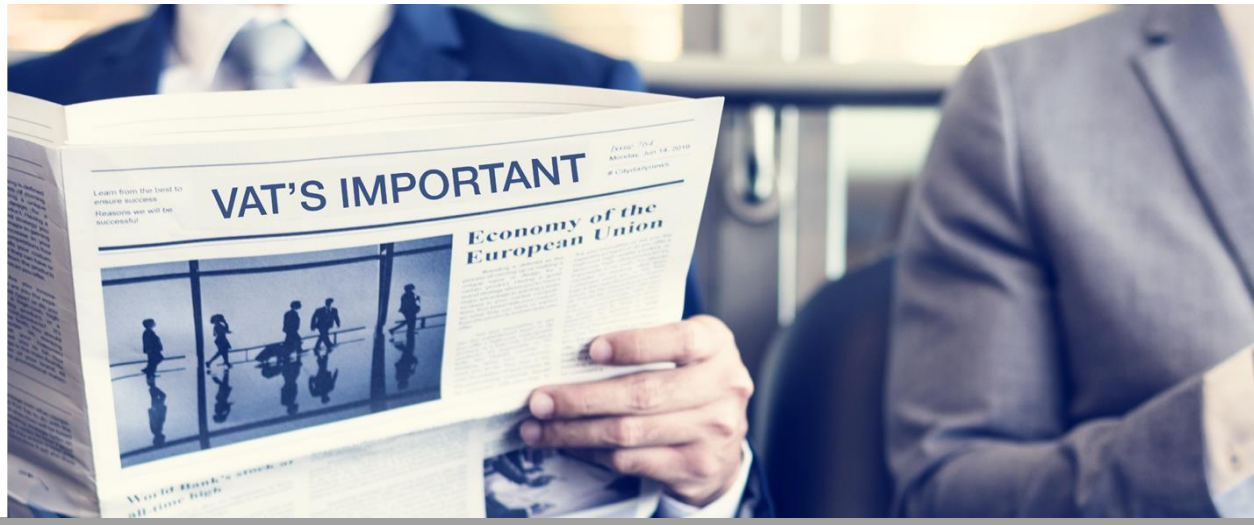

VAT'S UP

VAT NEWSLETTER

Federal Court restricts prohibition of compensation for VAT – input VAT, if applicable, assessed as tax-reducing

54 I 2018

1 Background

According to the wording of the law, tax evasion is committed by anyone who makes incorrect or incomplete statements to the tax authorities or other authorities about significant tax-related facts or fails to fulfil its obligation and leaves the tax authorities unaware of significant tax-related facts and thereby understates taxes. In particular, taxes are deemed to have been understated where they are not assessed at all, in full or in time. This also applies if the tax, to which the offence relates, could have been reduced for other reasons (so-called prohibition of compensation). This means that, in principle, it is irrelevant for the determination of tax evasion whether the taxable person not only concealed taxable income or transactions but also tax-reducing facts (such as business expenses or input VAT). The tax-reducing facts are not to be taken into consideration for the assessment of the tax offence. This can lead to the curious situation where a taxable person, who has concealed taxable income or transactions, must answer for tax evasion even though it has a tax credit or expects a tax refund.

2 Previous case law of the Federal Court (BGH)

An exception to the prohibition of compensation applies where the concealed tax-increasing circumstances are in direct economic connection to the equally concealed tax-reducing circumstances. According to the hitherto Federal Court (BGH) case law, this applied e.g. to income tax on the acquisition costs of goods which were subsequently sold "under the counter". However, in the past, the Federal Court has refused to exclude input VAT, in terms of sec 15 of the German VAT Act, from the prohibition of compensation and to consider it as a tax-reducing measure. In the circumstances, to date, the

Katrin Schwarz
Lawyer,
Compliance Officer (Univ.)

+49 (0) 89 217 50 12-49
katrin.schwarz@kmlz.de

question of whether an act of tax evasion has taken place has had to be evaluated independently of any existing input VAT refund claims. Therefore, tax evasion could also be found to exist where the total monthly VAT return and / or the annual VAT return resulted in an overpayment of VAT.

3 Facts

As managing director of two limited companies (*GmbH*), the Defendant had, predominantly failed to submit any monthly VAT returns for his companies. Both dealt with used vehicles, which were either purchased by private individuals for their own use or by other taxable persons who subsequently resold the vehicles. The Defendant concealed these taxable transactions from the tax office by (generally) not submitting any monthly VAT returns. The Regional Court, being the lower court, calculated the fiscal damage from the concealed transactions by taking into consideration the unreported VAT from the sale of the vehicles but not the input VAT from the acquisition of the individual vehicles subsequently sold.

4 Decision by the BGH

In its decision of 13.09.2018 (Ref.: 1 STR 642/17) the BGH ruled that the calculation of the fiscal damage by the Regional Court and thus the conviction of the accused, with respect to a certain reporting period, had not been free of legal errors.

According to the BGH, input VAT can be directly deducted, when determining the scope of the taxes evaded, where there is an economic connection between the input and output supply. This is the case if a non-declared taxable output supply was a supply that had actually been carried out and if the used economic goods were purchased subject to the conditions of sec 15 German VAT Act. According to the BGH, the other conditions of sec 15 German VAT Act – especially those regarding the presentation of an invoice – have to be fulfilled in the relevant tax period.

In the case decided by the BGH, this resulted in there being, in some instances, no tax evasion at all because the concealed taxable supplies were offset by input VAT of the same amount.

5 Consequences for the practice

In cases in which there are already ongoing criminal proceedings, it should now be closely examined whether there are possible input supplies that are economically connected with output supplies that are, from the authorities' point of view, relevant regarding the criminal proceedings. This should always be the case if input supplies were received for concrete output supplies (e.g. when purchasing goods that are then resold). Here, it is important that the conditions of a VAT deduction, in accordance with sec 15 German VAT Act, are fulfilled in the respective tax period. In such cases, the authorities and courts must be consulted to ensure that the input VAT amounts are taken into account when calculating the tax loss. Thus, in some cases, the (potential) criminal liability of the concealment of taxable supplies will already be omitted. In other cases, the monetary amount of the tax evasion can, at the very least, be reduced. In the context of correction of past tax errors, the indicated input VAT amounts must be taken into account in order to correctly assess the risks and the corresponding available courses of action.

KÜFFNER MAUNZ LANGER ZUGMAIER Rechtsanwaltsgesellschaft mbH | www.kmlz.de | office@kmlz.de
D-80331 München | Unterer Anger 3 | Tel.: +49 89 217501220 | Fax: +49 89 21750125099
D-40221 Düsseldorf | Speditionstraße 21 | Tel.: +49 211 54095320 | Fax: +49 211 54095399