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Judgment of the Court of 19 September 2000. - Schmeink & Cofreth AG & Co. KG v Finanzamt Borken and Manfred Strobel v Finanzamt Esslingen. - Reference for a preliminary ruling: Bundesfinanzhof - Germany. - Sixth VAT Directive - Obligation of Member States to provide for the possibility of adjusting tax improperly mentioned on an invoice - Conditions - Good faith of issuer of invoice. - Case C-454/98.

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Keywords

Tax provisions - Harmonisation of laws - Turnover taxes - Common system of value added tax - Adjustment of tax improperly invoiced - Determination of conditions in which adjustments may be made - Competence of the Member States - Scope and limits

(Council Directive 77/388)

Summary

$$Since the Sixth Directive 77/388 does not contain any provisions relating to the adjustment by the issuer of an invoice of value added tax which has been improperly invoiced, it is for the Member States to lay down the conditions in which the improperly invoiced tax may be adjusted. However, where the issuer of the invoice has in sufficient time wholly eliminated the risk of any loss in tax revenues, the principle of the neutrality of value added tax requires that tax which has been improperly invoiced can be adjusted without such adjustment being made conditional upon the issuer of the relevant invoice having acted in good faith. Therefore, where such a risk has been eliminated, the adjustment of value added tax which has been improperly invoiced cannot be dependent on the discretion of the tax authorities.

(see paras 48 to 49, 58, 60, 63, 68, 70 and operative part 1 and 2)

Parties

In Case C-454/98,

REFERENCE to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the Bundesfinanzhof (Germany) for a preliminary ruling in the proceedings pending before that court between

Schmeink & Cofreth AG & Co. KG

and

Finanzamt Borken,

and between

Manfred Strobel

and

Finanzamt Esslingen,

on the interpretation of Article 21(1)(c) of the Sixth Council Directive of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, J.C. Moitinho de Almeida (Rapporteur) and L. Sevón (Presidents of Chambers), P.J.G. Kapteyn, J.-P. Puissochet, P. Jann, H. Ragnemalm, M. Wathelet and V. Skouris, Judges,

Advocate General: N. Fennelly,

Registrar: R. Grass,

after considering the written observations submitted on behalf of:

- Schmeink & Cofreth AG & Co. KG, by J. Hartmann and A. Schiller, Tax Advisers,

- the German Government, by W.-D. Plessing, Ministerialrat in the Federal Ministry for Economic Affairs, and C.-D. Quassowski, Regierungsdirektor in the same Ministry, acting as Agents,

- the Commission of the European Communities, by E. Traversa, Legal Adviser, and A. Buschmann, national civil servant seconded to the Legal Service, acting as Agents,

having regard to the report of the Judge-Rapporteur,

after hearing the Opinion of the Advocate General at the sitting on 13 April 2000,

gives the following

Judgment

Grounds

1 By order of 15 October 1998, received at the Court on 11 December 1998, the Bundesfinanzhof (Federal Finance Court) referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) three questions on the interpretation of Article 21(1)(c) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment (OJ 1977 L 145, p. 1, the Sixth Directive).

2 The questions were raised in two sets of proceedings between (i) Schmeink & Cofreth AG & Co. KG (Schmeink) and the Finanzamt (Tax Office), Borken, and (ii) Mr Strobel and the Finanzamt, Esslingen, concerning the refusal of the Finanzamt to exempt Schmeink and Mr Strobel on grounds of equity from paying value added tax (VAT) which had been improperly mentioned on an invoice.

The Sixth Directive

3 Article 21 of the Sixth Directive provides:

The following shall be liable to pay value added tax:

1. under the internal system:

...

(c) any person who mentions the value added tax on an invoice or other document serving as invoice;

...

National legislation relating to VAT

4 Paragraph 14(2) of the Umsatzsteuergesetz 1991 (Turnover Tax Law; UStG), which deals with the settlement of VAT in cases where the amount of tax mentioned on the invoice is incorrect, provides:

If in an invoice in respect of a supply or other service a trader mentions separately a higher amount of tax than he owes under this Law in respect of the transaction, then he shall also be liable for the higher amount. If he adjusts the amount of tax vis-à-vis the recipient of the service, Paragraph 17(1) shall apply correspondingly.

