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VAT Wrongly Charged by the Supplier and Right of the Customer to Deduct, from an Italian and EU Perspective: Where Are We?

A very common issue in the economic relationships between suppliers and customers is the application of excessive VAT in the invoices issued by the former to the latter. Since 2017, Italian VAT legislation has provided that the customer has the right to deduct the tax applied "in excess of the effective amount" in such cases, provided that such VAT has been paid by the supplier to the Italian tax authorities, outside a context of tax fraud. The customer will, however, be subject to a fixed, non-proportional, penalty. In this article, the authors seek to illustrate how the application of the principles of "neutrality", "effectiveness" and "proportionality" established by the case law of the ECJ could lead to a possible application of the said provision, not only in cases where a higher VAT rate was applied in a taxable transaction, but more generally where undue VAT has been charged to the customer (and so also in transactions that are exempt – with or without right to deduction – or outside the scope of VAT).

1. Introduction

The correct application of VAT provisions and, therefore, the correct VAT treatment of a transaction (whether exempt with or without right to deduction, outside the scope of VAT or taxable at a certain VAT rate) has always been a complex matter to handle, in any business.

In cases where the appropriate VAT treatment is in doubt, a simplistic approach could suggest the adoption – considering, as a general rule, the neutrality of VAT – of the more expensive solution. For example, charging a higher VAT rate rather than a lower (and possibly correct) one, or charging VAT to the customer even if the transaction should probably have been VAT exempt. Nevertheless, such an approach would not be so prudential where the incorrect application of VAT could create problems for the deduction of VAT by the customer, whose deducted VAT has been challenged by the tax authorities, and who should then ask the supplier for the reimbursement of such VAT, wrongly applied (by the supplier), but paid and deducted (by the customer).

Of course, the larger the volumes of transactions involved and the greater the difficulty to identify their correct VAT treatment,[1] the higher the risk that the customer will pay high amounts of tax and penalties in relation to wrongly deducted VAT. In such circumstances, the disallowance of the right to deduct could trigger an attempt to transfer the economic burden of the sums paid to the tax authorities to the supplier.

In this article, the authors first illustrate the terms of the question from an Italian and EU point of view, and then seek to suggest, based on some consolidated principles elaborated at an EU level, a broad and substantial interpretation of the relevant Italian VAT provisions. This interpretation entails the right for the customer to deduct VAT in any case where it has been wrongly applied by the supplier but has been paid (or accounted for as a VAT debt) by the same supplier, provided that the incorrect application of VAT has not occurred in a context of fraud.

2. The Italian Legislative Framework about the Recovery of Wrongly Applied VAT

According to the first sentence of article 6(6)of Italian Legislative Decree No. 471/1997,[2] "whoever unlawfully deducts the tax paid,[3] due or charged to him, shall be punished with an administrative penalty equal to ninety percent of the amount of the deduction made".[4,5]

Thus, as a general rule, the unlawful deduction of VAT paid is not allowed by the Italian VAT legislation and the customer is also subject to a very heavy penalty (90% of deducted but undue VAT) if they unlawfully deduct VAT.

Nevertheless, the second sentence of article 6(6) (hereinafter, Article 6[6]), provides that:

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1. For example, in the case of services rendered in innovative sectors not yet adequately ruled upon (by the law, by the interpretation of the tax authorities or by the judgments of the tax courts).
2. IT: Legislative Decree 471/1997 of 18 Dec. 1997, art. 6(6), second sentence, OJ of Italy 5 (1998).
3. More precisely, reference here should be made not only to the VAT actually "paid" ("*pagata*", in Italian) by the supplier, but in general to the VAT already registered ("*assolta*", in Italian) in the register of output VAT, "with consequent confluence (as a debt) in the VAT periodical settlement"; in this respect, *see* Italian tax authorities, Circular Letter 16/E of 11 May 2017, para. 3.
4. The reason for imposing a penalty (even if fixed and not proportional) on the customers lies in the fact that the VAT they are allowed the right to deduct for does not derive in any case from a proper application of VAT provisions, since it is VAT "in excess of the effective amount".
5. All English translations of Italian legislation are the authors' own translations.
6. IT: Law No. 205 of 27 Dec. 2017, art. 1(935), in force since 1 Jan. 2018, has changed Article 6 (as defined above) to its current version.

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> In the event of the application of tax in excess of the effective amount, erroneously paid[7] by the supplier, without prejudice to the right of the customer to deduct pursuant to articles 19 et seq. of Presidential Decree no. 633 of 26 October 1972, the aforementioned customer shall be punished with an administrative penalty of between 250 euros and 10,000 euros. Refund[8] of the tax is excluded if the payment was made in a context of tax fraud.

The authors anticipate that the expression "application of tax *in excess* of the effective amount" is crucial in the matter at hand, since the point here is to determine to what extent such an expression can be actually applicable. For instance, is it only applicable in cases where VAT was due (being a taxable transaction) but at a lower rate than the one actually applied, or in any hypothesis where the applied VAT was higher ("in excess of the effective amount") than the correct one (so, for example, in the case of VAT applied as exempt or outside the scope of VAT transactions)?

