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German Tax and Legal News

BFH requests preliminary ruling from CJEU on input VAT deduction on advance payments

Issues relate to the scope and interpretation of the CJEU decision in *Firin*

Two senates (divisions) of Germany's Federal Tax Court (BFH) have issued on September 21, 2016 requests for preliminary rulings to the Court of Justice of the European Union (CJEU) concerning the scope and interpretation of the CJEU decision in the *Firin* case (C-107/13) regarding the treatment of input VAT on advance payments for a transaction that ultimately is not carried out.

Background

In both cases, the input VAT deduction was at issue where a block heating power plant, which had been purchased and for which an installment had been paid, ultimately was not delivered due to fraud by sellers that were limited liability companies (GmbHs) that eventually became bankrupt. The persons acting for the respective GmbHs were convicted in several criminal proceedings, inter alia, for intentional bankruptcy to the detriment of the purchasers of the combined heat and power stations, but not for tax evasion.

The purchasers claimed a VAT deduction for their advance payments. In both cases (lower tax court of Munich decision of July 16, 2015, No. 14 K 277/12 and lower tax court of Baden-Württemberg decision of September 19, 2014, No. 9 K 2914/12), the respective appeals from the purchasers to the BFH were unsuccessful.

The lower tax courts held that the purchasers were entitled to deduct VAT on the advance payments since they had acted in their capacity as taxable persons and they possessed proper invoices for their down payments. The courts relied on the principles set forth in the CJEU's *Firin* decision to conclude that there was no false statement of VAT within the meaning of article 14c(2) of the German VAT law. Additionally, the courts concluded that an adjustment of the input VAT deduction was not possible under the relevant provisions of article 17 of the VAT law. Although there is a general rule that the deduction of input VAT must be corrected when remuneration is paid for an agreed-upon supply or service but the supply or service ultimately is not carried out, according to the case law of the BFH, as well as the CJEU *Firin* case, a correction is not possible if the advance payment has not been repaid to the purchasers. In these cases, the purchasers did not receive any reimbursement from the bankrupt GmbHs; therefore, there was no requirement to correct the input VAT deduction.

Questions referred to the CJEU

On appeal, both senates of the BFH concluded that, in accordance with the VAT regulations under the EU VAT directive, the general conditions for a VAT deduction on the advance payments were fulfilled. However, it was unclear whether the circumstances in which the purchasers had made their down payments precluded a VAT deduction for reasons of EU law, or required a correction. Both senates accordingly referred the cases to the CJEU for a preliminary ruling, although the questions on which the senates requested a ruling differed in some respects.

Under the CJEU's *Firin* decision, an additional condition for granting an input VAT deduction for an advance payment is that the occurrence of the taxable event must not be "uncertain" at the time of the down payment. In the case of fraudulent behavior (tax fraud), a taxable event is uncertain if the person that makes the advance payment knows or should have known about the tax fraud. According to the CJEU, the reason for establishing this condition was that the right to deduct input VAT, in general, does not come into existence until a claim for deductible input VAT exists, which requires that all necessary elements of the taxable event, i.e. of the future supply or other service, be precisely defined at the time of the down payment.

The questions referred to the CJEU by the fifth and 11th senates of the BFH, which are discussed in additional detail below, are as follows:

The fifth senate referred the following questions to the CJEU:

1. Are the requirements regarding the certainty of the provision/supply of a service that is a prerequisite for the deduction of input VAT on an advance payment, as provided in the *Firin* decision, to be determined purely objectively or from the point of view of the person that made the advance payment and based on the circumstances recognizable by that person?
2. Taking into account the simultaneous accrual of the VAT claim and of the right to deduct input VAT (in accordance with article 167 of the EU VAT directive and the rights conferred to the EU member states by article 185(2)(2) and article 186 of the VAT directive), do the member states have the right to make the correction of VAT and the deduction of input VAT dependent on a reimbursement of the advance payment?
3. Does the tax office for the person that made the advance payment have to refund the VAT to that person if it is not possible to recover the advance payment from the person that received the payment? If so, is that an issue to be settled through the regular tax assessment procedure, or is an alternative procedure through an equity-based proceeding sufficient?

