CASE LAW NOTE

The Right to VAT Deduction and the ECJ: Towards Neutral and Efficient Taxation in the Single Market?

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The right to deduct input VAT is recognized in the VAT Directive as well as in the corresponding jurisprudence of the ECJ as a fundamental component of the EU VAT system. It ensures the neutrality of taxation in the common system of VAT and, through that, equal treatment and undistorted competition in the single market. The exercise of the right of deduction may, however, undermine the efficient operation of national and, with that, the EU system of turnover taxation. The Member States may be prevented from collecting the revenues due in their national territory or addressing fraud and other abusive conduct that threaten the interests of national and EU public finances. In response to these challenges, ECJ case law has made considerable efforts to give effect to both the market integration and the tax efficiency objectives of the common system of VAT and reconcile the relevant legal rules. Developments in recent judgments seem to ensure that the concerns of Member States which face severe problems with the efficiency of VAT as a result of widespread practices of fraud may also be taken on board.

1 Introduction

This article analyses the development of the right to deduct input VAT in the jurisprudence of the EU Court of Justice (ECJ) and its contribution to the emergence of a system of turnover taxation in the integrated European economy that is neutral as well as efficient. With its origins in the principle of fiscal neutrality, the right to deduct has been interpreted as a fundamental entitlement of economic operators which gives effect to the neutrality principle and, thus, ensures equal treatment and undistorted competition in the single market. Its enforcement, which also receives support from the principle of legal certainty, has interfered considerably with the delivery of tax policy objectives in the Member States which aim at ensuring the efficient operation of the national and, with that, the EU VAT system. This presented an acute source of conflict within the common system of VAT – that between its market integration and tax efficiency objectives – to which the ECJ reacted by giving more weight to tax efficiency considerations when applying the legal principles governing VAT deduction. This jurisprudential move proved to be controversial and the ECJ approach, limited by the objectives and rules of the EU VAT Directives, has remained cautious. Developments in recent case law, however, seem to raise the possibility of giving further consideration to the problems faced by national tax systems, including those where the VAT system is severely compromised by widespread practices of fraud and other abuse.

The analysis is structured as follows. The article first examines the regulation of the right to deduct under EU law and the legal characteristics acquired by that right in judicial interpretation. This is followed by an analysis of jurisprudential developments which enabled the right to deduct, understood by the ECJ as an objective entitlement applicable uniformly throughout the EU, to internalize objectives of tax efficiency as raised by the Member States. Special attention will be paid to how the ECJ has managed to reconcile the aim of ensuring the collection of revenues and preventing fraud and other abusive practices with the objective legal position guaranteed to taxable persons in the common system of VAT, as guaranteed by the principles of fiscal neutrality and legal certainty. Finally, the article examines the assessment by the ECJ of the restrictions imposed in individual cases on grounds of national tax policy considerations on the right to deduct as carried out in the framework of review developed to scrutinize the necessity (proportionality) of those restrictions. The new case law analysed here indicates a reinforced understanding by the ECJ that the healthy and balanced operation of the VAT system in the single market requires not only robust individual rights for taxable persons, but also potent and capable tax administrations at the national level.

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2 VAT deduction as an EU (fundamental) right

The right of taxable persons to deduct input VAT is regulated in EU tax legislation as a central operational component of the common system of VAT.[1] Articles 168–177 of Directive 2006/112/EC[2] (the VAT Directive) define the right to deduct by regulating the circumstances in which it may be exercisable. Its exercise is subjected to formal-technical conditions which are defined explicitly in Article 178, such as holding of a lawful invoice and compliance with the formalities laid down in relation to specific taxable transactions. Article 179 specifies the timeframe when the deduction must take place. Further legislative provisions include Articles 180–183, which enable the Member States to depart from the Directive's requirements subject to conditions and detailed rules. The Directive also identifies those cases when the exercise of the right to deduct may be restricted (Articles 176–177), for example the restricting of deductions for 'cyclical economic reasons'. Article 273 permits, with general effect, the Member States to impose at their own discretion 'obligations' which are necessary to prevent tax evasion and ensure the correct collection of VAT.

In the case law of the ECJ, which has from the beginning relied directly on the general principles and detailed rules of the different VAT Directives,[3] the right to deduct is interpreted as an objective[4] legal entitlement the exercise of which is imperative to securing the neutral taxation of economic activities within the common system of VAT.[5] The jurisprudential formulas label the right to deduct as a 'fundamental principle', which forms an 'integral part' of the European VAT regime[6] and which 'may not be limited' and 'is exercisable immediately'.[7] The interpretation of the ECJ, especially when determining the limitations on the powers of national tax authorities, regularly falls back on the general principle of fiscal neutrality and the general requirement, integral to that principle, of securing equal treatment and equal competition in the single market's system of turnover taxation.[8] The fundamental principle of legal certainty, tied intimately to the principle of neutrality, has served an essential role in the legal development of the right of deduction, in particular by insisting on its binding legal force.[9] The interpretative framing of the right to deduct was also influenced by the emphasis on the uniform and objective character of the definitions, distinctions and other rules of the VAT Directives.[10] For further interpretative support, the ECJ has frequently made the claim that the legislator had intentionally established a 'very wide scope' for VAT.[11]

Based on its objective character, the right to deduct has been interpreted pronouncedly as exercisable without

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1 The right to deduct plays a 'central function' in the EU VAT mechanism designed to ensure complete neutrality of the tax and has the 'specific function' of ensuring the neutrality of VAT. IT: ECJ, 18 Dec. 2014, Case C-131/13, *Schoenimport 'Italmoda' Mariano Previti*, ECLI:EU:C:2014:2455, para. 48. For an early overview of the legislative pathways for creating a common system of turnover taxation, *see* K. V. Antal, *Harmonisation of Turnover Taxes in the Common Market*, 1 Com. Mkt. L. Rev. 1, 41 (1963). On the comparative advantages and disadvantages of different models of turnover taxation from the perspective of European integration, *see ibid.*, at 50.

2 EU VAT Directive (2006): Council Directive 2006/112/EC of 28 Nov. 2006 on the common system of value added tax (as most recently amended by Directive 2008/8/EU, text applicable with effect from 1 Jan. 2015), OJ L347/1 (11 Dec. 2006).

3 *See* e.g. RO: ECJ, 9 July 2015, Case C-183/14, *Salomie and Oltean*, ECLI:EU:C:2015:454, para. 55. The right to deduct is regulated in 'explicit and precise terms' in EU legislation. HU: ECJ, 23 Apr. 2009, Case C-74/08, *PARAT Automotive Cabrio Textiltetőket Gyártó Kft. v. Adó- és Pénzügyi Ellenőrzési Hivatal, Hatósági Főosztály, Északmagyarországi Kihelyezett Hatósági Osztály*, ECLI:EU:C:2009:261, paras 14–17.

4 In a tax system based on neutrality, it is unavoidable that taxpayers are taxed according to objective characteristics/that their taxation position is objective. In this regard, *see* UK: ECJ, 6 Apr. 1995, Case C-4/94, *BLP Group v. Commissioners of Customs & Excise*, ECLI:EU:C:1995:107, para. 26.

5 There is disagreement among commentators whether the approach of the ECJ in interpreting the rights of taxpayers has been overly influenced by the general purpose of the common system of VAT within the single market. *See* e.g. R. de la Feria, *The EU VAT System and the Internal Market*, Doctoral Series Vol. 16, 261–79 (IBFD 2009); M. Ridsdale, *Abuse of Rights, Fiscal Neutrality and VAT*, 14 EC Tax Rev. 2, 82 (2005); P. Boria, *European Tax Law: Institutions and Principles* 97–99 (Giuffrè Editore 2014).

6 The purpose of the right to deduct is to relieve economic operators 'entirely' and 'without delay' of the burden of the VAT payable or paid in the course of 'all' their economic activities. E.g. BE: ECJ, 6 July 2006, Joined Cases C-439/04 & C-440/04, *Alex Kittel v. Belgian State & Belgian State v. Recolta Recycling SPRL*, ECLI:EU:C:2006:446, para. 48.