Article 6 is to be read together with article 30-ter (hereinafter, Article 30-ter) of Italian Presidential Decree No. 633/1972[9] (hereinafter, the VAT Decree). Article 30-ter,[10,11] at items 2 and 3, provides that:

> (2) In the event of the application of a tax not due to a supply of goods or services, definitively assessed by the tax authorities, the request for reimbursement may be presented by the supplier [to the tax authorities] within two years of the reimbursement to the customer of the amount paid by way of recourse.
>
> (3) Refund of the tax is excluded if the payment was made in a context of tax fraud.

The link existing between Article 6 and Article 30-ter, and above all the rationale behind the issuing of these two provisions, is clearer if we consider that, according to the case law of the Court of Justice of the European Union (ECJ), the right to deduction is limited to the VAT correctly applied on taxable transactions, and paid since due, while no deduction in principle would be granted for VAT due only for having been (wrongly) mentioned on the invoice.[12]

As a consequence, domestic legislation granting the supplier the right to ask the tax authorities for the reimbursement of the unduly paid VAT and the customer the right to exercise a civil action against the supplier for the recovery of VAT paid (but, again, not due) to them, is to be considered legitimate.

Nevertheless, before the issuing of Article 6 and Article 30-ter, the Italian legislation was not compliant with the principle of "neutrality" of VAT, since the customer had a *ten*-year period[13] to ask the supplier for the repayment of undue VAT paid to them, while the same supplier was subject to a *two*-year period[14] for asking the Italian tax authorities for the repayment of undue VAT paid to them (in principle, for the same amount asked of them by the customer).

Due to this time mismatch, it could often happen that the assessment, if any, of the unduly applied VAT occurred before the expiry of the ten-year period (granted to the customer), but after the expiry of the two-year period (granted to the supplier). In such circumstances, the customer was on time when asking the supplier for the repayment of unduly paid VAT, but the supplier was too late to ask for the reimbursement of the same VAT from the Italian tax authorities.

In this sense, the introduction of Article 6 and Article 30-ter in the Italian VAT legislation was aimed at ensuring the neutrality of the unduly applied VAT in all cases where VAT, in the absence of tax fraud, has been charged and paid by the supplier,[15] so that there is no possibility of a loss to the Treasury.

It is clear that the above-mentioned time mismatch is overcome, since, based on Article 30-ter, the two-year period for the supplier to ask the Italian tax authorities for a reimbursement only starts on the date of their repayment of the undue VAT to the customer, further to a definitive assessment of VAT. Consequently, once they have paid a VAT amount to the customer, the supplier is always in the position to ask for the repayment of the same amount from the tax authorities in a timely manner (i.e. within two years).

Nevertheless, even with Article 30-ter, another main principle of EU VAT, the one of "effectiveness" of the deduction (according to which the procedures and the rules must not actually prevent the exercise of the right), is not always respected.

In fact, (i) the request for a reimbursement to the Italian tax authorities provided for by this provision is possible only when an assessment activity has become definitive (which could take a long time); (ii) cooperation between supplier and customer is required; and (iii) according to

7. Again, reference here should be more properly made to the VAT registered ("*assolta*", in Italian) in the register of output VAT by the suppliers and so computed in their periodical VAT settlement, and not necessarily to the VAT actually paid by them.
8. "Refund" here should be read more precisely as "deduction" for the customer.
9. IT: VAT Law, Presidential Decree No. 633 of 26 Oct. 1972, Primary Sources IBFD [hereinafter VAT Decree]. The Italian VAT Decree is the Italian VAT code, i.e. the set of Italian rules relating to VAT, implementing the EU provisions in the Italian legislation (except for some matters specifically ruled by other Italian provisions, such as the intra-EU supplies and acquisitions of goods).
10. IT: Law No. 167 of 20 Nov. 2017, art. 8(1) has introduced in the VAT Decree Article 30-ter (as defined above), which has been in force since 12 Dec. 2017.
11. Article 30-ter(1), fixing a general rule applicable in cases different from the ones referred to by Article 30-ter(2) of the same article, provides that:
    > The taxable person shall submit the request for repayment of the undue tax, under penalty of forfeiture, within two years from the date of payment of the same or, if later, from the day on which the conditions for repayment were met.
12. *See* IT: ECJ, 15 Mar. 2007, Case C-35/05, *Reemtsma Cigarettenfabriken Gmbh v. Ministero delle Finanze*, para. 23, Case Law IBFD (accessed 4 Apr. 2022), where it is stated that "the Court found that the right to deduct may be exercised only in respect of taxes actually due, that is to say, the taxes corresponding to a transaction subject to VAT or paid in so far as they were due. It thus found that that right to deduct does not apply to VAT which is due, under Article 21(1)(c) of the Sixth Directive [now replaced by Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006), Primary Sources IBFD [hereinafter VAT Directive]], solely because it is mentioned on the invoice".
13. IT: Italian Civil Code, arts. 2033 and 2946.
14. According to IT: Legislative Decree 546/1992, art. 21.
15. Or recorded and computed in their periodical VAT settlement when no debt arises and no payment is due.

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the Italian Supreme Court,[16] a specific measure ordering payment in favour of the customer is necessary for the supplier to ask the tax authorities for a reimbursement. This would mean that the repayment procedure provided for by Article 30-ter would be denied to the supplier any time they have spontaneously refunded the unduly applied VAT to the customer.

In the light of these considerations, Article 6 would ensure a full application of the above-mentioned "effectiveness" principle, since it could be invoked by the customer whenever recourse to Article 30-ter would be impossible or overly burdensome.

