OPINION OF ADVOCATE GENERAL

KOKOTT

delivered on 19 December 2013 (1)

**Case C?107/13**

**FIRIN OOD**

**v**

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

(Request for a preliminary ruling from the Administrativen sad Veliko Tarnovo (Bulgaria))

(Tax law — VAT — Directive 2006/112/EC — Deduction of input tax — Adjustment of input tax deduction in respect of payments on account for a supply which is not made)

## I – **Introduction**

1. Once again, a Bulgarian court has referred questions to the Court of Justice concerning the refusal of an input tax deduction in connection with suspected value added tax (VAT) fraud. The unusual feature in the present case is that the input tax deduction has been claimed on the basis of a payment on account, in circumstances where no supply was made following that prepayment.

2. To date, the Court has not considered what should happen to the input tax deduction in such a situation. For that reason, in the present case it is necessary not only to consider, as usual, the settled case-law of the Court on the refusal of an input tax deduction in the case of VAT fraud (which might be hard to prove) but also to answer a question of interpretation which has not been considered to date and which is of general importance for the law on VAT.

## II – **Legal framework**

### A – *European Union law*

3. The right to deduct input tax is governed by Article 168(a) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (2) (‘the VAT Directive’):

‘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'.

4. Under Article 167 of the VAT Directive, the right to deduct VAT arises 'at the time the deductible tax becomes chargeable'. Article 63 provides that VAT is to become chargeable 'when the goods or the services are supplied'. Article 65, however, lays down the following special rule:

'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.'

5. The VAT Directive provides for adjustment of the chargeable VAT and the right to deduct input tax in certain circumstances. Article 90(1) provides for the adjustment of the chargeable tax:

'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.'

6. Article 184 of the VAT Directive provides that '[t]he initial deduction shall be adjusted where it is higher or lower than that to which the taxable person was entitled'. In this respect, Article 185 of the VAT Directive provides:

'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.'

7. In addition, Article 192a et seq. of the VAT Directive contain provisions concerning '[p]ersons liable for the payment of VAT to the tax authorities'. According to the general rule in Article 193, VAT is to be payable by any taxable person 'carrying out a taxable supply of goods or services …'.

8. In this connection, recital 44 in the preamble to the VAT Directive states:

'Member States should be able to provide that someone other than the person liable for payment of VAT is to be held jointly and severally liable for its payment.'

9. To this end, Article 205 of the VAT Directive accordingly provides:

'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.'

B – *National law*

10. Under Article 177 of the Bulgarian Zakon za danak varhu dobavenata stoynost (Law on value added tax), a registered person who receives 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.

## III – **Main proceedings and proceedings before the Court**

11. The main proceedings concern a tax notice by which the claimant Firin OOD (‘Firin’) was refused the right to deduct input tax on the basis of an invoice issued by Agra Plani EOOD (‘Agra Plani’).

12. In 2010 those two companies concluded a purchase contract for 10 000 tonnes of wheat, notwithstanding the fact that under Bulgarian law Agra Plani was not entitled to trade in grain. Agra Plani was required to deliver the wheat at the latest by 31 December 2012, and Firin was to pay the purchase price of BGN 3.6 million (approximately EUR 1.8 million) in advance. On that basis Firin claimed a deduction of input tax, after it had paid 4.17 million Bulgarian lev (BGN) to Agra Plani.

13. This amount was immediately transferred by Agra Plani to the company York Skay EOOD as an ostensible loan, and on the same day that company transferred BGN 3.6 million back to Firin as an ostensible capital contribution. The shareholders in Firin were York Skay EOOD and a natural person who was also the sole shareholder in Agra Plani.

14. Following non-payment by Agra Plani of any VAT on the basis of the purchase contract and its non-delivery of the wheat, and also following its automatic de-registration as a taxable person in April 2011, the Bulgarian tax authorities demanded from Firin repayment of the input tax already claimed on the basis of the purchase contract. Those authorities take the view that an initial right to deduct input tax on the basis of a payment on account ceases if the supply contracted for is not subsequently made. In addition, those authorities assume that the case involves a fictitious transaction and a fictitious money flow, for which reason Firin knew that the VAT charged on the basis of the purchase contract would not be paid.