5 Paragraph 14(3) of the UStG provides, in relation to the settlement of VAT in cases where the tax mentioned on the invoice cannot be justified:

Where a person mentions an amount of tax separately in an invoice, and he is not entitled to mention the tax separately, he shall be liable to pay the amount mentioned. The same shall apply where a person mentions an amount of tax separately in any other document which he uses to make out a bill, in the manner of a trader making a supply or providing a service, even though he is not a trader or is not making a supply or providing any other service.

6 Paragraph 17(1) of the UStG provides:

When the basis of calculation in respect of a taxable transaction is modified for the purposes of Paragraph 1(1)(1) to (3):

1. the economic operator who carried out the transaction must adjust correspondingly the amount of tax due in respect of the transaction,

2. the economic operator who is the recipient in relation to the transaction must adjust correspondingly the deduction of input tax which he has claimed in respect of the transaction ...

7 Paragraph 190(3) of the Umsatzsteuer-Richtlinien (Turnover-Tax Guidelines) provides:

Unlike Paragraph 14(2) of the UStG, Paragraph 14(3) thereof does not provide for adjustment. However, if collecting the tax which has been wrongly mentioned results in a situation involving material hardship, it is accepted that, on grounds of equity, the issuer of an invoice may correct it by analogous application of Paragraph 14(2) of the UStG ... It should be noted that a situation of material hardship exists, for example, where a service in respect of which an invoice has been issued has been provided by the person who issued the invoice and it may reasonably be claimed that it was merely as a result of error that the name of the recipient of the service was incorrect or that the service was wrongly described.

8 Paragraph 227 of the Abgaberordnung (Tax Code, AO) provides:

The tax authorities may waive, in whole or in part, claims arising from a liability to tax where it would be inequitable to pursue them in the circumstances of the particular case; in such circumstances, amounts which have already been paid may be reimbursed or taken into account.

The disputes in the main proceedings and the questions submitted for a preliminary ruling

Schmeink

9 Schmeink acquired 50% of the shares in a GmbH (a German-law limited liability company, the GmbH) for which it paid DEM 3 781 220. On 31 December 1991 it issued to the GmbH a statement of account including an invoice mentioning that sum in respect of advisory services which it had, however, never provided. Schmeink expressly included on that statement of account a sum of DEM 529 370.80 in respect of VAT.

10 The pro forma invoice was one of the matters used by the GmbH in support of an application for an investment grant.

11 Following a special VAT investigation in March 1993, the Finanzamt, Borken, by a revised notice of 14 April 1993, assessed the VAT payable by Schmeink at the amount shown separately in the statement of account.

12 The GmbH did not claim any right to a deduction by virtue of the statement of account and returned it to Schmeink on 19 July 1993.

13 On 1 July 1994, Schmeink sent an application to the Finanzamt, Borken, seeking a waiver of the VAT on grounds of equity under Paragraph 227 of the AO.

14 By decision of 12 September 1994, the Finanzamt, Borken, dismissed the application.

15 Schmeink appealed against the decision of the Finanzamt, Borken, to the Finanzgericht (Finance Court), Münster, which, by judgment of 23 November 1995, confirmed the Finanzamt's decision.

16 On 24 March 1997 Schmeink appealed on a point of law (Revision) to the Bundesfinanzhof (Federal Finance Court) against the judgment of the Finanzgericht.

Strobel

17 During 1992 and 1993, when he was running an office-appliances business, Mr Strobel issued several leasing undertakings with invoices relating to deliveries which had never taken place.

18 Mr Strobel was using these bogus invoices to try to disguise losses in one of his subsidiaries and make profitability appear better than it was. The invoices were paid by the leasing undertakings. Subsequently, Mr Strobel repaid the undertakings concerned the amounts which they had paid him.

19 Mr Strobel made the sums in question subject to VAT. For their part, the leasing undertakings deducted the amount of VAT shown on the relevant invoices on account of input tax.

