JUDGMENT OF THE COURT (Third Chamber)

8 May 2008 *

In Joined Cases C-95/07 and C-96/07,

REFERENCES for a preliminary ruling under Article 234 EC from the Commissione tributaria provinciale di Genova (Italy), made by decision of 13 December 2006, received at the Court on 20 February 2007, in the proceedings

Ecotrade SpA

v

Agenzia delle Entrate — Ufficio di Genova 3,

THE COURT (Third Chamber),

composed of A. Rosas, President of the Chamber, U. Lõhmus, A. Ó Caoimh, P. Lindh and A. Arabadjiev (Rapporteur), Judges,

* Language of the case: Italian.

Advocate General: E. Sharpston,
Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 16 January 2008,

after considering the observations submitted on behalf of:

— Ecotrade SpA, by A. Lovisolo and N. Raggi, avvocati,

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

— the Cypriot Government, by A. Pantazi-Lambrou, acting as Agent,

— the Commission of the European Communities, by A. Aresu and M. Afonso, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 13 March 2008,

gives the following

Judgment

1 These references for a preliminary ruling concern the interpretation of Articles 17 and 18(1)(d), 21(1) and 22 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 2000/17/EC of 30 March 2000 (OJ 2000 L 84, p. 24) ('the Sixth Directive').

2 The references were made in the course of two disputes between Ecotrade SpA ('Ecotrade') and Agenzia delle Entrate — Ufficio di Genova 3 ('the Agenzia'), concerning a number of recovery notices issued by the latter reassessing, for the purposes of value added tax ('VAT'), tax returns submitted by Ecotrade for the tax years 2000 and 2001.

Legal context

Community rules

3 As regards the right to deduct, Article 17(1) and (2)(a) of the Sixth Directive, in the version resulting from Article 28f(1) thereof 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 within the territory of the country in respect of goods or services supplied or to be supplied to him by another taxable person'.

4 According to Article 17(6), until the Council of the European Union has decided what expenditure is not to be eligible for a deduction of value added tax, Member States may retain all the exclusions provided for under their national laws when the Sixth Directive came into force, subject to the qualification that VAT may in no circumstances be deductible on expenditure which is not strictly business expenditure, such as that on luxuries, amusements or entertainment. Article 17(7) allows Member States, subject to the consultation procedure provided for in Article 29, to exclude for cyclical economic reasons totally or partly all or some capital goods or other goods from the system of deductions.

5 According to Article 21(1)(b) of the Sixth Directive, in the version resulting from Article 28g thereof, VAT is payable, under the internal system, by taxable persons to whom services covered inter alia by Article 28bC are supplied, if the services are carried out by a taxable person established abroad. Article 28bC to which it refers covers 'services in the intra-Community transport of goods'. That regime, which is also applicable to other services, is widely known as the 'reverse charge procedure'.

6 With regard to the rules for exercise of the right to deduct in circumstances such as those described in the preceding paragraph, Article 18(1)(d) of the Sixth Directive, in

the version resulting from Article 28f(2) thereof, provides that, to exercise that right, a taxable person must comply with the formalities laid down by each Member State.

7 Article 18(2) and (3) of the Sixth Directive provides as follows:

'2. The taxable person shall effect the deduction by subtracting from the total amount of value added tax due for a given tax period the total amount of the tax in respect of which, during the same period, the right to deduct has arisen and can be exercised under the provisions of paragraph 1.

3. Member States shall determine the conditions and procedures whereby a taxable person may be authorised to make a deduction which he has not made in accordance with the provisions of paragraphs 1 and 2.'

8 Furthermore, Article 22 of the Directive, in the version resulting from Article 28h, lays down a series of obligations on persons liable for payment of VAT. Among those obligations is the obligation in Article 22(2)(a), according to which every taxable person is to keep accounts in sufficient detail for VAT to be applied and inspected by the tax authority, and the obligation provided for in Article 22(4)(a) and (b), according to which every taxable person is to submit a return by the stated deadline which must set out all the information needed to calculate the tax that has become chargeable and the deductions to be made.

9 Finally, Article 22(7) and (8) are worded as follows:

'7. Member States shall take the measures necessary to ensure that those persons who, in accordance with Article 21(1)(a) and (b), are considered to be liable to pay the tax instead of a taxable person not established within the territory of the country … comply with the above obligations relating to declaration and payment.

