JUDGMENT OF THE COURT (Third Chamber)

6 July 2006 *

In Joined Cases C-439/04 and C-440/04,

REFERENCES for a preliminary ruling under Article 234 EC from the Cour de cassation (Belgium), made by decision of 7 October 2004, received at the Court on 19 October 2004, in the proceedings

Axel Kittel (C-439/04)

v

État belge,

and

État belge (C-440/04)

v

Recolta Recycling SPRL,

* Language of the case: French.

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, J.-P. Puissochet, S. von Bahr (Rapporteur), U. Lõhmus and A. Ó Caoimh, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 9 February 2006,

after considering the observations submitted on behalf of:

— Axel Kittel, by J. Bublot, avocat (C-439/04),

— Recolta Recycling SPRL, by T. Afschrift and A. Rayet, avocats (C-440/04),

— the État belge, by E. Dominkovits, and subsequently by L. Van den Broeck, acting as Agents, and by B. van de Walle de Ghelcke, avocat,

— the Italian Government, by I.M. Braguglia, acting as Agent, and by G. De Bellis, avvocato dello stato,

— the Commission of the European Communities, by J.-P. Keppenne and M. Afonso, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 14 March 2006,

gives the following

Judgment

1 These references for a preliminary ruling concern the interpretation 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 95/7/EC of 10 April 1995 (OJ 1995 L 102, p. 18) ('the Sixth Directive').

2 The references were made in connection with two sets of proceedings between Mr Kittel and Recolta Recycling SPRL ('Recolta') respectively and the État belge (Belgian State) concerning the Belgian tax authorities' refusal to allow the right to deduct the value added tax ('VAT') paid on transactions allegedly connected with 'carousel' fraud.

Legal context

Community legislation

3 Article 2 of First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes (OJ, English Special Edition 1967, p. 14), as amended by the Sixth Directive ('the First Directive'), provides:

'The principle of the common system of value added tax involves the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, whatever the number of transactions which take place in the production and distribution process before the stage at which tax is charged.

On each transaction, value added tax, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of value added tax borne directly by the various cost components.

The common system of value added tax shall be applied up to and including the retail trade stage.'

4 Article 2(1) of the Sixth Directive provides:

'The following shall be subject to value added tax:

1. the supply of goods or services effected for consideration within the territory of the country by a taxable person acting as such;'

5 As set out in Article 4(1) and (2) of that directive:

'1. "Taxable person" shall mean any person who independently carries out in any place any economic activity specified in paragraph 2, whatever the purpose or results of that activity.

2. The economic activities referred to in paragraph 1 shall comprise all activities of producers, traders and persons supplying services including mining and agricultural activities and activities of the professions. The exploitation of tangible or intangible property for the purpose of obtaining income therefrom on a continuing basis shall also be considered an economic activity.'

6 According to Article 5(1) of the same directive, '"[s]upply of goods" shall mean the transfer of the right to dispose of tangible property as owner'.

7 Article 17(1) and (2)(a) of the Sixth Directive provides:

'1. The right to deduct shall arise at the time when the deductible tax becomes chargeable.

2. 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) value added tax due or paid in respect of goods or services supplied or to be supplied to him by another taxable person'.

National legislation

8 Article 1131 of the Belgian Civil Code provides that 'an obligation with no basis or with a false or unlawful basis can give rise to no effect whatsoever'.

9 In the words of Article 1133 of the same code, 'the basis is unlawful when it is contrary to law, morality or public policy'.

The main proceedings

Case C-439/04

10 The referring court states that the limited company Ang Computime Belgium ('Computime') bought and resold computer components and that, following a report drawn up by the tax authorities, those authorities decided that Computime had knowingly participated in a VAT 'carousel' fraud intended to recover one or more times amounts of VAT invoiced by suppliers for the same goods and that the supplies effected to Computime were fictitious. For those reasons, the tax authorities refused to allow Computime the right to deduct the VAT paid on those supplies.

