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VAT'S UP

VAT NEWSLETTER

Protection of good faith in the tax assessment procedure – referral to equitable relief procedure contrary to EU law

39 I 2026

1 Background

For the third time, the German Federal Fiscal Court sought a preliminary ruling on whether, under EU law, the protection of good faith in VAT law must be taken into account in the tax assessment procedure or only in a separate equitable relief procedure. Its first two attempts were unsuccessful because the Court of Justice of the European Union (ECJ) was not required to address the issue, as it was not relevant to the decisions in those cases. The German Federal Fiscal Court has now finally received an answer. The question was: Must the protection of good faith in VAT law be taken into account in the tax assessment procedure or in the (subsequent) equitable relief procedure? In practice, this procedural aspect is highly relevant for businesses, as it may affect costs, the duration of proceedings and the procedural rules relating to evidence. The substantive legal question concerns the special margin scheme. Good faith protection is of particular importance under the margin scheme: May a reseller rely on its supplier, i.e. the preceding reseller, having correctly applied the margin scheme, especially where the invoice refers to the application of the margin scheme?

2 Facts

The plaintiff sells jewelry and watches both at retail and wholesale level and applied the margin scheme to some of its transactions in the years in dispute, 2013 and 2014. The invoices received from its suppliers included a reference to the application of the margin scheme under sec. 25a of the German VAT Act. Nevertheless, following a tax audit, the tax office concluded that the margin scheme had, in part, been applied incorrectly because the watches were new. Therefore, the tax office denied the application of the margin scheme to the transactions concerned and applied the standard taxation.



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The Fiscal Court dismissed the action filed against that decision. The plaintiff's suppliers were themselves not entitled to apply the margin scheme. According to the Fiscal Court, the plaintiff's protection of legitimate expectations was not relevant in the tax assessment procedure but could, at most, be taken into account by way of equitable relief pursuant to secs. 163 and 227 of the German Fiscal Code. By order of 19 February 2025 (XI R 23/24), the German Federal Fiscal Court referred to the ECJ the question of whether Art. 314 of the EU VAT Directive, read in the light of the principle of effectiveness, precludes the German practice. The German practice takes the reseller's good-faith belief into account only outside the tax assessment procedure, in the context of a separate (subsequent) equitable procedure, the reseller's good-faith belief that its supplier satisfied the conditions for applying the margin scheme, where the supplier has indicated on its invoice that it has applied the margin scheme to the supply made to the reseller.

3 Judgment of the General Court (T-569/25 - X-GmbH)

By judgment of 14 October 2026, the General Court held that Art. 314 of the EU VAT Directive, read in the light of the principle of effectiveness, must be interpreted as precluding the established German practice. Under the previous German approach, a reseller's good-faith belief that its supplier met the requirements for applying the margin scheme was taken into account not in the tax assessment procedure, but only in a separate equitable relief procedure. According to the General Court, such a national practice entails procedural disadvantages that are incompatible with the principle of effectiveness. Those disadvantages arise from the increased cost risk, the longer duration of the proceedings and the less favourable procedural rules relating to evidence. In particular:

- Two separate proceedings may result in a duplication of legal representation costs and increased court fees.
- It may also significantly delay judicial protection. The national practice may extend the overall duration of the tax assessment and equitable relief procedures by several years.
- In an equitable relief procedure, the rules governing evidence may be less favourable to the taxable person, as the tax authorities review only the grounds for equitable relief put forward and exercise discretion when making their decision.

With reference to the judgment in *Litdana* (ECJ, judgment of 18 May 2017 – C-624/15), the General Court further clarified that the margin scheme may be denied only where the tax authorities establish that the taxable person did not act in good faith or failed to take all reasonable measures that could reasonably be expected to ensure that the transaction concerned was not connected with VAT fraud.

4 Conclusion

Although the judgment concerns the margin scheme, the General Court's ruling that the protection of good faith must be taken into account in the tax assessment procedure is likely to have broader significance. Accordingly, good faith protection should also be considered in other situations where it is not expressly provided for by statute, including cases involving the deduction of input VAT, Reemtsma-type direct refund claims, export supplies and liabilities of unduly charged VAT. This is a taxpayer-friendly and practically important decision. The equitable relief procedure will continue to play an important role in exceptional cases. However, the blanket practice of referring taxable persons to such proceedings is now, fortunately, likely to come to an end. Furthermore, the judgment may call into question the German approach to the allocation of the burden of proof under the margin scheme.

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