20 In 1994 Mr Strobel voluntarily filed a declaration setting out the true position with the Public Prosecutor's Office and with the Finanzamt, Esslingen, informing them of the bogus invoices and their addressees. The Finanzamt, Esslingen, passed this information to the tax offices responsible for the addressees of the invoices so that they could proceed to regularise the position regarding the deduction of input tax.

21 Following Mr Strobel's declaration, an investigation was carried out by the tax authorities and the Finanzamt, Esslingen, assessed Mr Strobel for VAT in an amount equal to the amounts mentioned separately on the invoices, namely DEM 519 346.36 for 1992 and DEM 653 156.51 for 1993.

22 On 24 August 1995, Mr Strobel applied to the Finanzamt, Esslingen, for waiver of the VAT on grounds of equity under Paragraph 227 of the AO.

23 By decision of 15 November 1995, the Finanzamt, Esslingen, dismissed the application.

24 Mr Strobel appealed against the decision of the Finanzamt, Esslingen, to the Finanzgericht (Finance Court), Baden-Württemberg, which, by judgment of 9 July 1997, confirmed the Finanzamt's decision.

25 On 19 August 1997 Mr Strobel appealed on a point of law (Revision) to the Bundesfinanzhof (Federal Finance Court) against the judgment of the Finanzgericht.

26 The Bundesfinanzhof joined the two cases. It observed that the determination of VAT in accordance with the second alternative of the second sentence of Paragraph 14(3) of the UStG was justified since Schmeink and Mr Strobel had issued invoices mentioning this tax separately and had delivered them to the addressees of the invoices without having provided the services described therein.

27 The Bundesfinanzhof observed that the objective of Paragraph 14(3) of the UStG is to prevent fraud in cases where invoices are issued showing a separate amount for tax and where the transactions in question are not carried out. In the case of Paragraph 14(3) of the UStG, the legislature has not, as it has in the case of Paragraph 14(2) thereof, provided for any possibility of adjustment in order not to undermine the deterrent effect of Paragraph 14(3).

28 According to a judgment of the Bundesfinanzhof of 21 February 1980 (BStBl II 1980, p. 283), equitable measures are called for in cases in which the issuer of the invoice has wholly, and in sufficient time, eliminated the risk of loss of tax revenues. In such cases Paragraph 14(3) of the UStG does not have a deterrent effect, particularly where the issuer of the invoice succeeds in

retrieving and destroying the invoices issued before they are used by their recipients for tax-deduction purposes or where the issuer of the invoice, although he has not managed to retrieve the invoice, eliminates the risk to tax revenue by taking alternative measures in good time, by, inter alia, making a declaration to his local Tax Office or to the Tax Office of the addressee of the invoice.

29 The Bundesfinanzhof referred, however, to paragraph 18 of the judgment in Case C-342/87 Genius Holding v Staatssecretaris van Financiën [1989] ECR 4227 which states that, in order to ensure the application of the principle of neutrality of VAT, it is for the Member States to provide in their internal legal systems for the possibility of correcting any tax improperly invoiced where the issuer of the invoice shows that he acted in good faith. The Bundesfinanzhof also referred to a judgment of the Bundesgerichtshof (Federal Court) of 23 November 1995, IX ZR 225/94 (Neue Juristische Wochenschrift 1996, p. 842), in which that court held that, taking into account the fact that Paragraph 14(3) of the UStG did not provide for any possibility of adjustment, the way to comply with Genius Holding was by a waiver of tax under Paragraph 227 of the AO.

30 The Bundesfinanzhof observed that it is not possible to infer from the scheme of Paragraph 14(3) that good faith is a prerequisite for adjustment. Such a requirement, which emerges from the case-law of the Court, does not arise from the principle of neutrality. Restricting the right of the issuer of the invoice to a remission of VAT to cases involving good faith is neither adequate nor compatible with the scheme of the VAT system. Instead, a more appropriate criterion for the purposes of disallowing adjustment of the amount of the tax mentioned in the invoice would be to take into account the fact that the corresponding tax deduction may actually have been obtained by the addressee of the invoice. If it were to transpire that it was no longer possible to cancel a deduction already granted to the addressee of an invoice, the issuer of the invoice would be held liable for the shortfall in tax revenues in order to ensure tax neutrality.

