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Fraud and Abuse in Recent CJEU Case Law on VAT

Michael Lang/Draga Turic

I. The Cases in 2014

The CJEU rendered four judgments in which the concepts of fraud, evasion or abuse played a role. Three of them came from Bulgaria, a country which, outside VAT, does not have much of a track record in respect of preliminary rulings. We are going to discuss three of the cases: two of the Bulgarian cases and one case from the United Kingdom. The CJEU made some interesting statements in respect of fundamental methodological issues, which we are going to analyse below.

II. *Maks Pen*, Case C-18/13

A. Facts and Preliminary Questions

In case C-18/13, the CJEU had to deal with the deductibility of input VAT invoiced by suppliers of the Bulgarian company Maks Pen operating as a wholesaler of office supplies and advertising material. The Bulgarian tax authorities queried whether the suppliers in question had the resources to be in a position to supply and whether certain transactions were carried out at all or with parties other than those stated in the invoices. As the tax authorities held that the invoiced transactions were not substantiated, they denied Maks Pen the deduction of the input VAT resulting from the supplies concerned. However, Maks Pen stated that it could provide evidence for the transactions in the form of invoices, contractual documents and bank transfers. Furthermore, these transactions were stated in the suppliers' accounting records and VAT declarations. Nonetheless, the tax authorities did not deem the invoices to be in a sufficiently proper form to be eligible for VAT deduction, as they doubted the reliability of the private documents, the completeness of the sub-contractors' accounting records and VAT declarations, and the validity of the suppliers' signatures.[1]

The referring court asked whether the VAT Directive[2] had to be interpreted as refusing the VAT input deduction on supplies that were effected, but not by the supplier stated on the invoice or its sub-contractor, inter alia, because they did not have the resources, the transactions were not to be found in the accounting records and the validity of the signatures on the documents was doubtful.[3]

Furthermore, the court wanted to know if, according to EU law, it had to conduct an examination of its own motion to ascertain whether tax evasion existed based on new facts brought up by the tax authorities for the first time and all other evidence, even if doing so would mean an infringement of obligations that are given under the national law.[4]

1 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) paras. 16–20.
2 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.
3 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 22.
4 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 33.

B. Fraudulent Conduct

The CJEU stated, referring to settled case law,[5] that the right to deduct input VAT, which is due or paid on goods and services, constitutes a fundamental principle of the EU's VAT system. This right is "*an integral part of the VAT scheme*" that – according to previous case law[6] – may not, in principal be limited. The right of input VAT deduction can be exercised immediately for all taxes charged on input transactions.[7] Thus limitations to the VAT deduction right are not allowed in principal. This begs the question of exceptions: in what cases can the taxpayer's right to deduct the input VAT be denied? The CJEU required in previous judgments[8] that any limitation would have to be applied "*in a similar manner*" in all other Member States, so that derogations could only occur "*in the cases expressly provided for in the directive*". According to the case *Lennartz v Finanzamt München III* a limitation would need a "*provision empowering the Member States to limit the right of deduction granted to taxable persons*".[9]

However, according to the Court in the *Maks Pen* case the right of deduction can be denied, "*if it is shown, in the light of objective evidence, that that right is being relied on for fraudulent or abusive ends*", as "*the prevention of tax evasion, tax avoidance and abuse is an objective recognized and encouraged by Directive 2006/112*".[10] This objective was deduced by the CJEU from the wording of Article 13(B) of the Sixth Directive: "*Member States shall exempt the following under conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions and of preventing any possible evasion, avoidance or abuse*".[11] The Court considered this objective not to be limited to the ap-

5 See CJEU, 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) para. 25; 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében and Dávid* (published in the electronic Reports of Cases) para. 37; 28 July 2011, Case C-274/10, *Commission v Hungary*, ECR 2011 I-07289, para. 42; 12 May 2011, Case C-107/10, *Enel Maritsa Iztok 3*, ECR 2011 I-03873, para. 31; 10 July 2008, Case C-25/07, *Sosnowska*, ECR 2008 I-05129, para. 14; 25 October 2001, Case C-78/00, *Commission v Italy*, ECR 2001 I-08195, para. 28; 18 December 1997, Joined Cases C-286/94, C-340/95, C-401/95 and C-47/96, *Garage Molenheide and Others v Belgian State*, ECR 1997 I-07281, para. 47.

6 See CJEU, 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) para. 26; 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében and Dávid* (published in the electronic Reports of Cases) para. 38; 28 July 2011, Case C-274/10, *Commission v Hungary*, ECR 2011 I-07289, para. 43; 12 May 2011, Case C-107/10, *Enel Maritsa Iztok 3*, ECR 2011 I-03873, para. 32; 30 September 2010, Case C-392/09, *Uszodaépítő*, ECR 2010 I-08791, para. 34; 15 July 2010, Case C-368/09, *Pannon Gép Centrum*, ECR 2010 I-07467, para. 37; 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 47; 15 December 2005, Case C-63/04, *Centralan Property*, ECR 2005 I-11087, para. 50; 21 March 2000, Joined Cases C-110/98 to C-147/98, *Gabalfrisa and Others*, ECR 2000 I-01577, para. 43; 6 July 1995, Case C-62/93, *BP Supergas v Greek State*, ECR 1995 I-01883, para. 18; 11 July 1991, Case C-97/90, *Lennartz v Finanzamt München III*, ECR 1995 I-03795, para. 27; 21 September 1988, Case C-50/87, *Commission v France*, ECR 1988 04797, para. 16.