Actually, the procedure provided for by Article 6 considerably simplifies the recovery of the unduly (applied and) paid VAT. Rather than the double reimbursement (from the supplier to the customer and then from the tax authorities to the supplier) foreseen by Article 30-ter, when applicable, the same result would be reached by recognizing, respectively, the debt (for the supplier) and credit (for the customer) positions towards the Italian tax authorities, even if this originated from an operation incorrectly invoiced (i.e. with a higher rate of VAT) by the supplier.

So, the supplier should not repay the undue VAT to the customer (who could deduct the higher amount applied to them and paid by them to the supplier), and the Italian tax authorities should not repay the higher VAT paid by the supplier but, evidently, in the end the result would be exactly the same as that obtained with the "two-passages" procedure provided for by Article 30-ter. Also, in any case, no loss to the Treasury would occur.

Because of the complementarity of Article 30-ter and Article 6 in terms of granting the right to recover the VAT unduly applied based on the above-mentioned principles provided for by the ECJ (those of "neutrality" and "effectiveness", but also the one of "proportionality", as we will see), the scope of application of these two provisions should necessarily be the same.

A contentious issue arises when the different wording used by the Italian legislator in defining their scope is considered. For example, compare the application of VAT "*in excess of* the effective amount" (for Article 6), and – in a broader sense – "the application of a tax *not due*" (for Article 30-ter).

3. The Different Approaches about the Applicability of Article 6

The possibility to recognize a narrow or, conversely, a broad scope of application to Article 6, considering on one side the literal formulation of such provision and on the other side the results it intends to pursue (as illustrated above), has given rise to different approaches by the different parties involved. For instance, Italian tax courts (including the Supreme Court), Italian tax authorities and other stakeholders able to provide relevant interpretations of the provisions at hand.[17]

3.1. A "narrow" approach

First, the authors examine the main positions against a broad interpretation of Article 6.

In this respect, a highly relevant judgment has been Judgment No. 24289 of 3 November 2020 of the Italian Supreme Court, which related to a case where the Italian tax authorities had denied the deduction of VAT applied on transactions actually exempt (with right to deduction) and not taxable.

The Supreme Court has first stated that, according to the case law of the ECJ, "the exercise of the right of deduction is limited to taxes corresponding to a transaction subject to VAT and paid as due",[18] and that "the right to deduct the VAT invoiced is linked, as a general rule, to the effective carrying out of a taxable transaction, but the exercise of that right does not extend to the VAT due merely because and insofar as it was indicated on the invoice."[19]

Coming back to the case examined in the judgment under discussion, the taxable person had asked for the application of Article 6 considering that VAT, in their view, had been applied "*in excess of* the effective amount"; consequently, the tax assessment about the VAT deduction should have been considered as not legitimate.

In this respect, the Supreme Court refused the taxable person's argument, considering that "as clearly shown by the literal content of the provision, it *is applicable only in relation to taxable transactions, when VAT has been paid at a higher rate than that actually due, and not also in relation to hypothesis* – one of which occurs in the present case – *of non-taxable transactions*" [emphasis added].

The conclusions on the specific case examined have given the Supreme Court the occasion to establish the following principle of law:

> In the field of VAT, the tax wrongly paid in relation to a non-taxable transaction cannot be deducted by the customer … the aforementioned provision [Article 6] applies only to the different hypothesis in which, following a taxable transaction, the VAT has been paid on the basis of a higher rate than that actually due.

Evidently, the Supreme Court has adopted an approach that, even if in line with the wording of the law (the "literal content of the provision", as written in the judgment), (i) appears simplistic, (ii) does not consider the principles of "neutrality", "effectiveness" and "proportionality" (as better illustrated hereinafter) that are to be considered as pillars in the EU VAT system, and (iii) whose applica-

16. *See*, for example, IT: Cass. [Supreme Court], 26 Jan. 2016, Judgment No. 1426/2016.

17. As pointed out hereinafter, the authors refer in particular to business representatives and associations/committees of professionals and tax experts.
18. As stated in, among others, the ECJ judgment in *Reemtsma Cigarettenfabriken* (C-35/05).
19. The Supreme Court has referred – among others – to BG: ECJ, 31 Jan. 2013, Case C-643/11, *LVK-56 EOOD v. Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – grad Varna pri Tsentralno Upravlenie na Natsionalnata Agentsia za Prihodite*, para. 34 et seq., Case Law IBFD (accessed 4 Apr. 2022).

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tion would grant the customer the right to deduct a VAT amount higher than the correct one applied by the supplier whenever (i.e. for any reason) they like.

The position of the Supreme Court was even stricter in the subsequent Judgment No. 10439 of 21 April 2021, where the dispute related to the application of a higher rate than the correct one and the right of the customer to deduct the higher VAT applied.

So, in the first instance, the case was just concerning Article 6, and, according to the principle of law established in Judgment No. 24389/2020, the Supreme Court should have recognized the arguments of the taxable person. But this was not the case, as the authors explain hereafter.

In fact, in Judgment No. 10439/2021, the Supreme Court, regarding Article 6, first underlined the two effects triggered by the application of VAT "in excess of the effective amount", operating outside the context of a tax fraud as:

– a reduced penalty to the customer for the undue VAT charged to and deducted by him, ranging between EUR 250 and EUR 10,000 (rather than the proportional "ordinary" penalty applicable in case of illegitimate deduction of VAT); such penalty is due, in any case; and
– "without prejudice to the right of the customer to deduct".

