

## **Tax Alert | Rejection of the right of input VAT deduction – supply of goods by an entity treated as non-existing**

The Court of Justice of the EU (CJEU) issued recently judgement **C-277/14 GST – PPUH Stehcemp sp. j. Florian Stefanek, Janina Stefanek, Jarosław Stefanek proti Dyrektor Izby Skarbowej w Łodzi** dealing with the possibility to reject the right of input VAT deduction should the supply be performed by an entity treated as non-existing.



### **The Case**

The company PPUH Stehcemp sp. j. Florian Stefanek, Janina Stefanek, Jarosław Stefanek (hereinafter „PPUH“) purchased from the company Finnet sp. z o.o. (hereinafter „Finnet“) diesel fuel and used this within its economic activity. PPUH claimed input VAT deduction from these purchases based on the invoices it received.

During a tax audit, the Tax Authorities challenged the right of the company PPUH of input VAT deduction on the ground that the invoices were issued by a non-existing entity, as Finnet was not registered for VAT purposes, did not submit a tax return and did not pay any taxes. In addition, that company did not publish its annual accounts, did not have a concession for the sale of liquid fuels and the building entered in the commercial register as being its corporate seat was in a dilapidated state, making any economic activity impossible. Finally,

all attempts to contact Finnet or the person registered as its statutory body was unsuccessful.

PPUH opposed that it had acted in good faith, as it received registration documents from Finnet indicating that that company was lawfully entitled to carry on the sale, namely an extract from the commercial register, the tax identification number and a certificate stating its statistical identification number.

#### *Note:*

*According to Polish legislation, should the supply of goods or services be proved by invoices issued by a non-existing entity or an entity not entitled to issue the invoices, such documents do not allow for input VAT deduction.*

### **The Question**

Is it possible to reject the taxable person's right to deduct VAT due or paid in respect of goods that were

supplied to him on the grounds that the invoice was issued by an entity that, in the light of the criteria provided by national legislation, is to be regarded as a non-existing and that it is impossible to determine the identity of the party which actually supplied the goods?

### **The Judgement**

#### *Right of input VAT deduction*

According to the CJEU, the right of deduction is a fundamental principle of the common system of VAT, in principle may not be limited, and is exercisable immediately in respect of all the taxes charged on transactions relating to inputs. The deduction system is intended to relieve the trader entirely of the burden of the VAT due or paid in the course of all his economic activities – the common system of VAT therefore ensures that all economic activities, whatever their purpose or results, provided that

they are, in principle, themselves subject to VAT, are taxed in a neutral way.

Material conditions which must be met in order to claim the right of deduction are as follows:

- the respective person must be a taxable person within the meaning of the VAT Directive,
- the goods or services relied on to give entitlement to that right must be used by the taxable person for the purposes of his own taxed output transactions,
- those goods or services as inputs must be supplied by another taxable person.

The formal condition governing the right of deduction provides that the taxable person must possess an invoice issued in accordance with the VAT Directive, i. e. the invoice must i. a. contain the VAT identification number under which the taxable person performed the supply, the full name and address of the taxable person and the quantity and nature of the goods supplied.

With regard to the case in the main proceedings, the CJEU states that according to the order for reference, PPUH has the status of a taxable person, actually received and paid for the goods concerned (namely fuel indicated in the invoices issued by Finnet) and used those goods for the purposes of its taxable transactions. The CJEU thus further dealt with a question whether the supplier – the company Finnet – is a taxable person.

*Criterion of existence of the supplier of the goods or his entitlement to issue the invoices*

According to the referring court, as a non-existing entity is neither able to supply the goods nor to issue an invoice relating to such a supply, there was no supply of goods, as it was also not possible to identify the actual supplier of those goods.

In this connection the CJEU states that the criterion that the supplier of the goods must exist or be entitled to issue invoices, does not feature among the conditions stipulated by the VAT Directive which give rise to the right of deduction. The VAT Directive provides that that supplier must have the status of a taxable person - the criteria set out in the national legislation must not be

at odds with this requirement.

The CJEU further notes that a taxable person is any person who independently carries out any economic activity of producers and persons supplying services, whatever the purpose or results of that activity. This term is defined widely, on the basis of the factual circumstances, while the provisions of the VAT Directive do not indicate that the status of taxable person depends on any authorisation or licence granted by the authorities for the exercise of an economic activity.

Even though every taxable person is obliged to state when his activity as a taxable person commences, changes or ceases, despite the importance of that declaration for the smooth functioning of the VAT system, it cannot constitute an additional condition to be met in order for the status of a taxable person to be recognised. That status also can neither depend on whether the taxable person complies with the obligations to submit a tax return and pay VAT nor be made subject to the obligation to publish annual accounts or have a concession to sell fuel.

Any failure by the supplier of goods to meet the requirement to state when taxable activity commences cannot call into question the right of deduction to which the recipient of goods supplied is entitled in respect of the VAT paid for those goods.