8. Member States may impose other obligations which they deem necessary for the correct collection of the tax and for the prevention of evasion, subject to the requirement of equal treatment for domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.'

National legislation

10 In Italian law, most of the relevant provisions relating to VAT are laid down by Presidential Decree No 633 of 26 October 1972 establishing and laying down rules on value added tax (Ordinary Supplement to the GURI No 292 of 11 November 1972), amended on several occasions ('DPR No 633/72') and Decree-Law No 331 of 30 August 1993 (GURI No 203 of 30 August 1993) ('Decree-Law No 331/93').

11 The first sentence of Article 17(3) of the DPR No 633/72 provides:

'The obligations relating to … the supply of services in the territory of the State by non-resident persons … shall be met by the purchasers resident in the territory of the State who … use the services in pursuit of business, artistic activities or professions.'

12 Article 19(1) of the DPR No 633/72 provides:

'… The right to deduct the tax on the goods and services purchased or imported shall arise at the time when the tax becomes chargeable and may be exercised, at the latest, in the tax return for the second year after the year in which the right to deduct arose and subject to the conditions applying at the time when the right arose.'

13 According to Article 23(1) and (2) of the DPR No 633/72, entitled 'Registration of invoices', taxable persons must record invoices issued in an appropriate register within 15 days, indicating for each invoice the serial number, the date of issue, the taxable amount of the transaction(s) and the amount of VAT, shown separately for each rate, and the undertaking, the name or company name of the purchaser of the goods or services or, in the cases to which Article 17(3) refers, the seller or supplier's name.

14 Under the heading 'Registration of purchases', Article 25(1) of the DPR No 633/72 requires taxable persons to number sequentially invoices and customs dockets relating to goods and services purchased or imported in the course of their business,

including invoices issued in accordance with Article 17(3) thereof, and to record them in a register before making the periodic payment or the annual return in which the right to deduct the VAT relating to those invoices is exercised.

15 Pursuant to Article 47(1) of Decree-Law No 331/93, entitled 'Registration of intra-Community transactions', invoices relating, in particular, to the supply of intra-Community transport of goods and related services must be recorded in the month in which they are received or subsequently, but in any event within 15 days of receipt, separately in the register of invoices issued referred to in Article 23(1) and (2) of the DPR No 633/72 and in the register of purchases, referred to in Article 25(1) thereof, with reference to the month of receipt or the month of issue respectively.

16 Finally, the first sentence of the first paragraph of Article 57(1) of DPR No 633/72 provides:

'Notices of reassessment and recovery … shall be served, on pain of loss of the related right, by 31 December of the fourth year after the year in which the tax return was submitted.'

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

17 Ecotrade is an Italian limited company specialising in granulated blast furnace slag and other ingredients, in particular synthetic gypsum and ashes used for the manufacture of cement.

18 In the tax years 2000 and 2001 Ecotrade entrusted to operators established outside Italy the transport of those materials from Italy to other Member States of the European Community. In the invoices issued by those operators for services supplied to Ecotrade, those services are described either as 'chartering of the vessel' or 'shipping' ('the transactions in question'). However, the invoices did not indicate the amount of VAT, and some of them stated that the transactions were exempt.

19 Ecotrade therefore regarded the relevant transactions as being exempt from VAT. Accordingly, it recorded the invoices relating to those transactions only in the register of purchases and not in the register of invoices issued, and did so on the basis of VAT exemption. The VAT relating to those transactions was therefore not mentioned in the returns drawn up by Ecotrade for the tax years 2000 and 2001.

20 After an inspection in 2004, the Agenzia took the view that the transactions in question were services in the intra-Community transport of goods subject to VAT, and that the reverse charge procedure was applicable to them, which, with the exception of one invoice, was not disputed by Ecotrade. The Agenzia also found that Ecotrade had not complied with the accounting requirements relating to the reverse charge procedure because the invoices concerned had been recorded only in the register of purchases and not in the register of invoices issued.

21 Therefore, the Agenzia, by a number of tax recovery notices, reassessed for VAT purposes the tax returns submitted by Ecotrade for the tax years 2000 and 2001, claimed payment of undeclared taxes amounting to a total of approximately EUR 321 000 and imposed penalties in respect of those taxes of approximately EUR 361 000.

