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Allocation of the burden of proof and status of domestic
administrative procedural law norms in the EU VAT sphere

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ABBREVIATIONS

EU	European Union
Member States	Member States of the European Union
VAT	Value added tax
CoJ	The Court of Justice of the European Union
CFREU	Charter of Fundamental Rights of the European Union
ECMR	European Convention for the Protection of Human Rights and Fundamental Freedoms
VAT Directive	Council Directive 2006/112/EC of November 2006 on the common system of value added tax
Sixth Directive	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes
Implementing Regulation	Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax
Commission	The European Commission
Council	Council of the European Union
TEU	The Treaty on European Union
TFEU	The Treaty on the Functioning of the European Union

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1. INTRODUCTION

1.1. Background

In its '*Green Paper on the future of VAT*' The Commission has recognized that weaknesses in current provisions in the existing EU VAT system renders it vulnerable to VAT fraud.¹ Statistics serve as evidence for the existence of a substantial VAT GAP. In 2006, the VAT GAP in the EU-25 was estimated at about 106.7 billion euros². The VAT GAP calculation includes VAT not paid as a result of legitimate tax avoidance measures, and VAT not paid because of fraud and insolvencies.³ Consequently, much possible VAT revenue is not collected. So naturally Member States are interested in effective safeguard procedures of their VAT revenues. Administrative procedural rules that govern the procedure for collection of VAT do not exist at the level of EU legislation. Article 273 of the VAT Directive refers to the Member States the competence to impose obligations which they deem necessary to ensure correct collection of VAT. Consequently, for the purposes of collecting VAT, the Member States are free to design their own administrative procedural rules. Because Member States are empowered with national procedural autonomy, the domestic procedural law through which EU law is exercised differs from one Member state to another.⁴

Due to the differences in domestic administrative procedural rules, EU VAT rules across the EU are enforced differently. This situation creates an additional administrative burden for businesses and causes additional risks for unexpected VAT liability, these can, consequently, be seen as obstacles for businesses in trying to benefit from the single market.⁵ Additionally, there is no unified (EU wide) understanding of what sort of evidence the taxable person must provide to safeguard its right to deduct VAT.⁶ Therefore, different approaches are exercised across the EU when questions in the VAT sphere arise regarding which information can be considered as evidence and how the allocation of the burden of proof is to be done.

Pursuant to Article 267 of the TFEU, the CoJ has jurisdiction to give preliminary rulings concerning the interpretation of EU law with the goal to provide Member State national courts with criteria necessary for the interpretation of domestic law in the light of EU law. Therefore interpretation of domestic procedural law and the assessment of whether domestic procedural law conforms to EU law falls within the competence of national courts.⁷ Despite the separation of the competence between CoJ and national courts and the procedural autonomy of each Member State the CoJ, in its preliminary rulings, aiming to ensure proper collection of VAT, has dealt with the question - when do national procedural laws of Member States have to be set aside in the light of EU law and how the burden of proof in VAT disputes is allocated between taxable persons and tax authorities. Consequently, the necessity for domestic administrative practise and administrative procedural rules to conform to EU law by ensuring proper collection of VAT has overall significant importance in the EU.

¹ The Commissions Green Paper on the future of VAT Towards a simpler, more robust and efficient VAT system. SEC(2010) 1455 final. p.5.

² Estimated VAT gap as of share of theoretical VAT liability varies in the EU-25 between 1% in Luxemburg and 30% in Greece. See Reckon LLP, (2009). "Study to quantify and analyse the VAT gap in the EU-25 Member States", p. 9. [Electronic] Available: http://ec.europa.eu/taxation_customs/resources/documents/taxation/. Download date 07.05.2013.

³ Reckon LLP, 2009, p. 8, 61-62.

⁴ B.Terra and P.Wattel, 2012, "*European Tax Law*". (Abridged student edition Sixth edition). Kluwer Law International, p 84

⁵ VAT Expert Group 1st meeting (2012). VEG NO 003. B2B supplies of goods – Taxation at destination Shortcomings of the current VAT system identified by stakeholders. p 3.

⁶ Article 168 of the VAT Directive sets a general rule that a taxable person who uses acquired goods and services for the purposes to carry out taxable transactions is entitled to deduct the VAT paid from the VAT due. Additionally to Article 168 Articles 168 a, 169, 170, 171, 172 of the VAT Directive refer to special circumstances where the right of deduction can be exercised or refund of VAT paid could be obtained.

⁷ Case C 527/11, *Ablissio*, para 35.