The recipient of the goods has a right to deduct input VAT and this right cannot be refused, even if the supplier of the goods is a taxable person who is not registered for VAT or the issuer of the invoice no longer has an individual business operator's licence and that, accordingly, he no longer has the right to use his tax identification number, where the invoices relating to the goods supplied contain all of the information required by the VAT Directive, in particular the information necessary to identify the person who issued those invoices and to ascertain the nature of the goods provided.

With regard to the case in the main proceedings, the CJEU states that it cannot be ruled out that the company Finnet performed economic activity on the date of the supplies of goods. That conclusion is not called into question by the fact, that it was impossible to establish contact with Finnet or

the person registered as its statutory body since those attempts at contact were made prior or subsequently to those supplies of goods or that the dilapidated state of the building in which Finnet's corporate seat is located did not allow any economic activity to take place. Finnet could conduct its economic activity in places other than the seat.

In particular, when this activity involves supplies of goods made in the context of a chain transaction, the first purchaser (who is also the reseller) can simply ask the first seller to transport the goods directly to the second purchaser, without necessarily having at his disposal the warehousing and transport facilities which are indispensable for supplying the goods.

The CJEU further notes that the invoices contain i. a. the information on the nature of the goods supplied and the amount of VAT due, as well as Finnet's name, tax identification number and the address of its seat. The circumstances noted by the referring court do not support the conclusion that Finnet does not have the status of a taxable person and, consequently, do not allow PPUH Stehcemp to be refused the right of deduction.

*The absence of the power of the supplier legally to dispose of the goods*

According to the CJEU, the concept of 'supply of goods' does not refer to the transfer of ownership in accordance with the procedures prescribed by the applicable national law but covers any transfer of tangible property by one party which empowers the other party actually to dispose of it as if he were its owner.

The possibility that Finnet lacks of the power legally to dispose of the goods cannot mean that a supply of those goods did not take place, since those goods were in fact delivered to PPUH, which used them for the purposes of its taxable transactions.

In addition, the question whether or not the supplier of the goods has paid the VAT due on those transactions to the public purse has no bearing on the right of the taxable person to deduct input VAT. VAT applies to each transaction by way of production or distribution after deduction of the VAT

directly borne by the various cost components.

#### *Potential tax fraud*

The CJEU bears in mind that the prevention of tax evasion, avoidance and abuse is an objective recognised and encouraged by the VAT Directive. It is therefore for the national courts and judicial authorities to refuse the right of deduction if it is shown, in the light of objective factors, that that right is being relied on for fraudulent or abusive ends.

Although that is the position where tax fraud is committed by the taxable person himself, it is also the case where a taxable person knew, or should have known, that, by his purchase, he was taking part in a transaction connected with VAT fraud, whether or not he profits from the resale of the goods or the use of the services in the context of the taxable transactions subsequently carried out by him.

By contrast, where the material and formal conditions laid down for the creation and exercise of that right are met, it is incompatible with the rules governing the right to deduct to impose a penalty, in the form of refusing that right to a taxable person who did not know, and could not have known, that the transaction concerned was connected with fraud committed by the supplier, or that another transaction forming part of the chain of supply prior or subsequent to that transaction carried out by the taxable person was vitiated by VAT fraud.

It is for the Tax Authorities, having found fraud or irregularities committed

by the issuer of the invoice, to establish, on the basis of objective factors and without requiring the recipient of the invoice to carry out checks which are not his responsibility, that that recipient knew, or should have known, that the transaction on which the right to deduct is based was connected with VAT fraud, this being a matter for the referring court to determine.

The determination of the measures which may, in a particular case, reasonably be required of a taxable person wishing to exercise the right to deduct VAT in order to satisfy himself that his transactions are not connected with fraud committed by a trader at an earlier stage of a transaction depends essentially on the circumstances of that particular case. When there are indications pointing to an infringement or fraud, a cautious taxable person could take for its obligation to make enquiries about the trader from whom he intends to purchase goods or services in order to ascertain the latter's trustworthiness.

The Tax Authorities cannot, however, as a general rule, require a taxable person to ensure that the issuer of the invoice relating to the goods and services in respect of which the exercise of that right to deduct is sought was in possession of the goods and was in a position to supply them and that he has complied with his obligations as regards the declaration and payment of VAT, in order to be satisfied that there are no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction and, to be in possession of documents in that

regard.

**The CJEU thus agreed with the company PPUH deciding that the VAT Directive precludes such national legislation, by which a taxable person is not allowed to deduct the VAT due or paid in respect of goods that were delivered to him on the grounds that:**

- **the invoice was issued by a trader which is to be regarded, in the light of the criteria provided by that legislation, as a non-existing entity, and**
- **it is impossible to determine the identity of the actual supplier of the goods,**

**except where it is established,**

- **on the basis of objective factors and**
- **without the taxable person being required to carry out checks which are not his responsibility,**

**that that taxable person knew, or should have known, that that transaction was connected with VAT fraud, this being a matter for the referring court to determine.**

*We remain at your disposal for any further information on how this judgment may affect your particular situation. Please contact your KPMG Slovakia VAT contact persons.*

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