22 Subsequently, the Agenzia took the view that Ecotrade had lost its right to deduct VAT because it had not exercised that right within a period of two years from the time the VAT becomes chargeable, as provided in the second sentence of Article 19(1) of the DPR No 633/72, whereas the tax authorities were still within the time-limits for recovering the VAT relating to the services concerned since, under the first sentence of Article 57 of the DPR No 633/72, notices of reassessment and recovery may be served within a period of four years calculated from the date on which the tax returns relating to disputed taxes were submitted.

23 By various appeals lodged on 13 February 2005 before the Commissione tributaria provinciale di Genova, Ecotrade challenged the recovery notices concerned and sought to have them annulled. In order to justify its accounting practice Ecotrade submitted that the invoices relating to the transactions in question had been duly recorded in the register of purchases, but that, because those transactions had been mistakenly regarded as exempt from VAT, they had not been recorded in the register of invoices issued. That irregularity should not however have compromised the exercise of the right to deduct, since no debt to the tax authority was generated. Therefore, any temporal limit on the right to deduct was inapplicable in this case.

24 Before the national court the Agenzia replied that Ecotrade should have invoiced itself for the transactions in question, calculated the VAT payable, and recorded the invoice in the register of invoices issued and the register of purchases so that it would have had a VAT credit for the purposes of deducting the input tax calculated. In accordance with that method, the VAT payable is not actually paid by the purchaser in so far as it is offset by the corresponding VAT credit. The right to deduct must be exercised in the period prescribed or it will lapse. Consequently, Ecotrade, which did not comply with the accounting procedure provided for under the national legislation, is required to pay the VAT due, while it has lost the right to deduct VAT on account of the time-bar.

25 In those circumstances, the Commissione tributaria provinciale di Genova decided to stay proceedings and refer the following questions to the Court for a preliminary ruling:

'(1) Does a correct interpretation of Articles 17, 21(1) and 22 of the Sixth Directive … preclude national legislation (in particular Article 19 of DPR No 633/72) that makes the exercise of the right to deduct [VAT], payable by a taxable person in the pursuit of his business activities, dependent on compliance with a (two-year) time-limit and penalises non-compliance with annulment of that right? That question is asked with reference, in particular, to cases where the liability to VAT on the purchase of the good or service stems from the application of the reverse charge procedure, which allows the authorities a longer period (of four years under Article 57 of DPR No 633/72) in which to demand payment of the duty than the period allowed to the trader for deduction of the duty, on expiry of which the trader's right to such deduction lapses.

(2) Does it follow from a correct interpretation of Article 18(1)(d) of the Sixth Directive … that national legislation may not, in regulating the 'formalities' referred to in that provision by means of the reverse charge procedure governed by the combined provisions of Articles 17(3), 23 and 25 of DPR No 633/72, make (solely to the detriment of the taxable person) the exercise of the right to deduct permitted by Article 17 of the Directive conditional upon compliance with a time-limit such as that laid down in Article 19 of DPR No 633/72?'

26 By order of the President of the Court of 27 April 2007, Cases C-95/07 and C-96/07 were joined for the purposes of the written and oral procedure and of the judgment.

The questions referred for a preliminary ruling

Observations submitted to the Court

27 Ecotrade submits that the Sixth Directive does not impose any time-limit on the right to deduct, since the entire VAT system, which is founded on the principle of neutrality is designed to guarantee the taxable person, in all circumstances, that fundamental right inherent in the overall VAT system. Furthermore, the national legislation at issue in the main proceedings cannot be justified by reliance on Articles 17(6) and (7) and 22(7) and (8) of the directive, which are not applicable in the cases in the main proceedings.

28 As regards the 'formalities' laid down by the Member States in accordance with Article 18(1)(d) of the Sixth Directive, with which the taxable person must comply in order to exercise the right to deduct under the reverse charge procedure, Ecotrade submits that those formalities may not be disproportionate to or incompatible with the general VAT mechanism. Accordingly, compliance with those formalities cannot lead to the taxable person definitively losing the right to deduct. In any event, the limitation on the right to deduct in Italian law is not proportionate, because the tax authority has a longer period in which to reassess incorrect tax returns than that accorded to the taxable person to claim deduction.

29 The Italian and Cypriot Governments point out that the period prescribed for the exercise of the right to deduct is a formality that the Member States may determine under Article 18(1)(d) and (3) and Article 22(8) of the Sixth Directive. Article 18 does not contain any provision inconsistent with the Member States' discretion to set temporal limits on deduction. According to Article 18(2), which refers to 'the same period', the right to deduct should be exercised as soon as possible, so that if

the taxable person does not exercise his right to deduct during that period, the possibility of doing so later may be coupled with conditions that the Member States can impose in accordance with Article 18(3).

