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GUARANTEE FOR THE VALUE ADDED TAX

Abstract

The paper examines legal disputes arising from the questionable implementation of article 205 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax into the Czech legal order. The main aim of the paper is to find out whether the provisions resulting from that implementation are applicable, and if so under what conditions. Author draws conclusions mainly from case law of the Court of Justice of the European Union and Czech Supreme Administrative Court and uses analysis, synthesis and descriptive method.

Key words: tax, law, VAT, joint and several liability, guarantee, right to deduct VAT, judicial review.

JEL Classification: K34

1. Introduction

European system of value added tax is based on the principle of fiscal neutrality which presupposes that unless an explicit exception is provided, value added tax (VAT) applies to all business activities and all business entities, thus creating a level playing field for all business entities from a tax point of view. The system is based on the assumption that VAT is borne only by the final consumer, but is paid by the supplier - the VAT thus only "flows"

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through taxable persons without affecting their costs and revenues [Bakeš 2012: 169-170]. At least that is the idea. Essential part of the system therefore is the right to deduct VAT. It allows a taxable person to deduct the VAT paid to his supplier in the price of the taxable performances received by him (input tax) from the VAT which he is obliged to pay for the taxable performances made by him (output tax). Individual taxable persons thus pay the VAT derived from that part of the price for the goods or services provided by them by which they increased the selling price compared to the acquisition price (only the added value is taxed). If the output tax is lower than the tax deduction (the value of received taxable transactions exceeds the value of those made), a right to excessive deduction arises - taxable person is reimbursed by a public budget for the VAT paid to his supplier. It is the main reason for which deduction of input tax (especially excessive deduction) is the primary target of VAT frauds organizers as their intended profit[1].

The system is clearly based upon a premise that all entities participating on it will fulfil their legal obligations. And that is what makes it vulnerable. If they will not, it hurts not only public budgets, but also the system as a whole. The system may be able to survive some infractions, even major ones. Its continuing endurance despite the reports on huge VAT gap is enough evidence of that. European Comission claims that member states lost approximately €137 billion in VAT revenues just in 2017 [VAT Gap: EU countries lost €137 billion in VAT revenues in 2017]. However, if it stops adapting and fighting those infractions, the system will crumble. If not for anything else, it would be for the lack of faith in it and dwindling motivation to participate on it. It is and always will be just a tax system. And there is only a handful of things less popular than paying taxes. This is also the reason why the fight against tax frauds, tax evasion and tax abuse is an objective that is recognised and encouraged by the European Union law [Court of Justice of the European Union, Cases C-80/11 and C-142/11, (Mahagében and Dávid), par. 42 and 43].

One of the means to achieve that objective should provide article 205 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, as amended (VAT Directive), which allows member states to provide that in the situations referred to in Articles 193 to 200 and Articles 202, 203 and 204 a person other than the person liable for payment of VAT is to be held jointly and severally liable for payment of

[1] VAT fraud is generally defined as a situation in which one of the participants does not pay the collected tax to the public budget and another tax entity draws a exercise the right to deduct VAT under suspicious (i.e. not standard) circumstances. VAT fraud is a term defined by the case law of the Court of Justice of the European Union and the Supreme Administrative Court, and participation in fraud may result in the loss of the right to deduct VAT. The conceptual features of VAT fraud are therefore the missing VAT and suspicious circumstances that led to its non-payment to the public budget.

VAT. However, the way it was implemented into Czech national law is somewhat questionable. To provide a meaningful translation of the term “liable” proved to be a great challenge for the Czech lawmaker. Czech language mutation of article 205 of the VAT Directive therefore states that Member States may provide that a person other than the person liable for payment of VAT jointly and severally guarantees the payment of VAT.

This paper examines legal disputes arising from such an implementation represented by three issues. The first issue is whether such an implementation imposes obligations on taxable persons that go beyond the limits allowed by European Union law. The second issue is the relationship between the obligation to pay the VAT and the right to deduct VAT, i.e. whether the existence of provisions regulating guarantee for VAT in national law does not prevent the refusal of the right to deduct VAT due to the participation on a tax fraud. The third issue is whether the application of such a guarantee subsequently allows the tax administration to refuse the participant on a fraudulent conduct the right to deduct VAT. The main purpose of this paper is to find out if there is a plausible resolution of these issues in the current case law of the Court of Justice of the European Union and the Supreme Administrative Court. To achieve this goal, the author uses analysis, synthesis and descriptive method.

