JUDGMENT OF THE COURT (Second Chamber)

13 March 2014 (*)

(Common system of value added tax – Deduction of input tax paid – Payments made on account – Refusal to allow the deduction – Fraud – Adjustment of the deduction in the case where the taxable transaction is not carried out – Conditions)

In Case C?107/13,

REQUEST for a preliminary ruling under Article 267 TFEU from the Administrativen sad Veliko Tarnovo (Bulgaria), made by decision of 14 February 2013, received at the Court on 4 March 2013, in the proceedings

FIRIN OOD

v

Direktor na Direktsia ‘Obzhalvane i danachno-osiguritelna praktika’ – Veliko Tarnovo pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite,

THE COURT (Second Chamber),

composed of R. Silva de Lapuerta, President of the Chamber, J.L. da Cruz Vilaça, G. Arestis, J.-C. Bonichot (Rapporteur) and A. Arabadjiev, Judges,

Advocate General: J. Kokott,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– the Direktor na Direktsia ‘Obzhalvane i danachno-osiguritelna praktika’ – Veliko Tarnovo pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite, by A. Manov, acting as Agent,

– the Bulgarian Government, by E. Petranova and D. Drambozova, acting as Agents,

– the Estonian Government, by N. Grünberg and M. Linntam, acting as Agents,

– the Italian Government, by G. Palmieri, acting as Agent, and A. De Stefano, avvocato dello Stato,

– the European Commission, by L. Lozano Palacios and N. Nikolova, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 19 December 2013,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Articles 65, 90(1), 168(a), 185(1), 193 and 205 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ 2006 L 347, p. 1).

2 The request has been made in proceedings between FIRIN OOD (‘FIRIN’) and the Direktor na Direktsia ‘Obzhalvane i danachno-osiguritelna praktika’ – Veliko Tarnovo pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite (Director of the ‘Appeals and Tax and Social Security Office’ Directorate for the city of Veliko Tarnovo, attached to the central office of the National Public Revenue Agency; ‘the Direktor’) concerning the right to deduct, in the form of a tax credit, value added tax (‘VAT’) relating to the payment on account made by that company in respect of the supply of flour.

Legal context

European Union law

3 Article 2(1)(a) and (c) of Directive 2006/112 provides that the supply of goods and the supply of services for consideration within the territory of a Member State by a taxable person acting as such are to be subject to VAT.

4 As set out in Article 14(1) of that directive:

‘“Supply of goods” shall mean the transfer of the right to dispose of tangible property as owner.’

5 Article 63 of Directive 2006/112 provides that the chargeable event is to occur and VAT is to become chargeable when the goods or the services are supplied.

6 Article 65 of the directive states:

‘Where a payment is to be made on account before the goods or services are supplied, VAT shall become chargeable on receipt of the payment and on the amount received.’

7 Article 90(1) of Directive 2006/112 provides:

‘In the case of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place, the taxable amount shall be reduced accordingly under conditions which shall be determined by the Member States.’

8 Article 167 of that directive provides that the right of deduction is to arise at the time when the deductible tax becomes chargeable.

9 Article 168 of Directive 2006/112 states:

‘In so far as the goods and services are used for the purposes of the taxed transactions of a taxable person, the taxable person shall be entitled, in the Member State in which he carries out these transactions, to deduct the following from the VAT which he is liable to pay:

(a) the VAT due or paid in that Member State in respect of supplies to him of goods or services, carried out or to be carried out by another taxable person;

…’

10 Article 178 of the directive specifies that:

‘In order to exercise the right of deduction, a taxable person must meet the following conditions:

(a) for the purposes of deductions pursuant to Article 168(a), in respect of the supply of goods or services, he must hold an invoice drawn up in accordance with Articles 220 to 236 and Articles 238, 239 and 240;

…’

11 Article 184 of Directive 2006/112 provides that the initial deduction is to be adjusted where it is higher or lower than that to which the taxable person was entitled.

12 Article 185 of Directive 2006/112 is worded as follows:

‘1. Adjustment shall, in particular, be made where, after the VAT return is made, some change occurs in the factors used to determine the amount to be deducted, for example where purchases are cancelled or price reductions are obtained.

2. By way of derogation from paragraph 1, no adjustment shall be made in the case of transactions remaining totally or partially unpaid or in the case of destruction, loss or theft of property duly proved or confirmed, or in the case of goods reserved for the purpose of making gifts of small value or of giving samples, as referred to in Article 16.

However, in the case of transactions remaining totally or partially unpaid or in the case of theft, Member States may require adjustment to be made.’