1.2. Purpose

Since Member States have procedural autonomy to lay down administrative procedural rules with the goal to ensure proper collection of VAT, the overall purpose of this thesis is to identify the grounds on which domestic administrative practice and domestic administrative rules have to be regarded as incompatible with rules and principles common to EU law. Specifically, this thesis aims to analyse EU VAT rules and CoJ case law by establishing how the burden of proof in VAT disputes is divided. Additionally this thesis intends to define the scope of the procedural autonomy of Member States to lay down rules of evidence and rules that allocate the burden of proof in the EU VAT system.

1.3. Research question

The questions to be answered are:

1. When do domestic procedural laws of Member States have to be set aside in order to ensure proper functioning of the EU VAT system?
2. To what extent can Member States exercise their procedural autonomy to lay down rules of evidence in the EU VAT system?
3. What is the limitation of the procedural autonomy of Member States allocating the burden of proof in the EU VAT system?

1.4. Method and material

In general this thesis is based on legal study and applies traditional legal dogmatic method in compliance with descriptive and analytical research technique. Materials used are EU legislation, CoJ case law, Commission proposals, communications and other material as well as scholarly literature. Additionally the comparative legal research method is applied, for example, by comparing the different methods exercised across EU Member States when allocating the burden of proof. The analysis of the different methods of the allocation of the burden of proof is based on secondary sources of law. The analysis of Latvia's approach in this matter is based on primary sources of law.

1.5. Disposition

This thesis is divided into five chapters. The first chapter introduces the issues discussed in this thesis. The second part is devoted to the analysis of the principles of proportionality, fiscal neutrality, effectiveness and equivalence, legal certainty and protection of legitimate expectations. These principles common to EU law are examined from the perspective of the EU VAT system. The third part of this thesis is devoted to ascertain the status of domestic administrative procedural laws in the EU VAT system. In this section the thesis suggests the answer to the question - when do domestic procedural laws of Member States have to be set aside in order to ensure proper functioning of the EU VAT system. The fourth part of this thesis analyses EU VAT rules and CoJ case law regarding evidence and allocation of the burden of proof. Additionally, an answer is suggested to the questions - to what extent can Member States exercise their procedural autonomy to lay down rules of evidence in the EU VAT system and what is the limitation of the procedural autonomy of Member States allocating the burden of proof in the EU VAT system. The thesis concludes in the fifth chapter.

1.6. Limitation

In this thesis the CoJ case law and the principles of EU law are analysed through the perspective of the EU VAT system. The CoJ conclusions in VAT related cases are not

sufficient enough to define the weight of the scope of the principles of proportionality, effectiveness and equivalence, therefore, CoJ case law from other fields of EU law is applied. This thesis does not examine whether unified administrative procedural rules are necessary to ensure proper collection of VAT. Neither does this thesis examine methods for preventing VAT avoidance and evasion. Moreover, does this thesis not discuss how the burden of proof is allocated in infringement procedures brought against EU Member States in accordance to Articles 258 and 259 of the TFEU and neither does it cover the allocation of the burden of proof in criminal proceedings.

2. PRINCIPLES OF THE EU VAT SYSTEM

2.1. Background

EU law sets obligations with which domestic administrative procedural rules in the VAT sphere must comply. Article 325 of the TFEU sets a general obligation for the EU and its Member States to counter fraud and any other illegal activities affecting the financial interests of the EU. The Member States must take the same measures to counter fraud affecting the financial interests of the EU as they take to counter fraud affecting their own financial interests. Article 4 (3) of the TEU stipulates that Member States are obliged, for the purpose of preventing evasion and proper collection of VAT, to ensure that all legislative and administrative measures are effective within its territory. Article 2 of the VAT Directive stipulates which transactions across the EU shall be subjected to VAT, and Article 273 of the VAT Directive empowers the Member States through the national procedural law to impose obligations on a taxable person which they deem to be necessary to ensure the correct collection of the VAT and prevent evasion. Moreover, the Member States are obligated to ensure that such obligations do not give rise to formalities related to crossing of frontiers and that they do not impose additional invoicing obligations above those which are set out in Chapter 3 of the VAT Directive.