11 The file shows that the Verviers VAT collector issued Computime with a demand for payment dated 13 October 1997. The sums claimed amounted to approximately BEF 240 million in respect of taxes and nearly BEF 480 million in respect of fines (approximately EUR 18 million in total).

12 Computime applied to the Tribunal de première instance de Verviers (Verviers Court of First Instance) to have that demand for payment set aside. By a judgment of 28 July 1999, that court declared the application to be unfounded. That ruling was upheld by a judgment of the Cour d'appel de Liège (Liège Court of Appeal) of 29 May 2002.

13 Mr Kittel, acting in his capacity as Computime's receiver, subsequently brought an appeal against that judgment before the Cour de cassation (Court of Cassation).

Case C-440/04

14 The referring court states that Recolta bought from a certain Mr Ailliaud 16 luxury vehicles, which the latter had himself purchased from the company Auto-Mail. The purchases by Mr Ailliaud did not give rise to any VAT payable to the Treasury and Mr Ailliaud did not pass on to the Belgian State the VAT paid by Recolta, which resold the vehicles free of VAT to Auto-Mail under an authorisation for export sale.

15 The documents in the file show that, according to an investigation by the Special Inspectorate of Taxes, Mr Ailliaud and Auto-Mail had set up a scheme for 'carousel' tax fraud, of which the transactions with Recolta formed part.

16 On 26 October 1989, the Verviers VAT collector issued Recolta with a demand for payment of a sum in excess of BEF 4.8 million in respect of taxes and just over BEF 9.7 million in respect of fines (approximately EUR 360 000 in total).

17 Recolta brought opposition proceedings against that demand for payment before the Tribunal de première instance de Verviers. By a judgment of 1 October 1996, that court, after having found that there was nothing to suggest that Recolta and its directors knew or had any suspicion that they were involved in a major fraud scheme, declared that the demand for payment issued by the collector had no lawful basis and was therefore null and void. The case also gave rise to criminal proceedings, in the course of which the Tribunal correctionnel de Bruxelles

(Brussels Criminal Court) made an order on 7 January 1994 discharging the manager of Recolta.

18 The Belgian State brought an appeal against that judgment before the Cour d'appel de Liège, submitting that the agreements on which those invoices were based were incurably void under domestic law because Mr Ailliaud's main purpose in entering into a contract with Recolta was to effect transactions which were contrary to the workings of VAT. As the transactions at issue had an unlawful basis, under Article 1131 of the Civil Code, the conditions required for entitlement to the right to deduct, inter alia that there should be a supply of goods, were not fulfilled.

19 The Cour d'appel de Liège upheld the judgment, whereupon the Belgian State appealed to the Cour de cassation.

The questions referred

20 The referring court observes, first, that the provisions of the Belgian VAT Code at issue in the main proceedings transpose Article 2, Article 4(1), Article 5(1) and Article 17(2) of the Sixth Directive into domestic law.

21 Next it notes that, in accordance with the Court of Justice's settled case-law, the Sixth Directive is based on the principle of fiscal neutrality, which, as regards the levying of VAT, precludes any general distinction between lawful and unlawful transactions, with the exception of those circumstances, unrelated to the present case, where because of the special characteristics of certain products all competition between a lawful economic sector and an unlawful sector is precluded.

22 The referring court also observes that, in domestic law, an agreement intended to defraud a third party, in the present case the Belgian State, whose rights are protected by public policy legislation, has an unlawful basis and is incurably void. Since the matter concerns the general interest, it is enough that one party has contracted for unlawful purposes and it is not necessary for the other party to the contract to know of those purposes.

23 In Case C-439/04, the Cour de cassation notes that the Cour d'appel de Liège declared that a void agreement cannot have any legal effect, such as the deduction of VAT, where the unlawful basis is the fraudulent evasion of the tax itself, and that Mr Kittel submits, in support of his ground of appeal, that the VAT invoiced by a taxable person in respect of a supply of goods is deductible even if the supply occurs in connection with an agreement which is incurably void under domestic law and that the right to deduct tax persists even where the unlawful basis is a fraudulent evasion of VAT itself.