31 If adjustment were made dependent on proof of the good faith of the issuer of the invoice, Article 21(1)(c) of the Sixth Directive would as a result come to resemble a provision of criminal law. The question of who ultimately bears the burden of the tax mentioned would depend solely on the existence of culpable conduct, namely acting in bad faith. That legal position would give rise to some constitutional difficulties.

32 Therefore the Bundesfinanzhof decided to stay proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

1. Does Community law require that provision be made to allow adjustment of an improperly invoiced tax as part of the procedure for determining the tax or is it sufficient for the Member States to permit adjustment only in a later procedure for determining whether payment of the tax is equitable (on "objective" grounds)?

2. Is it an imperative prerequisite for adjusting an improperly invoiced tax that the issuer of the invoice should demonstrate good faith or are there other circumstances in which an invoice may be adjusted (and, if so, what are those circumstances)?

3. What conditions must be satisfied for the issuer of an invoice to be acting in good faith?

Admissibility

33 The German Government disputes the admissibility of the first and third questions on the ground that answers to those questions would not assist in deciding the case in the main proceedings.

34 As regards the first question, the German Government claims that in the main proceedings the procedure for determining tax has ended and that appeals may no longer be brought in respect of

the notices of assessment, with the result that adjustment of amounts wrongly determined as part of the assessment procedure is no longer possible. The disputes in the main proceedings are concerned solely with the dismissal of the application for equitable remission under Paragraph 227 of the AO of sums to be paid by way of VAT and not with the tax assessment notices issued in accordance with the second alternative of the second sentence of Paragraph 14(3) of the UStG.

35 As to the third question, the German Government submits that, in the present case, there are no grounds for considering the concept of good faith. According to the Government, issuing the invoices was an abuse, and not an error, since Schmeink and Mr Strobel knew that they had no right to show VAT as a separate entry on the invoices.

36 In that regard, it must be observed that the procedure provided for by Article 177 of the Treaty is an instrument of cooperation between the Court of Justice and the national courts, by means of which the Court of Justice provides the national courts with the points of interpretation of Community law which they need in order to decide the disputes before them (see, inter alia, the order in Case C-361/97 Nour v Burgenländische Gebietskrankenkasse [1998] ECR I-3101, paragraph 10).

37 It is settled case-law that it is solely for the national court before which the dispute has been brought, and which must assume responsibility for the subsequent judicial decision, to determine in the light of the particular circumstances of the case both the need for a preliminary ruling in order to enable it to deliver judgment and the relevance of the questions which it submits to the Court. Consequently, where the questions submitted by the national court concern the interpretation of Community law, the Court of Justice is, in principle, bound to give a ruling (see, in particular, Case C-415/93 Union Royale Belge des Sociétés de Football Association and Others v Bosman and Others [1995] ECR I-4921, paragraph 59; Case C-200/97 Ecotrade v AFS [1998] ECR I-7907, paragraph 25; and Case C-254/98 Schutzverband gegen unlauteren Wettbewerb v TK-Heimdienst Sass [2000] ECR I-151, paragraph 13).

38 In the present case, it is not obvious that the interpretation of Community law that the national court seeks by its first question bears no relation to the subject-matter of the cases in the main proceedings.

39 In the event that Community law should be interpreted as meaning that Member States are obliged to make it possible under their national law to adjust VAT which has been improperly invoiced, adjustment could be effected, inter alia, as part of a later procedure initiated on equitable grounds, such as the procedure provided for in Paragraph 227 of the AO.

40 In addition, the objection raised by the German Government goes to the substance of the question rather than its admissibility, in that it is based on the premiss that the adjustment concerned may not form part of a later procedure initiated on equitable grounds but should have been part of the procedure for determining tax.

41 Similarly, as regards the third question, the German Government's argument that the concept of good faith should not be considered in the present case, since the issuing of invoices by taxpayers who, as in the case in the main proceedings, know that they have no right to mention VAT as a separate entry constitutes an abuse, in fact has to do with what is meant by good faith and therefore also goes to the substance of the question.