Therefore, it is clear that EU law gives broad powers to the Member States to design their national law with an aim to ensure that the obligation set out in Article 325 of the TFEU and in Article 273 of the VAT Directive is executed efficiently. Due to these wide powers and lack of scrutiny in EU law, the principles common to the EU play a pivotal role when the interpretation of the conformity of domestic procedural laws with EU law is involved. Some of the principles derive from written EU rules, but some of them are introduced and developed by CoJ case law. In the literature, the following principles of the EU VAT system have been listed: the principle of the common system of VAT, of cooperation, the destination principle, the principle of direct applicability/direct effect, of effectiveness, of elimination of distortion in competition, of equality, of equal treatment, of equivalence, of fiscal neutrality, of free movement of goods, of freedom of competition, of immediate deduction, of legal certainty, of liability, of non-discrimination, of people's participation in the exercise of power, of primacy of Community Law, of prohibiting double taxation/tax cumulation, of proportionality, of protection of individuals, of protection of legitimate expectations, of reciprocity, of respect for the right of the defense, of unequivocal legislation and of VAT uniformity.⁸

For the purpose of the research in this thesis, it is proper to examine the relevant principles of EU law which ensure the proper functioning of the VAT system from the perspective of domestic administrative practice and its compliance with EU law. In situations when domestic administrative procedural law or administrative practice clashes with the principles, the relative weight and importance of the principles must be taken in to account,⁹ since they supersede the domestic administrative law. The principles of EU law follow in the tier of the hierarchy of EU law after the rules stipulated in the TFEU and TEU. The principles can be used when the application of the particular articles of the constituent Treaties is involved.¹⁰

⁸ B. Terra and J. Kajus, 2011. *"A Guide to the European VAT Directive: Introduction to European VAT 2011"*, volume 1, IBFD, p.42.

⁹ A.Zalasinski, 2007., *"Proportionality of Anti-Avoidance and Anti-Abuse Measures in the ECJ's Direct Tax Case Law"*, Intertax, volume 35, issue 5, Kluwer Law International, p 311.

¹⁰ P.Craig and G. Burca.2011. *"EU Law, Text, Cases and Material"*.Fifth edition, Oxford University Press, p.109.

Therefore, this thesis will examine the principles of the EU VAT system which are more frequently used by the CoJ as a basis to render domestic administrative proceedings incompatible with EU law. Hence, the following principles of EU law are dealt with specifically: the principle of proportionality, the principles of effectiveness and equivalence, the principles of legal certainty and the protection of the legitimate expectations and the principle common to VAT system—the principle of fiscal neutrality.

2.2. The principle of proportionality in EU law

The principle of proportionality is recognized as a general principle of EU law. The principle of proportionality, along with the principles of conferral and subsidiarity, is incorporated in the TEU. Article 5 (4) of the TEU states that:

“Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality.”

Owing to inclusion of the principle of proportionality in the TEU, it can be concluded that this principle has a constitutional status. The principle of proportionality plays a vital role in balancing public and private sector interests when the application of the EU is involved.¹¹

In the Oxford dictionary of Law the principle of the proportionality in EU law is defined as follows:

“A principle of European Union law requiring that action taken by the EU does not go beyond what is necessary to achieve the objectives EC Treaty [.....] In order to be proportionate action, must be appropriate, necessary, and not impose an excessive burden on those affected by it [...]”¹²

The principle of proportionality requires that the action undertaken must be proportionate to its objectives. Before the principle of proportionality was included in the TEU it was developed by the CoJ with inspiration from the legal systems of Germany and France.¹³ The CoJ extensively dealt with the principle of proportionality in the case *Internationale Handelsgesellschaft*, where the CoJ refused to apply German Constitutional law principles, but, nevertheless, concluded that the plaintiff could rely on general principles of law if they are common to EU law. The CoJ determined that protection of the rights of individuals inspired by the Constitutions of the Member States must be ensured by the objectives and structure of the EU.¹⁴

According to T.Tridimas, the principle of proportionality contains two tests;

- A test of suitability – the means allowed by the measures must be suitable and reasonable to achieve its objectives;
- A test of necessity – entails the weighting of the competing interests.

¹¹ A. Zalasinski, p 311.

¹² N.Acomb and others, 2009. „*Oxford Dictionary of Law*”, Seventh edition, Oxford University Press, p.432.

¹³ T. Tridimas, 2006. “*The General Principles of EU Law*”. Second edition, Oxford University Press, p.136.

¹⁴ Case 11/70, *Internationale Handelsgesellschaft mbH*, paras 2- 4.

Consequently when the principle of proportionality is applied the balancing exercise between the objectives pursued by the measure and its adverse effects on individual freedom must be taken into account.¹⁵

In the domestic legislation of Member States the principle of proportionality is not widely acknowledged as a constitutional principle. Regardless of that, the principle of proportionality is broadly accepted in domestic case law, and frequently it is incorporated in the domestic administrative procedure acts of the Member States.¹⁶

The above mentioned allows the conclusion that the principal of proportionality ensures that an individual should not have his freedom of action limited more than necessary for public interests. The inclusion of the principle of proportionality in the TEU indicates its importance in the hierarchy of EU law.