13 Under Article 186 of Directive 2006/112, Member States are required to lay down the detailed rules for applying Articles 184 and 185 of that directive.

14 Article 193 of the directive states:

‘VAT shall be payable by any taxable person carrying out a taxable supply of goods or services, except where it is payable by another person in the cases referred to in Articles 194 to 199 and Article 202.’

15 Under Article 203 of Directive 2006/112, VAT is payable by any person who enters the VAT on an invoice.

16 Under Article 205 of that directive:

‘In the situations referred to in Articles 193 to 200 and Articles 202, 203 and 204, Member States may provide that a person other than the person liable for payment of VAT is to be held jointly and severally liable for payment of VAT.’

Bulgarian law

17 Article 70(5) of the Law on Value Added Tax (Zakon za danak varhu dobavenata stoynost), in the version applicable to the dispute in the main proceedings (DV No 63 of 4 August 2006; ‘the ZDDS’), provides that there is no right to deduct input VAT paid where it has been invoiced improperly.

18 Article 177 of the ZDDS provides as follows:

‘1. A registered person who is the recipient of a taxable supply is liable for the unpaid tax owed by another registered person where the right to deduct input tax directly or indirectly connected

with the tax owed but not paid has been exercised.

2. Liability under paragraph 1 arises if the registered person knew or should have known that the tax would not be paid and this is proved by the investigating authority in accordance with Articles 117 to 120 of the Tax and Social Security Code of Procedure.

3. Knowledge is imputed to a person for the purposes of paragraph 2 where the following cumulative conditions are satisfied:

(1) the tax owed, within the meaning of paragraph 1, for a particular tax period has ultimately effectively not been paid by any prior provider of a taxable supply of goods or a taxable service, whether or not in the same, a changed or a processed form;

(2) the taxable supply merely appears to have been made, circumvents legislation, or is made at a price that differs significantly from the market price.

4. Liability under paragraph 1 is not dependent on obtaining a specific advantage on account of the non-payment of the tax owed.

5. In the circumstances envisaged in paragraphs 2 and 3, the upstream supplier of the taxable person who owes the unpaid tax is also liable.

6. In the cases referred to in paragraphs 1 and 2, liability is enforced against the taxable person who is the direct recipient of the supply in respect of which the tax owed has not been paid, and, where recovery fails, liability may be enforced against any downstream recipient in the chain of supply.

7. Paragraph 6 shall also apply *mutatis mutandis* to upstream suppliers.'

The dispute in the main proceedings and the questions referred for a preliminary ruling

19 FIRIN, which succeeded to the rights of 'Hlebozavod Korn', is a company incorporated under Bulgarian law whose objects are the production and marketing of bread and pastries. York Skay EOOD ('York Skay') holds 99% of its share capital and the remainder is held by Mr Yorkishev.

20 At the end of 2010, FIRIN placed an order for 10 000 tonnes of wheat with Agra Plani EOOD ('Agra Plani'), a company wholly owned by Mr Yorkishev. In respect of that transaction, which was payable in advance, Agra Plani issued, on 29 November 2010, an invoice for 3 600 000 Bulgarian leva (BGN), referring to VAT payable in the amount of BGN 600 000.

21 Following an audit, the Bulgarian tax authority challenged the deduction of that sum of BGN 600 000 that FIRIN had made in its VAT returns for the period from November to December 2010.

22 The tax authority substantiated that challenge by claiming that the supply had not been made and that the invoice of 29 November 2010 was part of a fraudulent scheme revealed by the audit. As it was not registered with the National Office for Grain, Agra Plani was not authorised to trade in grain under national law, a fact of which FIRIN could not have been unaware. Furthermore, the total amount of the payments made, from 30 November 2010, by FIRIN to Agra Plani, amounting to BGN 4 170 000, a sum greater than the amount payable according to the invoice, was transferred on that date to York Skay's account. On that same date also, the sum of BGN 3 600 000 was paid into FIRIN's bank account by York Skay.

23 In the absence of reliable justification, the tax authority did not accept the explanations

provided as to the nature of those transfers, the first of which, according to FIRIN, stemmed from a loan from Agra Plani to York Stay, and the second from an additional contribution to FIRIN's capital.

24 A tax adjustment notice was issued on 26 September 2011 as a consequence of that audit. FIRIN lodged an administrative objection to that notice with the Direktor. By decision of 16 January 2012, the Direktor confirmed that notice.