30 Furthermore, the Italian and Cypriot Governments take the view that the period allowed to the authority to recover tax cannot be the same as that allowed to the taxable person to exercise his right to deduct for objective and practical reasons, since the authority needs time after the tax return is lodged to check it and verify its contents.

31 The Italian Government acknowledges, moreover, that the Member States must comply with the principle of effectiveness, so as not to render exercise of the right to deduct impossible or excessively difficult. However, it submits that the period of two years is perfectly appropriate in that respect.

32 The Commission of the European Communities maintains that the deduction should be exercised in compliance with the tax deadlines prescribed. Its exercise cannot therefore be deferred indefinitely. It concludes that the determination of limitation periods for the exercise of the right to deduct is not incompatible with the objectives pursued by the Sixth Directive, provided that those limitation periods are not less favourable than those laid down for the exercise of analogous rights in matters relating to tax (principle of equivalence) and are not such as to render the exercise of the rights conferred by Community law virtually impossible or excessively difficult (principle of effectiveness). It concludes that the principle of equivalence has not been complied with on account of the fact that the legislation at issue in the main proceedings allows a period of four years to the tax authority for reassessments and recovery, whereas it provides for a period of only two years for deduction of VAT paid. As regards compliance with the principle of effectiveness, the Commission points out that a two-year limitation period for the exercise of the right to deduct is likely, for the same reasons, to render the exercise of that right excessively difficult.

33 In addition, the Commission takes the view that it is wholly excessive and disproportionate for the Member State concerned to seek unduly to enrich itself because mere accounting formalities have not been carried out, although the latter must be allowed the possibility of penalising the irregularities concerned in an appropriate manner.

34 Should the Court decide that Article 19 of the DPR No 633/72 is not compatible with this Sixth Directive, the Cypriot Government proposes that the temporal effects of its judgment should be limited, so that it would apply solely from the date of its delivery.

The Court's reply

35 As a preliminary point, it must be noted that the national court's questions seek to establish whether Articles 17, 18(1)(d), 21(1) and 22 of the Sixth Directive preclude national legislation such as that at issue in the main proceedings which, where the reverse charge procedure applies, makes the exercise of the right to deduct VAT subject to compliance with a limitation period which is shorter than that available to the tax authority for recovering tax.

36 However, it is clear from the order from reference that the main dispute arises from the accounting irregularity committed by Ecotrade, that is to say, the incorrect recording of the transactions in question only in the register of purchases exempt from VAT, that irregularity also affecting the tax returns relating to VAT drawn up by Ecotrade, which led the Agenzia to reassess them. That situation is clearly different from the case in which a taxable person who is aware of the taxable nature of a supply fails on account of delay or carelessness to claim deduction of input tax within the period prescribed by the national legislation.

37 It should be recalled in that regard that, according to settled case-law, it is for the Court of Justice to provide the national court with all the elements of interpretation of Community law which may be of assistance in adjudicating on the case pending before it, whether or not that court has specifically referred to them in its questions (see, in particular, Case C-315/92 *Verband Sozialer Wettbewerb, 'Clinique'* [1994] ECR I-317, paragraph 7; Case C-87/97 *Consorzio per la tutela del formaggio Gorgonzola* [1999] ECR I-1301, paragraph 16; Case C-456/02 *Trojani* [2004] ECR I-7573, paragraph 38; and Case C-452/03 *RAL (Channel Islands) and Others* [2005] ECR I-3947, paragraph 25).

38 Accordingly it is necessary to reformulate the national court's questions, which it is appropriate to examine together, to the effect that it is asking, first, whether Articles 17, 18(2) and (3) and 21(1)(b) of the Sixth Directive preclude the introduction of a limitation period for the exercise of the right to deduct VAT, such as that laid down by the national legislation at issue in the main proceedings, in the case of a reverse charge procedure('the limitation period'), and, secondly, whether Articles 18(1)(d) and 22 preclude a practice whereby declarations are reassessed and VAT recovered which penalises an irregularity in the accounts and tax returns, such as that at issue in the main proceedings, by denying the right to deduct in the case of a reverse charge procedure ('the reassessment and recovery practice').