24 In Case C-440/04, the Belgian State maintains, in support of its ground of appeal, that the VAT invoiced by a taxable person for the supply of goods is not deductible where the supply, albeit physically effected, took place under an agreement which was, in domestic law, incurably void, even if the purchase was made in good faith.

25 It is in those circumstances that the Cour de cassation decided to stay the proceedings and to refer the following questions to the Court of Justice for a preliminary ruling:

In Case C-439/04:

'(1) Where the recipient of a supply of goods is a taxable person who has entered into a contract in good faith without knowledge of a fraud committed by the seller, does the principle of fiscal neutrality in respect of [VAT] mean that the fact that the contract of sale is void — by reason of a rule of domestic civil law which renders the contract incurably void as contrary to public policy on the ground that the basis of the contract is unlawful by reason of a matter which is attributable to the seller — cannot cause that taxable person to lose the right to deduct that tax?

(2) Is the answer different where the contract is incurably void for fraudulent evasion of [VAT] itself?

(3) Is the answer different where the unlawful basis of the contract of sale which renders it incurably void under domestic law is a fraudulent evasion of [VAT] known to both parties to the contract?'

In Case C-440/04:

'(1) Where the recipient of a supply of goods is a taxable person who has entered into a contract in good faith without knowledge of a fraud committed by the seller, does the principle of fiscal neutrality in respect of [VAT] mean that the

fact that the contract of sale is void — by reason of a rule of domestic civil law which renders the contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller — cannot cause that taxable person to lose the right to deduct that tax?

(2) Is the answer different where the contract is incurably void for fraudulent evasion of [VAT] itself?'

26 By order of the President of the Court of 28 January 2005, Cases C-439/04 and C-440/04 were joined for the purposes of the written procedure, the oral procedure and the judgment.

The questions

27 By its questions, which must be considered together, the referring court asks essentially whether, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was part of a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders the contract incurably void as contrary to public policy on the ground that the basis of the contract is unlawful by reason of a matter which is attributable to the seller, causes that taxable person to lose his right to deduct that tax. That court asks whether the answer to that question is different where the contract is incurably void for fraudulent evasion of VAT.

28 The referring court also asks whether the answer to that question is different where the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT.

Observations submitted to the Court

29 Mr Kittel submits that the principle of fiscal neutrality stemming from, inter alia, Article 2 of the First Directive and Article 17(2)(a) of the Sixth Directive prevents a taxable person from losing the right to deduct merely on account of the fact that a transaction is void in national law.

30 In addition, Article 5 of the Sixth Directive does not preclude a transaction which, by virtue of its specific characteristics, takes place within competitive economic channels from being regarded as a supply of goods even if part of that supply is carried out with aim of fraudulently evading VAT. In those circumstances, Article 17(2) of the Sixth Directive must be interpreted as meaning that it allows the recipient the right to deduct where he is not acting with the aim of fraudulently evading VAT.

31 Likewise, that article allows the right to deduct in the case of a recipient who is not acting with the aim of fraudulently evading VAT even if he knows of the fraudulent motives of his supplier, whether or not he profits by that fraud. Article 17(2) of the Sixth Directive must thus be interpreted as meaning that it allows the recipient a

right to deduct even if he knows of the fraudulent motives of his supplier, whether or not he profits by that fraud.

32 The Belgian State maintains that where the transfer of goods is to a taxable person who has contracted in good faith, without knowledge of the fraud committed by the seller, the principle of fiscal neutrality in respect of VAT does not preclude that taxable person from being refused the right to deduct to the extent that it can be established that he does not meet the substantive requirements governing entitlement to that right.

33 That is so in particular where the taxable person is an unwitting participant in a 'carousel' fraud, since he cannot be considered to be the recipient of a supply of goods within the meaning of Article 5 of the Sixth Directive or to be using the goods concerned for the purposes of his taxable transactions, and also where the taxable person does not hold an invoice in accordance with the provisions of Articles 18(1) and 22(3) of that directive.