The Supreme Court then recognized that, according to a certain interpretation, based on the wording of Article 6[20] and on the requirements of economic efficiency and simplification of taxable persons' fulfilments, the right to deduction could in principle be granted to the customer, excluding cases of tax fraud.

In fact, on the one hand, the recognition of such a right does not entail any damage to the Treasury, since it is expressly conditional on the payment of the tax by the supplier.

Secondly, it would allow the customer to recover the amount wrongly overpaid more quickly and more effectively than if they asked for a repayment from the supplier.

It is interesting to note that the Supreme Court has not disputed this interpretation in itself, and indeed has admitted to have shared it even recently.[21] Rather, it has stated that such an interpretation would conflict with the (above-mentioned) ECJ interpretation of EU VAT provisions (now contained in the VAT Directive), according to which, although the right to deduct VAT is an integral part of the tax mechanism, its exercise is limited to the taxes due and cannot be extended to input VAT wrongly paid, so that it does not extend to the tax due solely because it is shown on the invoice.

Further, the Supreme Court has affirmed that such a strict approach on the right to deduction of the unduly applied VAT, which is aligned with the one of the ECJ, would consent to fully achieve the results pursued by the VAT Directive, as also requested by article 288(3) of the TFEU.[22]

On these grounds, in Judgment No. 10439/2021, the Supreme Court has come to the following conclusions:

– as a matter of fact, also in the case of taxable transactions where VAT has been applied at a higher rate than the correct one, Article 6 would be applicable only as regards the reduction of penalties from a proportional to a fixed range amount, and not also in order to grant the customer the full deduction of all VAT (even incorrectly) charged by the supplier and paid by them;
– the words "without prejudice to the right of the customer to deduct" mean that the customer maintains the right to deduct only the VAT correctly applicable to the transaction, based on its nature and features; and
– consequently, with reference to the case at hand, the only way for the customer to recover the higher VAT unduly paid to the supplier would have been to directly activate a request of repayment to the latter, according to the domestic legislation.[23]

A few months after this judgment, the Italian tax authorities published Resolution Letter No. 52 of 3 August 2021,[24] specifically issued in relation to the scope of application of Article 6.

In their reply, the Italian tax authorities have strangely referred only to the above-illustrated Supreme Court Judgment No. 24289/2020 (and not also to the "stricter" Judgment No. 10439/2021), in order to affirm also from their point of view a narrow interpretation of the provision at issue.

In particular, two possible behaviours of the taxable persons have been identified, as follows:

– if the error committed by the supplier concerns the application of a "higher amount" (i.e. a higher rate) of VAT, wrongly paid by the supplier to the tax authorities, a fixed penalty (between EUR 250 and EUR 10,000) is applicable, without prejudice to the right of the customer to deduct the higher VAT paid to the supplier; and
– in the other cases, where a higher VAT than the correct one has been wrongly applied to the customer (because of transactions that were exempt or outside the scope of VAT), the latter is not entitled to deduct

20. As seen, the application of the (reduced) penalty operates "without prejudice" to the right to deduction of the customer.
21. Reference is made to IT: Cass. [Supreme Court], 28 Oct. 2020, Judgment No. 23817.
22. Treaty on the Functioning of the European Union, article 288(3), Primary Sources IBFD [hereinafter TFEU] provides that a directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, even if the national authorities have the powers as concerns the form and methods of implementation.
23. On this point, even if it is not expressly specified in the judgment under discussion, reference would seem to be to the procedure provided for by Article. 30-ter.
24. A Resolution Letter is an administrative decision issued by the Italian tax authorities, containing their opinion on a specific case submitted to them by a taxable person. It is binding for the Italian tax authorities but not for the taxable person (who may or may not adapt to their opinion – if it does not, it will risk penalties in case of an audit). Even if referring to a specific case, of course, a Resolution Letter can be assumed as expressing the opinion of the Italian tax authorities also in similar cases, and so it can be of general use to taxable persons.

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the higher VAT paid to the supplier and is subject to a proportional penalty equal to 90% of the VAT they have illegitimately deducted.

It is also worth mentioning that Supreme Court Judgment No. 35500 of 19 November 2021 referred to a case where VAT had been wrongly applied to transactions that were exempt with right to deduction, and the customer had been challenged on the related deduction.

In said judgment, reiterating the arguments already expressed in Judgments No. 24289/2020 and No. 10439/2021, the Supreme Court has denied the deduction to the customer based on a narrow interpretation of Article 6.

But, a relevant passage in the judgment under discussion, which has probably not been given proper attention, is the one stating that:

> the principle of neutrality cannot in any case justify the existence of a right to deduction, which is admitted only in respect of tax actually due, *except in cases of excessive cost or difficulty of recovery, which have not even been pleaded in the present case.* [Emphasis added.]

By reading this sentence, the impression is that the Supreme Court could have actually taken a different position (up to even recognizing the right to deduction in the case at hand, maybe), if only the taxable person had underlined the need to ensure the respect of the EU VAT principles of "proportionality" (that is, that rules and penalties cannot go beyond what is necessary to ensure the correct application of VAT provisions) and, above all, "effectiveness" (that is, as already pointed out, that the procedures must not, as a matter of fact, prevent the exercise of the right to deduction).