7 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) paras. 23–24.

8 CJEU, 6 July 1995, Case C-62/93, *BP Supergas v Greek State*, ECR 1995 I-01883, para. 18; 11 July 1991, Case C-97/90, *Lennartz v Finanzamt München III*, ECR 1995 I-03795, para. 27; 21 September 1988, Case C-50/87, *Commission v France*, ECR 1988 04797, para. 17.

9 CJEU, 11 July 1991, Case C-97/90, *Lennartz v Finanzamt München III*, ECR 1995 I-03795, para. 27.

10 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 26.

11 See Art. 131 of the VAT Directive.

plication of exemptions, but rather to be valid for the entire Sixth Directive.[12] The objective was repeated in subsequent cases.[13] The regulations concerning deductions in the VAT Directive as such do not contain any provision similar to the one for exemptions. Only according to Article 343 of the VAT Directive may a Member State be authorized by the Council, on a proposal from the Commission, to "*introduce special measures to combat tax evasion*" concerning the right of deduction. But, this is a special regulation for second-hand goods, works of art, collectors' items and antiques, which only covers the case of evasion. A general rule for deductions does not exist.

According to the CJEU, the EU law may not be relied on for "*fraudulent or abusive ends*", as this would contradict this objective. If this is the case "*in the light of objective evidence*", the national courts and authorities have to refuse the deduction.[14] Initially, the CJEU used a similar terminology in a case regarding social security, where the Court stated, referring to previous case law concerning the fundamental freedoms[15] and a case regarding the Common Agricultural Policy,[16] that "*Community law cannot be relied on for the purposes of abuse or fraud*".[17] The cited case law is aimed at giving examples of abuse: a Member State is allowed "*to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom [...] for the purpose of avoiding the professional rules of conduct [...]*".[18] The exercise of freedoms in order "*wrongfully to avoid obligations under national law*" can be prevented by the Member States.[19] In other cases abuse was characterized by an action that was "*for the sole purpose of re-importation in order to circumvent legislation*",[20] "*for the sole purpose of enjoying [...] the benefit of the student assistance system*"[21] or "*for the sole purpose of wrongfully securing an advantage [...]*".[22] The same wording as in

12 CJEU, 29 April 2004, Joined Cases C-487/01 and C-7/02, *Gemeente Leusden and Holin Groep*, ECR 2004 I-05337, para. 76.

13 See inter alia CJEU, 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében and Dávid* (published in the electronic Reports of Cases) para. 41; 27 October 2011, Case C-504/10, *Tanoarch*, ECR 2011 I-10853, para. 50; 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 54; 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, para. 71; 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) para. 35.

14 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 26.

15 CJEU, 3 December 1974, Case C-33/74, *Van Binsbergen v Bedrijfsvereniging voor de Metaalnijverheid*, ECR 1974 01299, para. 13; 5 October 1994, Case C-23/93, *TV10 v Commissariaat voor de Media*, ECR 1994 I-04795, para. 21; 10 January 1985, Case C-229/83, *Leclerc v Au blé vert*, ECR 1985 00001, para. 27; 21 June 1988, Case C-39/86, *Lair v Universität Hannover*, ECR 1988 03161, para. 43.

16 CJEU, 3 March 1993, Case C-8/92, *General Milk Products v Hauptzollamt Hamburg-Jonas*, ECR 1993 I-00779, para. 21.

17 CJEU, 2 May 1996, Case C-206/94, *Brennet v Paletta*, ECR 1996 I-02357, para. 24.

18 CJEU, 3 December 1974, Case C-33/74, *Van Binsbergen v Bedrijfsvereniging voor de Metaalnijverheid*, ECR 1974 01299, para. 13.