7 E.g. *Kittel* (C-439/04 & C-440/04), *supra* n. 6, para. 47. The ECJ has confirmed the direct effect of the right to deduct and asserted that, unless allowed under EU legislation, national authorities may not rely against a taxable person on a national provision that derogates from that right. *PARAT Automotive Cabrio* (C-74/08), *supra* n. 3, paras 32–35.

8 On the emergence and the role of general principles in the law of the common system of VAT, *see* R. de la Feria, *EU VAT Principles and Interpretative Aids to EU VAT Rules: The Inherent Paradox*, in *Recent Developments in Value Added Tax*, Series on International Tax Law 99 (M. Lang et al. eds, Linde Verlag 2015). From recent jurisprudence, *see* SK: ECJ, 26 Oct. 2017, Case C-534/16, *Finančné riaditeľstvo Slovenskej republiky v. BB construct s.r.o.*, ECLI:EU:C:2017:820, paras 34–42, where the legal position of the taxable person found support in the freedom to conduct a business (Art. 16 EUCFR) and was interpreted in the context of the related requirement of an 'unhindered use of the financial resources' of the taxable person. *See also* paras 31–33, where the ECJ denied that general obligations imposed under national tax law would have a 'criminal' nature and thus guarantee the application of the criminal law principles of the EUCFR, such as *ne bis in idem*. *See also* IT: ECJ, 5 Apr. 2017, Joined Cases C-217/15 & C-350/15, *Orsi*, ECLI:EU:C:2017:264.

9 E.g. UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc v. Commissioners of Customs & Excise*, ECLI:EU:C:2006:121, para. 57. From recent jurisprudence, *see* HU: ECJ, 17 May 2018, Case C-566/16, *Dávid Vámos v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, ECLI:EU:C:2018:321.

10 *See* e.g. UK: ECJ, 12 Jan. 2006, Joined Cases C-354/03, C-355/03 & C-484/03, *Optigen Ltd (C-354/03), Fulcrum Electronics Ltd (C-355/03) and Bond House Systems Ltd (C-484/03) v. Commissioners of Customs & Excise*, ECLI:EU:C:2006:16, paras 36–44. The purpose of the VAT Directives was interpreted as laying down the rules on VAT in a uniform manner and without allowing divergences in the application of the VAT system from one Member State to another (the principle of uniformity). LU: ECJ, 27 Nov. 2003, Case C-497/01, *Zita Modes Sàrl v. Administration de l'enregistrement et des domaines*, ECLI:EU:C:2003:644, para. 32.

11 *Kittel* (C-439/04 & C-440/04), *supra* n. 6, paras 39–41.

significant limitations.[12] As a fundamental legal benchmark, the ECJ has confirmed that Member State authorities may impose restrictions on that right only 'in the cases expressly provided for' in the VAT Directive.[13] In harmony with the general VAT principles, such restrictions may be acceptable only when they are applied in a similar manner in all Member States.[14] Furthermore, it has been repeatedly held that the right to deduct must be exercisable as ordered by EU legislation without regard to the 'purpose or results' of taxable transactions,[15] or to the 'intentions' of other traders (and of the taxable person) and the (illicit) nature of the transactions carried out by them.[16] The assessment of such subjective or factual circumstances in the exercise of the right to deduct was considered by the ECJ as contravening the core objectives of the EU VAT system, namely the ensuring of legal certainty in taxable transactions and facilitating – having regard to the objective nature of taxable transactions – the measures necessary for the application of VAT.[17] The case law also indicated that the exercise of the right to deduct is independent from the actual payment of the VAT,[18] and rejected, with reference to the principle of neutrality, that it could be made dependent on general distinctions between lawful and unlawful transactions.[19]

The principle of fiscal neutrality, which is implemented in the real economy through the exercise of the right of deduction,[20] has set as its principled basis a particular path for the interpretative framing of the right to deduct. As a fundamental principle of the common system of VAT,[21] it requires – and for that purpose relies on – the right to deduct, that in the single market all economic activities are taxed 'in a wholly neutral way'.[22] The neutrality of taxation is closely linked to the general objective of market integration[23]; it secures a neutrality of competition in an integrated market by requiring that in each Member State similar goods and services bear the same tax burden, and fosters cross-border trade by making known the amount of the tax burden borne, as well as by enabling 'an exact equalisation' of that amount irrespective of national boundaries.[24] This fits in with the overall objective of the First, Second[25] and Sixth[26] Directives and the VAT Directive[27] of preventing and eliminating distortions of

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[12] BE: ECJ, 15 Jan. 1998, Case C-37/95, *Belgian State v. Ghent Coal Terminal NV*, ECLI:EU:C:1998:1, para. 17. *See also ibid.*, paras 19–20; BE: ECJ, 29 Feb. 1996, Case C-110/94, *INZO v. Belgian State*, ECLI:EU:C:1996:67, paras 20–21. *See also* the case law on ordering the retrospective repayment of fraudulently deducted VAT, which possibility served as another reason for delimiting the discretion of national authorities. PL: ECJ, 1 Mar. 2012, Case C-280/10, *Kopalnia Odkrywkowa Polski Trawertyn P. Granatowicz, M. Wąsiewicz spółka jawna v. Dyrektor Izby Skarbowej w Poznaniu*, ECLI:EU:C:2012:107, paras 36–37; DK: ECJ, 3 Mar. 2005, Case C-32/03, *I/S Fini H v. Skatteministeriet*, ECLI:EU:C:2005:128, para. 33.

[13] E.g. LT: ECJ, 21 Oct. 2010, Case C-385/09, *Nidera Handelscompagnie BV v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos*, ECLI:EU:C:2010:627, para. 41. *See also* the case law on the requirement of declaring in good faith the beginning of taxable economic activities. *INZO* (C-110/94), *supra* n. 12, paras 23–24.

[14] E.g. *Ghent Coal Terminal* (C-37/95), *supra* n. 12, para. 16. *See especially* GR: ECJ, 6 July 1995, Case C-62/93, *BP Soupergaz v. Greek State*, ECLI:EU:C:1995:223, para. 18. This rule has likely been influenced by the principle of neutrality, which requires that taxable persons are be subjected to the same level of tax burden. *PARAT Automotive Cabrio* (C-74/08), *supra* n. 3, paras 14–17. This issue was extensively examined in the related judgment in *Alakor*, where neutralizing the economic burden imposed by the VAT unduly collected provided the benchmark for assessing the obligations of national tax authorities. HU: ECJ, 16 May 2013, Case C-191/12, *Alakor Gabonatermelő és Forgalmazó Kft. v. Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága*, ECLI:EU:C:2013:315, paras 24–25 & 28–33.

[15] The activities of taxpayers are considered 'per se'. *Halifax and Others* (C-255/02), *supra* n. 9, para. 55.

[16] E.g. *Kittel* (C-439/04 & C-440/04), *supra* n. 6, paras 41–46.

[17] *Ibid.*, para. 42. In *Halifax*, in the context of distinguishing legitimate and illegitimate (abusive) uses of the rights granted under EU law, the ECJ asserted that the objective nature of the right to deduct ensures the neutrality of the common system of VAT and held that it would be contrary to the principle of fiscal neutrality, 'and, therefore, contrary to the purpose' of the rules on VAT deduction, if the taxable person were allowed to deduct VAT 'even though, in the context of their normal commercial operations, no transactions conforming' with the applicable deduction rules had taken place. *Halifax and Others* (C-255/02), *supra* n. 9, paras 78–80.

[18] E.g. *Kittel* (C-439/04 & C-440/04), *supra* n. 6, para. 49.

[19] *Ibid.*, para. 50 (and that it would actually be possible to make such distinctions).

[20] BG: ECJ, 23 Apr. 2015, Case C-111/14, *GST – Sarviz AG Germania v. Direktor na Direktsia 'Obzhalvane i danachno-osiguritelna praktika' Plovdiv pri Tsentralno upravlenie na Natisonalnata agentsia za prihodite*, ECLI:EU:C:2015:267, para. 32.