If this is the correct meaning to be attributed to the sentence pointed out, the judgment under discussion is a missed opportunity for creating clarity in the contentious issue at hand on the basis of an approach based more on substance (and on the rationale of Article 6) than on form.

3.2. Arguments for a wider interpretation approach

After having examined the positions in favour of a narrow interpretation of Article 6, the authors now assess whether, based on different arguments, different conclusions are possible.

For this purpose, it is essential here to better define a few principles well established in EU case law, some of them previously covered in this article.

To do so, reference is made to ECJ judgments cited by way of example that, even if not specifically referring to the right of deduction for a customer of the higher VAT they have been invoiced, could offer relevant arguments in the authors' exercise.

The first principle is the one of "neutrality", "which is a fundamental principle of the common system for VAT, … meant to relieve the taxable person entirely of the burden of the VAT in the course of its economic activities. That system therefore ensures that all economic activities, whatever their purpose or results, provided that they are, in principle, themselves subject to VAT, are taxed in a wholly neutral way".[25] In a few words, the neutrality principle implies that, as a general rule,[26] VAT must always be neutral for a taxable person, when said VAT is fully recoverable (and not a cost).

The second principle is the one of "proportionality", well defined by the ECJ when stating that:

> the Member States may indeed adopt measures in order to ensure the correct levying and collection of the tax and for the prevention of fraud … None the less, *the measures must not go further than is necessary to attain the objectives thereby pursued and may not, therefore, be used in such a way that they would have the effect of undermining the neutrality of VAT, which is a fundamental principle of the common system of VAT established by the relevant European Union law.*[27] [Emphasis added.]

That is, the measures adopted by a Member State in order to ensure the collection of VAT and the prevention of fraud must be "proportional" to these objectives and can never risk infringing the "neutrality" of VAT.

Two other EU principles relevant here are the one of "equivalence" and above all that of "effectiveness". In this respect, the ECJ has stated that:

> It is clear from the case-law that, in the absence of Community rules in the field, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, secondly, that they do not render virtually impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness).[28]

In the context under discussion, these two principles unquestionably represent a protection for a taxable person, since the rules and procedures implemented by a Member State in order to safeguard rights derived from EU law (such as the deduction of VAT) must be as favourable as those governing similar domestic actions ("equivalence") and in any case cannot make the exercise of such rights impossible or excessively difficult ("effectiveness").

25. *See* RO: ECJ, 2 July 2020, Case C-835/18, *SC Terracult SRL v. Direcția Generală Regională a Finanțelor Publice Timișoara – Administrația Județeană a Finanțelor Publice Arad – Serviciul Inspecție Fiscală Persoane Juridice 5 and Agenția Națională de Administrare Fiscală – Direcția Generală Regională a Finanțelor Publice Timișoara – Serviciul de Soluționare a Contestațiilor*, para. 25 (and case law cited therein), Case Law IBFD (accessed 4 Apr. 2022).
26. And so excluding specific exceptions, like the ones of businesses carrying out an exempt activity, not giving right to the deduction of VAT in any case.
27. *See* BG: ECJ, 11 Apr. 2013, Case C-138/12, *Rusedespred OOD v. Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – gr. Varna pri Tsentralno Upravlenie na Natsionalnata Agentsia za Prihodite*, para. 28 and 29 (and case law cited therein), Case Law IBFD (accessed 4 Apr. 2022).
28. *See* NL: ECJ, 7 June 20017, Joined Cases C-222/05 to C-225/05, *J. van der Weerd and Others (C-222/05), H. de Rooy sr. and H. de Rooy jr. (C-223/05), Maatschap H. en J. van 't Oever and Others (C-224/05) and B.J. van Middendorp (C-225/05) v. Minister van Landbouw, Natuur en Voedselkwaliteit*, para. 28 (and case law cited therein), ECLI:EU:C:2007:318, available at http://curia.europa.eu/juris/liste.jsf?num=C-222/05&language=en (accessed 4 Apr. 2022).

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From the brief examination of such EU principles, it seems possible to affirm that, once there is the good faith of the parties and no risk of a loss to the Treasury (a condition met if the customer could deduct the higher VAT charged to them, paid by them to the supplier and then paid by the supplier to the Italian tax authorities), then the fundamental principle of "neutrality" of VAT could make it possible to validate the actual treatment, and also the principles of "effectiveness" and "proportionality" would be surely respected. Thus, the payment made by the supplier would allow the deduction of the VAT paid to them by the customer.

A confirmation in this sense would come, for example, from the ECJ judgment in *Geocycle Bulgaria* (Case C-314/17[29]), which referred to a transaction that had been taxed twice, first by the supplier who had applied the VAT in their invoice, and then by the customer through the reverse charge mechanism, in the context of an assessment by the tax authorities.

Here, the ECJ has established that, in accordance with the principles of "neutrality" and "effectiveness", the behaviour of a Member State denying the customer the deduction of the VAT paid to the supplier is not acceptable since it does not acknowledge the fact that the VAT is paid twice, once by the supplier and then by the customer.

In *Fatorie* (Case C-424/12[30]), a transaction subject to reverse charge had been wrongly invoiced with VAT by the supplier, who (consequently) had not mentioned on the invoice that reverse charge was applicable to the customer.