19 CJEU, 5 October 1994, Case C-23/93, *TV10 v Commissariaat voor de Media*, ECR 1994 I-04795, para. 21.

20 CJEU, 10 January 1985, Case C-229/83, *Leclerc v Au blé vert*, ECR 1985 00001, para. 27.

21 CJEU, 21 June 1988, Case C-39/86, *Lair v Universität Hannover*, ECR 1988 03161, para. 43.

22 CJEU, 3 March 1993, Case C-8/92, *General Milk Products v Hauptzollamt Hamburg-Jonas*, ECR 1993 I-00779, para. 22.

Maks Pen was used with reference to the aforementioned cases in a case regarding the freedom of establishment[23] and in other subsequent cases.[24]

The right has to be refused both to a taxable person, who has committed tax evasion, and to a taxable person, who "*knew, or should have known, that, by his acquisition, he was taking part in a transaction connected with the evasion of VAT*". He is regarded as a participant regardless of whether he makes a profit on the subsequent taxable transaction that was carried out by him or not. Thus, the right to deduct input VAT can only be denied to a taxable person, who was the recipient in the transaction, for which the deduction right was claimed, if "*it was established on the basis of objective evidence*" that he "*knew or should have known that, through the acquisition of those goods or services, he was participating in a transaction connected with the evasion of VAT committed by the supplier or by another trader acting upstream or downstream in the chain of supply of those goods or services*".[25] From this it follows that a limitation of the deduction right is only allowed in the case of evasion. According to the CJEU case law[26], the refusal of the deduction right in the case of tax evasion can be justified by the absence of the objective criteria required for "supply of goods"[27] or "supply of services"[28] and "economic activity".[29]

It would not, "*in itself, be sufficient ground*" to deny the deduction right, if a transaction was not carried out at all or carried out with a supplier or sub-contractor other than that stated on the invoices, "*inter alia because they did not have the personnel, equipment or assets required, there was no record of the costs of making the supply in their accounts and the identification of persons signing certain documents as suppliers was shown to be inaccurate*".[30] So, other requirements have to be fulfilled in order to understand that tax fraud is present.

In fact the deduction right can only be denied, if the national court determines that the following two requirements are met: the above stated facts constitute "*fraudulent conduct*" and demonstrate, "*that it is established, in the light of objective evidence provided by the tax authorities, that the taxable person knew or should have known that the transaction relied on to give entitlement to the right to*

23 CJEU, 12 May 1998, Case C-367/96, *Kefalas and Others v Elliniko Dimosio and Others*, ECR 1998 I-02843, para. 20.

24 See inter alia CJEU, 23 March 2000, Case C-373/97, *Diamantis*, ECR 2000 I-01705, para. 33; regarding VAT, 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, para. 68; 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 54; 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében and Dávid* (published in the electronic Reports of Cases) para. 41; 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) para. 36.

25 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) paras. 27–28.

26 CJEU 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, paras. 58–59; 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 53; 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) paras. 38–39.

27 See Art. 14(1) of the VAT Directive.

28 See Art. 24(1) of the VAT Directive.

29 See Art. 9(1) of the VAT Directive.

30 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 31.

deduct was connected with that fraud".[31] The wording "*knew or should have known*" has already been used in previous judgments.[32]

Consequently, the refusal of the deduction right can be extended to other taxpayers who have not themselves committed tax evasion.[33] This approach arises from the joined cases C-439/04 and C-440/04 *Kittel*, where the CJEU stated that a taxable person who "*knew or should have known*" helps the offender and is an accomplice. This interpretation should prevent fraud by making it more difficult to commit it.[34]

According to the CJEU, the tax authorities have to establish that objective evidence regarding the above mentioned requirements is given and the national courts must determine whether this evidence is established, as the refusal of the deduction right constitutes an exception to the fundamental principle resulting from this right.[35] This indicates that the criteria for the denial of the deduction right should be interpreted narrowly, as such denial constitutes an exception from the fundamental principle. The requirement for a narrow interpretation of the exceptions can be found from time to time in the CJEU case law.[36]

This theory is, however, obsolete and methodically unsound. It has to be considered, that it is a question of legal drafting technique whether an exception is used or not. Every regulation can be designed either as a broad general rule which is narrowed by an exception, or, from the outset, as a rule having a more narrow scope. The same result can be achieved in different ways. Only in the first mentioned case is an exception used, whereas in the latter case no exception is needed to draft laws with the same content. It would be odd if in the first mentioned case the exception should be understood as "strict" whereas in the latter case no general presumption of a broad understanding has ever been suggested. According to up-to-date legal methodology it is clear that there is no basis for a general presumption that exceptions have to be understood as requiring strict interpretation.[37]

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31 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 32.

32 CJEU 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 56; 6 December 2012, Case C-285/11, *Bonik* (published in the electronic Reports of Cases) para. 39; see similar wording "*knew, or ought to have known*", 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében and Dávid* (published in the electronic Reports of Cases) para. 45.

33 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 27.

34 CJEU 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, paras. 56–58.

35 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 29.

36 See inter alia CJEU, 15 June 1989, Case C-348/87, *Stichting Uitvoering Financiële Acties v Staatssecretaris van Financiën*, ECR 1989 I-01737, para. 13; 12 December 1995, Case C-399/93, *Oude Luttikhuis and Others v Verenigde Coöperatieve Melkindustrie Coberco*, ECR 1995 I-04515, para. 23; 5 June 1997, Case C-2/95, *SDC v Skatteministeriet*, ECR 1997 I-03017, para. 20; 12 February 1998, Case C-92/96, *Commission v Spain*, ECR 1998 I-00505, para. 31; 7 September 1999, Case C-216/97, *Gregg*, ECR 1999 I-04947, para. 12; 8 May 2003, Case C-384/01, *Commission v France*, ECR 2003 I-04395, para. 28; 6 May 2010, Case C-94/09, *Commission v France*, ECR 2010 I-04261, para. 29; 17 June 2010, Case C-492/08, *Commission v France*, ECR 2010 I-05471, para. 35.

