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Good faith and the right to deduct VAT

Tax Alert 17/2015

Dear Sir or Madam,

On October 22, 2015, the Court of Justice of the European Union: (hereinafter: CJEU) issued its judgement in the case of *Stehcemp sp. j. Florian Stefanek, Janina Stefanek, Jarosław Stefanek (C-277/14)*, in which it referred to the fundamental issue in the common VAT system regarding the taxable person's right to deduct VAT paid from transactions considered as "suspicious". Although the decision was made in favor of taxable person, it does not entirely solve the problem of taxpayers, whose suppliers turn out to be frauds.

The essence of the problem refers to the situation that can be seen more and more often, where the taxable person is refused the right of deduction of the value added tax – VAT, due to the fact that his Client (supplier, issuer of the invoice) participates in a fiscal fraud, e.g. by issuing so called "blank invoices", or acting as a straw person, whose function is reduced to being listed on the invoice as a seller. As a consequence, the value added tax is not paid and both the real, and presumed seller often disappears in inexplicable circumstances. In such situations, tax authorities aim to compensate the loss of the budget receivables by refusing the buyer the right to deduct the VAT on the part of the buyer. Here the so-called "good faith" plays its crucial role. In a number of judgements of the CJEU, it was stressed that the right of deduction of the value added tax may depend on the good faith of the taxable person and his due diligence in regard to the transaction¹. However, what is taxable person's good faith? What actions should the taxable person take in order to convince the tax authorities that he has truly exercised due diligence when verifying of the vendor?

Unfortunately, there is no unambiguous answer to the questions above. Admittedly, the Court, in the above mentioned judgement, held the position that one cannot expect the taxable person to make the findings to which they are not obligated (by the applicable law), however, it was also pointed out that identifying the actions which, in a given case, could be reasonably expected from the taxable person (who intends to exercise the right to deduct VAT), depends primarily on the circumstances of the examined case. Therefore, in each case one should approach the issue of good faith individually.

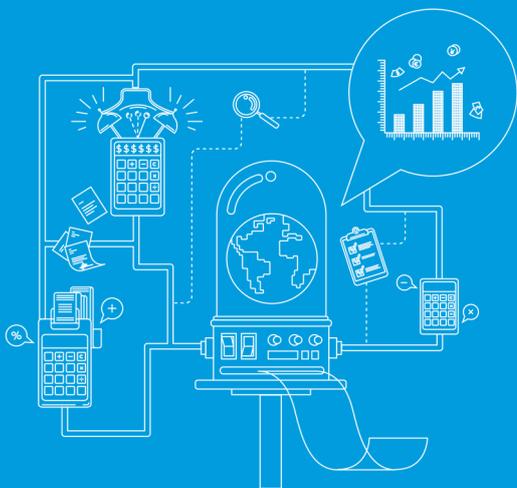
¹ Compare, in particular, following judgements were mentioned: judgement of January 12, 2006 in Joined Cases C-354/03, C-355/03 and C-484/03 *Optigen and others*, paragraphs 52, 55, as well as judgement in Joined Cases C-439/04 and C-440/04 *Kittel and Recolta Recycling*, paragraphs 45, 46, 60; judgement in Joined Cases C-80/11 and C-142/11 *Mahagáben and Dávid*, paragraph 47, and judgement in Case C-285/11 *Bonik*, paragraph 41.

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The stakes, however, are high because not only is the right to deduct the VAT in play, but also the risk of acknowledging the taxable person as a party to a transaction whereby a tax offence is employed. As indicated by the CJEU – in case when the taxable person knew or should have known that by purchasing a commodity, they participate in a transaction connected with an offence regarding the VAT, they should be deemed as participating in an offence, regardless of whether they gain the benefit from commodity resale or service usage under the taxed transactions done by them at a later stage of trade². In turn, acknowledging the taxable person as a participant of the tax offence entails their liability based on provisions of the Fiscal Penal Code and is punishable by a penalty, restriction of liberty or imprisonment.

Also, the national administrative courts case-law is restrictive in this matter, stating that it is important for the transaction circumstances to indicate that the taxable person who purchases a commodity (or service) presented due diligence required in marketing of the given commodity (or service), thus making this transaction transparent. At the same time, the Supreme Administrative Court of Poland (NSA) indicated that the taxable person should take any and all necessary actions that can be rationally expected from him, in order to make sure that the transaction concluded by him does not lead to participation in the tax offence.³

The verification of the counterpart's reliability is performed, among other things, by checking, if they are an active VAT taxpayer and analyzing the data disclosed in the National Court Register of businesses, or in the Central Electronic Register and Information on Economic Activity (CEiDG). However, these actions often prove insufficient, which is why in order to secure own interests, taxable persons should implement appropriate procedures to verify their trading partners. Unfortunately, there is no ready-made and universal recipe on how taxable persons can prove that during a particular transaction they performed due diligence – in each case rationally expected. A variety of significant factors must be recognized here: the industry, in which the transaction occurs, other legal circumstances under which the taxable person and the potential trading partner operate. Therefore, the adoption of a specific model of action should be preceded by an appropriate analysis of the taxable person's individual circumstances.

RSM Poland, as a team of experienced specialists in tax consulting, auditing, bookkeeping, and legal counselling services, offers to develop effective verification procedures, which will allow to minimize the risk of challenging the taxable person's good faith by the tax authorities and thus will become a defense mechanism in potential disputes with the tax authorities.

²Judgements: Bonik, C285/11, EU:C:2012:774, sections 38, 39 and the rulings cited; Maks Pen, C18/13, EU:C:2014:69, section 27.

³The NSA judgement dated May 6, 2015, file ref. No. I FSK 1739/13.



Please contact us in case of any questions, or the need to discuss the subject.

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