[21] BG: ECJ, 11 Apr. 2013, Case C-138/12, *Rusedespred OOD v. Direktor na Direktsia 'Obzhalvane I upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*, ECLI:EU:C:2013:233, para. 29.

[22] E.g. *Salomie and Oltean* (C-183/14), *supra* n. 3, para. 57 (and irrespective of their 'purpose or results').

[23] The concept itself is, however, not homogenous and is rather open-ended. B. J. M. Terra, *Sales Taxation: The Case of Value Added Tax in the European Community*, Series on Int'l Tax'n. 8, 15–18 (Kluwer Law International 1988). On the right to deduct, legal certainty and the prohibition of distortion of competition constituting different limbs of neutrality, *see also* Ridsdale, *supra* n. 5, at 84–87.

[24] Preamble of First Council Directive 67/227/EEC of 11 Apr. 1967 on the harmonization of legislation of Member States concerning turnover taxes, OJ L1301/71 (14 Apr. 1967), which also mentioned that neutrality is compatible with the idea of 'international trade'. The harmonization of turnover taxes will eliminate distortions of competition and, therefore, secure neutrality in competition by levelling out tax burdens in the different Member States. NL: ECJ, 1 Apr. 1982, Case C-89/81, *Staatssecretaris van Financiën v. Hong-Kong Trade Development Council*, ECLI:EU:C:1982:121, para. 6. Neutrality is linked to the original impetus behind harmonizing turnover taxation in the EU which is to avoid the distortion of cross-border competition and discrimination and to achieve market integration. Antal, *supra* n. 1, at 45–46.

[25] Second Council Directive 67/228/EEC of 11 Apr. 1967 on the harmonization of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax, OJ L1303/67 (14 Apr. 1967).

[26] Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, OJ L145/1 (13 June 1977). For a brief analysis of the Sixth Directive, *see* J. Reugebrink, *The Sixth Directive for the Harmonisation of Value Added Tax*, 15 Com. Mkt. L. Rev. 3, 309 (1978).

[27] In particular, *see* Preamble of VAT Directive, Recital 4. *See also* Committee of Experts set up under Ord. 1–53 of the High Authority, *Report on the problems raised by the different turnover tax systems applied within the Common Market* (5 Mar. 1953) (Tinbergen Report); Neumark Committee, *Report of the Fiscal and Financial Committee* (1962) (Neumark Report); Commission of the European Community, *White Paper on Completing the Internal Market*, COM(85) 310 final (14 June 1985); Commission of the European

conditions of competition and removing hindrances and restrictions in intra-EU trade by establishing a common system of VAT for the integrated European economy. As a direct and specific legislative basis, neutrality can rely on the provision first laid down in Article 2 of the First Directive that the tax imposed must be 'exactly proportional' to the price of goods and services[28] and that the VAT is chargeable on each transaction only after deducting the amount of the VAT borne directly by the cost of the various price components.[29]

The conjoint application, in recent case law, of the requirement of equal treatment, which is the core component of the neutrality principle,[30] and the related policy objective of undistorted competition (unobstructed competitive conditions) in an integrated marketplace[31] provides a clear expression of how fundamentally the market integration objective of the VAT Directive depends on ensuring the neutrality of taxation. As emphasized by the ECJ, the equal treatment of economic operators under the principle of neutrality enables avoiding distortions of competition in the (internal) market.[32] Fiscal neutrality, which has been interpreted as prohibiting the different treatment of taxable persons 'who are in comparable situations and thus in competition with each other' for VAT purposes,[33] was also given a distinct role in creating a level playing field among economic operators in the national and European markets. In the recent judgment in *Vámos*, the ECJ held that neutrality precludes, in particular, national tax practices which confer on certain economic operators undue competitive advantages to the detriment of others in a comparable economic situation.[34] Such competitive advantages may include enabling certain undertakings to choose an advantageous tax arrangement in circumstances which are not available to others.[35]

When applied in case law, the principle of neutrality has further reinforced the status of the right to deduct as an entitlement which is fundamental to the functioning of the common system of VAT.[36] Neutrality was interpreted by the ECJ as authorizing taxable persons to exercise their right of deduction even in cases when its substantive requirements are satisfied, but 'some of the formal requirements' imposed have not been complied with.[37] The rationale for granting this relief to taxable persons is that the tax authorities may already have the information necessary to allow the exercise of the right to deduct, and imposing additional formal conditions may have the effect of rendering it ineffective for practical purposes.[38] Logically, taxable persons can be required to comply with the formal requirements when that enables the production of conclusive evidence concerning whether the substantive conditions of the right to deduct have been satisfied.[39] The enforcement of nationally relevant formal requirements also fell victim to the legal position granted to taxpayers. National practices, supported by strict domestic policies aimed at collecting the revenues due or fighting fraud, which require the meeting of additional formal requirements imposed under national law are usually struck down by the ECJ. The relevant judicial formula states that taxable persons must comply with the relevant rules of the Directive only and that 'it is not open to Member States to make the exercise of the right to deduct VAT dependent on compliance with conditions

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Community, *Completion of the Internal Market: Approximation of Indirect Tax Structures and Harmonisation of Indirect Tax Structure*, COM(87) 320 final (26 Aug. 1987); Commission of the European Community, *A Strategy to Improve the Operation of the VAT System within the Context of the Internal Market,* COM(2000) 348 final (7 June 2000).

[28] According to de la Feria, this rule regulates the principle of neutrality in general, which provides the basis of the right to deduct and the principle of fiscal neutrality *strictu senso*, which latter serves as the basis of the requirements of uniformity, equal treatment and equal (undistorted) competition. de la Feria, *supra* n. 5, at 263–264.

[29] In this regard, *see* spelling out the related obligations of national tax authorities in *Sarviz Germania* (C-111/14), *supra* n. 20, para. 40; LT: ECJ, 28 Feb. 2018, Case C-387/16, *Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos v. Nidera BV*, ECLI:EU:C:2018:121, paras 24–25.

[30] E.g. *Vámos* (C-566/16), *supra* n. 9, para. 46. When the Member States regulate the exercise of the right to deduct in order to give effect to the principle of equal treatment as embedded in the neutrality principle, the restrictions thus imposed cannot be contested on the basis of the latter principle. DK: ECJ, 29 Oct. 2009, Case C-174/08, *NCC Construction Danmark v. Skatteministeriet*, ECLI:EU:C:2009:669, para. 46.

[31] *NCC Construction* (C-174/08), *supra* n. 30, para. 27. In this regard, *see* C. Amand, *VAT Neutrality: A Principle of EU Law or a Principle of the VAT System*, 2(3) World J. VAT/GST L. 161, 162–63 (2013).

[32] *NCC Construction* (C-174/08), *supra* n. 30, para. 44.

[33] *Vámos* (C-566/16), *supra* n. 9, para. 58. *See also BB construct* (C-534/16), *supra* n. 8, para. 29 (the ECJ set out to examine whether the groups of persons affected by the national restriction are in a comparable situation. The principle of equal treatment was also examined separately with the purpose of determining the comparability of the relevant groups of taxable persons). *Ibid.*, paras 43–46. *See also* BG: ECJ, 5 Oct. 2016, Case C-576/15, *ET 'Maya Marinova' v. Direktor na Direktsia „Obzhalvane i danachno-osiguritelna praktika" Veliko Tarnovo pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*, ECLI:EU:C:2016:740, para. 49. For extensive analyses of the comparability of taxable persons in recent case law, *see* UK: ECJ, 14 June 2017, Case C-38/16, *Compass Contract Services Limited v. Commissioners for HMRC*, ECLI:EU:C:2017:454, paras 24–28; PL: ECJ, 8 Sept. 2016, Case C-390/15, *Rzecznik Praw Obywatelskich (RPO)*, ECLI:EU:C:2017:174.

[34] *Vámos* (C-566/16), *supra* n. 9, para. 47.

[35] *Vámos* (C-566/16), *supra* n. 9.

[36] Neutrality, interpreted together with the proportionality principle, is responsible for the line of case law which identified the obligation of national tax systems to provide for the adjustment of any tax improperly invoiced. *Rusedespred* (C-138/12), *supra* n. 21, paras 26–29.