2. Implementation of tax liability in the form of guarantee

As was stated above, Article 205 of the VAT Directive allows member states to provide that in the situations referred to in Articles 193 to 200 and Articles 202, 203 and 204 a person other than the person liable for payment of VAT is to be held jointly and severally liable for payment of VAT. Even though the English, German, Polish, and other language mutations of Article 205 of the VAT Directive view the provision as granting the member states a right to impose joint and several liability on a person other than the person originally liable for payment of VAT, Czech and Slovakian translation of the provision view this provision as a right to impose guarantee on the same person in that situation [Sejkora 2017: 128-130; Cakoci 2018: 143-145]. The problem is that there is a great difference between joint and several liability and guarantee. To simplify the matter, one may either be jointly and severally liable with someone else for payment of a debt, in which case all jointly and severally liable persons are more or less in the same position in relation to the creditor and debt in question, or one may be a guarantor for payment of a debt by someone else, in which case the debt of the guarantor is secondary and collateral to the

primary debt. A provision that contains a mixture of both (i.e. joint and several guarantee) is therefore somewhat nonsensical. One simply cannot have both at the same time.

The Czech legislators chose the way of pure guarantee. In Act no. 235/2004 Coll., on value added tax, as amended (VAT Act), are therefore provisions regulating situations in which originates the guarantee for unpaid VAT. Those provisions include section 108a of the VAT Act, which regulates specific situations pertaining to the transactions subject to excise taxes (and are therefore out of the scope of this paper), and section 109 of the VAT Act regulating guarantee of the recipient of taxable performance. The latter is the main focus of this paper.

Section 109 subsection 1 of the VAT Act states that a taxable person who accepts a taxable supply in the Czech Republic made by another taxable person or provides payment for such a supply (recipient of a taxable supply) shall guarantee the payment of VAT on this supply if, at the time of such a performance, he knew or ought to have known and could have known that (a) the tax stated on the tax document will not be intentionally paid, (b) the taxable person making the taxable supply or receiving payment for such a supply (taxable supply provider) has intentionally become or will become unable to pay the VAT; or (c) the tax is evaded or the tax advantage is unlawfully elicited. The provision cited above clearly aims to fight VAT frauds and other similar forms of tax evasion. It is evidenced by the knowledge test contained in this provision, which presupposes that the guarantee for unpaid VAT arises only in situations in which the recipient of a taxable supply knew or ought to have known that the VAT will remain unpaid by the provider of the taxable supply in question. Some authors are convinced that this is a reason why the guarantee in this form should take precedent over refusing the right to deduct VAT in cases of fraudulent conduct [Lichnovský 2017]. This claim is the main focus of the third chapter of this paper (4. Does the existence of provisions of the national law regulating guarantee for unpaid VAT mean that the recipient of a taxable supply cannot be refused the right to deduct VAT?).

The most problematic are the situations regulated by section 109 subsection 2 of the VAT Act. It states that the recipient of a taxable supply also guarantees for unpaid tax on this supply, if the payment for this supply (a) clearly deviates from the usual price without economic justification, (b) is provided in whole or in part by a non-cash transfer to an account held by a payment service provider outside the country, (c) is provided in whole or in part by a non-cash transfer to an account other than the account of the provider of the taxable supply, which is published by the tax administrator in a manner enabling remote access, and if the payment for this supply exceeds twice the amount required by law make

a non-cash transfer, or (d) provided, in whole or in part, in virtual currency in accordance with legislation regulating certain measures against money laundering and terrorist financing. Many authors claim that the provision cited above are in conflict with the principles of proportionality and legal certainty. Examination of this claim is the main focus of the second chapter of this paper (3. Is guarantee under section 109 subsection 2 of the VAT Act even applicable?).

