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Highlights & Insights on European Taxation

Please find below a selection of articles published this month (March 2024) in Highlights & Insights on European Taxation, plus one freely accessible article.

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– ***Sancra*** **(C-377/23)**. VAT liability when the taxable person erroneously applies a zero rate and cannot recover the tax from the purchaser. Court of Justice

(comments by **José M. Macarro Osuna**) (*H&I* 2024/61)

The case

The facts of this case concern DC, a taxable person who sells motor vehicles to final consumers.

DC thought that these cars could be considered as second-hand goods and, therefore, applied the special scheme for this type of goods. According to the profit margin scheme, the taxable person, following the Portuguese Law on VAT, mentioned in the invoices that the special arrangement was applicable and the transactions were subject to a zero tax rate. However, the Portuguese Tax Administration (Autoridade Tributària e Aduaneira) responded that the motor vehicles sold by DC should be considered as new, according to the definition of Article 2(2)(b) of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (VAT Directive) and refused the application of the special scheme of second-hand goods.

Following this reasoning, the transactions should have been subject to the general VAT rate of 23%, and not to a zero rate. Hence, the Tax Administration rectified the tax returns of the taxable person, applying the general tax rate to the amounts that appeared in the invoices issued by DC and provided to the customers. The taxpayer appealed the corrections of the tax returns, and the Administrative Supreme Court referred the case to the Court of Justice of the European Union (CJ) regarding the calculation of the taxable amount and the tax payable on the transactions. The Portuguese Tax Administration had stated that the prices paid by the final consumers had to be considered as the tax base of the transaction and the tax liability would result from the application of the tax rate to that amount. On the contrary, DC claimed that the amounts exchanged should include both the taxable amount and the VAT due, stating that he was not able to correct the invoices and pass the tax on to the customers due to the absence of a mechanism to make such an adjustment.

The referring Court doubted whether the reasoning and method applied by the Portuguese Tax Administration was compatible with the case law of the CJ, which had interpreted Articles 73 and 78 of the VAT Directive. More specifically, the Portuguese referring Court recalled that the case law had stated that the tax burden of VAT must only be borne by customers and that the public Treasury should not receive a higher amount than that paid by the final consumer. Therefore, it asked the CJ whether, according to the principle of fiscal neutrality and VAT rules, the price exchanged already included the VAT or should it be considered as the taxable amount of the transaction, to which the general tax rate must be applied to calculate the VAT due.

Even though the referring Court considered that the correct interpretation of these articles could be 'easily deduced' from the case law of the CJ, it did not apply the *Acte Éclairé* doctrine (CJ 6 October 1982, C-283/81 *CILFIT*, ECLI:EU:C:1982:335). The reason being that the Portuguese Court considered that there were differences with the other cases addressed by the CJ, mainly that in the other judgments, there was no invoice or no mention of VAT in the invoice, whereas in the current case, the invoices did mention the VAT, although with a zero rate.

The two judgments that the Portuguese Court seems to mention, and that are used by the CJ to answer the referred question are CJ 7 November 2013, C-249/12 and C-250/12 *Tulic? e Plavo?in*, ECLI:EU:C:2013:722 (hereinafter: *Tulic? e Plavo?in*), and CJ 1 June 2021, C-521/19 *Tribunal Económico Administrativo Regional de Galicia*, ECLI:EU:C:2021:527 (hereinafter: *TEAR Galicia*). The first case concerned two individuals who had concluded contracts for the sale of land, which contained no mention with regard to VAT. Despite the fact that they considered those sales to be not an economic activity, the Tax Administration reclassified them as taxable persons subject to VAT. The second judgment was a clear case of tax fraud, in which the taxable person, CB, had provided services and received the payments in cash, without issuing invoices or declaring the transactions in his tax returns. In both cases, the CJ addressed whether the amounts exchanged included VAT or could only be considered

as the taxable amount without the tax, given that it was not possible to recover the unpaid VAT from the purchaser.

The judgment of the CJ

Despite the slight differences pointed out by the referring Court between this case and the previous judgments recalled above, the CJ considered that the question referred admitted no reasonable doubt regarding the existing case law and decided to rule by reasoned order. In fact, the legal reasoning developed by the CJ is based on paragraphs of the mentioned judgments. As acknowledged by the referring Court, in *Tulic? e Plavo?in* (C-249/12 and C-250/12), the CJ focused on the essence of VAT as a tax aimed exclusively at tax final consumption and not the supply of goods and services. In those circumstances, in which the taxable person could not recover the VAT from the buyers under national law, if the amount received did not include the VAT and was strictly the tax base, the tax requested by the tax authorities would become a cost for the taxable person and not borne by the final consumer. The CJ stated that tax authorities cannot charge a VAT amount exceeding the amount received by the taxpayer. Furthermore, the CJ, in its judgment, considered that the interpretation of the tax authorities would go further than is necessary to dissuade irregularities, as having the VAT borne by the supplier would not be compatible with the functioning of the VAT system.

The reasoning of the CJ in *TEAR Galicia* (C-521/19) was very similar, although in the order at comments, the CJ only mentions its conclusion. Nevertheless, it is interesting to recall some of the statements made in that judgment. This was a case in which the taxable person had hidden the transactions and not charged VAT. The Spanish VAT Law did not allow him to pass the tax on to the consumers because he was involved in a fraudulent scheme. The CJ stated that Member States cannot use the articles of the VAT Directive that establish the calculation of the taxable amount (Articles 73 and 78 of the VAT Directive) to fight evasion.