25 FIRIN thereupon brought an action against the Direktor's confirmatory decision before the Administrativen sad Veliko Tarnovo (Administrative Court, Veliko Tarnovo), claiming that it satisfied all of the conditions for entitlement to deduct the sum of BGN 600 000 and that the grounds for refusal of that deduction referred to circumstances, including the fictitious nature of the transaction, that are relevant, not for the purposes of refusing the right of deduction, but for the triggering of FIRIN's liability for its supplier's unpaid VAT.

26 Against that background, the referring court is unsure whether a right to deduct VAT can be accepted in a situation where, for various reasons, the supply envisaged could not be made and whether a subsequent adjustment remains possible. It also expresses uncertainty as to whether the national system of joint and several liability for VAT is compatible with European Union law.

27 In those circumstances, the Administrativen sad Veliko Tarnovo decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

'(1) In cases such as that in the main proceedings, in which VAT connected with a payment made in advance for a future clearly defined taxable supply of goods is immediately and effectively deducted, are the provisions of Article 168(a), in conjunction with Article 65, Article 90(1) and Article 185(1), of … Directive 2006/112 … to be consistently interpreted as meaning that, in light of a failure, for objective and/or subjective reasons, to render the principal counter-performance in accordance with the terms and conditions of supply, the right to deduct input tax at the date on which it is exercised must be refused?

(2) Does it follow from such a consistent interpretation, having regard to the principle of the neutrality of VAT, that, in this situation, the supplier's objective possibility of adjusting the VAT charged and/or the basis of assessment of the tax on the invoice in the manner provided for under national law is (or is not) significant; and how might such an adjustment affect the refusal to allow the original deduction of input tax?

(3) In the light also of recital 44 in the preamble to Directive 2006/112, is Article 205, in conjunction with Article 168(a) and Article 193, to be interpreted as meaning that the Member States are permitted to refuse to allow the recipient of a supply to deduct input tax by applying only such criteria as they themselves have laid down in their national legislation, according to which a liability to tax is imposed on a person other than the taxable person where, in such a case, the ultimate tax outcome would differ from the outcome if the rules established by the Member State had been strictly observed?

(4) If the answer to the third question should be in the affirmative: are national legal provisions such as those in the main proceedings permissible in the context of the application of Article 205 of Directive 2006/112 and compatible with the principles of effectiveness and proportionality if they introduce joint and several liability for the payment of VAT by reference to suppositions that are not based on objective facts that can be directly established but on expressed precepts of civil law, disputes in respect of which are conclusively settled on other legal grounds?'

Consideration of the questions referred

Admissibility

28 By its questions, the referring court is seeking from the Court of Justice an interpretation of provisions in Directive 2006/112 concerning two separate aspects of the VAT system, namely, first, that which governs the right to deduct input VAT paid and, secondly, that which governs the joint and several liability of a taxable person in respect of tax payable by a third party as provided for in Article 205 of that directive.

29 According to settled case-law, the procedure provided for in Article 267 TFEU is an instrument of cooperation between the Court of Justice and the national courts, by means of which the Court provides the national courts with the points of interpretation of European Union law which they need in order to decide the disputes before them (see, inter alia, Case C?279/12 *Fish Legal and Shirley* [2013] ECR, paragraph 29).

30 In the context of that cooperation, questions concerning European Union law enjoy a presumption of relevance. The Court may refuse a request for a preliminary ruling made by a national court only where it is quite obvious that the interpretation of European Union law that is sought bears no relation to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it (see, inter alia, *Fish Legal and Shirley*, paragraph 30).

31 Although it is common ground that the dispute in the main proceedings concerns the challenge to FIRIN’s right to deduct VAT, it is apparent, on the other hand, from the decision of the referring court that the Bulgarian tax authority did not regard FIRIN as being jointly and severally liable for payment of the VAT owed by Agra Plani.

32 Consequently, in so far as they concern the scope of such joint and several liability, the referring court’s third question, in part, and fourth question, concerning the interpretation of the provisions of Article 205 of Directive 2006/112, are clearly unrelated to the subject-matter of the dispute in the main proceedings and must, for that reason, be declared inadmissible.

Substance

33 By its questions concerning the rules governing the right to deduct VAT, which it is appropriate to examine together, the referring court asks, in essence, whether Articles 65, 90(1), 168(a), 185(1) and 193 of Directive 2006/112 must be interpreted as meaning that the deduction of VAT made by the recipient of an invoice drawn up with a view to a payment on account being made in relation to the supply of goods must be adjusted where, in circumstances such as those in the main proceedings, that supply is ultimately not made, even if the supplier remains liable for that tax and has not refunded the payment made on account.