15. The Administrativen sad Veliko Tarnovo (Administrative Court, Veliko Tarnovo), before which the dispute concerning the refusal of the right to deduct input tax has been brought, has now referred the following questions to the Court pursuant to Article 267 TFEU:

‘(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 the VAT Directive 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 the VAT Directive, 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 the VAT Directive 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?'

16. In the proceedings before the Court, the Bulgarian tax authorities, the Republic of Bulgaria, the Republic of Estonia, the Italian Republic and the Commission have submitted written observations.

## IV – **Legal analysis**

17. The national court asks four questions touching on two different regulatory areas of the VAT Directive. On the one hand, the first, second and third questions concern the refusal of the right to deduct input tax, and in particular the conditions for the right of deduction laid down by Article 167 et seq. and by Article 184 et seq. of the VAT Directive. On the other hand, the fourth question, and also in part the third question, concern the joint and several liability of a taxable person for the tax debt owed by another person under Article 205 of the VAT Directive.

18. It should be stressed that the refusal of the right to deduct input tax is to be strictly distinguished from liability for the tax debt of another person. This is because deduction of input tax and liability are respectively subject to different conditions and provisions of the VAT Directive.

19. In its request for a preliminary ruling, the national court itself explained that the Bulgarian tax authorities have *not* made a claim against Firin, the taxable person, on the basis of joint and several liability for Agra Plani's tax liability, but have refused it the right to deduct input tax. According to the Court's settled case?law, it may refuse to rule on a question referred to it where it is quite obvious that the interpretation that is sought bears no relation to the actual facts of the main action. (3) On that basis the questions referred are inadmissible in so far as they concern joint and several liability of a taxable person for another person's tax debt, as the grounds on which the request for a preliminary ruling has been made do not show those questions to have any relevance to the main proceedings. It follows that neither the fourth question nor the third question, in so far as it likewise concerns the interpretation of Article 205 of the VAT Directive, need be answered.

20. In relation to the right to deduct input tax, by its first, second and third questions the national court asks whether this right is to be refused where a payment on account within the meaning of Article 65 of the VAT Directive has been made but the supply has not been made (see B below), and whether it makes any difference that the supplier continues to be liable for VAT on the supply that has not been made (see C below). In order to be able to provide the national court with a helpful answer, (4) I will first consider the question as to the circumstances in which a right to deduct input tax on the basis of a payment on account arises at all (see A below).

### A – *Creation of a right to deduct input tax in the case of a payment on account*

21. According to Article 167 of the VAT Directive, the right to deduct input tax arises at the time when the deductible tax becomes chargeable. Accordingly, for Firin to have the right to deduct which is disputed in the main proceedings, having regard to the purchase contract which it concluded with Agra Plani, it is necessary that the tax authorities' tax claim against Agra Plani

should have arisen. Article 63 of the VAT Directive provides that this tax claim in principle arises only when the goods are supplied; Agra Plani, however, has not in fact done this.

22. However, where a payment on account is made in respect of the taxable transaction, Article 65 of the VAT Directive provides that the tax liability and, with it, the right to deduct input tax arise when the payment on account is received by the taxable person. Such a payment on account need not be limited to part of the consideration, but can — as in the present case — constitute the entire consideration. (5) According to the case-law of the Court, for Article 65 of the VAT Directive to apply 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 the payment on account is made. (6)

23. The reasoning underlying the request for a preliminary ruling proceeds on the basis that, regardless of subsequent payments, the consideration was effectively made available to Agra Plani, the supplier, and that there was therefore a payment on account within the meaning of Article 65 of the VAT Directive. In addition, the first question, in particular, assumes that the requirements laid down by the above case-law as regards the identification of the supply are satisfied in the present case. From this, the national court concludes that in principle Firin has a right to an input tax deduction.

24. However, the national court must also have regard for the fact that Article 65 of the VAT Directive cannot apply where, at the time of the payment on account, it is not certain that the supply will be made.

25. Thus, the Court has refused to apply this provision in one case inter alia because the buyer was entitled to terminate the contract unilaterally at any time. (7) This right of termination meant that it was not certain that a taxable supply would subsequently in fact be made.