37 See M. Lang, *Doppelbesteuerungsabkommen und innerstaatliches Recht* (Vienna 1992), p. 75 et seq.; H.G. Ruppe, *Die Ausnahmebestimmung des Einkommensteuergesetzes* (Vienna 1971), p. 28 et seq.; G. Stoll, *Das Steuerschuldverhältnis in seiner grundlegenden Bedeutung für die steuerliche Rechtsfindung* (Vienna 1972), p. 104.

However, there may be other reasons for a narrow interpretation of the refusal of deduction within the scope of VAT. A general denial of the right to deduct in the case of fraud would not comply with the principles of legal certainty and protection of legitimate expectations that are, according to settled case law,[38] part of the EU legal order and have to be observed by the EU institutions as well as the Member States.

C. Existence of Evasion "ex offo"?

Regarding the question of whether according to EU law national courts have to conduct an examination of their own motion concerning the existence of tax evasion contradicting national law, the CJEU stated that the right of deduction has to be denied by the court, when the requirements are met. Even though the parties in question do not refer to binding EU law, according to settled case law[39] the national courts have to bring up the relevant rules on their own motion, where they would be required under national law to do so regarding national provisions.[40] This obligation of the national courts does not have to be met, when it would go "*beyond the ambit of the dispute*".[41] Furthermore, the domestic courts are obliged to "*ensure the legal protection which persons derive from the effect of provisions of Community law*".[42]

The CJEU views Article 160(2) of the Bulgarian Tax and Social Security Procedure Code[43] as being such a rule; requiring the courts to examine whether the taxpayer's claimed VAT deduction is in conformity with national law and whether tax evasion is present. In this context, the courts also have to check for conformity with EU law and with the objective of the VAT Directive of preventing any tax evasion, tax avoidance and abuse.[44] This position seems defendable in regard to the relation between EU and national law. However, the CJEU gives the impression that it is interpreting domestic law, in this case Bulgarian law.

38 See inter alia CJEU, 3 December 1998, Case C-381/97, *Belgocodex*, ECR 1998 I-08153, para. 26; 29 April 2004, Joined Cases C-487/01 and C-7/02, *Gemeente Leusden and Holin Groep*, ECR 2004 I-05337, para. 57; 26 April 2005, Case C-376/02, *'Goed Wonen'*, ECR 2005 I-03445, para. 32; 14 September 2006, Joined Cases C-181/04 to C-183/04, *Elmeka*, ECR 2006 I-08167, para. 31.

39 CJEU, 16 December 1976, Case C-33/76, *Rewe v Landwirtschaftskammer für das Saarland*, ECR 1976 01989, para. 5; 14 December 1995, Joined Cases C-430/93 and C-431/93, *Van Schijndel v Stichting Pensioenfonds voor Fysiotherapeuten*, ECR 1995 I-04705, para. 13; 24 October 1996, Case C-72/95, *Kraaijeveld and Others*, ECR 1996 I-05403, para. 57.

40 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 34.

41 CJEU, 14 December 1995, Joined Cases C-430/93 and C-431/93, *Van Schijndel v Stichting Pensioenfonds voor Fysiotherapeuten*, ECR 1995 I-04705, para. 22; 12 February 2008, C-2/06, *Kempter*, ECR 2008 I-00411, para. 45.

42 CJEU, 16 December 1976, Case C-33/76, *Rewe v Landwirtschaftskammer für das Saarland*, ECR 1976 01989, para. 5; 19 June 1990, Case C-213/89, *The Queen v Secretary of State for Transport, ex parte Factortame*, ECR 1990 I-02433, para. 19; 14 December 1995, Joined Cases C-430/93 and C-431/93, *Van Schijndel v Stichting Pensioenfonds voor Fysiotherapeuten*, ECR 1995 I-04705, para. 14; 24 October 1996, Case C-72/95, *Kraaijeveld and Others*, ECR 1996 I-05403, para. 58.

43 "*The court shall assess whether the amended notice complies with the law and its validity by checking whether that notice was issued by a competent department, in the required form, and whether it complies with the substantive and procedural provisions.*"

44 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 35.