42 It follows that the first and third questions are admissible.

The questions referred for a preliminary ruling

The second question

43 By its second question, which it is appropriate to consider first, the national court is asking essentially whether the issuer of an invoice must have acted in good faith in order to obtain adjustment of VAT which has been improperly invoiced.

44 The German Government submits that, in the absence of any Community rules on the subject, it is for the Member States to lay down the detailed rules on adjustment of VAT which has been improperly invoiced.

45 According to the German Government, the requirements of Community law resulting from Genius Holding are met by the fact that it is possible under German law for a person who has issued an invoice in good faith, but who has committed an excusable error, to adjust on objective grounds improperly invoiced VAT by means of equitable measures.

46 The German Government further submits that, where VAT has been improperly mentioned not in good faith but abusively by the issuer of the invoice because he knows either that he is not a taxable person or that the supply of goods or services in respect of which the invoice has been issued has not been carried out, the principle of neutrality of VAT does not require there to be any possibility of adjusting the VAT improperly invoiced. In such cases, the rule of national law that a person who mentions an amount in respect of VAT separately on an invoice is liable for that amount operates as a penalty and a deterrent.

47 It should first be observed that, under Article 21(1)(c) of the Sixth Directive, any person who mentions VAT on an invoice or other document serving as invoice is liable to pay VAT under the internal system.

48 Secondly, it should be observed that the Sixth Directive does not contain any provisions relating to the adjustment by the issuer of the invoice of VAT which has been improperly invoiced. The Sixth Directive merely defines, in Article 20, the conditions which must be complied with in order that deduction of input taxes may be adjusted at the level of the person to whom goods or services have been provided.

49 In those circumstances, it is for the Member States to lay down the conditions in which improperly invoiced VAT may be adjusted.

50 The national court has pointed out that, according to Genius Holding, an issuer of an invoice is not entitled to adjust VAT which has been improperly invoiced unless he can show that he acted in good faith.

51 It should be noted in that regard that in Genius Holding the plaintiff in the main proceedings had deducted VAT in respect of which he had been invoiced by two of his subcontractors. This was an infringement of the applicable national law under which the subcontractors were not liable to pay VAT in respect of services provided to the principal contractor, the tax being due only by the latter on the amount which he invoiced to the person who had placed the order. The tax authorities had taken the view that VAT had been improperly invoiced to the plaintiff and that it could not therefore deduct it. The authorities had therefore reassessed the taxable amount.

52 Following the plaintiff's claim that Article 17(2) of the Sixth Directive allowed any tax mentioned on the invoice to be deducted, the national court decided to refer to the Court of Justice the question whether Article 17(2) was to be interpreted in that way.

53 In answering that question, the Court held in Genius Holding that the right to deduct provided for in the Sixth Directive did not apply to tax which is due solely because it is mentioned on the invoice. The Court explained in paragraph 13 of its judgment that the right to deduct could be

exercised only in respect of taxes actually due, that is to say, the taxes corresponding to a transaction subject to VAT or paid in so far as they were due.

54 As the Court observed in paragraph 17 of its judgment in Genius Holding, if any tax which has been invoiced could be deducted, even though it does not correspond to taxes legally due, tax evasion would be made easier.

55 In Genius Holding the deductions which had been made initially by the plaintiff had therefore to be adjusted in accordance with Article 20(1)(a) of the Sixth Directive.

56 That was the context in which the Court held in paragraph 18 of its judgment in Genius Holding that, in order to ensure the application of the principle of neutrality of VAT, it was for the Member States to provide in their internal legal systems for the possibility of correcting any tax improperly invoiced where the issuer of the invoice shows that he acted in good faith.

57 It should be observed that, unlike the situation in Genius Holding, in the cases in the main proceedings the risk of any loss in tax revenues has been completely eliminated in sufficient time either because the issuer of the invoice has retrieved and destroyed the invoice before its recipient used it or because, although the invoice has been used, the issuer of the invoice has settled the amount shown separately on the invoice.

