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JUDGMENT OF THE COURT (First Chamber)

21 February 2013 (*)

(Sixth VAT Directive – Article 17(2)(a) – Right to deduct input tax – Need for a direct and immediate link between an input and an output transaction – Criterion for determining that link – Services of lawyers performed in the context of criminal proceedings for corruption brought in a personal capacity against the managing director and main partner of a limited company)

In Case C-104/12,

REQUEST for a preliminary ruling under Article 267 TFEU from the Bundesfinanzhof (Germany), made by decision of 22 December 2011, received at the Court on 29 February 2012, in the proceedings

Finanzamt Köln-Nord

v

Wolfram Becker,

THE COURT (First Chamber),

composed of A. Tizzano, President of the Chamber, M. Berger, A. Borg Barthet, E. Levits and J.-J. Kasel (Rapporteur), Judges,

Advocate General: V. Trstenjak,

Registrar: A. Calot Escobar,

having regard to the written procedure,

after considering the observations submitted on behalf of:

- the German Government, by T. Henze and K. Petersen, acting as Agents,
- the European Commission, by B.-R. Killmann and C. Soulay, acting as Agents,

having decided, after hearing the Advocate General, to proceed to judgment without an Opinion,

gives the following

Judgment

1 This request for a preliminary ruling concerns the interpretation of Article 17(2)(a) and Article 22(3)(b) of 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), as amended by Council Directive 2001/115/EC of 20 December 2001 (OJ 2001 L 15, p. 24) ('the sixth directive').

2 The request has been made in proceedings between the Finanzamt Köln-Nord ('the Finanzamt') and Mr Becker concerning the right to deduct input value added tax ('VAT') paid by Mr

Becker on lawyers' fees relating to criminal proceedings against him as managing director and majority shareholder in a limited company.

Legal context

European Union law

3 Article 17(2)(a) of the sixth directive, as amended by Article 28f thereof, provides:

'In so far as the goods and services are used for the purposes of his taxable transactions, the taxable person shall be entitled to deduct from the tax which he is liable to pay:

(a) [VAT] due or paid within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person;'

4 Under Article 18(1)(a) of the sixth directive:

To exercise his right to deduct, the taxable person must:

(a) in respect of deductions under Article 17(2)(a), hold an invoice, drawn up in accordance with Article 22(3);'

5 In accordance with the fifth indent of Article 22(3)(b) of the sixth directive, as amended by Article 28h thereof, the invoices issued pursuant to that directive must, for VAT purposes, include the full name and address of the taxable person and of his customer.

German law

6 Under Paragraph 15(1)(1)(1) of the Law on turnover tax of 2005 (Umsatzsteuergesetz 2005, BGBl. 2005 I, p. 386) ('UStG'), a trader may deduct as input tax the tax lawfully due in respect of supplies effected by another trader for his business.

7 In accordance with Paragraph 15(2)(1)(1) of the UStG, it is not possible to deduct tax in respect of supplies which a trader uses for exempt transactions.

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

8 At the time of the events that gave rise to the main proceedings, Mr Becker was a sole trader and a majority shareholder in A-GmbH ('A'), a limited company under German law. Mr Becker and X were managing directors of A, which carries out construction works for consideration that are subject to VAT. P, A's authorised representative, subsequently also became a managing director of that company.

9 Mr Becker and A were linked by an *Organschaft* for tax purposes within the meaning of the UStG. Consequently, Mr Becker and A were treated as one single taxable person, and Mr Becker, as a so-called 'controlling entity', took responsibility for the fiscal obligations of the group of undertakings consisting of his sole-trader undertaking and A.

10 After A had won and performed a construction contract for consideration and subject to tax, the competent prosecuting authority brought criminal proceedings against Mr Becker and P. In effect, A was suspected of having benefited, prior to the conclusion of the contract, from confidential information concerning the tenders submitted by competing undertakings and of having therefore been able to submit the most advantageous tender. In order to obtain that information, it made payments which under criminal law were likely to be regarded as bribery or

aiding and abetting on the part of Mr Becker and P, and accepting a bribe on the part of the recipient of those payments.