[37] E.g. *Salomie and Oltean* (C-183/14), *supra* n. 3, paras 58–61. *See* in particular, *Polski Trawertyn* (C-280/10), *supra* n. 12, paras 44–49.

[38] E.g. *Salomie and Oltean* (C-183/14), *supra* n. 3, para. 59.

[39] BG: ECJ, 12 July 2012, Case C-284/11, *EMS-Bulgaria Transport OOD v. Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' Plovdiv*, ECLI:EU:C:2012:458, para. 71. *See also* assessment in IT: ECJ, 28 July 2016, Case C-332/15, *Astone*, ECLI:EU:C:2016:614, paras 54–57.

[…] which are not expressly laid down' by EU legislation.[40]

3 Tax efficiency and the right to deduct

As indicated above, the right to deduct as supported by the principle of fiscal neutrality had emerged in the jurisprudence as a legal entitlement that serves primarily the market integration objective(s) of EU turnover tax harmonization. However, the ECJ was soon confronted with the weaknesses of this approach in an economic reality with opportunities for aggressive tax planning leading to tax evasion, as well as for other fraudulent and abusive conduct damaging the taxation interests of the Member States. Many of these opportunities have, in fact, arisen from the introduction of VAT as a common fiscal burden in Europe, especially in the context of cross-border trade in an integrated market.[41] However, the damaging fiscal consequences of taxpayer conduct have brought to light the importance of finding a balance between the different objectives of the common system of VAT, in particular between the neutrality of taxation and the efficient operation of national VAT regimes and, with that, the EU VAT system.[42] In order to address these challenges and respond to hardening Member State tax enforcement practices, the ECJ decided to expand the narrow framework that had been mapped out in the jurisprudence for the right to deduct and place emphasis on considerations of tax efficiency when interpreting that right.[43] The jurisprudential move was controversial and the ECJ proceeded with perceptible caution.

The creation of an 'abuse of law' limb for the jurisprudence in order to address fraud committed by the taxable person[44] and the later establishment of third-party responsibility for fraud committed in a chain of supply (so-called 'carousel fraud' or 'missing trader fraud')[45] transformed the legal position of taxable persons by excluding that, in defence of their right to deduct, they rely in such situations on the objective character of that right.[46] As part of this significant change, the relevant judgments openly confirmed the power of national authorities to investigate and then validate transactions suspected of fraud or abuse by using the objective evidence they could collect in their investigations.[47] The central principle was anchored in *Halifax*, where the ECJ held that the right to deduct cannot be relied on for abusive or fraudulent ends and used to cover up abusive practices.[48] National authorities were, thus, allowed to preclude the exercise or retention of the right to deduct when the 'transactions from which that right derives constitute an abusive practice'.[49] Later case law also established that taxable persons are prevented from exercising the right to deduct when they knew or should have known ('had reasonable grounds to suspect') that other transactions in the chain of supply were vitiated by fraud.[50] In such circumstances, the taxable person must be regarded as a participant in tax fraud irrespective of whether or not such person profited from the transactions carried out.[51]

The new principles were met with harsh criticism from commentators. It was asserted that the newly found

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[40] E.g. *Polski Trawertyn* (C-280/10), *supra* n. 12, paras 41–42. *See also* HU: ECJ, 6 Sept. 2012, Case C-324/11, *Gábor Tóth v. Nemzeti Adó- és Vámhivatal Észak-magyarországi Regionális Adó Főigazgatósága*, ECLI:EU:C:2012:549, paras 22–33. Even the VAT Directive's formal requirements can be overlooked when, without jeopardizing the national authority's position, they render the right to deduct ineffective, and when, taking into account the 'important documentary functions' of invoices, the relevant information can be legitimately established using other means. *Polski Trawertyn* (C-280/10), *supra* n. 12, paras 44–46, 48.

[41] In detail, *see* de la Feria, *supra* n. 5, at 100–101; R. de la Feria, *The European Court of Justice's Solution to Aggressive VAT Planning: Further Towards Legal Uncertainty?*, 15(1) EC Tax Rev. 27, 34 (2006); Ridsdale, *supra* n. 5, at 93–94. Generally, under a system of VAT, economic operators are incentivized to lessen their fiscal burdens, including the burden of the VAT not recovered, which then leads to continuous efforts to mitigate such costs through aggressive VAT planning. Ridsdale, *supra* n. 5, at 82.

[42] Introducing VAT as an own resource of the EU budget played an important role in making tax efficiency a more carefully guarded EU interest.

[43] R. de la Feria, *Tax Fraud and the Rule of Law*, OUCBT Working Paper 18/02, 16–20 & 32 (Jan. 2018) (also arguing that the inefficiency of the VAT system may ultimately undermine the rule of law).

[44] For an analysis of its evolution, *see* R. de la Feria, *Prohibition of Abuse of (Community) Law: The Creation of a New General Principle of EC Law Through Tax*, 45(2) Com. Mkt. L. Rev. 395, 418–24 (2008).

[45] For a brief overview, *see ibid.* Fraud, in particular 'carousel fraud', was identified as a serious problem in the common system of VAT. *See* Completion of the internal market: approximation of indirect tax structures and harmonization of indirect tax structure, *supra* n. 27; A strategy to improve the operation of the VAT system within the context of the Internal Market, *supra* n. 27.

[46] *Halifax and Others* (C-255/02), *supra* n. 9, paras 59–69. The principle of fiscal neutrality may not be legitimately invoked when the taxable person intentionally participated in tax evasion and jeopardized the operation of the common system of VAT. *Astone* (C-332/15), *supra* n. 39, para. 58. Nor may they rely on the principles of protection of legitimate expectations or legal certainty to exonerate fraudulent conduct. *Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, para. 60. However, the risk of VAT evasion or abuse alone is insufficient to justify a restriction on the right to deduct (as it follows from the strict provisions of the directive). *Polski Trawertyn* (C-280/10), *supra* n. 12, paras 36–37.

[47] de la Feria, *supra* n. 43, at 30–31 (also criticizing this 'responsibilization' turn in the jurisprudence for undermining the rule of law and fundamental rights). For a structural criticism challenging the impact on taxable persons and Member State tax policies, *see* de la Feria, *supra* n. 41, at 35.

[48] *Halifax and Others* (C-255/02), *supra* n. 9, paras 68–69.

[49] *Ibid.*, paras 83–85.

[50] E.g. *Optigen and Others* (C-354/03, C-355/03 & C-484/03), *supra* n. 10, para. 52. The formula denotes a 'conscious participation, or participation which must have been conscious' in a chain of supply affected by fraud. *Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, para. 66.

[51] E.g. HU: ECJ, 21 June 2012, Joined Cases C-80/11 & C-142/11, *Mahagében and Dávid*, ECLI:EU:C:2012:373, para. 46. In such a situation, the taxable person aids the perpetrators of the fraud and becomes their accomplice. *Kittel* (C-439/04 & C-440/04), *supra* n. 6, para. 57.

emphasis on tax efficiency objectives lacked a legal (legislative) basis, and their application by the ECJ contradicts the purpose and the principles of the common system of VAT[52] and ignores the objective nature of the rights of taxable persons.[53] The ECJ was seen as risking a violation of the expectation by taxable persons that their conduct will be assessed on the basis of the principle of neutrality and its complementary principle, the principle of legal certainty.[54] These observations seem overly harsh. As revealed by its reasoning, the ECJ had anticipated these issues and made a conscious effort to reconcile the newly introduced principles with the principle of neutrality and its implications for the legal position of taxable persons. In *Halifax*, the judgment emphasized that legal certainty, which safeguards the position of taxable persons in the VAT system, must be observed,[55] and held, with reference to that principle and the requirement of foreseeable application, that illegal conduct by the taxable person may be established only in very specific circumstances and when supported by sufficient 'objective' evidence[56] collected by the tax authority.[57]