26. Moreover, Article 65 of the VAT Directive constitutes a derogation from the general rule in Article 63 of the VAT Directive and, according to the settled case-law of the Court, is therefore to be interpreted strictly. (8) Specifically, Article 62(1) of the VAT Directive provides that it is only through the occurrence of the chargeable event that the legal conditions for the tax authorities' claim are satisfied. From this it follows that the tax liability can arise at the same time as or after the chargeable event, but in principle not before. (9) The chargeable event to be considered in the present case, namely under Article 2(1)(a) of the VAT Directive, occurs only when the supply of goods is made. If Article 65 of the VAT Directive were to allow a tax liability to arise in the case of a payment on account before the chargeable event occurred and the basis for imposing tax thereby came into being at all, it would have to be expected that in the ordinary course of events the taxable supply would also be made. If any realistic doubts exist in this respect, Article 65 of the VAT Directive is not applicable.

27. Such doubts could exist in the main proceedings in the present case.

28. This is so, first, having regard to the fact that in the grounds for the request for a preliminary ruling the national court at times describes the purchase contract as 'fictitious'. It could therefore be the case that there was no serious intention from the outset to carry out the supply of wheat.

29. Second, in this context account must also be taken of the fact that Agra Plani did not have the necessary legal authorisation to supply wheat, and for that reason the purchase contract may have been invalid. It is true that the principle of fiscal neutrality precludes distinguishing generally between legal and illegal transactions. (10) However, a legal prohibition of the supply may raise the question, at the time of the payment on account, as to whether the supply will ever be made.

30. Since both of these circumstances concern the facts and the interpretation of national law, they must be clarified by the national court in the main proceedings. To the extent that Article 65 of the VAT Directive is not applicable in the present case because of real doubts existing at the time of the payment on account as regards the future supply, pursuant to Article 167, in conjunction with Article 63, of the VAT Directive no right to deduct input tax would have yet arisen at the time of the payment on account. However, to answer the questions referred I will assume in what follows that such a right did arise in favour of Firin.

B – *Refusal of the right to deduct input tax in the case where the supply is not made*

31. By its first question the national court essentially asks whether the right to deduct input tax in the case of a payment on account, which leads to application of Article 65 of the VAT Directive, continues to exist if the taxable supply is subsequently not made.

32. In this connection the parties to the proceedings have pointed out that, according to settled case-law, the right to deduct input tax is to be refused where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent or abusive ends. That is the position where a tax fraud is committed by the taxable person himself or when he knew, or should have known, that he was taking part in a transaction connected with VAT fraud. (11)

33. However, the question as to whether the right to deduct input tax is to be refused because of fraudulent conduct logically comes after the question as to whether such a right exists at all under general provisions, that is, regardless entirely of any fraud that is yet to be proved. Therefore, in the present case it is first necessary to establish whether the right to deduct input tax is to be adjusted in any event pursuant to Article 184 et seq. in the case where a payment on account pursuant to Article 65 of the VAT Directive has been made and the supply of goods has not followed.

34. Article 185(1) of the VAT Directive provides that an adjustment is, in particular, to be made where, after the VAT return is made, some change occurs in the factors used to determine the amount to be deducted. As I have already explained in more detail in the case of *TETS Haskovo*, this concerns inter alia the question as to whether the expectations that gave rise to the right to deduct input tax have subsequently in fact been realised. (12)

35. The factors to be taken into account in determining the input tax deduction in the present case include, in the case of a payment on account within the meaning of Article 65 of the VAT Directive — as already explained, (13) — the expectation that in the normal course of events the taxable supply will be made. If it is established that this expectation can no longer be maintained because it is anticipated that no taxable supply will be made, the factors taken into account in determining the input tax deduction will then have changed. Therefore, in accordance with Article 185(1) of the VAT Directive the input tax deduction must in principle be adjusted if it is no longer expected that the supply will be made. This is a matter for the national court to clarify in the main proceedings.

36. The derogating rule in Article 185(2) of the VAT Directive does not preclude adjustment. That provision specifies various cases in which no adjustment is to be made. However, it does not mention the failure to make a supply after a payment has been made on account.

37. Thus, in principle the answer to the first question is that, where there is a payment on account which has led to the application of Article 65 of the VAT Directive, the input tax deduction is to be adjusted if the taxable supply is ultimately not made.

C – *Connection with the adjustment of the tax liability*

38. By its second and third questions the national court, however, essentially asks in addition whether, having regard to the principle of fiscal neutrality, the adjustment of the input tax deduction in the present case depends on the objective possibility of adjusting the corresponding tax liability. Specifically, if this tax liability is not adjusted, although the input tax deduction is adjusted, the tax authorities could ultimately receive more than they would have done in the normal course of events.