11 The criminal proceedings brought against Mr Becker and P were discontinued following the payment of amounts pursuant to the German Code of Criminal Procedure.

12 In the context of the criminal investigation proceedings, Mr Becker and P were each represented by their respective lawyers. However, under the terms of those lawyers' fee agreements, Mr Becker's lawyer represented Mr Becker, as accused, and A, whereas P's lawyer represented P, as accused, and A. Both agreements were signed, on the part of the clients, only by A and affixed with the A's official stamp, represented by Mr Becker and P as managing directors.

13 The lawyers addressed their invoices to A. Mr Becker, as controlling entity, deducted, for the year in question, namely 2005, the VAT charged on those invoices.

14 As is apparent from the file submitted to the Court, the Finanzamt considered that the VAT in question was not deductible and it therefore issued an additional assessment against Mr Becker. Since his objection lodged before the Finanzamt was rejected, Mr Becker started proceedings before the Finanzgericht Köln, which granted his action.

15 Hearing the appeal on a point of law brought by the Finanzamt, the Bundesfinanzhof, in its order for reference, notes that, according to the Court's case-law, the exercise of the right of deduction is based on the assumption that there is a direct link between the input and the output transactions. However, the Finanzamt has doubts as to whether the existence of such a link depends on the objective content of the supply acquired or rather on the reason for the acquisition of that supply.

16 First, it follows from the Court's case-law that the existence of a direct and immediate link depends on objective factors (Case C-98/98 *Midland Bank* [2000] ECR I-4177, paragraph 32) and the objective character of the transaction at issue (Case C-4/94 *BLP Group* [1995] ECR I-983, paragraph 24). However, in the present case, taking into account the objective character of the supplies of legal services at issue in the main proceedings, they sought directly and immediately to protect the private interests of the two accused. Furthermore, the criminal proceedings were brought against the latter solely in a personal capacity, and not against A, although proceedings against the latter would also have been legally possible.

17 Secondly, the Court has held that it is necessary also to determine whether the exclusive reason for the supply acquired is the taxable activities of the taxable person (Case C-435/05 *Investrand* [2007] ECR I-1315, paragraph 33). That is applicable also to the main proceedings, since the supplies at issue would not have been performed by the two lawyers in question if A had not exercised an activity which produced turnover and, consequently, which was taxable. Those supplies could, therefore, be considered to have a direct and immediate link with A's economic activity as a whole. In such a case, Mr Becker, as A's controlling entity, would have a right to deduct input VAT.

18 Having regard to those considerations, the Bundesfinanzhof decided to stay the proceedings and to refer the following questions to the Court for a preliminary ruling:

'1. Is the direct and immediate link, which is regarded by the case-law of the Court of Justice of the European Union as being determinant for interpreting the term 'for the purposes of his taxable transactions' within the meaning of Article 17(2)(a) of [the sixth directive], to be determined:

- according to the objective content of the supply acquired by the taxable person (in the present case: the activity of a criminal defence lawyer with a view to preventing the conviction of a natural person); or
- according to the fact which gave rise to the supply acquired (in the present case: the economic activity of the taxable person during which a criminal act was purportedly committed by a natural person)?

2. If the fact which gave rise to the supply is determinant: Is a taxable person who commissions a supply together with an employee entitled to deduct input tax in full or only in part under Article 17(2)(a) of [the sixth directive] and, where a supply is acquired by several recipients, what requirements exist as to the issuing of the invoice pursuant to the fifth indent of Article 22(3)(b) of [the sixth directive]?’