Similarly, in the case of third-party responsibility, the ECJ aimed to soften the impact of the new rule by imposing the burden on national authorities to collect objective evidence and prove on that basis the fraudulent or abusive nature of the conduct.[58] It made it clear, in particular, that the taxable person cannot be burdened with absolute responsibility for the alleged fraud and that national authorities must establish, 'to the requisite legal standard,[59] that the taxable person knew, or ought to have known' the fraud committed by others in the chain of supply.[60] Further safeguards were introduced when the ECJ held that the taxable person cannot be obliged, with a general effect, to carry out a full-blown investigation into the economic circumstances of other traders, which task falls within the responsibility of the national authorities,[61] and that they may be required to take only (precautionary) steps 'which could reasonably be required' from them.[62]

The ECJ's move, which introduced an interpretative construction aiming to provide an overall balanced response to the concerns of national tax administrations, received further support when judicial reasoning made it explicit that preventing tax evasion and avoidance and fighting fraud and abuse are recognized objectives of, and are encouraged by the VAT Directive.[63] The problems faced by national tax jurisdictions were further alleviated when the judgment in *Schoenimport 'Italmoda' Mariano Previti* established the opportunity for national authorities and courts to apply the 'abuse of law' principle

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[52] Which is fiscal neutrality. For a critical comment that the right to deduct may only be denied when dictated by the principle of fiscal neutrality, *see* Ridsdale, *supra* n. 5, at 92.

[53] Ridsdale, *supra* n. 5, at 89–90 & 93 (also arguing that the 'abuse of law' principle must be applied as a strict exception which must be reserved to cases of extreme and manifestly aggressive tax planning).

[54] Ridsdale, *supra* n. 5, at 90–92 (nevertheless, conceding that the principle may follow from a broader reading of the purpose of the relevant EU rules, which he saw as too uncertain and violating legal certainty); de la Feria, *supra* n. 43, at 34. In contrast, *see* T. Tridimas, *Abuse of Rights in EU Law with a Focus on Financial Law*, in *Prohibition of Abuse of Law: A New General Principle of EU Law?* 169–191, 191 (R. de la Feira & S. Vogenauer eds, Hart 2011); J. Freedman, *The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level*, in *Prohibition of Abuse of Law. A New General Principle of EU Law?* 365–380, 369 (R. de la Feira & S. Vogenauer eds, Hart 2011).

[55] *Halifax and Others* (C-255/02), *supra* n. 9, para. 72 (legal certainty in the sense that individuals know precisely the extent of the obligations imposed on them). It also confirmed that economic operators, in particular when they are offered legitimate taxation choices, have a right under EU law to limit their tax liability, in para. 73. In Tridimas' assessment, with this paragraph the judgment ensured that the abuse of law principle is able to establish a balance 'between, on the one hand, preventing the claiming of unjustified tax benefits and, on the other hand, the need to ensure certainty and foreseeability in the application of Community legislation'. Tridimas, *supra* n. 54, at 174.

[56] The threshold of proof was set high: abuse cannot be established 'where the economic activity carried out may have some explanation other than the mere attainment of tax advantages'; only transactions driven by taxation reasons which (essentially) aim at circumventing tax rules are caught by the new principle. *Halifax and Others* (C-255/02), *supra* n. 9, para. 75.

[57] *Halifax and Others* (C-255/02), *supra* n. 9, paras 71–75.

[58] E.g. *Mahagében and Dávid* (C-80/11 & C-142/11), *supra* n. 51, paras 42 & 46. In the particular context of the judgment in *Federation of Technological Industries*, the ECJ indicated that the objective evidence collected constitutes a presumption of liability which is rebuttable on proof supplied by the taxable person; 'such presumptions may not be formulated in such a way as to make it practically impossible or excessively difficult for the taxable person to rebut them with evidence to the contrary'. UK: ECJ, 11 May 2006, Case C-384/04, *Commissioners of Customs & Excise and Attorney General v. Federation of Technological Industries and Others*, ECLI:EU:C:2006:309, paras 31–32.

[59] Summary proof of fraud is not acceptable. HU: ECJ, 16 May 2013, Case C-444/12, *Hardimpex Kft, in liquidation v. Nemzeti Adó- és Vámhivatal Kiemelt Ügyek és Adózók Adó Főigazgatósága*, ECLI:EU:C:2013:318, para. 27. A strict system of liability where no proof is collected concerning the part of the taxable person in the fraud is prohibited. BG: ECJ, 6 Dec. 2012, Case C-285/11, *Bonik EOOD v. Direktor na Direktsia 'Obzhalvane i upravlenie na izpalnenieto' – Varna pri Tsentralno upravlenie na Natsionalnata agentsia za prihodite*, ECLI:EU:C:2012:774, paras 41–42.

[60] *Mahagében and Dávid* (C-80/11 & C-142/11), *supra* n. 51, para. 42. The obligation to provide objective proof 'to the requisite legal standard' was connected by the ECJ to the claim that the right of deduction cannot be regarded as 'an exception to the application of the fundamental principle constituted by that right'. *Astone* (C-332/15), *supra* n. 39, para. 52. The rule of law offers another explanation: the proof of fraudulent conduct and the evidence collected must be open to judicial review and must be able to withstand judicial scrutiny in that process. *Hardimpex* (C-444/12), *supra* n. 59, paras 28–29.

[61] *Hardimpex* (C-444/12), *supra* n. 59, paras 26–27. *See also Táth* (C-324/11), *supra* n. 40, paras 41–45. In *Táth*, the ECJ also rejected, on grounds of the objective nature of the right to deduct, that an overall assessment of the circumstances of the conduct could replace proof based on objective evidence. *Táth* (C-324/11), *supra* n. 40, paras 47–51.

[62] *Kittel* (C-439/04 & C-440/04), *supra* n. 6, para. 51 (e.g. examine the trustworthiness of other traders). Such traders (traders that are not in the position to recognize, even by exercising due commercial care, that others in the chain of supply had acted fraudulently) must be able to rely on the legality of their transactions without the risk of being made liable for the fraud committed by others. *Federation of Technological Industries and Others* (C-384/04), *supra* n. 58, para. 33.

[63] E.g. SK: ECJ, 21 Mar. 2018, Case C-533/16, *Volkswagen AG v. Finančné riaditeľstvo Slovenskej republiky*, ECLI:EU:C:2018:204, para. 48; *Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, para. 68.

despite the lack of provisions under national law to the same effect.[64] In that ruling, the ECJ openly discussed that fraudulent transactions often hide behind the objective legislative terms of the Directive and exploit the objectiveness of the rights provided for taxable persons, and concluded that a failure to recognize the possibility of abuse 'would not comply with' the directive's tax efficiency objectives.[65] Overall, the jurisprudence seems now better prepared to give a green light to the implementation of tax efficiency objectives in the Member States affected severely by fraud or other forms of abuse, even if that may come at the cost of exposing the exercise of taxpayers' rights to uncertainties, in particular those emerging from proving and disproving fraudulent or abusive conduct.

4. Proportionality, countervailing policy objectives and the right to deduct

The integration of tax efficiency objectives into the interpretative framework developed for the right to deduct was given a further impetus when the case law opened up to examining the necessity (proportionality) of national restrictions.[66] This found its basis in the jurisprudence recognizing, with reference to the VAT Directive, that the rights of taxable persons (including the right to deduct) can be restricted on general interest grounds, such as ensuring the correct collection of tax and the proper functioning of the EU VAT system,[67] and preventing and fighting tax evasion and avoidance and other kinds of tax abuse and fraud.[68] In general, the case law has produced a rather cautious scrutiny of the tax policy objectives pursued by Member State administrations; their relationship with the principle of neutrality and legal certainty[69]; and the impact of that relationship on the objective entitlements of taxpayers.[70] The ECJ insisted that national restrictions must provide a proportionate response to the tax efficiency problem addressed and observe, by enabling an equal exercise of taxpayer rights, the principle of fiscal neutrality. Recent rulings, in domains where the Member States are granted discretion under EU law in implementing tax efficiency objectives, however, reveal an increased readiness by the ECJ to endorse the concerns of national tax jurisdictions about their ability to enforce anti-fraud policies and secure the efficiency of turnover taxation.[71]