The conclusion of the CJ in both cases is identical and clear: either because the price of a good has been established without any reference to VAT (*Tulic? e Plavo?in*, C-249/12 and C-250/12, paragraph 43), or because of a fraud scheme the VAT had not been charged nor the invoices issued, the amounts paid and received during the transaction must be regarded as already including the VAT, unless the taxable persons have the possibility of subsequently passing on the VAT to the purchaser (*TEAR Galicia*, C-521/19, paragraph 39). The final statement of the CJ in the current case is identical but adapted to the specific circumstances of the case. The incorrect application of a zero rate meant that the VAT had been applied to final consumers, allowing the taxable person to deduct the input tax. However, this situation does not allow the tax authorities to charge an amount of VAT that disregards the mentioned principles of the tax: its tax burden should be borne only by final consumers, and the amount collected cannot exceed that received by the taxpayer. Therefore, the CJ concluded that when a taxable person has erroneously applied a wrong tax rate in an invoice with a VAT zero rate when a higher tax rate was applicable, the amount indicated in the invoices will be considered as an amount including VAT, unless, in accordance with national law, the taxable person is able to pass on to the purchasers and recover from them the correct amount of VAT corresponding to the correct application of the tax rate.

Discussion: The price includes the VAT regardless of the type of error made by the taxable person

With this order, the CJ reinforces the criteria established in the previous cases, *Tulic? e Plavo?in* (C-249/12 and C-250/12) and *TEAR Galicia* (C-521/19), as it will be applicable to all cases in which the taxable person has charged to the purchaser a lower amount of VAT than due and it is not possible to adjust this error to recover the appropriate amount of VAT from the customer. In the opposite situation, in which the VAT charged is higher than the tax due and it is not possible to correct the invoices issued to the final consumers, the CJ has determined that the taxable person is not liable for the amount overpaid if there is no risk of loss of tax revenue (CJ 8 December 2022, C-378/21 *P GmBH v Finanzamt Österreich*, EU:C:2022:968). Thus, the main conclusion is that the type of error is not relevant, it may either be a mistake in the interpretation of VAT legislation – the taxable person considered that her activity was not subject to VAT, or that a special regime with a zero rate was applicable – or a fraud deliberately committed by the taxpayer. If it is not possible to adjust this situation, the payment received by the supplier will be considered to include both the taxable amount and the VAT liability.

Therefore, the key element is whether or not the VAT can be passed to the purchaser. In fact, probably the most coherent solution with the principle of fiscal neutrality would be to make the taxable person charge the tax liability to the purchaser. The responsibility for the mistake or fraud could entail the imposition of sanctions (J.M. Macarro Osuna, *La cuota IVA se considera incluida en el precio de las operaciones ocultas*, Nueva Fiscalidad 1 (2022) and J.M. Macarro Osuna, *La respuesta definitiva al cálculo de la base imponible del IVA en las operaciones no declaradas*, Studi Tributari Europei 11 (2021)).

Nevertheless, there are a number of cases in which it is not possible to make such adjustments. Under these circumstances, the legal reasoning developed by the CJ seems the most respectful towards the principles and functioning of VAT. The determination of the taxable amount cannot be used as a method to punish fraud or incorrect applications of the VAT rules. In *TEAR Galicia* (C-519/21), Advocate General (AG) Hogan considered that ‘economic rationality advocates that, under certain circumstances, the price paid might not include any VAT’ (Opinion of AG Hogan 4 March 2021, C-521/19 *TEAR Galicia*, ECLI:EU:C:2021:176, paragraph 42). Even though this statement could be right, mostly in cases of fraud, the solution had to avoid the tax burden being borne by the suppliers and not by the consumers. If the payment received by the taxable person was considered exclusively as the taxable amount of the transaction, the impossibility of passing the tax to the purchaser would mean that the tax burden would not have been borne by the buyer, but only by the supplier.

At the same time, this would mean that the tax authorities would request a tax liability that has not been received by the taxpayer. On the contrary, including both amounts in the price exchanged – tax base and VAT due – entails that the tax has been passed to the purchaser, and that he has paid it to the supplier.

If the payment received by the taxable person was indeed the price without VAT, as suggested by AG Hogan, the supplier will try to correct the invoice or to issue one with the correct taxable amount. Nevertheless, in the cases in which these adjustments are not possible, as seen in the rulings commented, the solution provided by the CJ seems logical and coherent with the core principles of VAT, as it prevents VAT from becoming a tax on the supply of goods and services rather than a tax on consumption.

Finally, the conclusion of this order could help to clarify the way in which other doubts should be solved. In the mentioned case *P GmBH v Finanzamt Österreich* (C-378/21), although the CJ did not address the matter, AG Kokott dealt with the calculation of the amount that had to be reimbursed to the taxable person. The taxable person had charged a higher amount of VAT to final consumers when a reduced tax rate was applicable, and it was not possible to adjust the invoices. As the CJ answered the question under the premise that all the customers were final consumers, there was no risk of loss of tax revenue, and the CJ concluded that there was no tax liability for the amount that exceeded the correct tax due. Nevertheless, the taxpayer and the Austrian tax authorities argued about the calculation of the amount that should be reimbursed. AG Kokott referred to *TEAR Galicia* (C-521/19), and stated that 'VAT is therefore always included, in the correct amount, in the agreed price by operation of law' (AG Kokott 8 September 2022, C-378/21, *P GmBH v Finanzamt Österreich*, ECLI:EU:C:2022:657, paragraph 72). The order that has been studied, in which the invoices included the wrong tax rate, and it is not possible to rectify the mistake with the purchasers, seems to confirm the interpretation of AG Kokott. Hence, the final price received by the taxpayer, which erroneously had applied the standard tax rate, should be considered to include the taxable amount and the correct amount of VAT liability.

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