Under section 109 subsection 3 of the VAT Act the recipient of a taxable supply guarantees for unpaid tax on this supply if, at the time of its occurrence or the transfer of payment for it, the fact that the taxable supply provider is an unreliable taxable person is published in a manner enabling remote access. The provision cited above derives origin of guarantee from receiving taxable supply from a taxable person with a status of unreliable taxable person. The status itself is regulated by section 106a of the VAT Act. If a taxable person seriously breaches his obligations related to VAT administration, the tax administrator issues a decision marking the taxable person in question as unreliable. Unreliability is therefore a status bestowed upon a taxable person by an administrative decision. When such a decision becomes enforceable, the financial administration is obliged to publish the information of the unreliability of a taxable person on its website. After a period of one year, the status may be levied by another administrative decision. The author is convinced that such a provision is thoroughly justified. If the legitimate objective recognized by the European Union law is to prevent tax evasion, then taxable persons who demonstrably seriously impede or thwart the administration of the VAT pose a threat to that objective. The legislator does not directly exclude such persons from economic life, but transfers the risk of VAT loss arising from possible non-fulfillment of their obligations to those who receive taxable supplies of goods and services from them. All this in a situation where the recipient of a taxable supply has sufficient information of the unreliability of the supplier at the time of its receipt. It is therefore the recipient's choice to either willingly undertake such a risk, or to acquire demanded supplies by other means. The author therefore does not view the institute of guarantee for the VAT unpaid by unreliable taxable person as a breach of the principles of fiscal neutrality, proportionality or legal certainty. The same may be said about guarantee arising from the situation regulated by section 109 subsection 4 of the VAT Act, under which the recipient of a taxable supply, which consists of the supply of fuel by a fuel distributor pursuant to the Act regulating fuels, shall guarantee for VAT on this supply, unless at the time of its occurrence or payment the fact that the taxable supply provider is registered as a fuel distributor under the law governing fuels is published in a manner enabling remote access.

It is also important to note that taxable persons may avoid the guarantee for an unpaid VAT altogether by means of special security provided by section 109a of the VAT Code. It is nothing else than a slightly convoluted way for the recipient of a taxable supply to pay the VAT instead of a liable taxable person, not entirely unlike the mechanism of reverse charge. The only caveat being that VAT is usually a part of the price of goods and services agreed upon in contract between its supplier and recipient. Such practice, if not accepted by both parties, may therefore constitute a breach of contract of the recipient resulting in his civil liability [Děrgel 2019: 19].

3. Is guarantee under section 109 subsection 2 of the VAT Act applicable at all?

As was stated above, the purpose of article 205 of the VAT Directive is to give member states a mean to fight against tax frauds, tax evasion and tax abuse within European Union. However, scope of such a fight must inevitably have its limits. Those limits are primarily set by case law of the Court of Justice of the European Union. In one of its judgement, reminded that a rule now contained in article 205 of the VAT Directive grants member states right to make a person jointly and severally liable for the payment of VAT if, at the time of the supply, that person knew or had reasonable grounds to suspect that the VAT payable in respect of that supply, or of any previous or subsequent supply, would go unpaid, and to rely on presumptions in that regard. However, 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. Those presumptions would bring about a system of strict liability, which would go beyond what is necessary to preserve the public budget's rights. The Court of Justice of the European Union also reminded that traders who take every precaution which could reasonably be required of them to ensure that their transactions do not form part of a chain which includes a transaction affected by VAT fraud must be able to rely on the legality of those transactions without the risk of being made jointly and severally liable to pay the VAT due from another taxable person [Court of Justice of the European Union, Case C-384/04 (Federation of Technological Industries), par. 32-34]. It is also important to note that the Court of Justice of the European Union refused the notion of strict liability in situations like these repeatedly [e.g. Court of Justice of the European Union, Case C-499/10 (Vlaamse Oliemaatschappij NV)].

The issue with the provision of section 109 subsection 2 of the VAT Act is that many authors believe it brings about the strict liability for unpaid VAT to the situations it

regulates. [Děrgel 2019: 15-18; Sejkora 2017: 140-149]. For example, under section 109 subsection 2 (c) of the VAT Act, the guarantee for unpaid VAT originates if the payment for taxable supply is provided in whole or in part by a non-cash transfer to an account other than the account of the provider of the taxable supply published by the tax administrator. However, taxable persons may choose which of their accounts (if any) shall be published in this manner [Děrgel 2019: 17]. Does the mere fact that the account was not published by tax administration form basis for a reasonable suspicion that the VAT on this supply will not be paid? The Financial Administration of the Czech republic does not conceal the fact that it does think so, as it views the situations regulated by section 109 subsection 2 of the VAT Act as not standard and potentially suspicious [General Financial Directorate: Information on the institute of Guarantee pursuant to Act no. 235/2004 Coll., on Value Added Tax, as amended by the Act from 1 July 2017: 4-7]. If only things were that simple.