The caution of the ECJ can be explained by the earlier mentioned controversies of giving more emphasis in judicial interpretation to the objective of tax efficiency,[72] in particular the potential conflict with the principle of neutrality.[73] In the seminal ruling in *Halifax*, the ECJ decided to keep the assessment of the competing policy objectives of neutral and efficient taxation within the general framework of the 'abuse of law' principle and, thus, shaped the relationship between the interests of national tax administrations and the rights of taxable persons by stating categorically (objectively) that if fraud is proved using objective evidence, the right of deduction is not available. The judgment also developed, in a two-part legal test, the details of when abuse or fraud, as virtually the only legitimate reasons, may exclude the exercise of the right to deduct. Accordingly, when national authorities and courts investigate transactions allegedly affected by fraud, they need to establish whether the transaction – despite complying with the relevant formal conditions – resulted in 'the accrual of a tax advantage' contrary to purpose of the VAT Directive and

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[64] *Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, paras 54–57. The possibility that the 'abuse of law' principle may override the neutrality principle was seen by de la Feria as permissible in light of the jurisprudence which has consistently interpreted the neutrality principle not as a 'rule of primary law but a principle of interpretation'. DE: ECJ, 19 July 2012, Case C-44/11, *Finanzamt Frankfurt am Main V-Höchst v. Deutsche Bank AG*, ECLI:EU:C:2012:484, para. 45; DE: ECJ, 13 Mar. 2014, Case C-204/13, *Finanzamt Saarlouis v. Heinz Malburg*, ECLI:EU:C:2014:147, para. 43; de la Feria, *supra* n. 42, at 34. In *NCC Construction*, the ECJ distinguished between the general principle of equal treatment, which 'has constitutional status', and equal treatment demanded by the neutrality principle, which 'requires legislation to be drafted and enacted' for it to be enforceable. *NCC Construction* (C-174/08), *supra* n. 30, paras 41–43.

[65] *Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, paras 67–68.

[66] FR: ECJ, 19 Sept. 2000, Joined Cases C-177/99 & C-181/99, *Ampafrance and Sanofi*, ECLI:EU:C:2000:470, paras 57–62 (assessing the compatibility of a Council decision, which excluded in the interest of preventing tax evasion and avoidance the deductibility of input VAT, with the principle of neutrality and proportionality).

[67] E.g. *Maya Marinova* (C-576/15), *supra* n. 33, para. 39.

[68] E.g. *Mahagében and Dávid* (C-80/11 & C-142/11), *supra* n. 51, para. 41.

[69] On the application of legal certainty in support of the taxable person, *see* e.g. *Halifax and Others* (C-255/02), *supra* n. 9, paras 93–96; RO: ECJ, 6 Feb. 2014, Case C-424/12, *SC Fatorie SRL v. Direcţia Generală a Finanţelor Publice Bihor*, ECLI:EU:C:2014:50, para. 46; *Astone* (C-332/15), *supra* n. 39, para. 33. Legal certainty has also been applied to support the legitimate interests of national tax administrations. *Nidera* (C-385/09), *supra* n. 13, paras 50–52; *Astone* (C-332/15), *supra* n. 39, paras 34, 37–38; *Salomie and Oltean* (C-183/14), *supra* n. 3, paras 41–42.

[70] de la Feria offers a critical assessment of the different positions taken by the ECJ in non-harmonized and in extensively harmonized areas, such as VAT, where it has been more withdrawn and the intensity of its scrutiny of national policies and regulation has been lower. R. de la Feria, *VAT and the EC Single Market: The Shortcomings of Harmonisation*, OUCBT Working Paper 09/29 35–36 (2009).

[71] *See also Schoenimport 'Italmoda' Mariano Previti* (C-131/13), *supra* n. 1, paras 51–52 (emphasizing that it is a responsibility and an obligation of national authorities and courts, even where there are no specific provisions in national law to that effect, to refuse the exercise of the right to deduct in case of fraud, as the prevention of fraud 'applies as a general principle of law in the application of the national provisions transposing' the Directive).

[72] *See also* De la Feria, *supra* n. 43, at 24–25.

[73] Ridsdale, *supra* n. 5, at 82; de la Feria, *supra* n. 5, at 275–77 (also asserting that tackling the actual taxation problem of aggressive VAT planning is not a judicial, but rather a policy-making and legislative task).

whether there are objective factors which make it evident that the 'essential aim' of the transaction was to obtain a tax advantage.[74]

In *Kittel*, the judgment was quite explicit about its reluctance to undertake an examination of the national restrictions outside the bounds of the legal test developed for third-party liability. It can be discerned from the judicial reasoning that having introduced the liability of the taxable person for fraud committed by others in a chain of supply, the ECJ felt that jurisprudence had already done enough, without jeopardizing the objectiveness of taxpayer rights and the neutrality of taxation in the single market as ensured by uniform and objective legal rules, to warrant that it is 'more difficult to carry out fraudulent transactions'.[75] The application of the same legal test in *Mahagében and Dávid* also demonstrates that the ECJ is satisfied that the tax efficiency considerations of the common system of VAT can be given due effect within the framework of the VAT Directive and in the context of the national administrative procedures initiated to investigate fraud.[76] The judgment in *Federation of Technological Industries*, concerning the introduction in national law of joint and several liability for taxpayers in a chain of supply, at first seemed prepared to abandon this rather cautious judicial approach. The main reason for this was that the applicable provision of EU VAT legislation[77] provided an explicit legal basis for the adoption of such national measures. Ultimately, the ECJ chose, however, to determine the proportionality of the national restriction on the basis of an aspect familiar from the general legal test, namely whether the taxable person had been given an opportunity to challenge the restriction by relying on proof capable of contradicting the objective evidence collected by the tax authorities.[78]

In cases concerning the enforcement of formal requirements by national authorities, the scrutiny by the ECJ was similarly oriented.[79] While the ECJ was prepared to examine the necessity of national restrictions in light of the mainly efficiency-driven tax policy objectives pursued, it also expected them to comply with the principle of neutrality.[80] In *Sarviz Germania*, dealing with invoicing irregularities, the ECJ examined a national rule which placed the fiscal burden for the irregularities on the taxable person, and struck down that rule for violating the neutrality principle.[81] In this regard, it was decisive that no opportunities for correction and, with that, the recovery of VAT and the exercise of the right to deduct were provided. It also warned that such restrictions enabling strict VAT enforcement may be regarded as necessary only when there is an 'actual' risk of loss of tax.[82] In the similar *Rusedespred* case, the ECJ made it explicit, on the basis of the principles of neutrality and effectiveness (of remedies), that the conditions under national law for the refund of improperly invoiced VAT must not make the refund impossible or excessively difficult, and held that the Member States must provide for the 'instruments' and 'detailed procedural rules' necessary for taxable persons to exercise their rights.[83] Having regard to the circumstances of the case, it declared the formal condition laid down in national law protecting the institutional position of national tax authorities, which was 'impossible to satisfy', as excessive.[84]

The judicial scrutiny in *Halifax* of the reparations ordered by the national authorities followed a similar legal construction of allowing the assessment of the national tax policy objective but also demanding compliance with the principle of neutrality.[85] The limb of the legal dispute, which concerned Member State measures

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[74] *Halifax and Others* (C-255/02), *supra* n. 9, para. 86. The requirement of 'essential aim' was relaxed to 'principal aim' in the *Part Service* case. IT: ECJ, 21 Feb. 2008, Case C-425/06, *Ministero dell'Economia e delle Finanze, formerly Ministero delle Finanze v. Part Service Srl*, ECLI:EU:C:2008:108, para. 62 (in principle, allowing for a broader scrutiny of what practices can be permitted or prohibited).

[75] *Kittel* (C-439/04 & C-440/04), *supra* n. 6, paras 58–59 (the legal test as developed in the case law 'is apt to prevent' such transactions).

[76] *Supra* n. 58 and 60. *See also* the assessment in *Kittel* concerning whether sufficient objective evidence has been collected and presented. *Kittel* (C-439/04 & C-440/04), *supra* n. 6, paras 55, 57 & 59.