The limitation period

39 It must be pointed out at the outset that a taxable person liable for VAT as the recipient of goods or services is able to rely on the right to deduct contained in Article 17(2)(a) of the Sixth Directive (see Case C-90/02 *Bockemühl* [2004] ECR I-3303, paragraph 37). According to consistent case-law, the right to deduct laid down in Article 17 forms an integral part of the VAT mechanism and in principle cannot be limited (see Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others* [2000] ECR I-1577, paragraph 43, and *Bockemühl*, paragraph 38).

40 It is also settled case-law that the right to deduct must be exercised immediately in respect of all the taxes charged on transactions relating to inputs (see, in particular, Case 50/87 *Commission* v *France* [1988] ECR 4797, paragraphs 15 to 17; Case C-37/95 *Ghent Coal Terminal* [1998] ECR I-1, paragraph 15; *Gabalfrisa and Others*, paragraph 43; and *Bockemühl*, paragraph 38).

41 As it is clear from the wording of Article 18(2) of the Sixth Directive, the right to deduct must be exercised in principle 'during the same period' as that in which it arose.

42 A taxable person may nevertheless be authorised to make a deduction, pursuant to Article 18(3) of the Sixth Directive, even if he did not exercise his right during the period in which the right arose. However, in that case, the right to deduct is coupled with certain conditions and procedures determined by the Member States.

43 It follows that the Member States may require the right to deduct to be exercised either during the period in which it arose or over a longer period, subject to compliance with certain conditions and procedures determined by their national legislation.

44 Furthermore, the possibility of exercising the right to deduct without any temporal limit would be contrary to the principle of legal certainty, which requires the tax position of the taxable person, having regard to his rights and obligations vis-à-vis the tax authority, not to be open to challenge indefinitely.

45 Consequently, the argument that the right to deduct may not be coupled with any limitation period cannot be accepted.

46 It must be added that a limitation period the expiry of which has the effect of penalising a taxable person who has not been sufficiently diligent and has failed to claim deduction of input tax by making him forfeit his right to deduct cannot be regarded as incompatible with the regime established by the Sixth Directive, in so far as, first, that limitation period applies in the same way to analogous rights in tax matters founded on domestic law and to those founded on Community law (principle of equivalence) and, second, that it does not render virtually impossible or excessively difficult the exercise of the right to deduct (principle of effectiveness) (see, Case C-327/00 *Santex* [2003] ECR I-1877, paragraph 55, and Case C-241/06 *Lämmerzahl* [2007] ECR I-8415, paragraph 52).

47 As regards the principle of equivalence, it does not appear from the file, nor has it been argued before the Court, that the limitation period provided for in Article 19(1) of the DPR No 633/72 does not comply with that principle.

48 With respect to the principle of effectiveness, it should be pointed out that a two-year time-limit, such as that at issue in the main proceedings, cannot, in itself, render the exercise of the right to deduct virtually impossible or excessively difficult, since Article 18(2) of the Sixth Directive allows Member States to require that the taxable person exercise his right to deduct during the same period as that in which it arose.

49 It is also appropriate to examine whether that conclusion is not invalidated by the fact that, under the national legislation, the tax authority has a longer period in which to demand recovery of the VAT due than that accorded to taxable persons to claim deduction of VAT.

50 In that regard, it should be pointed out that the tax authority does not have the information necessary to determine the amount of the tax chargeable and the deductions

to be made until it receives the taxable person's tax return. In the case of an inaccurate return, or where it turns out to be incomplete, it is therefore only from that time that the authorities can reassess the tax return and, where necessary, recover unpaid tax (see, to that effect, Case C-85/97 *SFI* [1998] ECR I-7447, paragraph 32).

51 Thus the position of the tax authority cannot be compared with that of a taxable person (*SFI*, paragraph 32). As the Court has already held, the fact that a limitation period begins to run as regards the tax authority at a date subsequent to the date from which the limitation period applicable to the right to deduct of a taxable person begins to run is not such as to infringe the principle of equality (see, to that effect, *SFI*, paragraph 33).

52 Therefore, a limitation period, such as that the issue in the main proceedings does not render impossible or excessively difficult the exercise of the right to deduct merely because the tax authority has a longer period in which to recover unpaid VAT than that accorded to the taxable person for the exercise of such a right.