Naturally, application of section 109 subsection 2 of the VAT Act gave way to some legal disputes, one of which was brought before the Supreme Administrative Court. The dispute concerned application of guarantee in a case where the supposed guarantor made payment for a taxable supply received from another Czech taxable person on his bank account held in Slovakia. As the taxable supply provider evaded VAT on that supply, the recipient was called upon by the tax administrator to pay the VAT as a guarantor under section 109 subsection 2 (b) of the VAT Code. The decision of the tax administrator did not hold up under judicial review. According to the Supreme Administrative Court, the provision of payment by the recipient of a taxable supply in whole or in part by non-cash transfer to an account held by a payment service provider outside the country cannot automatically establish a guarantee relationship, although the literal wording of the law could indicate this. In order for the guarantee to take effect, the payment itself must be accompanied by other circumstances which make it clear that the taxable person who made the payment on account outside the country knew or could have known that the intention of such a payment is tax evasion [Supreme Administrative Court, 5 Afs 78/2017 - 33].

The Supreme Administrative Court further argued that a payment to an account outside the country is not exceptional. Even among entities carrying out taxable transactions in the country, it does not have to signal an economically unjustified, suspicious or fraudulent conduct. Therefore, the consequences in the form of guarantee for the conduct of another entity that has not paid the VAT and exhibits tax arrears cannot be directly associated with it. The Supreme Administrative Court therefore held that application of section 109

subsection 2 (b) of the VAT Act on its own would breach the principle of proportionality established by the Court of Justice of the European Union in the case of Federation of Technological Industries. Establishment of guarantee must therefore be based upon a knowledge test regulated by section 109 subsection 1 of the VAT Code as to not bring about a system of strict liability [Ibidem].

The Supreme Administrative Court also rejected the notion that special means of security provided by section 109a of the VAT Code constitutes a sufficient possibility of liberation from guarantee. It stated that referring to the possible elimination of the effects on the guarantor by the recommended procedure pursuant to the said provision (which de facto imposes an obligation on the guarantor to pay the VAT), it does not release the burden of proof imposed on tax administrators by section 109 of the VAT Act [Ibidem].

The case law examined above allows to draw a conclusion that section 109 subsection 2 of the VAT Act is applicable, but for the most part only in conjunction with section 109 subsection 1 of the VAT Act. The author believes that such a limit to its applicability de facto means that it is not applicable at all. The general rule provided by section 109 subsection 1 of the VAT Act potentially covers all situations regulated by subsection 2 (i.e. taxable person knew or ought to have known that VAT from a transaction will not be paid). Therefore, if the provision of section 109 subsection 2 of the VAT Act cannot be applied on its own as a basis for the guarantee in situations regulated by it, it has virtually no purpose.

It is, however, important to note that the Supreme Administrative Court also obiter dictum stated conditions for application of section 109 subsection 2 (a) of the VAT Code. According to the Supreme Administrative Court, the tax administrator must in such a case prove that the price of the supply in question is clearly deviating from the usual price; it is then up to the potential guarantor to explain the possible economic reasons for the resulting deviation of the price (in other words, to liberate from the suspicion of knowingly acting with the intention of not paying VAT). The taxable person is presumed to have reason to believe that this is the case where VAT or part of it due on that supply (or on any previous or subsequent supply of the goods or services in question) would remain unpaid if the price charged to him was either lower than the lowest price which it could reasonably be expected to pay for those goods on the market, or lower than the price charged for any previous supply of the same goods. This presumption can be rebutted by proving that the lower price paid for the goods can be attributed to circumstances independent of non-payment of VAT [Ibidem]. The clear distinction therefore is the possibility to liberate oneself from the guarantee based on the conditions expressly stated by the provision.

4. **Does the existence of provisions of the national law regulating guarantee for unpaid VAT mean that the recipient of a taxable supply cannot be refused the right to deduct VAT?**

As was more than once stated above, the fight against tax frauds, tax evasion and tax abuse is an objective that is recognised and encouraged by the European Union law. What does it mean for the right to deduct VAT? As the Court of Justice of the European Union puts it, provisions of VAT directives must be interpreted as meaning that it is for the national authorities and courts to refuse a taxable person, in the context of an intra-Community supply, the benefit of the rights to deduction of, exemption from or refund of value added tax, even in the absence of provisions of national law providing for such refusal, if it is established, in the light of objective factors, that that taxable person knew, or should have known, that, by the transaction relied on as a basis for the right concerned, it was participating in evasion of value added tax committed in the context of a chain of supplies [Court of Justice of the European Union, Joined Cases C-131/13, C-163/13 and C-164/13 (Italmoda)]. It is therefore an obligation of the tax authorities and national courts to refuse such a right if it was applied for fraudulently. Moreover, tax authorities and national courts are obliged to do so even if there is not a provision of national law as a basis for such refusal.