34 Under Article 167 of Directive 2006/112, the right to deduct input VAT paid arises at the time when the tax becomes chargeable and, under Article 63 of that directive, the chargeable event for VAT occurs and the tax becomes chargeable when the goods or the services are supplied.

35 Article 65 of Directive 2006/112, which provides that, where payments are made on account before the goods or services are supplied, VAT becomes chargeable on receipt of the payment and on the amount received, constitutes a derogation from the rule laid down in Article 63 and, as such, must be interpreted strictly (Case C?419/02 *BUPA Hospitals and Goldsborough Developments*

[2006] ECR I?1685, paragraph 45).

36 Thus, in order for VAT to become chargeable in such circumstances, all the relevant information concerning the chargeable event, namely, the future supply of goods or services, must already be known and therefore, in particular, the goods or services must be precisely identified at the time when the payment on account is made (to that effect, *BUPA Hospitals and Goldsborough Developments*, paragraph 48).

37 It is necessary to verify whether that is the case in the main proceedings in order to be able to conclude that the right of deduction exercised by FIRIN on the basis of the payment on account at issue exists.

38 In this connection, it is apparent from the order for reference that, when FIRIN made the payment on account at issue in the main proceedings, the goods which were to be the subject of the supply were clearly identified.

39 None the less, as the Advocate General has observed in point 24 of her Opinion, Article 65 of Directive 2006/112 cannot apply where, at the time of the payment on account, it is uncertain whether the chargeable event will take place. This would be the case, in particular, where there is fraudulent conduct.

40 The prevention of tax evasion, avoidance and abuse is an objective recognised and encouraged by Directive 2006/112. In that connection, the Court has held that European Union law cannot be relied on by individuals for abusive or fraudulent ends. It is therefore for the national courts and judicial authorities to refuse the right of deduction if it is shown, in the light of objective factors, that that right is being relied on for fraudulent or abusive ends (to that effect, Case C?285/11 *Bonik* [2012] ECR, paragraphs 35 to 37).

41 That is the position where a tax fraud is committed by the taxable person himself. In such a case, the objective criteria which form the basis of the concepts of ‘supply of goods or services effected by a taxable person acting as such’ and ‘economic activity’ are not met (*Bonik*, paragraph 38 and the case-law cited).

42 By contrast, it is incompatible with the rules governing the right of deduction under Directive 2006/112 to impose a penalty, in the form of refusal of that right, on a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier or that another transaction forming part of the chain of supply, upstream or downstream of the transaction carried out by the taxable person, was vitiated by VAT fraud (*Bonik*, paragraph 41 and the case-law cited).

43 The establishment of such a penalty system would go beyond what is necessary to preserve the public exchequer’s rights (see, to that effect, *Bonik*, paragraph 42 and the case-law cited).

44 Consequently, since the refusal of the right of deduction is an exception to the application of the fundamental principle constituted by that right, it is incumbent upon the competent tax authorities to establish, to the requisite legal standard, the objective evidence needed to substantiate the conclusion that the taxable person knew, or should have known, that the transaction relied on as the basis for the right of deduction was connected with fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply (*Bonik*, paragraph 43 and the case-law cited).

45 However, in proceedings brought under Article 267 TFEU, the Court has no jurisdiction to check or to assess the factual circumstances of the case before the referring court. It is therefore

for the referring court to carry out, in accordance with the rules of evidence of national law, an overall assessment of all the facts and circumstances of that case (see, inter alia, *Bonik*).

46 It follows that it is for the referring court alone to satisfy itself that the tax authorities in question have established the objective evidence on which they rely to substantiate the conclusion that FIRIN was not unaware, or could not have been unaware, that the purpose of the payment on account made to its supplier was not in fact the supply of goods as entered on the invoice issued by that supplier.

47 Nevertheless, in order to provide the referring court with a useful answer, it is necessary to examine the questions concerning the adjustment of the VAT deducted by FIRIN, in the event that, following the assessment which it must carry out, the referring court should find that all the information relevant to the future supply could be considered to have been already known to that company at the time when the payment on account was made and that the supply did not therefore appear uncertain.

48 In this connection, it should be noted that Articles 184 to 186 of Directive 2006/112 lay down the conditions under which the tax authority may require adjustment to be made by a taxable person (to that effect, Case C?234/11 *TETS Haskovo* [2012] ECR, paragraph 26).