53 That conclusion remains valid where, as in the cases in the main proceedings, the reverse charge procedure applies. Article 18(2) and (3) of the Sixth Directive is also applicable to such a procedure. That follows unequivocally from the wording of those provisions, both of which refer expressly to Article 18(1)(d), which covers the case of the reverse charge procedure.

54 In light of the foregoing, the answer to the national court must be that Articles 17, 18(2) and (3) and 21(1)(b) of the Sixth Directive do not preclude national legislation which lays down a limitation period for the exercise of the right to deduct, such as

that at issue in the main proceedings, provided that the principles of equivalence and effectiveness are respected. The principle of effectiveness is not infringed merely because the tax authority has a longer period in which to recover unpaid VAT than the period granted to taxable persons for the exercise of their right to deduct.

The reassessment and recovery practice

55 It is appropriate to consider whether the Sixth Directive precludes a reassessment and recovery practice which penalises an accounting irregularity consisting, as described in paragraph 36 of this judgment, of the incorrect recording of the relevant transactions only in the register of purchases exempt from VAT, that irregularity also affecting the tax returns drawn up by Ecotrade, by denying the right to deduct where the reverse charge procedure applies.

56 It must be pointed out in that regard that, in accordance with the reverse charge procedure introduced by Article 21(1)(b) of the Sixth Directive, Ecotrade, as the recipient of services supplied by taxable persons established abroad, was liable for VAT on the transactions effected, that is to say the input tax, although it could, in principle, deduct exactly the same amount of tax so that no tax was due to the Exchequer.

57 However, where the reverse charge procedure is applicable, as in the cases in the main proceedings, Article 18(1)(d) of the Sixth Directive authorises the Member States to establish the formalities with which the taxable person must comply in order to be able to exercise his right to deduct.

58 It follows from the application of such a formality, introduced into Italian law by Article 47(1) of Decree-Law No 331/93, that Ecotrade should have invoiced itself for the relevant transactions and recorded that invoice separately, together with the invoice issued by the supplier of the relevant services, in the register of invoices issued and in the register of purchases, so that it would have had a VAT credit corresponding precisely to the tax due.

59 Furthermore, according to Article 22(2) and (4) of the Sixth Directive, every taxable person is to keep accounts in sufficient detail for VAT to be applied and inspected by the tax authority and to submit a return which must set out all the information needed to calculate the tax that has become chargeable and the deductions to be made. In order to ensure that every taxable person complies with those obligations, Article 22(7) authorises Member States to take the necessary measures for that purpose, including in the case of the reverse charge procedure.

60 The cases in the main proceedings concern the fact that Ecotrade failed to comply with its obligations arising, first, from the formalities laid down by the national legislation pursuant to Article 18(1)(d) of the Sixth Directive, and, second, its obligations relating to accounts and tax returns under Article 22(2) and (4) respectively ('failure to comply with accounting obligations').

61 It is therefore appropriate to consider whether such a failure may validly be penalised by denying the right to deduct in the case of a reverse charge procedure.

62 As far as concerns the obligations arising from Article 18(1)(d) of the Sixth Directive, although it is true that that provision allows Member States to lay down the formal-

ities relating to the exercise of the right to deduct in the case of the reverse charge procedure, a failure to comply with those formalities by the taxable person cannot deprive him of his right to deduct.

63 Since the reverse charge procedure was indisputably applicable to the cases in the main proceedings, the principle of fiscal neutrality requires deduction of input tax to be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements (see, by way of analogy, Case C-146/05 *Collée* [2007] ECR I-7861, paragraph 31).

64 Therefore, where the tax authority has the information necessary to establish that the taxable person is, as the recipient of the supply of services in question, liable to VAT, it cannot, in relation to the right of that taxable person to deduct that tax, impose additional conditions which may have the effect of rendering that right ineffective for practical purposes (see *Bockemühl*, paragraph 51).

65 The same is true of Article 22(7) and (8) of the Sixth Directive, pursuant to which the Member States are to take the necessary measures to ensure that taxable persons comply with their obligations relating to declaration and payment or impose other obligations which they deem necessary for the correct collection of the tax and for the prevention of evasion.

66 Although those provisions allow Member States to take certain measures, they must not however go further than is necessary to attain the objectives mentioned in the preceding paragraph. Such measures may not therefore be used in such a way that they would have the effect of systematically undermining the right to deduct VAT, which is a fundamental principle of the common system of VAT established by the

relevant Community legislation (see Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96 *Molenheide and Others* [1997] ECR I-7281, paragraph 47, and *Gabalfrisa and Others*, paragraph 52).