The issue in this matter is an argument that there is such a provision in the Czech law and that it must take precedence over principles formulated by case law. The attentive reader must have already guessed that the provision according to the argument is meant to be section 109 of the VAT Act. As wording of this provision is dangerously similar to the conditions set for refusal of the right to deduct VAT (he knew or ought to have known about VAT evasion), proponents of this argument claim that both rules apply for the same situation. They therefore believe that guarantee should take precedence over refusal of the right to deduct VAT. Proponents of such an approach emphasize its benefits for taxable persons: as opposed to a taxable person whose right to deduct VAT was refused, guarantor is not required to pay a fine and interest arising from default on VAT payment he guarantees [Lichnovský 2017].

The problem is that tax procedure in the Czech Republic falls into two categories of relatively independent proceedings. The first category consists of tax assessment proceedings. Their purpose is to either assess tax due and its maturity, or reassess the tax in cases where it was assessed incorrectly in previous proceedings. The second category

consists of proceedings related to payment of taxes. Initiation of those proceedings either presupposes that the tax was already assessed in the relevant assessment proceedings, or that the law specifically allows them to be initiated in other cases, mainly in relation to other proceedings. These proceedings include deferral of the tax and the distribution of its payment in installments, security of tax payment and enforcement of tax payment [see Section 134 of the Tax Procedure Code]. As guarantee is considered a mean of security of tax payment, proceedings concerning guarantee of tax payment fall exclusively into the second category. It is therefore important to note that guarantee may come into play only if the tax was already assessed and the proceeding leading to payment of tax by guarantor cannot be considered to be a tax assessment proceeding.

Moreover, as was already established above, guarantee under Czech law is by definition secondary and collateral to the principal debt, meaning that the guarantor is required to pay the debt he guarantees for only if the principal debtor defaults on it. General provisions regulating guarantee for tax arrears go even further. Under section 171 subsection 3 of the Code of Tax Procedure, tax administrators may call on the guarantee to pay the tax arrears only if the arrears have not been paid by the taxable person, even though the taxable person has been unsuccessfully reminded of their payment, and the arrears have not been paid even in the enforcement procedure (execution) of the taxable person, unless it is clear that enforcement would be demonstrably unsuccessful. Those are facts that must be proven by tax administrator before they initiate proceedings against guarantor. And this is still not a definitive list of obstacles that the tax administrator must overcome in order to secure payment of tax by the means of guarantee. As was stated above, tax authorities must also prove that the requirements of for establishing guarantee were met. And even if the tax authority manages to do all of that, its call on guarantor may be appealed. During appellate procedure, the guarantor may challenge even the administrative decision of tax assessment of the principal debtor. And that is still not all. Both procedures (tax assessment procedure in case of principal debtor and proceeding leading to payment of tax by guarantor) must be concluded within a time limit derived from the origin of the principal debt. As both time limits are somewhat independent on each other, it is even possible that by the time the tax assessment is finished, the time limit for application of guarantee has long passed [Rozehnal 2019: 316].

The author therefore sees the application of guarantee for VAT as too convoluted and risky to be applied on a larger scale. And he is certainly not alone. According to the audit conducted by the Supreme Audit Office, the expected impact of the introduction of the institute of guarantee of the recipient of taxable performance in the period of years 2011–

2013 in the amount of CZK 1.5 billion was not fulfilled, mainly due to the difficulty of proving the knowledge test regulated by the section 109 subsection 1 of the VAT Act. According to the General Financial Directorate, the Financial Administration used this institute only in sixteen cases in which a tax of CZK 15.3 million was paid [Supreme Audit Office, 14/17, Value added tax administration and the effects of legislative changes on state budget revenues: 263-264]. And its application to date is still rare[2].