39. The principle of fiscal neutrality constitutes not only a particular manifestation of the principle of equality in VAT law, but also means that each trader should, by means of the deduction mechanism, be relieved entirely of the burden of the VAT payable or paid in the course of all his economic activities. (14) The present case might be regarded as involving an imposition on a taxable person in a manner inconsistent with the system of VAT in so far as the supplier, Agra Plani, could still be liable to pay VAT even though its contracting partner Firin had made a payment on account but has had to adjust the input tax deduction that had arisen.

40. In this regard it must be borne in mind that in a situation such as that in the present case a tax liability exists for two reasons.

41. First, the supplier owes the VAT, as the parties to the proceedings have correctly pointed out, in accordance with Article 203 of the VAT Directive on the basis of the VAT indicated by him in his invoice. According to settled case-law, this tax liability can be adjusted by the supplier subject to certain conditions, (15) and adjustment is not precluded by the fact that at the time of the adjustment he is no longer registered as a taxable person. (16) So long as there has been no adjustment, the tax liability continues, whereas, as indicated above, the corresponding input tax deduction is to be adjusted.

42. Consistent with this, in *Stroy trans* and *LVK — 56* the Court has accordingly already held that the traders involved in a transaction need not necessarily be treated identically if the issuer of an invoice has not corrected it. This is because the issuer of an invoice is liable, under Article 203 of the VAT Directive, to pay the VAT entered on that invoice even if there is no taxable transaction, whereas the recipient of the invoice in such a case does not have any right to deduct input tax. (17)

43. Second, in the present case the supplier is liable for the VAT also under Article 193, in conjunction with Article 65, of the VAT Directive on the basis of the payment on account. In principle, a tax liability of this type can be extinguished if the taxable amount is reduced, in accordance with Article 90 of the VAT Directive. However, it is doubtful whether this can occur without the payment on account being repaid. This is because the judgment of the Court in *Freemans* (18) can be understood as meaning that a reduction in the taxable amount generally presupposes that any amounts paid to the taxable person are in fact repaid. (19) Thus, if the supplier does not pay back the payment on account, the tax liability can no longer be adjusted, in contrast to the position under Article 203 of the VAT Directive, even though at the same time the input tax deduction is to be adjusted.

44. In this regard two different aspects are to be considered.

45. First, it must be recalled that, according to case-law, it is in general unobjectionable that a tax liability exists even though the corresponding right to deduct input tax cannot be claimed. Thus, in *Petroma Transports and Others* the Court held that the charging of VAT is not conditional upon the actual exercise of the right to deduct input tax. Accordingly, VAT can be charged on turnover

even if the corresponding right to deduct input tax cannot be claimed because of a formal irregularity in the invoice. (20)

46. Furthermore, however, the question arises as to whether an adjustment of an input tax deduction specifically in the case of a payment on account requires that the payment on account be repaid. On the one hand, this would correspond to the requirements set out above for adjusting the taxable amount and thus the tax liability. On the other hand, in the case of the supplier's insolvency this would prevent the person entitled to deduct input tax from incurring a loss in the amount of the VAT element of his payment on account.

47. Regardless of whether the statements in the judgment in *Freemans* were intended to apply also to cases of payments on account, there are different requirements underlying adjustment of the taxable amount under Article 90 and adjustment of the input tax deduction under Article 184 et seq. of the VAT Directive. Thus, the Court based its judgment in *Freemans* on the fact that, according to settled case-law, the definitive taxable amount is the consideration actually received. (21) However, in regard to the right to deduct input tax there is no corresponding principle making the right to make such a deduction dependent on actual payment of the consideration. This is clear simply from the fact that the first subparagraph of Article 185(2) of the VAT Directive precludes adjustment of the input tax deduction in the case of transactions remaining totally or partially unpaid. In this case the taxable person thus retains the right to deduct input tax, even if he has not made any payment at all.