Moreover, the CJEU emphasizes that domestic law has to be interpreted "*in the light of the wording and the purpose*" of EU law. Therefore, the national courts have to use "*whatever lies within [their] jurisdiction, taking the whole body of domestic law into consideration and applying the interpretative methods recognized by that law*" and must determine whether a possible contradicting national provision can be interpreted in accordance with EU law and its objectives.[45]

However, if the application of EU law would occasion a disregard of the principle of the prohibition of "reformatio in peius", the domestic courts are not obliged to apply EU law of their own motion. According to the CJEU it was, "*not obvious*", that this prohibition could be applied in the *Maks Pen* case, as the new evidence brought up by the tax authorities concerned the same invoices that were in question regarding the VAT deduction from the beginning. Thus, the situation of the taxpayer claiming the right of deduction could not be affected.[46] The CJEU pointed out in *Heemskerk and Schaap*[47] that the infringement of the principle of the prohibition of "reformation in peius" would not be in accordance with "*the principles of respect for the rights of the defence, legal certainty and protection of legitimate expectations*" and would lead to a "*less favourable position*".

Even though the classification of tax evasion as a criminal offence can only be made by a criminal court, according to the CJEU, "*it is not obvious*" that this fact can hinder national courts from applying another provision, which prohibits the deduction of "*unlawfully invoiced*" VAT in order to examine the existence of tax evasion within the framework of the assessment of the amended tax notice's legality.[48] However, in this context it is not clear what the meaning of the phrase "*it is not obvious*" is. It seems to be the case that the question of which domestic court is responsible for which decision is a question of domestic law. Therefore it does not fall within the competence of the CJEU to decide issues of local competence at all, nor to make a statement on whether a certain interpretation of domestic law is "obvious" or not.

III. *Firin*, Case C-107/13

A. Facts and Preliminary Questions

In case C-107/13, the CJEU had to deal with the deductibility of input VAT invoiced by a wheat supplier to the Bulgarian company Firin which was engaged in the production and marketing of bread and pastries. Firin is owned by York Skay

45 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 36; see also CJEU 13 November 1990, Case C-106/89, *Marleasing v Comercial Internacional de Alimentación*, ECR 1990 I-04135, para. 7; 5 October 2004, Joined Cases C-397/01 to C-403/01, *Pfeiffer and Others*, ECR 2004 I-08835, paras. 115, 116, 118.

46 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 37.

47 CJEU, 25 November 2008, Case C-455/06, *Heemskerk and Schaap*, ECR 2008 I-08763, paras. 45–47.

48 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 38.

(99 %) and Mr Yorkishev (1 %). Mr Yorkishev wholly owned the wheat supplier in question. The Bulgarian tax authorities claimed that the supply in question (10 000 tonnes of wheat) was not made and that the respective invoice was part of a fraudulent scheme revealed through audit. The supplier was not allowed to trade in wheat, as he was not registered with the National Office for Grain. Firin could not have been unaware of this. Moreover, when Firin made the payment to the supplier, a greater sum was paid into the account of York Skay. York Skay also paid a considerable sum to Firin's account on the same date. The tax authorities did not accept the explanation that the former was a loan payment and the latter an additional contribution.[49]

The referring court asked whether the VAT Directive had to be interpreted so that the VAT deduction made by the recipient of an invoice drawn up with a view to a payment on account has to be adjusted, when the supply is not made, even though the payment is not refunded and the supplier remains liable.[50]

Furthermore, the court raised questions regarding the joint and several liability of a taxable person in respect of tax payable by a third party, which were declared inadmissible by the CJEU, as they were not related "*to the subject-matter of the dispute*".[51]

B. Fraudulent Conduct

According to Article 167 of the VAT Directive, the VAT is deductible "*at the time the deductible tax becomes chargeable*". This is the case, according to Article 63 of the VAT Directive, "*when the goods or the services are supplied*".[52]

However, there is an exception to this general rule: Article 65 of the VAT Directive provides for payments on account, that "*VAT shall become chargeable on receipt of the payment and on the amount received*". This rule should be interpreted narrowly because of its exceptional character. VAT is therefore only chargeable, if "*all the relevant information concerning the chargeable event, namely, the future supply of goods or services, must already be known and therefore, in particular, the goods or services must be precisely identified at the time when the payment on account is made*".[53]

According to the CJEU, the goods to which the supply in question related were "*clearly identified*" at the time the payment on account was made.[54]

49 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 19–26.
50 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 33.
51 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 28–32.
52 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 34.
53 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 35–36; , see also CJEU, 21 February 2006, Case C-419/02, *BUPA Hospitals and Goldsborough Developments*, ECR 2006 I-01685, paras. 45, 48.
54 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 38.

"*None the less*", Article 65 cannot be applicable if at the time of the payment on account it is uncertain whether the chargeable event will occur. This applies "*in particular*" to the case of fraudulent conduct.[55] Thus, "*fraudulent conduct*" is one circumstance, where it is not certain whether the supply will actually be carried out, so that the tax will be chargeable.