The customer, once they received the incorrect invoice, had not mentioned the VAT as a "reverse charge", and had paid the VAT directly to the supplier.

In this scenario, the ECJ ruled that no right to deduction had to be granted to the customer (in relation to the VAT paid to the supplier), since, on the one hand, they had violated a formal obligation (in respect of the invoice received from the supplier) and, on the other hand, they had committed a substantial violation concerning the payment of VAT (carried out to the supplier and not to the tax authorities, due to the reverse charge). A similar situation has prevented the tax authorities from checking the application of the reverse charge mechanism, also determining the risk for the loss of tax for the Member State involved. In fact, in this case, the supplier had gone bankrupt and had not paid to the tax authorities the VAT paid to them by the customer.

The negligence of the customer and the loss of the missed VAT payment by the supplier played a crucial rule in denying the customer the right to deduction.

Mutatis mutandis, the idea here is that in the case of (i) no negligence imputable to the customer (which could happen especially in the case of new, complex – from a VAT treatment point of view – or non-recurrent transactions with the supplier) and of (ii) incorrect application but *actual* payment of the VAT by the supplier to the tax authorities, the right to deduction could have been otherwise granted to the customer, in relation to the VAT unduly paid to the supplier.

At this point, it is worth mentioning the ECJ judgment in *Grupa Wa.* (Case C-935/19[31]), where the ECJ ruled on the incorrect application of VAT to an exempt transaction, due to an error of assessment committed by the parties about the taxable nature of the supply carried out. Such an incorrect interpretation had led to a penalty equal to 20% of the higher VAT deducted (and asked to be refunded), even if neither fraud nor loss of VAT had been in place in the case at hand.

In particular, the *Grupa Wa* case was about the interpretation of article 273 of the VAT Directive,[32] and the principles of "proportionality" and "neutrality" of VAT.

The ECJ has ruled that:

> Article 273 of the VAT Directive and the principle of proportionality must be interpreted as precluding a national legislation which imposes on a taxable person who has mistakenly classified a transaction exempt from VAT as a transaction subject to that tax a penalty equal to 20% of the higher VAT refund wrongly claimed, *in so far as that penalty applies without distinction to a situation in which the irregularity results from an error of assessment made by the parties to the transaction as to the taxable nature of that transaction, which is characterised by the absence of indications of fraud and loss of tax revenue to the Treasury, and to a situation in which there are no such special circumstances.* [Emphasis added.]

The ECJ has challenged the application of a penalty always in the same measure, regardless of the circumstances in which a violation has been committed, but it seems to the authors that a fundamental principle has been stated here, i.e. that it is not possible to treat the behaviour of two taxable persons (customers) having both paid a higher VAT than the correct one to a supplier in the same way, regardless of an evaluation of the specific circumstances in which such payments have been made.

In particular, once it has been verified that the VAT has in any case (even if wrongly applied) been paid to the tax authorities by the supplier – so that there is no risk of loss – and that the payment by the customer has not been carried out in a context of fraud, then the safeguard requirements provided for by Article 6 are respected.

29. BG: ECJ, 23 Nov. 2017, Case C-314/17, *Geocycle Bulgaria EOOD v. Direktor na direktsia 'Obzhalvane i danachno-osiguritelna praktika' – Veliko Tarnovo, pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*, Case Law IBFD (accessed 12 Apr. 2022).
30. RO: ECJ, 6 Feb. 2014, Case C-424/12, *SC Fatorie SRL v. Direcția Generală a Finanțelor Publice Bihor*, Case Law IBFD (accessed 12 Apr. 2022).
31. PL: ECJ, 15 Apr. 2021, Case C-935/19, *Grupa Warzywna Sp. z o.o. v. Dyrektor Izby Administracji Skarbowej we Wrocławiu*, Case Law IBFD (accessed 12 Apr. 2022).
32. According to art. 273 VAT Directive:
    Member States may, while respecting equal treatment of domestic transactions and transactions between Member States by taxable persons, *lay down other obligations which they deem necessary in order to ensure the exact levying of VAT and to prevent evasion*, provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers. Member States may not avail themselves of the option provided for in the first item to impose invoicing obligations additional to those laid down in Chapter 3. [Emphasis added.]

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At this point, the following step is that nothing changes if an exempt transaction was wrongly subject to tax, or if a higher VAT rate was applied than the one due. Indeed, in certain cases, denying the customer the deduction of the VAT unduly applied in an exempt transaction would lead to consequences even more unjustifiable than if the denial had occurred in a case of application of a higher (undue) VAT rate. Let us assume – having in mind the Italian VAT rates – that:

(a) Italian VAT at a rate of 10% (amounting to EUR 10) was wrongly applied to an exempt transaction; or
(b) Italian VAT at a rate of 10% (amounting to EUR 10) was wrongly applied, rather than the correct one at a rate of 4% (amounting to EUR 4); and
  - in both cases, all the VAT charged by the supplier was paid by the customer, and then by the supplier to the Italian tax authorities; and
  - no context of fraud existed, in either case (a) or (b).

Therefore, in the example described, a narrow interpretation of Article 6, mainly based on its literal wording, could lead to the exclusion of the right of the customer to deduct the amount of VAT "in excess of the effective amount" in case (a) and to grant the same deduction in case (b).

