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Input tax on defence costs of managers against criminal charges not deductible

The ECJ has held that the input tax on the costs incurred by managing directors in defending themselves against criminal charges was incurred in a private capacity and was thus not deductible against the output tax on the business turnover.

The two joint managing directors of a German GmbH in the building trade were accused of having won a contract put out for tender, on the strength of information obtained on rival bids through bribing an employee of the customer. The two appointed lawyers to defend both themselves and the company. Ultimately, the charges were dropped against payment of a fine under an arrangement possible under German criminal law to allow a prosecutor to close a case if he feels the evidence to be too weak to ensure a conviction, if acceptable to the accused in the interests of avoiding a lengthy legal struggle. The lawyers then tendered their bills showing VAT. The tax office refused to accept this VAT as deductible input tax on the grounds that a managing director's defence against criminal charges was a personal matter. Thus, the input tax had not been incurred in earning income.

The German Supreme Tax Court was unsure of the position under the Sixth (now the VAT) Directive. The tax had been incurred in the course of defending managing directors against charges levelled against them personally. The nature of the expense was therefore private. On the other hand, the accusations were of bribery in order to obtain a business advantage. Without the business background, the suspicion of bribery could not have arisen and there would have been no call for any sort of defence. The underlying cause of the expense was therefore business.

The ECJ has responded to this question by placing the emphasis on the "direct and immediate link" to the nature of the expense, rather than to its cause. The nature of the cost was lawyers' fees for the defence (negotiations with the staff of the public prosecutor) against charges laid against the two individuals personally. A successful defence would benefit them in the main privately. That the cause of the cost was business was not disputed; this, though, led to a subjective link, rather than to the "direct and immediate" (objective) link to taxable outputs demanded by the ECJ in previous cases. The tax office was therefore right to refuse an input tax deduction.

The ECJ case reference is C-104/12 *Becker*, judgment of February 21, 2013.

Keywords

criminal charges, defence, input tax