However, it was only was just a matter of time before the issue in question underwent judicial review. And the Regional Court in Ostrava took the argument of precedence of guarantee over refusal of the right to deduct VAT as its own and ran with it. According to the Regional Court, provisions of section 109 of the VAT Act represents a transposition of Article 205 of the VAT Directive, while case law of the Court of Justice of the European Union and the Supreme Administrative Court on the mutual relationship between refusal of the right to deduct VAT and liability (or in this case guarantee) within the meaning of Article 205 of the VAT Directive does not exist. The Regional Court stated that the principle that special provisions of the legislation preclude the application of general provisions (lex specialis derogat legi generali) should be respected while the possibility of refusal of the right to deduct VAT is based primarily on the general principle of prohibition of abuse of rights in tax law. The Regional Court therefore came to the conclusion that it is primarily necessary to use specific provisions of the legal order regulating the situation in question, while the general principle of refusal to protect the abuse of rights can be applied only when there are no such provisions. The Regional Court concluded that in situations where, according to the tax authorities, the direct suppliers of the plaintiff did not pay VAT as a result of fraudulent conduct, the hypothesis of section 109 subsection 1 of the VAT Act is fulfilled an its application takes precedence over the application of the general principle of prohibition of abuse of rights. Therefore, according to the Regional Court, the tax authorities erred in proceeding in this situation towards the plaintiff by refusing him the right to deduct VAT, even though the regulation contained in section 109 subsection 1 of the VAT Act identified him as VAT guarantor for the taxable person who did not pay the VAT in question [Regional Court in Ostrava, 22 Af 33/2016 - 60].

Fortunately, the judgment of the Regional Court in Ostrava was reversed by the Supreme Administrative Court. According to the Supreme Administrative Court, it is clear that the institute of guarantee systematically falls into the phase of paying taxes. Within this phase

[2] The author is aware of only one pending court dispute pertaining to this issue. The court proceeding in question originated from administrative decisions issued in 2015. There may be more, but certainly not hundreds more and probably not tens more.

of tax administration, it functions as a secondary and collateral means of securing the payment of tax already assessed to another tax entity. The condition that the taxable person knew or ought to have known does not establish the comparability of guarantee with the doctrine of refusal of the right to deduct VAT, but is "just" another precondition for the application of guarantee, an assumption based mainly on the principle of legal certainty and proportionality. In other words, the current form of rule contained in section 109 subsection 1 of the VAT Act represents a “mere” special case of guarantee as a security institute, which has its place in the partial tax proceedings in the payment of taxes. It is therefore not a general regulation of the response to all conceivable tax frauds and application of the rule lex superior derogat legi priori does not have any place in such cases [Supreme Administrative Court, 7 Afs 8/2018 - 56].

In order to reverse the decision of the Supreme Administrative Court cited above, the Regional Court in Ostrava tried to refer following preliminary question to the Court of Justice of the European Union: *“Does the existence of an express national rule on guarantee for missing VAT in a fraudulent chain prevent financial authorities from refusing the guarantor the right to deduct value added tax, in accordance with the case-law of the Court of Justice of the EU on VAT fraud? Do Article 17 (1), Article 20, Article 52 (1), Article 52 (6) and Article 54 of the EU Charter of Fundamental Rights preclude such a procedure in that situation?”* However, as the Regional Court in Ostrava failed to meet basic form and content requirements of a request for a preliminary ruling, it was rejected for its manifest inadmissibility[3] [Court of Justice of the European Union, Case C-520/2019 (Armostav Místek)].

As it stands out, the existence of provisions of the national law regulating guarantee for unpaid VAT does not mean that the recipient of a taxable supply cannot be refused the right to deduct VAT. The author views this conclusion of the dispute described above as a victory of reason. As the application of the guarantee is actually very difficult, it is definitely not a standard tool for effectively fighting most forms of tax evasion.

5. May the right to deduct VAT be refused to a guarantor for unpaid VAT?

[3] Court of Justice of the European Union reminded that in order to be able to give an effectively useful answer to a preliminary question, the referring court must provide (1) a summary of the subject-matter of the dispute and the relevant findings of fact as determined by the referring court or tribunal, or, at least, an account of the facts on which the questions referred are based; (2) the tenor of any national provisions applicable in the case and, where appropriate, the relevant national case-law; and (3) a statement of the reasons which prompted it to inquire about the interpretation or validity of certain provisions of European Union law, and the relationship between those provisions and the national legislation applicable to the main proceedings. The Regional Court in Ostrava failed to meet every single one of these requirements.