[77] Art. 21 Sixth Directive.

[78] *Federation of Technological Industries* (C-384/04), *supra* n. 58, paras 24–30 & 31–33.

[79] In this regard, *see* the assessment in *Fatorie* (C-424/12), *supra* n. 69, paras 37–44 (concerning formal requirements which were imposed under national tax law to avoid the risk of a loss of tax revenue).

[80] Formal requirements imposed within national discretion must not go further than necessary and must not undermine the neutrality of VAT. IT: ECJ, 11 Dec. 2014, Case C-590/13, *Idexx Laboratories Italia v. Agenzia delle Entrate*, ECLI:EU:C:2014:2429, paras 35 & 37.

[81] *Sarviz Germania* (C-111/14), *supra* n. 20, paras 35–38. The ECJ referred to the specific legislative manifestation of neutrality that there must be 'exact proportionality' between the tax burden and the price of goods and services, which rule excludes the collection of excessive (disproportionate) tax and imposes the obligation on national tax administrations to enable the correction of invoicing irregularities.

[82] *Sarviz Germania* (C-111/14), *supra* n. 20, paras 39–41. *See also supra* n. 46.

[83] *Rusedespred* (C-138/12), *supra* n. 21, para. 30. It also asserted in para. 28 that national restrictions pursuing objectives of tax efficiency must not go beyond what is necessary and may not, therefore, be used in such a way that they would have the effect of undermining the neutrality of VAT as a fundamental principle.

[84] *Rusedespred* (C-138/12), *supra* n. 21, paras 31–34.

[85] The Court pointed out in *Fatorie*, under the claim that legal certainty had been violated, that in the absence of EU harmonization in the field of tax penalties, the Member States retain the power to choose penalties 'which they seem to them to be appropriate'; that power must, however, be exercised in accordance with EU law and its general principles, including the principle of proportionality. *Fatorie* (C-424/12), *supra* n. 69, para. 50. Penalties introduced in the interest of tax efficiency considerations will be proportionate if they take into account the nature and the degree of seriousness of the infringement, and express those factors adequately in their amount. HU: ECJ, 26 Apr. 2017, Case C-564/15, *Tibor Farkas v. Nemzeti Adó- és Vámhivatal Dél-alföldi Regionális Adó Főigazgatósága*, ECLI:EU:C:2017:302, para. 60.

introduced in the absence of applicable EU provisions to regulate the recovery of VAT and recover the unpaid VAT, was decided in the following way. First, the ECJ made it clear that the discretion available to the Member States must be exercised 'within the limits imposed' by EU law and the measures introduced in national discretion must not go beyond what is necessary.[86] Then, as recurrent in other areas of the jurisprudence, it reminded the Member States that their actions must not undermine the neutrality of the VAT system as required by EU law.[87] It concluded its assessment by emphasizing, with reference to the principles of the common system of VAT and in harmony with the legal formula introduced earlier, that when the taxable person is cleared of allegations of illicit conduct, the national authorities must allow it to exercise its objective entitlement to deduct VAT after input transactions.[88]

In the instances when EU tax legislation explicitly empowers the Member States to introduce – in national discretion – measures necessary for realizing tax efficiency objectives, the ECJ will, in general, subject national restrictions on the right to deduct to a scrutiny which seems to be less constrained than that in the earlier mentioned cases and generally more sensitive towards national tax policy interests.[89] In *Gabalfrisa*, concerning national restrictions introduced under Article 22(8) of the Sixth Directive, the ECJ appeared to have given a more closely observed examination of the tax efficiency considerations raised when it supplemented its scrutiny under proportionality by asserting that the discretion granted under EU legislation must not be exercised so as to 'systematically undermine' the rights of taxpayers, in particular the right to deduct.[90] The case law under Article 273(1) of the VAT Directive, which as mentioned earlier permits the Member States to introduce additional obligations for taxable persons in the interest of ensuring the efficient operation of VAT, followed a largely similar judicial approach. The ECJ examined efficiency-based national restrictions in light of the detailed requirements of EU law and its general principles, including the principle of proportionality and the principles of fiscal neutrality and legal certainty,[91] but also warned against 'systematically undermining' the right to deduct and the neutrality of VAT.[92] The open-ended character of this latter term may allow the ECJ to defer to Member State discretion perhaps more liberally than in other domains of the jurisprudence.[93]

Recent judgments concerning the discretion exercised under Article 273(1) by Member States with severe efficiency problems in the local VAT system, have demonstrated that the ECJ is indeed prepared to depart from its original cautious approach and appreciate more fully the difficulties faced by individual national tax administrations. It signalled a shift of focus in its usual scrutiny when it asserted that when delivering – with 'all measures appropriate' – tax efficiency objectives[94] within the discretion allowed under the Article 273(1), the Member States in actual fact proceed in fulfilment of their obligations imposed under EU law.[95] The weight of this change is indicated by the ECJ bringing in Article 4(3) of the TEU on the principle of loyalty as a legal basis alongside the VAT Directive of the EU legal obligations referred to. These assertions reframe what are discretionary possibilities provided in EU VAT legislation for the promotion of considerations of tax efficiency as legal obligations imposed on national tax administrations. Arguably, this

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[86] *Halifax and Others* (C-255/02), *supra* n. 9, paras 90–92. *See Salomie and Oltean* (C-183/14), *supra* n. 3, paras 50–52 (regarding the discretion of national authorities in imposing penalties, the limits of which must be determined on the basis of the facts of the case and factors, such as the penalty actually imposed, the seriousness of the breach, and the possibility of fraudulent or other illicit conduct by the taxable person).

[87] *Halifax and Others* (C-255/02), *supra* n. 9, para. 92.

[88] *Ibid.*, para. 97.

[89] In particular, *see* PL: ECJ, 26 Mar. 2015, Case C-499/13, *Marian Macikowski v. Dyrektor Izby Skarbowej w Gdańsku*, ECLI:EU:C:2015:201.

[90] ES: ECJ, 21 Mar. 2000, Joined Cases C-110/98 to C-147/98, *Gabalfrisa* et al. *v. Agencia Estatal de Administración Tributaria*, ECLI:EU:C:2000:145, paras 48–52. In the circumstances of the case, these general benchmarks led to declaring the national restriction as well as the penalties imposed as excessive. *Ibid.*, para. 53. *See also PARAT Automotive Cabrio* (C-74/08), *supra* n. 3, paras 25 & 27–29 (concerning restrictions introduced under Art. 17(6) of the Sixth Directive, which were held excessive, in particular when they are introduced in a 'measure of general nature' and without sufficiently distinguishing between transactions of different 'nature or purpose'). National restrictions will be declared as excessive when they lead to the loss of the right to deduct. *Salomie and Oltean* (C-183/14), *supra* n. 3, para. 63. The Member States are thus required to find less restrictive alternative solutions. *Salomie and Oltean* (C-183/14), *supra* n. 3; DE: ECJ, 15 Sept. 2016, Case C-518/14, *Senatex v. Finanzamt Hannover-Nord*, ECLI:EU:C:2016:691, para. 42.

[91] E.g. *Vámos* (C-566/16), *supra* n. 9, paras 36–41; *BB construct* (C-534/16), *supra* n. 8, paras 20–24.

[92] RO: ECJ, 19 Oct. 2017, Case C-101/16, *SC Paper Consult SRL v. Direcţia Regională a Finanţelor Publice Cluj-Napoca and Administraţia Judeţeană a Finanţelor Publice Bistriţa Năsăud*, ECLI:EU:C:2017:775, paras 49–50.

[93] However, the national restriction must not make the right to deduct 'practically impossible or excessively difficult' and it must not 'systematically undermine' the right to deduct.

[94] Which also serve the interests of the EU budget.