58 In such circumstances, where the issuer of the invoice has in sufficient time wholly eliminated the risk of any loss in tax revenues, the principle of the neutrality of VAT requires that VAT which has been improperly invoiced can be adjusted without such adjustment being made conditional by the Member States upon the issuer of the relevant invoice having acted in good faith.

59 It should be noted in that respect that the measures which the Member States may adopt under Article 22(8) of the Sixth Directive in order to ensure the correct levying and collection of the tax and for the prevention of fraud must not go further than is necessary to attain such objectives (Joined Cases C-110/98 to C-147/98 Gabalfrisa and Others v Agencia Estatal de Administración Tributaria [2000] ECR I-1577, paragraph 52). They may not therefore be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant Community legislation.

60 It must be noted that the requirement that the issuer of the invoice should demonstrate his good faith when he has in sufficient time wholly eliminated any risk of lower tax yields is not necessary to ensure the collection of VAT or to prevent tax evasion (see, to this effect, Case C-361/96 Grandes Sources d'Eaux Minérales Françaises v Bundesamt für Finanzen [1998] ECR I-3495, paragraphs 29 and 30).

61 By contrast, as was the case in Genius Holding, where the risk of any loss of tax revenues has not been wholly eliminated, the Member States may make the possibility of adjusting VAT which has been improperly invoiced conditional upon the issuer of the relevant invoice having acted in good faith. As the national court has stated, if it transpires that it is no longer possible to cancel a deduction granted in respect of the addressee of the invoice and the issuer of the invoice has not acted in good faith, he may be held responsible for the shortfall in tax revenues in order to ensure tax neutrality.

62 Finally it should be noted that, as the Commission has rightly submitted, Community law does not prevent Member States from treating the issuing of bogus invoices improperly mentioning VAT as attempted tax evasion and from imposing, in such a case, fines or penalty payments prescribed by their domestic law.

63 The answer to the second question must therefore be that where the issuer of the invoice has in sufficient time wholly eliminated the risk of any loss in tax revenues, the principle of the

neutrality of VAT requires that VAT which has been improperly invoiced can be adjusted without such adjustment being made conditional upon the issuer of the relevant invoice having acted in good faith.

The first question

64 By its first question, which it is appropriate to consider in the second place, the national court is asking essentially what type of procedure is appropriate as regards the adjustment of VAT which has been improperly invoiced.

65 As is apparent from paragraphs 47 to 49 above, it is for the Member States to lay down the conditions in which improperly invoiced VAT may be adjusted.

66 The Member States may therefore decide, in particular, whether such adjustment should take place as part of the procedure for determining the tax payable or in the course of a subsequent procedure.

67 As the Advocate General has observed in point 20 of his Opinion, a Member State may take the view that an adjustment of improperly invoiced VAT should take place during a later procedure in order to allow the tax authorities to verify that any risk of loss of revenue has been removed, especially where a deduction has been made in respect of the VAT in question.

68 Nevertheless, when such a risk has been eliminated, adjustment in respect of improperly invoiced VAT cannot be dependent upon the discretion of the tax authorities.

69 It follows from the answer to the second question that, in such a situation, the principle of the neutrality of VAT requires that improperly invoiced VAT can be adjusted.

70 The answer to be given to the first question must therefore be that it is for the Member States to lay down the procedures to apply as regards the adjustment of improperly invoiced VAT, provided that such adjustment is not dependent on the discretion of the tax authorities.

The third question

71 Taking account of the answers given to the first and second questions, it is not necessary to reply to the third question.

Decision on costs

Costs

72 The costs incurred by the German Government and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

Operative part

On those grounds,

THE COURT,

in answer to the questions referred to it by the Bundesfinanzhof by order of 15 October 1998, hereby rules:

1. Where the issuer of the invoice has in sufficient time wholly eliminated the risk of any loss in tax revenues, the principle of the neutrality of VAT requires that VAT which has been improperly invoiced can be adjusted without such adjustment being made conditional upon the issuer of the relevant invoice having acted in good faith.

2. It is for the Member States to lay down the procedures to apply as regards the adjustment of improperly invoiced VAT, provided that such adjustment is not dependent on the discretion of the tax authorities.