48. In addition, the principle of fiscal neutrality does not require that, where a payment on account has been made, the right to deduct input tax is not to be adjusted so long as the payment on account has not been repaid. The Court has already held that it is in principle consistent with this principle if the recipient of the supply has only a private law right to repayment from his contracting partner, in order to safeguard his financial interests. (22)

49. In the corresponding case of *Reemstma Cigarettenfabriken* the Court granted the recipient of a supply a direct right against the tax authorities for repayment of VAT that had been wrongly paid where his contracting partner had become insolvent, but this is not comparable to the facts of the present case, in which the tax authorities have not received any VAT. In this regard, the Italian Republic correctly stated that in the present case the refusal of the right to deduct input tax, at the same time as the tax liability is not paid, in effect merely avoids a loss to the tax authorities, but does not levy VAT in a manner inconsistent with the tax system. The circumstance that this loss is suffered instead by the potential recipient of a supply, who may not receive back his payment on account, is justified by the fact that the recipient himself has sought out his contracting partner and knowingly assumed the risk of making a payment on account.

50. Thus, in conclusion the answer to the second and third questions of the national court is that the adjustment to the right to deduct input tax does not depend on either the adjustment of the corresponding tax liability or repayment of the payment on account.

## V – **Conclusion**

51. On the basis of all of the foregoing considerations I propose that the questions posed by the Administrativen sad Veliko Tarnavo should be answered as follows:

(1) It is a condition for the creation of a tax claim under Article 65 of the VAT Directive that it is expected that in the normal course of events the taxable supply will in fact be made.

(2) In accordance with Article 185(1) of the VAT Directive, a deduction of input tax claimed on the basis of a payment on account within the meaning of Article 65 of the VAT Directive is to be

adjusted if the taxable supply is ultimately not made. The adjustment to the right to deduct input tax does not depend on either the adjustment of the corresponding tax liability or repayment of the payment on account.

1 – Original language: German.

2 – OJ 2006 L 347, p. 1.

3 – Case C?290/12 *Della Rocca* [2013] ECR, paragraph 29 and the case-law cited.

4 – On this power of the Court of Justice, see Case 35/85 *Tissier* [1986] ECR 1207, paragraph 9, and Case C?342/12 *Worten* [2013] ECR, paragraph 30.

5 – Case C?549/11 *Orfey* [2012] ECR, paragraph 37, and Case C?19/12 *Efir* [2013] ECR, paragraph 39.

6 – Case C?419/02 *BUPA Hospitals and Goldsborough Developments* [2006] ECR I?1685, paragraph 48; Case C?270/09 *MacDonald Resorts* [2010] ECR I?13179, paragraph 31; Case C?520/10 *Lebara* [2012] ECR, paragraph 26; *Orfey*, paragraph 28; and *Efir*, paragraph 32.

7 – *BUPA Hospitals and Goldsborough Developments*, paragraph 51.

8 – *BUPA Hospitals and Goldsborough Developments*, paragraph 45; *Orfey*, paragraph 27; and *Efir*, paragraph 32.

9 – *BUPA Hospitals and Goldsborough Developments*, paragraph 46.

10 – Case C?283/95 *Fischer* [1998] ECR I?3369, paragraph 22, and Case C?275/11 *GfBk* [2013] ECR, paragraph 32.

11 – Case C?78/12 *Evita-K* [2013] ECR, paragraphs 39 and 40 and the case-law cited.

12 – See the Opinion in Case C?234/11 *TETS Haskovo* [2012] ECR, points 25 to 28.

13 – See above, point 24 et seq.

14 – Case C?174/11 *Zimmermann* [2012] ECR, paragraphs 46 to 48 and the case-law cited.

15 – Case C?138/12 *Rusedespred* [2013] ECR, paragraphs 25 to 27 and the case-law cited.

16 – Case C?643/11 *LVK — 56* [2013] ECR, paragraph 49.

17 – Case C?642/11 *Stroy trans* [2013] ECR, paragraph 41 et seq., and *LVK — 56*, paragraph 46 et seq.

18 – See the judgment of the Bundesfinanzhof (German Federal Finance Court) of 2 September 2010, V R 34/09, paragraph 17, referring to its judgment of 18 September 2008, V R 56/06, paragraph 43 et seq.

19 – Case C?86/99 *Freemans* [2001] ECR I?4167, paragraph 35.

20 – Case C?271/12 *Petroma Transports and Others* [2013] ECR, paragraphs 41 to 43.

21 – *Freemans*, paragraph 27.

22 – Case C?35/05 *Reemtsma Cigarettenfabriken* [2007] ECR I?2425, paragraph 39.