As was stated above, it is an obligation of the tax authorities and national courts to refuse a right to deduct VAT if it was applied for fraudulently. As it was concluded above, mere existence of the provisions regulating guarantee for VAT in the form discussed above does not preclude the tax authorities to fulfill that obligation. But what are the options in cases where the right to deduct VAT was already refused in tax assessment proceeding, or where the guarantor was already called upon to pay the VAT instead of the principal debtor? Are tax authorities in such cases allowed to demand the other option? In other words, can they have both? The author believes that to answer those questions, it is important to determine whether the right to deduct VAT and the obligation to pay VAT are the same thing.

First of all, it is important to note that the principles of fiscal neutrality or legal certainty, or the principle of the protection of legitimate expectations may not legitimately be invoked by a taxable person who has intentionally participated in tax evasion and who has jeopardized the common system of VAT [Court of Justice of the European Union, Case C-285/09 (criminal proceedings against R.), par. 54; for similar conclusions see also Court of Justice of the European Union, Case C-24/15 (Josef Plöckl), par. 44]. Furthermore, as abusive or fraudulent acts cannot form the basis of a right under EU law, the refusal of a benefit under the VAT directives does not amount to imposing an obligation on the individual concerned under that directive, but is merely the consequence of the finding that the objective conditions required for obtaining the advantage sought in fact have not been satisfied [Court of Justice of the European Union, Joined Cases C-131/13, C-163/13 and C-164/13 (Italmoda), par. 57].

Similarly, the Supreme Administrative Court views the right to deduct VAT within the meaning of Section 72 of the VAT Act as recognizable by tax administration neither ex officio nor after simply fulfilling the obligatory requirements. According to the Supreme Administrative Court, tax administrator will recognize the right to deduct VAT only after the fulfillment of specific conditions, which must be proven by the taxable person. Refusal of the right to deduct VAT due to non-fulfillment of the conditions for its recognition cannot therefore be considered as taxation of a certain performance. The reasoning that refusal of the right to deduct VAT under such circumstances constitutes double taxation of the same transaction has the effect of negation of the meaning and purpose of the right to deduct VAT [Supreme Administrative Court, 7 Afs 82/2013 – 34].

The refusal of the right to deduct VAT on the ground of participation on a VAT fraud is therefore a result of a failure to satisfy the conditions for its recognition, even though

these conditions are formulated by the case law of the Court of Justice of the European Union and not explicitly by provisions of national law. The author is therefore convinced that such refusal of the right to deduct VAT does not compensate the collection of the VAT unpaid by another taxable person. Right to deduct VAT is therefore a specific right arising from the European system of VAT governed by the law of the European Union. If the conditions to exercise the right are not met due to conscious participation of taxable person on a fraudulent conduct, refusal of the right to deduct VAT merely protects the purpose of the VAT Directive, because the right to deduct VAT cannot be granted to a person who exercised it fraudulently. To put it simply, if the conditions for the exercise of the right to deduct VAT are not satisfied, the right in question does not exist. The author is convinced that the non-existence of the right to deduct VAT in such cases does not mean that the obligation to pay VAT also ceases to exist, nor that more taxable persons could not be jointly and severally liable for the payment of VAT.

Right to deduct VAT and obligation to pay VAT are therefore two separate legal phenomena. The Supreme Administrative Court seems to hold a similar view as it declares that the refusal of the right to deduct VAT must be strictly distinguished from guarantee for the VAT unpaid by another person. Both the right to deduct VAT and the guarantee are subject to different conditions and provisions of the VAT Directive [Supreme Administrative Court, 5 Afs 60/2017 - 60].

From the case law examined above one may draw a conclusion that it should generally be possible to both refuse the right to deduct VAT of and apply guarantee towards the same taxable person. However, the case law pertaining to this issue became a little blurry, as the Supreme Administrative Court decided at least one case on the base of opposite reasoning. The dispute in question related to the security of tax payment via securing order issued on the grounds of participation of the taxable person on a VAT fraud [for the mechanism of securing orders see Balcar 2019: 21-24]. The problem was that the taxable person in question was called upon as a guarantor to pay the VAT on the transactions under section 109 subsection 2 of the VAT Act. According to the Supreme Administrative Court, if the administrative authorities required the plaintiff to pay the VAT arrears by means of guarantee, it was clear that they could no longer claim the same tax on the same transactions via securing orders. Securing order is a security instrument in relation to a tax not yet assessed, and therefore it can only be used to secure a tax which cannot yet be recovered on the basis of an enforceable decision. Therefore, the use of the institute of guarantee and securing orders for the same tax against the same tax entity meant that the

plaintiff was obliged to pay VAT on the same transactions twice (once in a position guaranteed by guarantors, once as a result of non-recognition of the right to deduct under precautionary orders), which violates the basic principles of the tax burden [Supreme Administrative Court, 4 Afs 140/2017-54].