The 11th senate referred the following questions:

1. Based the *Firin* decision, an input VAT deduction on an advance payment is denied if the occurrence of the taxable event is uncertain at the point in time when the advance payment is made. Is this uncertainty determined according to an objective view of the situation, or from the perspective of the person who made the advance payment?
2. Does the *Firin* decision mean that, according to EU law, a correction of the input VAT deduction made by the person that made the advance payment does not require the reimbursement of the advance payment if the relevant supply ultimately is not delivered?
3. If the answer to question 2 is yes, does article 186 of the EU VAT directive, authorizing the EU member states to determine the details of the adjustment provided for under article 185 of the VAT directive, authorize Germany to provide under its domestic law that the reimbursement of the advance payment is required for the tax base to be reduced and for the VAT and the input VAT deduction to be corrected, and regulate the relevant timing and conditions?

The senates' positions regarding these questions are discussed below.

Question 1: Based on their interpretations of the case law, both of senates questioned whether the requirements regarding the certainty of the delivery/provision of a service as a prerequisite for the deduction of input VAT on an advance payment are to be determined purely objectively or from the point of view of the person who makes the advance payment and based on the circumstances recognizable by that person. If the certainty of the subsequent delivery/provision of services is determined according to the circumstances that were apparent to the purchasers, the senates agreed that the purchasers would be entitled to deduct VAT because they neither knew nor should have known the intent of the GmbH to deceive.

Unlike the fifth senate, the 11th senate was of the opinion that the determinative factor was not the subjective view of the person making the advance payment; instead, it opined that the uncertainty of the occurrence of the taxable event should be determined objectively, which would lead to a denial of the input VAT deduction based on the circumstances of the case. The fifth senate refused to deviate from its judgment that the subjective view of the person who makes the advance payment is determinative. With this background, both senates referred variations of this question to the CJEU.

Question 2: The second question raised by the senates is aimed at whether the input VAT correction with respect to an advance payment requires a reimbursement of the advance payment and, in this context, how the CJEU ruling in *Firin* should be interpreted regarding the applicable provisions of EU law.

The 11th senate interprets *Firin* to mean that a correction of the deduction of input VAT paid by the person that made the advance payment does not require the reimbursement of the advance payment if the supply ultimately is not made and the supplier is required to pay the tax. If this interpretation is correct, the jurisprudence of the fifth senate, under which the reimbursement of an advanced payment is a precondition for the reduction in the assessment base and, thus, for the correction of the VAT deduction, no longer would be good law. On the other hand, the fifth senate's position is that there would be a permanent

enrichment of the treasury if the plaintiff was required to correct the VAT deduction, irrespective of a reimbursement — in the absence of a reimbursement, the treasury would still hold the original VAT claim against the seller, and would, at the same time, be entitled to recover the deductible VAT amount from the buyer.

Question 3: The third questions raised by the senates differed. The 11th senate's question was on the scope of the competence of the EU member states under article 186 of the EU VAT directive: whether the member states are entitled to make the carrying out of a VAT correction dependent on the reimbursement of an advance payment if the delivery/provision of the service is ultimately not carried out.

However, the third question of the fifth senate dealt with the CJEU decision in the 2007 Reemtsma case (C-35/05). According to this decision, VAT that was invoiced erroneously to the recipient of the services and paid to the tax authorities is not refundable. Moreover, the tax office must not reimburse the VAT to the recipient if the recipient cannot recover its payment from the supplier. If, in the present case, the VAT deduction regarding the advanced payment must be denied because no VAT claim had arisen as a result of the lack of certainty regarding the provision/supply of the service, the legal situation would be similar to the situation in Reemtsma. However, in the Reemtsma case, the CJEU also stated that where the reimbursement of VAT is impossible or excessively difficult, in particular, in the case of the insolvency of the service provider, the recipient of the service may file a request for reimbursement directly to the tax authorities. In view of the insolvency of the service provider, the purchaser that made the advance payment therefore could be entitled to submit an application for reimbursement directly to the tax authorities. This is followed by a related question of the fifth senate: whether the person that made the advance payment may assert a claim for reimbursement in the regular tax assessment process or through an equity proceeding.

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