67 A reassessment and recovery practice, such as that at issue in the main proceedings, which penalises non-compliance on the part of the taxable person with the obligations relating to accounts and tax returns by a denial of the right to deduct, clearly goes further than is necessary to attain the objective of ensuring the correct application of such obligations within the meaning of Article 22(7) of the Sixth Directive, since Community law does not prevent Member States from imposing, where necessary, a fine or a financial penalty proportionate to the seriousness of the offence in order to sanction a failure to comply with those obligations.

68 That practice also goes further than is necessary for the correct collection of the tax and for the prevention of evasion within the meaning of Article 22(8) of the Sixth Directive, since it may even lead to the loss of the right to deduct if the reassessment of the tax return by the tax authorities is made after the expiry of the limitation period available to the taxable person in which to make the deduction (see, by analogy, *Gabalfrisa and Others*, paragraphs 53 and 54).

69 Nor can such a reassessment and recovery practice be justified under Article 17(6) and (7) of the Sixth Directive. Those two provisions are not applicable to a situation such as that at issue in the cases in the main proceedings, since they govern the existence of the right to deduct itself and not the procedure for exercising it. Moreover, Article 17(6) applies only to expenditure which is not strictly business expenditure, such as luxuries, amusements or entertainment, whereas it is common ground that no such expenditure is involved in the cases in the main proceedings. As to the possibility open to the Member States under Article 17(7), it need merely be pointed out that they cannot avail themselves of it unless they have first used the consultation

procedure provided for in Article 29 (see, to that effect, Case C-409/99 *Metropol and Stadler* [2002] ECR I-81, paragraphs 61 to 63, and Case C-228/05 *Stradasfalti* [2006] ECR I-8391, paragraph 29), which, according to the file, is not the case in the Italian Republic.

70 Furthermore, it is not apparent from the orders for reference, nor indeed was it alleged before the Court, that Ecotrade's failure to comply with its accounting obligations was the result of bad faith or evasion.

71 In any event, the good faith of a taxable person is relevant for the answer to be given to the national court only in so far as there is, on account of the conduct of that taxable person, a risk of a loss of tax revenues for the Member State concerned (see, to that effect, *Collée*, paragraphs 35 and 36). However, a failure to comply with accounting obligations, such as that at issue in the main proceedings, cannot be regarded as giving rise to a risk of loss of tax revenues, since, as stated in paragraph 56 of this judgment, in the context of the application of the reverse charge procedure, no tax is due in principle to the Exchequer. For those reasons, such a failure also cannot be treated as a transaction designed to evade tax or as a misuse of Community rules, since it was not intended to obtain a tax advantage to which there was no entitlement (see, to that effect, *Collée*, paragraph 39).

72 Therefore the answer to be given to the national court must be that Articles 18(1)(d) and 22 of the Sixth Directive do preclude a reassessment and recovery practice which penalises a failure to comply, first, with obligations arising from formalities laid down in national legislation pursuant to Article 18(1)(d) and, second, with the obligations

relating to accounts and tax returns under Article 22(2) and (4) respectively, such as that at issue in the main proceedings, by denying the right to deduct in the case of a reverse charge procedure.

73 Having regard to the answer given in paragraph 54 of this judgment, there is no need to give a ruling on the Cypriot Government's proposal to limit the temporal effects of this judgment.

Costs

74 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:

1. **Articles 17, 18(2) and (3) and 21(1)(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, as amended by Council Directive 2000/17/EC of 30 March 2000, do not preclude national legislation which lays down a**

limitation period for the exercise of the right to deduct, such as that at issue in the main proceedings, provided that the principles of equivalence and effectiveness are respected. The principle of effectiveness is not infringed merely because the tax authority has a longer period in which to recover unpaid value added tax than the period granted to taxable persons for the exercise of their right to deduct.

2. However, Articles 18(1)(d) and 22 of Sixth Directive 77/388, as amended by Directive 2000/17, do preclude a practice whereby tax returns are reassessed and value added tax recovered which penalises a failure to comply, first, with obligations arising from formalities laid down in national legislation pursuant to Article 18(1)(d), and, second, with the obligations relating to accounts and tax returns under Article 22(2) and (4) respectively, such as that in the main proceedings, by denying the right to deduct in the case of a reverse charge procedure.

[Signatures]