The CJEU stated – like in *Maks Pen*[56] – that "*the prevention of tax evasion, avoidance and abuse*" constitutes an objective of the VAT directive and that EU law cannot "*be relied on by individuals for abusive or fraudulent ends*", which have to be examined by national courts. When a taxable person commits tax fraud, EU law would be relied on for abusive or fraudulent ends.[57]

Furthermore, it was pointed out that "*two traders involved are not necessarily treated identically*", when there is no taxable transaction because of improperly invoiced VAT. According to Article 203 of the VAT Directive, the VAT is always payable – no matter if there was a taxable transaction – when it is entered on an invoice and leads to the liability of the invoice's issuer. However, the right to deduct input VAT under Articles 63 and 167 of the VAT Directive requires a taxable transaction. In such a case, the improperly invoiced VAT can be corrected, if the invoice's issuer "*acted in good faith or where he has, in sufficient time, wholly eliminated the risk of any loss of tax revenue*". Even though the payment on account was not refunded and the supplier remains liable, the repayment of the input VAT can be demanded from the recipient of an invoice by the tax authorities.[58]

On the one hand, the provision regarding payment on account under Article 65 of the VAT Directive has to be – as an exception – interpreted narrowly.[59] On the other hand, however, the refusal of the deduction right constitutes an exception from this narrowly interpreted rule. It is therefore up to the tax authorities to establish objective evidence that the taxable person claiming the right of deduction "*knew, or should have known*" that the transaction was "*connected with fraud committed by the supplier or by another trader acting upstream or downstream in the chain of supply*".[60] This approach causes a methodological problem: since the fraud related exception to the exception establishes the general rule again, one could come to the opposite result: the "*fraudulent conduct*" has obviously to be interpreted broadly, instead of strictly. This illustrates that the presumption of interpreting exceptions narrowly leads to completely arbitrary results.

The CJEU considers that a penalty in the form of a refusal of the deduction right for a taxable person, who "*did not know, and could not have known*" is not in ac-

55 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 39.
56 CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) paras. 26–27.
57 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 40–41.
58 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 54–57, see also 31 January 2013, Case C-643/11, *LVK – 56* (not yet published) paras. 46–48.
59 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 35.
60 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 44.

cordance with the VAT Directive, as this "*would go beyond what is necessary to preserve the public exchequer's rights*".[61] However, the CJEU is inconsistent in its wording and also uses "*knew, or should have known*". The wording "*knew or should have known*"[62] and "*did not and could not know*"[63] was also used in the joined cases C-439/04 and C-440/04 *Kittel*, where this concept was developed. This would suggest that the Court seems to apply slightly different standards in different cases, without reflecting deeply.

C. Joint Liability

According to settled case law,[64] a request for preliminary ruling may only be refused by the CJEU, "*where it is quite obvious that the interpretation of European Union law that is sought bears no relation to the actual facts of the main action or its purpose, where the problem is hypothetical, or where the Court does not have before it the factual or legal material necessary to give a useful answer to the questions submitted to it.*"[65] Thus, the CJEU has three reasons at its disposal to refuse to provide a ruling on a question. The *Firin* case[66] is an example, where the CJEU decided that certain aspects of the questions were not related to the "*subject-matter of the dispute*". The question relating to joint liability would be irrelevant, as joint liability according to national law was not applicable here. In the case *Meilicke*[67] the CJEU detected a hypothetical problem, as the eight questions over eight pages were not directly related to the right in question, but rather raised the problem of whether a doctrine of national law – which was not applicable in that case – was compatible with EU law. Inadmissibility due to the lack of information regarding the factual and legal context was observed in the *Cannito* case.[68]

Rarely were cases really inadmissible. How problematic the determination of questions regarding their admissibility is, can be seen from the fact that even the CJEU and its Advocates General sometimes have opposing views.[69] In the case *Thomasdünger* , the Advocate General[70] considered the questions not to be rele-

61 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 42–44.
62 CJEU, 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 56.
63 CJEU, 6 July 2006, Joined Cases C-439/04 and C-440/04, *Kittel*, ECR 2006 I-06161, para. 60.
64 See inter alia CJEU, 7 June 2007, Joined Cases C-222/05 to C-225/05, *van der Weerd and Others*, ECR 2007 I-04233, para. 22; 12 October 2010, Case C-45/09, *Rosenbladt*, ECR 2010 I-09391, para. 33; 6 June 2013, Case C-648/11, *MA and Others* (not yet published) para. 37; 19 December 2013, C-279/12, *Fish Legal and Shirley* (not yet published) para. 30.
65 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) para. 30.
66 CJEU, 13 March 2014, Case C-107/13, *FIRIN* (not yet published) paras. 31–32.
67 CJEU, 16 July 1992, Case C-83/91, *Meilicke v ADV/ORGA*, ECR 1992 I-04871, para. 28.
68 CJEU, 11 February 2004, Joined Cases C-438/03, C-439/03, C-509/03 and C-2/04, *Cannito*, ECR 2004 I-01605, para. 7.
69 See K. Lenaerts, 'The Unity of European Law and the Overload of the CJEU – The System of Preliminary Rulings Revisited' in: I. Pernice/J. Kokott/C. Saunders (eds.) *The Future of the European Judicial System in a Comparative Perspective*, (Berlin 2006) pp. 211–239 (p. 225).
70 CJEU, 15 May 1985, Case C-166/84, *Thomasdünger v Oberfinanzdirektion Frankfurt am Main*, Opinion of Advocate General Mancini, points 2–3.