It is important to note that the Supreme Administrative Court dealt with a specific case of concurrence of two distinct legal instruments pertaining to security of tax payment, as opposed to tax assessment. It is therefore not given that application of guarantee must always constitute a barrier for refusing a tax input (deduction) to a tax fraud participant. It is, however, a signal that such a practice may be frowned upon as a prohibited double taxation. Even though the aforementioned ruling does not expressly deal with the problem of such "double dipping" from the perspective of tax assessment, it may be considered a taste of things to come.

6. Conclusion

This paper examined legal disputes arising from implementation of article 205 of the VAT Directive into the Czech legal orders. It was concluded that the transposition of said provision into the VAT Act was far from ideal. The reason probably lies in the incorrect translation of the term "liability" into Czech language, as the provisions of the VAT Code resulting from said transposition regulate guarantee in situations where the VAT Directive presumed imposition of joint and several liability. This phenomenon also formed basis for the legal disputes that were the main focus of this paper. Therefore, aim of this paper was to find out if current case law provides plausible resolution of these disputes. The author is convinced that the results of the research are mixed.

The first issue this paper aimed to resolve was whether implementation of article 205 of the VAT Directive imposed on taxable persons obligations that go beyond the limits allowed by European Union law. It was found out that the European Union law prohibits imposition of strict liability in the situations regulated by said provision, meaning it should not be impossible or excessively difficult for the taxable person to liberate himself from such liability. However, the wording of some parts of the section 109 subsection 2 of the VAT Code seemed to violate the rule. The matter was resolved by the Supreme Administrative Court in favour of the extension of the reasons for liberation. In the cases where law does not provide specific opportunity for liberation, such as proving that deviation from usual price is economically justified in the cases of guarantee under section 109 subsection 2 (a) of the VAT Code, the tax authorities must conduct a knowledge test

under section 109 subsection 1 of the VAT Code. This solution made in opinion of the author parts of the section 109 subsection 2 of the VAT Code effectively obsolete.

The second issue the paper aimed to resolve was whether the existence of provisions regulating guarantee for VAT in national law does prevent the refusal of the right to deduct VAT of a taxable person due to his participation on a tax fraud. Even though there were some tendencies to resolve this matter in favour of the precedence of guarantee over the refusal of the right to deduct VAT during tax assessment procedure in such cases, the latter eventually prevailed. The resolution of this matter was based on the fact that the institute of guarantee systematically falls into the phase of paying taxes and therefore cannot be viewed as a substitute for the assessment of tax. The condition that the taxable person knew or ought to have known of the tax evasion, shared by the provisions of guarantee and the principle on which is based the refusal of the right to deduct VAT, does not establish the comparability of the two. Application of section 109 subsection 1 of the VAT Act therefore cannot be viewed as a special rule in relation to the principle. As the conditions for application of guarantee under said provision are very strict and somewhat convoluted, it would be virtually impossible to effectively use it as only tool for combating VAT frauds.

The third issue this paper aimed to resolve was whether the application of a guarantee for unpaid VAT subsequently allows the tax authorities to refuse the participant on a fraudulent conduct the right to deduct VAT. This is also the most problematic one. Its resolution depends on whether the right to deduct VAT and the obligation to pay VAT in relation to the same transaction could be viewed as two separate legal phenomena. The author is convinced that if the conditions for its origin are not satisfied, the right to deduct VAT does not exist. Refusal of such a right therefore does not necessarily mean that the obligation to pay VAT on the same transactions also does not exist. And if it does, there is probably no reason why it could not be paid by guarantor. The case law seems to concur with the opinion that both guarantee and refusal of right to deduct are separate things regulated by different provision of the law. However, the only case pertaining specifically to this issue was decided by the Supreme Administrative court on the basis that refusal of the right to deduct of the guarantor called upon to pay VAT violates the principle of tax burden, i.e. constitutes prohibited double taxation.

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