34 Exercise of the right to deduct can also be refused where it is proved that that right has been claimed fraudulently or unreasonably.

35 Recolta and the Italian Government submit that the first question should be answered in the affirmative and the second in the negative.

36 However, where the unlawful basis of the contract of sale is fraudulent evasion of VAT known to the two contracting parties, the Italian Government takes the view that the principle prohibiting abuse of Community law precludes the transferee from being allowed the right to deduct the tax paid.

37 The Commission of the European Communities maintains that the supply of goods to a taxable person who has contracted in good faith, without knowledge of the fraud committed by the seller, constitutes a supply of goods within the meaning of Article 5(1) of the Sixth Directive, giving entitlement to the right to deduct under Article 17(2) of that directive, and that the principle of the neutrality of that tax precludes the taxable person from being refused the right to deduct VAT because of a rule of national law which renders the contract incurably void as contrary to public policy on the ground that the basis of the contract is unlawful by reason of a matter which is attributable to the seller.

38 In the Commission's opinion, the same answer should be given to the referring court's questions where the unlawful basis of the contract of sale, which renders it incurably void under domestic law, is fraudulent evasion of VAT known to both parties to the contract, unless it is proven that the exercise of the right to deduct would constitute an unreasonable use of that right on the part of the purchaser.

Findings of the Court

39 The Sixth Directive establishes a common system of VAT based, inter alia, on a uniform definition of taxable transactions (see, inter alia, Case C-305/01 *MKG-Kraftfahrzeuge-Factoring* [2003] ECR I-6729, paragraph 38, and Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and Others* [2006] ECR I-483, paragraph 36).

40 That directive assigns a very wide scope to VAT by mentioning in Article 2 on taxable transactions, in addition to importation of goods, supplies of goods and services effected for consideration within the territory of the country by a taxable person acting as such (*Optigen*, paragraph 37).

41 In fact, an analysis of the definitions of 'supply of goods effected by a taxable person acting as such' and 'economic activities' shows that those terms, which define taxable transactions for the purposes of the Sixth Directive, are objective in nature and apply without regard to the purpose or results of the transactions concerned (see, to that effect, *Optigen*, paragraphs 43 and 44).

42 As the Court held at paragraph 24 of the judgment in Case C-4/94 *BLP Group* [1995] ECR I-983, requiring the tax authorities to carry out inquiries to determine the intention of the taxable person would be contrary to the objectives of the common system of VAT of ensuring legal certainty and facilitating the measures necessary for the application of VAT by having regard, save in exceptional cases, to the objective character of the transaction concerned.

43 A fortiori, requiring the tax authorities, in order to determine whether a given transaction constitutes a supply by a taxable person acting as such and an economic activity, to take account of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge, would be contrary to those objectives (*Optigen*, paragraph 46).

44 The Court drew the conclusion, at paragraph 51 of *Optigen*, that transactions which are not themselves vitiated by VAT fraud constitute supplies of goods effected by a taxable person acting as such and an economic activity within the meaning of Article 2(1), Article 4 and Article 5(1) of the Sixth Directive where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge.

45 The Court observed that the right to deduct input VAT of a taxable person who carries out such transactions likewise cannot be affected by the fact that, in the chain of supply of which those transactions form part, another prior or subsequent transaction is vitiated by VAT fraud, without that taxable person knowing or having any means of knowing (*Optigen*, paragraph 52).

46 The same conclusion applies where such transactions, without that taxable person knowing or having any means of knowing, are carried out in connection with fraud committed by the seller.

47 In fact, the right to deduct provided for in Article 17 et seq. of the Sixth Directive is an integral part of the VAT scheme and in principle may not be limited. The right to deduct is exercisable immediately in respect of all the taxes charged on transactions relating to inputs (see, in particular, Case C-62/93 *BP Soupergaz* [1995] ECR I-1883, paragraph 18, and Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 43).

