



# KMLZ VAT NEWSLETTER

## VAT deduction: Application of latest ECJ jurisdiction by the Federal Fiscal Court remains unclear

### 1. Facts and proceedings

In 2002, the complainant K purchased 33 high-quality processors from the B-Ltd. amounting to approximately EUR 8,250,000.00 net. Later on, K sold those processors to a Malaysian company. K commissioned a forwarder to pick up the goods at B-Ltd. and also to send them to the Malaysian customer so that the goods did not get to the premises of K. Criminal proceedings for VAT fraud against persons responsible at B-Ltd. were conducted, some of them were even convicted. The tax authorities and the tax court both denied VAT deduction for K on the grounds that cheap goods instead of high-quality processors had been delivered. Also K should have known that she was part of VAT fraud in the supply chain.

### “Should have known” about VAT fraud in supply chain

In its decision of 18 February 2013, the Federal Fiscal Court had to decide on an issue that appears frequently in advisory business: The tax authorities denied VAT deduction for goods purchased by the complainant K by arguing the goods were part of a VAT fraud. Although K explicitly referred to the European Court of Justice’s (ECJ) latest jurisdiction regarding VAT deduction, the Federal Fiscal Court was not able to directly refer to this issue due to K’s failures in the previous instances.

### 2. Complete taking of evidence is important

K said, among other things, that the tax court neglected the hearing of an explicitly appointed witness who could have confirmed the actual delivery of high-quality processors. K remained unheard with this argument in front of the Federal Fiscal Court due to failures in the taking of evidence in the first instance.

### 3. Knowledge of employees of limited companies is sufficient

The case decided on by the Federal Fiscal Court exemplarily shows the existing risks for companies concerning VAT deduction: According to the Federal Fiscal Court’s jurisdiction, not only the knowledge of the managing director of the limited company is attributable to the company, but also the knowledge of their employees (sec. 166 of the German Civil Code).



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#### **4. Application of latest ECJ jurisdiction regarding VAT deduction by the Supreme Tax Court remains unclear**

Due to failures of K in the first instance, the Federal Fiscal Court was not able to deal with the latest ECJ jurisdiction regarding VAT deduction. The ECJ clearly stated in legal cases *Mahageben* and *Peter David* (ECJ, judgment of 21 June 2012 – C-80/11 and C-142/11) that doubts by the tax authorities are not enough to deny VAT deduction. In fact, the tax authorities have to prove the objective circumstances indicating that the taxable person knew or should have known that the purchased goods were part of VAT fraud. The ECJ has explicitly confirmed and solidified this jurisdiction in the last couple of months.

Exactly the question of who bears the burden of proof regarding VAT deduction was decisive at the case at hand: The processors were directly picked up at the supplier by a forwarder commissioned by K and were delivered to the customer. Therefore, K never had – what is usually typical for chain transactions – the physical possibility to check the goods. In this respect, the argument brought up by K to not

have known about the participation in VAT fraud in the supply chain, was quite obvious indeed. Although K did explicitly refer to the latest ECJ jurisdiction, the Federal Fiscal Court was not able to take refer to this jurisdiction due to failures by K in the first instance. According to the Federal Fiscal Court's jurisdiction, the entrepreneur bears the burden of proof regarding his right to deduct VAT. It is to be hoped that the Federal Fiscal Court will soon take its position on the important question regarding the burden of proof concerning the right to deduct VAT.

#### **5. Recommendations**

Entrepreneurs should always check their contracting partners carefully in order to "save their right to deduct VAT". This can take place by checking the certificate of registration and the VAT-ID-No., visiting the premises or checking the identity of the acting persons. There are different requirements by the tax authorities depending on each individual case, such as the amount of turnover, the duration of business relations, the specific sector or the size of the company.