Consideration of the questions referred

The first question

19 In order to answer the first question it should, first, be recalled, as the Court has previously held, that the existence of a direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct is, in principle, necessary before the taxable person is entitled to deduct input VAT and in order to determine the extent of such entitlement (see *Midland Bank*, paragraph 24; Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 26; and *Investrand*, paragraph 23). The right to deduct VAT charged on the acquisition of input goods or services presupposes that the expenditure incurred in acquiring them is part of the cost components of the taxable output transactions giving rise to the right to deduct (see *Midland Bank*, paragraph 30; and *Abbey National*, paragraph 28).

20 It is however also accepted that a taxable person has a right to deduct even where there is no direct and immediate link between a particular input transaction and one or more output transactions giving rise to the right to deduct, where the costs of the services in question are part of his general costs and are, as such, components of the price of the goods or services which he supplies. Such costs do, in effect, have a direct and immediate link with the taxable person’s economic activity as a whole (see, to that effect, inter alia, *Midland Bank*, paragraph 31, and Case C-465/03 *Kretztechnik* [2005] ECR I-4357, paragraph 36).

21 It should, next, be noted, with regard to the nature of the ‘direct and immediate link’ which must exist between an input and an output transaction, that the Court has held that it would not be realistic to attempt to be more specific in that regard. In view of the diversity of commercial and professional transactions, it is impossible to give a more appropriate reply as to the method of determining in every case the relationship which must exist between the input and output transactions in order for input VAT to become deductible (see, to that effect, *Midland Bank*, paragraph 25).

22 Finally, it is apparent from the case-law that, in the context of the direct-link test, which the tax authorities and national courts are to apply, they should consider all the circumstances surrounding the transactions at issue (see, to that effect, *Midland Bank*, paragraph 25) and take account only of the transactions which are objectively linked to the taxable person’s taxable activity.

23 The obligation to take account only of the objective content of the transaction at issue is the

most compatible with the aim pursued by the common system of VAT, which seeks to ensure legal certainty and to facilitate the application of VAT (see, to that effect, *BLP Group*, paragraph 24; Case C-108/99 *Cantor Fitzgerald International* [2001] ECR I-7257, paragraph 33; and Case C-29/08 *SKF* [2009] ECR I-10413, paragraph 47).

24 The Court has, furthermore, held that it is also in the light of their objective content that it is necessary to determine whether there is a direct and immediate link between the supply of goods or services utilised and a taxable output transaction or, exceptionally, a taxable input transaction (see, to that effect, *Midland Bank*, paragraph 32, and, by analogy, with regard to the evidence to be taken into account so as to establish the taxable person's declared intention to allocate specific goods to a transaction subject to VAT, Case 268/83 *Rompelman* [1985] ECR 655, p. 24).

25 The view that, in order to determine whether there is a 'direct and immediate link' between a given transaction and the taxable activity as a whole for the purposes of the abovementioned case-law, it is necessary to take account of the objective characteristics of the supply of goods or services acquired is not called into question by the fact that the Court, in paragraphs 33 and 36 of *Investrand*, held, in essence, that where the pursuit of the taxable activity is not the exclusive reason for certain fees and costs being incurred, the latter cannot be considered as having a direct and immediate link with that activity.

26 As follows from paragraphs 25 to 34 of that judgment, it is in the light of all the circumstances in which the transactions at issue in the case which gave rise to that judgment took place and, in particular, the facts apparent from the case-file submitted to the Court, that the Court held, first, that *Investrand BV* had not performed any specific output transactions subject to VAT that gave rise to the fees at issue in the main proceedings. It held, secondly, that, unless *Investrand BV* could prove that it would not have incurred those costs if it had not exercised a taxable economic activity, those costs could not be considered as having been incurred for the purpose of the taxable activities as a whole.

27 It is only because the Court took account, in the context of its examination, of the objective content of the transactions at issue that it was able to find, in paragraph 34 of *Investrand*, that the situation of *Investrand BV* was similar to that of a private shareholder and hold that those transactions could not be considered as falling within the scope of the sixth directive.