vant for the interpretation of EU law, whereas the CJEU[71] left it to the national court to *"determine in the light of the facts of each case whether the preliminary ruling is necessary in order to decide the dispute pending before it."* Another example would be the case *Gmurzynska-Bscher*, where the CJEU[72] held to be admissible, questions concerning the interpretation of EU law in order to apply a national provision only for a domestic matter although the Advocate General[73] was of the opinion that they were beyond the scope of EU law.

Even in the *Firin* case, the inadmissibility of the questions concerning joint liability could be doubted. One could argue, even though Firin is not jointly liable according to national law, that Firin is "economically" jointly liable. The Bulgarian provision regarding joint and several liability[74] would be applicable if Firin had exercised the right to deduct input VAT and if Firin *"knew or should have known"* that the VAT would not be paid by its supplier, so that Firin would be liable for the VAT. However, the same result is achieved, when Firin's right of deduction is denied due to involvement in a fraud. In both cases the VAT becomes a cost factor for Firin. Thus, the effect of the denial of the deduction right may be seen as joint liability in the economic sense.

IV. *GMAC*, Case C-589/12

A. Facts and Preliminary Questions

In case C-589/12, the CJEU had to deal with the cumulative application of national and EU law to the UK company, GMAC which was, inter alia, selling motor cars on deferred payment terms. A car dealer sells a car, which was chosen by a consumer, to GMAC and GMAC supplies the car – under a hire purchase contract – to the consumer. The sale of the cars by the dealer and the provision of the cars by GMAC are subject to VAT. In the case of the customer's default, GMAC would repossess the car and auction it. The auction sale was treated according to a provision of national law[75] as neither a supply of goods nor a supply of services. The case which arose concerned the situation where the customer has not paid a part of the consideration for the supply to GMAC because of his default, for which GMAC has claimed bad debt relief.[76]

The referring court asked whether the VAT Directive had to be interpreted as preventing a taxable person from referring to the direct effect of a provision of EU

71 CJEU, 26 September 1985, Case C-66/84, *Thomasdünger v Oberfinanzdirektion Frankfurt am Main*, ECR 1985 03001, para. 11.
72 CJEU, 8 November 1990, Case C-231/89, *Gmurzynska-Bscher v Oberfinanzdirektion Köln*, ECR 1990 I-04003, paras. 15–26.
73 CJEU, 3 July 1990, Case C-231/89, *Gmurzynska-Bscher v Oberfinanzdirektion Köln*, Opinion of Advocate General Darmon, points 5–14.
74 Art. 177 of the ZDDS (Bulgarian law).
75 Art. 4 of the Cars Order (UK law).
76 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) paras. 16–25.

law concerning one transaction by reasoning that a provision of national law was applicable on another transaction regarding the same goods and the application of both provisions would lead to a result that was intended neither by EU law nor by national law.[77]

B. *Halifax* Case Law

In its judgment, the CJEU refers to the *Halifax* case,[78] where an abuse test was developed for the sphere of VAT: "*Abusive practice*" can only be present, if "*first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions and, second, it is apparent from a number of objective factors that the essential aim of the transactions concerned is solely to obtain that tax advantage*".[79] On the one hand, the CJEU uses an objective criterion, namely the grant of a tax advantage that would not be in accordance with the purpose of the relevant provision of the VAT Directive. On the other hand, the CJEU requires a second criterion with subjective character: the essential aim of the relevant transaction is solely to gain the tax advantage.

Regarding this subjective element of the abuse test, the CJEU makes use of various wordings, even within the same judgment. Whereas there is talk of "*the essential aim*" in the *Halifax*[80] and other cases[81], in other cases "*the sole aim*"[82] or "*the principal aim*"[83] is decisive. A subjective element is never preferable, as it refers to the intention of the taxable person, which only that taxable person can really know. But compared to other formulations, the CJEU's criterion seems like the lesser evil. The OECD's action plan on base erosion and profit shifting contains an action 6 "*Prevent treaty abuse*" that has a proposal for a general anti-avoidance rule. The subjective element of that rule is "*one of the main purposes*", which means there can also be other "*main purposes*". As long as one main purpose is to obtain a benefit, the criterion is fulfilled. This OECD definition is much broader.[84]