Nevertheless, in both cases the legal requirements (of no fraud and no loss to the Treasury) are met, and the disallowed deduction would imply, in case (a), a cost for the customer equal to EUR 10, while, in case (b), it would be equal to (only) EUR 6 (i.e. 10-4).

Would this conclusion be correct? In the authors' view it would not be.

It is likely that these have been the same arguments of the Regional Tax Court of Lombardy in its Judgment No. 2270 of 15 June 2021, in which, without referring to Supreme Court Judgment No. 10439/2021 (earlier commented upon), the Court focused on the ECJ judgment in *Grupa Wa.* (Case C-935/2019) mentioned earlier.

The case examined in Judgment No. 2270/2021 was about *the undue application of VAT in an exempt transaction*, and, contrary to the Italian tax authorities (who, during the trial, had supported what the authors call a "narrow" interpretation of Article 6), the Regional Tax Court of Lombardy affirmed that (i) the customer had the right to deduct the undue VAT paid to the supplier and (ii) only the fixed penalty – and not the proportional one – was applicable to the customer, as provided for by Article 6.[33]

Its conclusions were based on the principles of "neutrality" and "proportionality", whose application has been expressly recognized in relation to Article 6 under discussion.

With regard to the approach to the interpretation of Article 6 in cases where VAT was wrongly applied but was not due at all (i.e. in exempt transactions – with or without right to deduction – or transactions out of the scope of VAT), the authors have mentioned Supreme Court Judgment No. 35500 of 19 November 2021 earlier in this article. This judgment – in relation to a case where VAT had been wrongly applied in an exempt transaction with right to deduction – did not recognize the customer's right to deduct the VAT charged by the supplier, based on the ECJ case law according to which VAT can be deducted only for the amount correctly due, charged and paid to the supplier in a taxable transaction.

As already anticipated, the authors want to now underline a passage of this judgment which is relevant for the present purposes, i.e. the one stating that "the principle of neutrality cannot in any case justify the existence of a right to deduction, which is admitted only in respect of tax actually due, *except in cases of excessive cost or difficulty of recovery, which have not even been pleaded in the present case*" [emphasis added].

The judgment thus has left the door open to a different solution. In other words, perhaps the principle of neutrality could not be, in itself, as "strong" as to justify in any case the deduction for the customer of the VAT wrongly applied in the invoice, but, if one considers also the other principles examined (effectiveness and proportionality), then the conclusion could be to allow a broader application of the deduction in place (and so, for example, also in the case of exempt transactions wrongly treated as taxable).

The taxable person who appealed to the Supreme Court in Judgment No. 35500/2021 could have pleaded that they would have had to bear high costs to start a legal case with the supplier, or – if possible – they could have shown evidence that the supplier was unreachable, or again that the latter had been declared bankrupt. In all these circumstances, Article 6 widely interpretated would have been the natural solution to combine, in an equitable manner, the principles of neutrality, effectiveness and proportionality.

Unfortunately, as pointed out in the judgement, no specific arguments in this sense were pleaded to the Supreme Court, so a (possible) different approach was not used in the present case.

33. In particular, in IT: CTR Lombardia [Tax Court of Appeal], 15 June 2021, Judgment No. 2270/2021, it is stated that:

> Contrary to the view taken by the Office in this case (which argued that the rule [i.e. Article 6] was applicable only in the case of transactions actually subject to VAT, in case of overcharged tax), the Court of Justice of the European Union, in Case C-935/19 in its judgment of 15 April 2021, affirmed the principle of law according to which the automatic application of proportional penalties to a customer who has deducted the VAT wrongly charged on an exempt transaction is unlawful, where there is no evidence of fraud and no loss to the Treasury, by reason of the general principles of neutrality of VAT and the proportionality of penalties in relation to the public interest objective of ensuring the correct collection of VAT.
>
> The judgment of the Court of Justice is directly and immediately applicable to the case at hand.
>
> *The challenge by the Italian Tax Authorities about the VAT deduction and the penalties calculated on a proportional basis must therefore be annulled*, with the result that only the fixed-rate penalty provided for by Article 6, paragraph 6, of Legislative Decree no. 471/1997 as amended by Law no. 205/2017, applicable under the terms set out in the aforementioned ruling of the Court of Justice, can be imposed. [Emphasis added.]

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Another good argument for the adoption of what the authors have called a "broad" application of Article 6 is the rule contained in item 9-bis(3) of Article 6 of Legislative Decree No. 471/1997.

Such a provision refers to the cases where the customer has wrongly applied the reverse charge (so accounting both output and input VAT) in exempt (with or without right to deduction) transactions or, in any case, transactions not subject to tax.

In such cases, the incorrectly applied (and deducted, on the input side) VAT is not to be repaid by the customer to the Italian tax authorities in case of assessment, since only the VAT output and input write-off (in the respective periodical tax settlement) is provided for by the rule.

Thus, as a matter of fact, in such a hypothesis, the deduction is allowed and, hence, no VAT is claimed by the ITA, and the transaction, with the removal of its (debt and credit) effects in case of an assessment, is in principle neutral from a VAT point of view.

In the end, all the arguments explained seem to go in the direction of supporting the possible application of Article 6 to all cases where VAT has been unduly applied (but in any case paid) by the supplier, regardless of the nature (taxable, exempt, outside the scope of VAT) of the invoiced transaction, and so to granting the deduction of such a VAT to the customer; provided, of course, that the transaction was not carried out in a context of fraud.