28 In that regard, it should be noted that, in its judgment in *Investrand*, the Court did not preclude that, in the light of their content, the transactions at issue could, in other circumstances, have been related to a taxable economic activity. The Court merely held, as is in essence apparent from paragraph 33 of that judgment, that, even if *Investrand BV* had not exercised a taxable activity, that company would nevertheless have incurred the costs in question, and, therefore, that the latter could not be considered to have been incurred as a result of the taxable activities of that company.

29 In those circumstances, as the German government claimed, the fact that the existence of the direct and immediate link between a supply of services and the overall taxable economic activity must be determined in the light of the objective content of that supply of services does not preclude that the exclusive reason for the transaction at issue can also be taken into account, since that reason must be considered as a criterion for determining the objective content. Where it is clear that a transaction has not been performed for the purposes of the taxable activities of a taxable person, that transaction cannot be considered as having a direct and immediate link with those activities within the meaning of the Court's case-law, even if that transaction would, in the light of its objective content, be subject to VAT.

30 In the present case, first, according to the information provided by the referring court, the

supply of services by lawyers at issue in the main proceedings sought directly and immediately to protect the private interests of the two accused who were charged with offences relating to their personal behaviour. Furthermore, as has already been pointed out in paragraph 16 of this judgment, the criminal proceedings were brought against them solely in a personal capacity, and not against A, although proceedings against A would also have been legally possible. That court correctly concludes that, in the light of their objective content, the costs relating to those supplies can not be considered as having been incurred for the purposes of A's economic activities as a whole.

31 Secondly, the referring court states that, since the supplies would not have been performed by the two lawyers at issue if A had not exercised an activity which produced turnover and, consequently, which was taxable, there would be a causal link between the costs relating to those services and A's economic activity as a whole. It should, however, be noted that that causal link cannot be considered to constitute a direct and immediate link within the meaning of the Court's case-law. As the referring court itself observes, there is no legal link between the criminal proceedings and A, and those services must therefore be considered to have been performed entirely outside A's taxable activities.

32 In that regard, it should be added that the fact that domestic civil law obliges an undertaking such as that at issue in the main proceedings to incur the costs relating to the defence, in criminal proceedings, of its representatives' interests is not relevant for the interpretation and application of provisions relating to the common system of VAT. In the light of the objective scheme of VAT set up by that system, only the objective relationship between the supplies performed and the taxable economic activity of the taxable person is decisive (see, to that effect, Case C-277/09 *RBS Deutschland Holdings* [2010] ECR I-13805, paragraph 54). Otherwise the uniform application of European Union law in that area would be severely undermined.

33 Therefore, the answer to the first question referred is that the existence of a direct and immediate link between a given transaction and the taxable person's activity as a whole for the purposes of determining whether the goods and services were used by that person 'for the purposes of taxable transactions' within the meaning of Article 17(2)(a) of the sixth directive depends on the objective content of the goods or services acquired by that taxable person. In this case, the supplies of lawyers' services, whose purpose is to avoid criminal penalties against natural persons, managing directors of a taxable undertaking, do not give that undertaking the right to deduct as input tax the VAT due on the services supplied.

The second question

34 In view of the answer to the first question, there is no need to answer the second question.

Costs

35 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 (First Chamber) hereby rules:

The existence of a direct and immediate link between a given transaction and the taxable person's activity as a whole for the purposes of determining whether the goods and services were used by the latter 'for the purposes of taxable transactions' within the meaning of Article 17(2)(a) of 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, as amended by Council Directive 2001/115/EC of 20 December 2001, depends on the objective content of the goods or

services acquired by that taxable person.

In this case, the supplies of lawyers' services, whose purpose is to avoid criminal penalties against natural persons, managing directors of a taxable undertaking, do not give that undertaking the right to deduct as input tax the VAT due on the services supplied.

[Signatures]

* Language of the case: German.