77 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 27.
78 CJEU, 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, paras. 74–75.
79 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 45.
80 CJEU, 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, paras. 75, 86.
81 CJEU, 22 December 2010, Case C-103/09, *Weald Leasing*, ECR 2010 I-13589, para. 31; 22 December 2010, Case C-277/09, *RBS Deutschland Holding*, ECR 2010 I-13805, para. 49; CJEU, 27 October 2011, Case C-504/10, *Tanoarch*, ECR 2011 I-10853, para. 52; 20 June 2013, Case C-653/11, *Newey* (not yet published) para. 35.
82 CJEU, 21 February 2008, Case C-425/06, *Part Service*, ECR 2008 I-00897, para. 30; 22 May 2008, Case C-162/07, *Ampliscientifica and Amplifin*, ECR 2008 I-04019, para. 28; 22 December 2010, Case C-277/09, *RBS Deutschland Holding*, ECR 2010 I-13805, para. 51; 27 October 2011, Case C-504/10, *Tanoarch*, ECR 2011 I-10853, para. 51; CJEU, 20 June 2013, Case C-653/11, *Newey* (not yet published) paras. 46, 52.
83 CJEU, 21 February 2008, Case C-425/06, *Part Service*, ECR 2008 I-00897, para. 45.
84 Critical comments on this by M. Lang, 'BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties', *Tax Notes International*, Vol. 74, No. 7 (2014) pp. 655–664 (pp. 658 et seq.).

Even the objective criterion appears not to be justified. When the "*formal application*" is "*contrary to the purpose*" one of the requirements of the abuse test is met. But the interpretation of a provision is never merely the "*formal application*". The "*purpose*" has always to be taken into account. Why should that be done only if the essential aim is to obtain a tax advantage and not in every case? In other cases,[85] however, the CJEU has not felt itself prevented from using purposive interpretation also in settings where the taxpayer is not in any way accused of obtaining a tax advantage.

C. Inapplicability of *Halifax* Case Law

If the objectives of the Sixth Directive cannot be achieved, it is because of a "*windfall*" caused by the application of national law.[86] There is no scope for the *Halifax* doctrine: according to the CJEU, a Member State cannot "*plead, as against individuals, its own failure to perform the obligations which the directive entails*".[87]

The taxpayer may claim the right derived from EU law irrespective of whether Article 4 of the Cars Order does or does not comply with EU law.[88] Thus, incompatible national law cannot prevent a taxpayer from applying EU law.

"*Moreover*", the trader's choice regarding the VAT treatment may be based "*on a range of factors, including tax considerations relating to the neutral system of VAT*".[89] The CJEU leaves room for tax planning: if the taxable person has several options regarding the form of transaction, he may choose an option "*to structure his business in such a way as to limit his tax liability*".[90]

This leads to the question whether such reasoning leaves room for *Halifax* and for applying the anti-abuse-standards adopted there: if no anti-abuse test can be applied if the law allows the taxpayer to structure his business and to choose between different options, then the question boils down to whether the taxpayer has different options. Ultimately, this is merely a question of interpretation and does not leave any room for the application of anti-abuse tests.

85 See CJEU, 13 February 2014, Case C-18/13, *Maks Pen* (not yet published) para. 36; referring to cases on social policy: CJEU, 5 October 2004, Joined Cases C-397/01 to C-403/01, *Pfeiffer and Others*, ECR 2004 I-08835, paras. 115, 116, 118, 119; 4 July 2006, Case C-212/04, *Adeneler and Others*, ECR 2006 I-06057, para. 111.

86 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 47.

87 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 39.

88 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 43.

89 See also CJEU, 6 April 1995, Case C-4/94, *BLP Group v Commissioners of Customs and Excise*, ECR 1995 I-00983, para. 26; 9 October 2011, Case C-108/99, *Cantor Fitzgerald International*, ECR 2001 I-07257, para. 33.

90 CJEU, 3 September 2014, Case C-589/12, *GMAC UK* (not yet published) para. 48; see also CJEU, 21 February 2006, Case C-255/02, *Halifax and Others*, ECR 2006 I-01609, para. 73; 22 December 2010, Case C-277/09, *RBS Deutschland Holding*, ECR 2010 I-13805, para. 54.

V. Conclusions

The CJEU tends to use "fraud", "evasion" and "abuse" all in the one breath, without distinguishing between these very different concepts. It should make a big difference whether a taxpayer structures his business in a way which is clearly and intentionally beyond the law or whether it is unclear from the purpose of the law, that a certain structure is covered. If one party in a transaction commits fraud or evasion, the Court has developed a doctrine that declares it to be relevant whether the other party knew or should have known about this behavior. Although this is not a new trend, the Court still suffers from the fact that there is no real legal basis for this case law and the methodical weaknesses are obvious.

The judgments on abuse illustrate that the CJEU has tried to find a balance between leaving room for the application of an anti-abuse doctrine on the one hand and guaranteeing legal certainty on the other. However, the application of this anti-abuse doctrine seems highly problematic, and it is clear that the Court is struggling with this doctrine. Its case law lacks a legal basis, is inconsistent in itself and is based on doubtful methodological consequences. So it is time that that CJEU reconsiders its line and finds its way back to an approach where the question of whether a rule has been circumvented is only decided by interpreting that particular rule.