[95] *Maya Marinova* (C-576/15), *supra* n. 33, para. 41; *Paper Consult* (C-101/16), *supra* n. 92, para. 47 (and Art. 325 TFEU). For the use of the same formula in an 'abuse of law' situation, *see* HU: ECJ, 17 Dec. 2015, Case C-419/14, *WebMindLicenses kft v. Nemzeti Adó- és Vámhivatal Kiemelt Adó – és Vám Főigazgatóság*, ECLI:EU:C:2015:832, para. 41. *See also* RO: ECJ, 9 July 2015, Case C-144/14, *Cabinet Medical Veterinar Dr Tomoiagă Andrei v. Direcţia Generală Regională a Finanţelor Publice Cluj Napoca prin Administraţia Judeţeană a Finanţelor Publice Maramureş*, ECLI:EU:C:2015:452, paras 25–26. The latter is the first in this line of cases, where the ECJ also specified the obligations of national authorities to check the returns, accounts and other relevant documents of the taxable person and to calculate and collect the tax due. In para. 29, it asserted that the discretion enjoyed by the Member States is 'subject to the obligation to ensure effective collection of the European Union's own resources and not to create significant differences in the manner in which taxable persons are treated, either within a Member State or throughout the Member States'.

makes the jurisdiction exercised in connection with Article 273(1) qualitatively different from the judicial assessments produced under other provisions of the VAT Directives which took tax efficiency simply as an objective of the common system of VAT.[96] The shift in judicial interpretation was prepared in *Maya Marinova* where the ECJ pointed out that infringements of obligations introduced to enable the correct collection of tax in national territory, compromise the proper functioning of the common system of VAT.[97] In *article Consult*, the ECJ rushed to emphasize that when the Member States address tax evasion in their own competences, they 'undoubtedly' act in fulfilment of their EU obligations.[98] In that judgment, the ECJ explicitly raised the necessity of balancing the right to deduct, as an 'essential component of the VAT scheme', and the EU objective of fighting tax evasion,[99] and also discussed the problems caused by VAT evasion for both national and EU public finances.[100]

The actual assessment in these cases of the individual national restrictions, in which the general formula that national restrictions must be proportionate and must not undermine the neutrality of VAT resurfaced,[101] was perhaps less revolutionary. In *article Consult*, having enlisted numerous examples of proportionate as well as disproportionate national restrictions,[102] the ECJ examined the nature of the national measure and observed that the obligation imposed was limited, straightforward and reasonable, and, in particular, did not involve the transfer of the national task authority's tasks onto the taxable person.[103] Ultimately, the ECJ struck down the national restriction on the ground which is familiar from previous jurisprudence, that it was impossible for the taxable person to demonstrate that the transactions investigated met the VAT Directive's conditions and that the VAT disputed had already been paid into the public treasury.[104] The ruling in *Maya Marinova* took more risks. There, the ECJ found that the national measure was proportionate mainly on the ground that its aim was to enable the national tax authorities to act under their newly discovered EU legal obligation to implement the tax efficiency objectives of the VAT Directive.[105] It also found that the principle of neutrality had no relevance in the case because the nature of the illicit conduct by the taxpayer, which put the operation of the common system of VAT in jeopardy, had excluded that the principle is applied to protect the legal position of the taxpayer.[106]

With these rulings, the jurisprudence might have arrived at another turning point. If the rhetoric of the ECJ can be believed, the law on the exercise of the right to deduct is going to be shaped – at least at the level of principles – by contrasting the entitlements of taxable persons, based on the objective and uniformly applicable provisions of the VAT Directive, with the obligations of the Member States, established under the VAT Directive, to ensure the efficiency of the national and, with that, the EU system of VAT. The dynamics of this process may be influenced by the earlier mentioned development, which occurred almost in parallel, when the ECJ re-emphasized the role of the principle of equal treatment within the neutrality principle and brought the specific objectives within that principle, such as avoiding distortions of competitive conditions in the market and maintaining a level playing field for economic operators, to the forefront of the judicial application of the law.[107] The emphasis on equal treatment may also have the consequence that the ECJ eventually gives voice to the claim that without efficient taxation (efficient national tax systems), equal taxation in the single market cannot be realized. In other words, for the equal treatment of taxpayers in the common system of VAT to prevail, as mandated by the objective (and principle) of fiscal neutrality, national tax administrations need to be able to collect the tax due from

Notes

[96] *Supra* n. 63. Fighting tax evasion is a tax policy objective i.e. legitimate and was 'even imposed' by EU law. *Paper Consult* (C-101/16), *supra* n. 92, para. 53. As in *Andrei*, concrete tax efficiency-related obligations were identified, such as tax investigation obligations (*ibid.*, para. 48) and the obligation 'to re-establish the situation that would have prevailed in the absence of tax evasion'. *Maya Marinova* (C-576/15), *supra* n. 33, para. 42.

[97] *Maya Marinova* (C-576/15), *supra* n. 33, para. 39.

[98] *Paper Consult* (C-101/16), *supra* n. 92, para. 47.

[99] *Ibid.*, para. 34.

[100] *Ibid.*, paras 44–46. *See also* IT: Opinion of A. G. Wahl, 22 Mar. 2018, Case C-648/16, *Fortunata Silvia Fontana v. Agenzia delle Entrate – Direzione provinciale di Reggio Calabria*, ECLI:EU:C:2018:213, paras 39–41.

[101] *Maya Marinova* (C-576/15), *supra* n. 33, paras 43–44.

[102] *Paper Consult* (C-101/16), *supra* n. 92, paras 51–52 (disproportionate: the tax authority's extensive investigative tasks were transferred onto the taxable person; proportionate: requiring a taxable person to take every step which could reasonably be required of him).

[103] *Paper Consult* (C-101/16), *supra* n. 92, paras 53–55.

[104] *Ibid.*, paras 56–60. In *BB construct*, the judgment started with a traditional assessment of the national restriction. The ECJ found that the taxable person was prevented from influencing the decision taken by the tax authority and the financial guarantee required was not sufficiently individualized. However, as in *Maya Marinova*, the principle of neutrality was found inapplicable. *BB construct* (C-534/16), *supra* n. 8, paras 23, 26–29. On the basis of the freedom to pursue an economic activity (*supra* n. 8), the ECJ held that national restriction at issue can 'deprive, without justification, the company concerned of its resources from the moment of its creation' and can prevent that company 'from developing its business activities', and is, therefore, disproportionate. *BB construct* (C-534/16), *supra* n. 8, paras 34–42.

[105] *Maya Marinova* (C-576/15), *supra* n. 33, paras 47–48.

[106] *Ibid.*, para. 49.

[107] *Supra* nn. 31–36.

every taxable person, including those that originally planned otherwise.

5 Conclusion

The contribution of the ECJ to the operation of the common system of VAT by interpreting the right of taxable persons to deduct input VAT has been driven by the complex system of rules and objectives of the EU's VAT Directives. The ECJ framed that right as an objective legal entitlement the exercise of which ensures the neutrality of VAT, and which should not interfere unduly with the ability of the Member States to maintain an efficient VAT system. Ultimately, the test of this extensive, often highly factual jurisprudence is whether the individual judgments have contributed to European market integration in the manner desired by the Member States. One significant aspect of this is whether the concerns of individual national tax jurisdictions within the EU's common regime – especially those that are affected severely by fraud or other forms of tax abuse and face as a result a significant loss of revenue – can be taken on board, possibly without putting the market integration objectives of the VAT Directive in jeopardy.

Recent case law from the ECJ indicates a potential way forward in the interpretation and the national application of taxpayers' objective entitlements, including the right to deduct. The relevant judgments suggest that the exercise of these rights can take place in the common system of VAT without unnecessarily constraining the collection of tax revenue due and generally the efficient operation of national tax systems. To achieve this, the ECJ decided to interpret the objective of tax efficiency as imposing an obligation on national tax authorities to take the necessary measures, especially when permitted by EU law in provisions governing the policy discretion available to the Member States. The novel jurisprudence could pose considerable risks for the exercise of the supposedly objective and universal rights guaranteed for taxpayers, as it makes it heavily dependent on the factual circumstances of the national restriction and exposes them to the assessment of national authorities. Nevertheless, when the details of the ECJ decisions are considered, it appears that objective rights of taxpayers are interfered with only when there is objective evidence indicating that their exercise can be excluded of account of the conduct of the taxable person concerned.