These conclusions are also in line with very relevant opinions issued by business representatives and associations/committees of professionals and tax experts.

In this respect, it is worthwhile to mention the contribution of Assonime (the association of Italian joint-stock companies), which, in its Circular letter No. 12/2018, in relation to the scope of application of Article 6, has specified that:

> With regard to the objective scope of application of the rule, we note that it considers "the application of tax in excess of the effective amount, wrongly paid …", so that it could be doubted that the scope is limited to cases where the tax is due, but its quantification has been wrongly overstated; in essence, these would be the cases where the supplier has wrongly applied a higher rate than the one actually applicable. However, it does not appear to us that this restrictive interpretation is the one that actually corresponds to the rationale and the logic of the rule. In fact, it would be difficult to find a systematic justification for the principle that the tax applied in excess of that due is deductible, and not also that which is not due for other reasons, for example because the transaction in question is exempt with or without right to deduction, or even excluded, as in the case … of the sale of a business. Even in such situations, in fact, a higher tax is applied than the one actually due according to the tax rules.

Moreover, two other, more recent, contributions sharing the proposed solution are worth mentioning here.

The first is the Rule of conduct (*Norma di comportamento*) No. 214 of 28 July 2021 issued by the Italian Association of Chartered Certified Accountants and Accounting Experts (*Associazione Italiana Dottori Commercialisti ed Esperti Contabili*), about the "deduction of unduly applied VAT in exempt (with or without right to deduction) and outside the scope of VAT transactions".

The second document is Interpretation principle (*Principio di interpretazione*) No. 2 – "VAT invoiced in excess and deduction", issued on 7 July 2021 by the Scientific committee Module 24 VAT (*Comitato scientifico Modulo 24 Iva*), a committee operating in connection with Sole 24 ore, the well-known Italian economics, finance and taxation newspaper.

As said, both of these documents share the correctness/opportunity, supported here by the authors, of a broad application of Article 6 in all cases where VAT was wrongly invoiced "in excess" to the customer.

4. Conclusions

Article 6 has been introduced within the Italian VAT provisions in order to allow a customer the right to deduct the VAT applied "in excess of the effective amount", provided that, in the absence of any tax fraud, the payment to the Italian tax authorities of the higher applied VAT has in any case been made by the supplier, so that no risk of loss to the Treasury exists.

In respect of such a provision, the approach of the Italian tax authorities and the case law of the Supreme Court seem to be quite restrictive, considering that, also based to some ECJ case law, from a general perspective they tend to admit the application of the provision only in cases where the VAT "in excess of the effective amount" results from a higher VAT rate than the correct one, and not also in cases where the tax should have not been applied at all (thus including the hypothesis of VAT charged in exempt transactions – with or without right to deduction – and transactions outside the scope of VAT).[34]

Such a "narrow" interpretative approach of Article 6 would imply, in all cases of exempt and outside-the-scope-of-VAT transactions,, the denial of the deduction for the customer, as well as the application of high penalties (90% of the wrongly applied and deducted VAT) in situations where there seems to be no reason for a different treatment than that applicable in case of a higher VAT rate.

Evidently, to apply – considering the Italian VAT rates – a 22% rate instead of 10% in a taxable transaction produces the same effects as applying VAT at 10% in an exempt transaction. But, if in both transactions, in the absence of a context of tax fraud, the unduly applied VAT has been in any case paid by the supplier to the tax authorities, then no risk of loss to the Treasury actually exists.

34. As seen, in IT: Cass. [Supreme Court], 21 Apr. 2021, Judgment No. 10439/2021, the Supreme Court has stated that Article 6 should be referred to only for recognizing the application of the fixed penalty provided for by it and not for admitting also the deduction of the VAT charged in excess, and these conclusions would apply even in case of VAT applied at a higher rate than the correct one. This interpretation would de facto render the content of Article 6 meaningless, considering that such provision, "in the event of the application of tax in excess of the effective amount" expressly provides for the application of fixed penalties "without prejudice to the right of the customer to deduct …".

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Thus, the possibility to adopt a "broad" interpretation of Article 6 has been explored, considering that such a provision had been introduced in order to simplify the recovery of VAT unduly (applied and so) paid by the customer to the supplier.

In this respect, the analysis of some case law of the ECJ has shown that the EU principles of VAT "neutrality", "effectiveness" and "proportionality" seem to offer good arguments in order to support a more favourable approach to the taxable person, which would help the customer to deduct the higher applied VAT regardless of the reason of its application in the supplier's invoice.

Recent judgments of Italian courts, as well as opinions issued by business representatives and associations/committees of professionals and tax experts, have also gone in this direction.

In conclusion, in the authors' opinion, it is time for defining a jurisprudential or legislative position recognizing a general broad application of Article 6, that would be as useful as ever, particularly in a historical period (the current one) in which the complexity of the economic transactions often makes it hard to correctly identify the related VAT treatment. For example, let us think about the application of VAT in a transaction that was considered taxable by the supplier and that, during an audit by the tax authorities, is requalified as ancillary to a financial one and therefore exempt, with all the difficulties (and further costs and formalities) for the customer to recover the incorrectly applied VAT that could derive from a narrow interpretation of said provision.

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