49 So far as concerns the impact on the deduction of VAT made by a taxable person of any events occurring after the deduction has been made, it is apparent from the case-law that the use to which the goods or services are put, or are intended to be put, determines the extent of the initial deduction to which the taxable person is entitled and the extent of any adjustments in the course of the following periods, which must be made under the conditions laid down in Articles 184 to 186 of the directive (*TETS Haskovo*, paragraph 29 and the case-law cited).

50 The adjustment mechanism provided for in those articles is an integral part of the VAT deduction scheme established by Directive 2006/112. It is intended to enhance the precision of deductions so as to ensure the neutrality of VAT, with the result that transactions effected at an earlier stage continue to give rise to the right to deduct only in so far as they are used to make supplies subject to VAT. That mechanism thus aims to establish a close and direct relationship between the right to deduct input VAT paid and the use of the goods or services concerned for taxable output transactions (*TETS Haskovo*, paragraphs 30 and 31).

51 So far as concerns the coming into existence of an obligation to make an adjustment to an input VAT deduction, Article 185(1) of Directive 2006/112 establishes the principle that such an adjustment must be made, inter alia, where, after the VAT return is made, some change occurs in the factors used to determine the amount of the deduction (*TETS Haskovo*, paragraph 32).

52 In a situation such as that in the main proceedings, in which it is apparent, according to the information provided by the referring court, that the supply of goods in respect of which FIRIN made a payment on account will not be made, it must be concluded, as the Advocate General has observed in point 35 of her Opinion, that a change in the factors used to determine the amount of the deduction has thus occurred after the VAT return was made. Therefore, in such a situation, the tax authority may require adjustment to be made to the VAT deducted by the taxable person.

53 That conclusion cannot be called into question by the fact that the VAT payable by the supplier has not itself been adjusted.

54 It must be recalled in this regard that, so far as concerns the treatment of VAT that has been improperly invoiced because there is no taxable transaction, it follows from Directive 2006/112 that the two traders involved are not necessarily treated identically. On the one hand, the issuer of an

invoice is liable to pay the VAT entered on that invoice even if there is no taxable transaction, in accordance with Article 203 of Directive 2006/112. On the other hand, exercise of the right of deduction by the recipient of an invoice is limited solely to tax corresponding to a transaction subject to VAT, in accordance with Articles 63 and 167 of that directive (Case C?643/11 *LVK – 56* [2013] ECR, paragraphs 46 and 47).

55 In such a situation, compliance with the principle of fiscal neutrality is ensured by the possibility, to be provided for by the Member States, of correcting any tax improperly invoiced where the issuer of the invoice shows that he acted in good faith or where he has, in sufficient time, wholly eliminated the risk of any loss of tax revenue (*LVK – 56*, paragraph 48).

56 Furthermore, as the Advocate General has observed in point 43 of her Opinion, as long as, in circumstances such as those in the main proceedings, the payment made on account has not been refunded by the supplier, the taxable amount payable by the latter by virtue of receipt of that payment on account cannot be reduced pursuant to the provisions of Article 65, in conjunction with Articles 90 and 193, of Directive 2006/112 (see, to that effect, with regard to adjustment of the taxable amount in the case of discounts, Case C?86/99 *Freemans* [2001] ECR I?4167, paragraph 35).

57 In those circumstances, and without prejudice to the right of the taxable person to obtain from its supplier, through the appropriate national legal remedies, a refund of the payment made on account for a supply of goods which ultimately was not made, the fact that the VAT payable by that supplier has not itself been adjusted does not affect the right of the tax authority to obtain repayment of the VAT deducted by that taxable person on the basis of the payment made on account corresponding to such a supply.

58 In the light of the foregoing, the answer to the questions referred is that Articles 65, 90(1), 168(a), 185(1) and 193 of Directive 2006/112 must be interpreted as requiring that the deduction of VAT made by the recipient of an invoice drawn up with a view to a payment being made on account in relation to the supply of goods be adjusted where, in circumstances such as those in the main proceedings, that supply is ultimately not made, even if the supplier remains liable for that tax and has not refunded the payment made on account.

Costs

59 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Second Chamber) hereby rules:

Articles 65, 90(1), 168(a), 185(1) and 193 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as requiring that the deduction of value added tax made by the recipient of an invoice drawn up with a view to a payment being made on account in relation to the supply of goods be adjusted where, in circumstances such as those in the main proceedings, that supply is ultimately not made, even if the supplier remains liable for that tax and has not refunded the payment made on account.

[Signatures]

* Language of the case: Bulgarian.