48 The rules governing deduction are meant to relieve the trader entirely of the burden of the VAT payable or paid in the course of all his economic activities. The common system of VAT consequently ensures neutrality of taxation of all economic activities, whatever their purpose or results, provided that those activities are themselves subject in principle to VAT (see, inter alia, Case C-408/98 *Abbey National* [2001] ECR I-1361, paragraph 24, and Case C-25/03 *HE* [2005] ECR I-3123, paragraph 70).

49 The question whether the VAT payable on prior or subsequent sales of the goods concerned has or has not been paid to the Treasury is irrelevant to the right of the taxable person to deduct input VAT (see, to that effect, the order of the Court in Case C-395/02 *Transport Service* [2004] ECR I-1991, paragraph 26). According to the fundamental principle which underlies the common system of VAT, and which follows from Article 2 of the First and Sixth Directives, VAT applies to each transaction by way of production or distribution after deduction of the VAT directly borne by the various cost components (see, inter alia, Case C-98/98 *Midland Bank* [2000] ECR I-4177, paragraph 29; Case C-497/01 *Zita Modes* [2003] ECR I-14393, paragraph 37; and *Optigen*, paragraph 54).

50 In that context, as the referring court observed, it is settled case-law that the principle of fiscal neutrality prevents any general distinction between lawful and unlawful transactions. Consequently, the mere fact that conduct amounts to an offence does not entail exemption from tax; that exemption applies only in specific circumstances where, owing to the special characteristics of certain goods or services, any competition between a lawful economic sector and an unlawful sector is precluded (see, inter alia, Case C-158/98 *Coffeeshop 'Siberië'* [1999] ECR I-3971, paragraphs 14 and 21, and Case C-455/98 *Salumets and Others* [2000] ECR I-4993, paragraph 19). It is common ground, however, that that is not the case with either the computer components or the vehicles at issue in the main proceedings.

51 In the light of the foregoing, it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT (see, to that effect, Case C-384/04 *Federation of Technological Industries and Others* [2006] ECR I-4191, paragraph 33).

52 It follows that, where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void, by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller, causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

53 By contrast, the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity' are not met where tax is evaded by the taxable person himself (see Case C-255/02 *Halifax and Others* [2006] ECR I-1609, paragraph 59).

54 As the Court has already observed, preventing tax evasion, avoidance and abuse is an objective recognised and encouraged by the Sixth Directive (see Joined Cases C-487/01 and C-7/02 *Gemeente Leusden and Holin Groep* [2004] ECR I-5337, paragraph 76). Community law cannot be relied on for abusive or fraudulent ends

(see, inter alia, Case C-367/96 *Kefalas and Others* [1998] ECR I-2843, paragraph 20; Case C-373/97 *Diamantis* [2000] ECR I-1705, paragraph 33; and Case C-32/03 *Fini H* [2005] ECR I-1599, paragraph 32).

55 Where the tax authorities find that the right to deduct has been exercised fraudulently, they are permitted to claim repayment of the deducted sums retroactively (see, inter alia, Case 268/83 *Rompelman* [1985] ECR 655, paragraph 24; Case C-110/94 *INZO* [1996] ECR I-857, paragraph 24; and *Gabalfrisa*, paragraph 46). It is a matter for the national court to refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent ends (see *Fini H*, paragraph 34).

56 In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.

57 That is because in such a situation the taxable person aids the perpetrators of the fraud and becomes their accomplice.

58 In addition, such an interpretation, by making it more difficult to carry out fraudulent transactions, is apt to prevent them.

59 Therefore, it is for the referring court to refuse entitlement to the right to deduct where it is ascertained, having regard to objective factors, that the taxable person

knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.

60 It follows from the foregoing that the answer to the questions must be that where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of the Sixth Directive must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void — by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller — causes that taxable person to lose the right to deduct the VAT he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of VAT or to other fraud.

61 By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, it is for the national court to refuse that taxable person entitlement to the right to deduct.

Costs

62 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 (Third Chamber) hereby rules:

Where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 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 95/7/EC of 10 April 1995, must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void — by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller — causes that taxable person to lose the right to deduct the value added tax he has paid. It is irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of value added tax or to other fraud.

By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct.

[Signatures]