In its VAT related case law, the CoJ often refers to the principle of proportionality. The principle of proportionality can be found in VAT related CoJ case law as early as in the *Direct Cosmetics* case judgment delivered in the January 27, 1988.¹⁷ In the recent judgment in *Ablissio* the CoJ referred to the principle of proportionality and reasoned that the actions taken by the Member States should be proportionate to the objective of preventing VAT evasion.¹⁸ The CoJ has recognized that prevention of tax evasion, avoidance and abuse is an objective recognized and encouraged by the VAT Directive.¹⁹ The legitimate interest of the Member States can be regarded as appropriate if the actions taken aim to protect their financial interests. Nevertheless, the Member States must act in accordance with the principle of proportionality, and the action taken should be the least detrimental to the objectives and principles of the EU.²⁰

In VAT disputes the proportionality test is often applied in cases which involve VAT fraud. The actions taken by the tax authorities when it denies the right to deduct input tax should be regarded proportionally before the principle of fiscal neutrality and principle of immediate right of deduction can be set aside. The denial of the right of deduction is regarded as proportional if,

- On the basis of objective evidence, it is established that a taxable person is using the right to deduct input tax on the abusive or fraudulent ends;
- The tax administration can prove that a taxable person knew or he had to know that another transaction forming part of the chain of supply prior or subsequent to the transaction carried out by the taxable person was involved in VAT fraud,²¹

This procedure is commonly known as the “*knowledge test*”.²²

The *knowledge test* cannot be applied in such a manner that the taxable person is forced to carry out checks of its business partner to ensure that the issuer of the invoice has the capacity

¹⁵ T. Tridimas, p.139.

¹⁶ Statskontoret, 2006. “Principles of Good Administration In the Member States of the European Union”. p.24, [Electronic] Available: <http://www.statskontoret.se/upload/Publikationer/2005/200504.pdf>/ Download date 26.05.2013.

¹⁷ Case C-138/86, *Direct Cosmetics*, para 48.

¹⁸ Case C-527/11, *Ablissio*, para 34.

¹⁹ Case C-643/11, *LVK – 56*, paras 61-62; Joined Cases C-80/11 and C-142/11, *MahagébenandPéterDávid*, para 41.

²⁰ Case C-525/11, *Mednis*, paras 31,32.

²¹ Case C-642/11, *Stroy trans*, paras 47,48; Case C-643/11, *LVK – 56*, paras 59-60; Case C-324/11, *GáborTóth*, para 38; Case C-285/11, *Bonik*, para 41; Joined cases C-439/04 and C-440/04, *Kittel and Recolta Recycling*, para 52.

²² B. Terra and J. Kajus, p.339

of a taxable person, also that he was in possession of the traded goods and was capable to supply them and last but not least, that his business partner has fulfilled his obligation to declare the transaction and pay VAT. (See section 4.3.3.3.)

Interim conclusions

It is clear that the principle of proportionality has major significance in EU law, and is regularly applied in VAT disputes. On the basis of the principle of proportionality it is possible to render national laws and practices incompatible with EU law. Consequently, national domestic law must be consistent with this principle.

In VAT related disputes the tax authority of the Member States tend to infringe the principle of fiscal neutrality and the principle of immediate right of deduction (see section 2.3.) by applying the *knowledge test*, such actions can be regarded as proportional to EU law because the general objective set by the EU is to counter VAT evasion and due to the constitutional status of the principle of proportionality, the principle of fiscal neutrality and principle of immediate right of deduction can be set aside. Consequently the infringement of the principle of fiscal neutrality and principle of immediate right of deduction passes the two-tier test of the principle of proportionality, therefore such actions are considered suitable and necessary since the main goal in the EU is to ensure proper functioning of the VAT system and it could not be achievable if the applicability of the principle of fiscal neutrality and principle of immediate right of deduction could not be set aside.

2.3. The principle of fiscal neutrality

The principle of fiscal neutrality is a principle related to the VAT sphere, and it is regarded as the leading principle in this sphere. Since VAT is a general, indirect tax on consumption, consequently it is aimed to be fiscally neutral for taxable persons who perform economic activities.²³ The principle of fiscal neutrality has its origin in EU law norms. Similar to the principle of the common system of VAT, the roots of the principle of fiscal neutrality can be found in the concept of VAT as enshrined in Article 1 of the VAT Directive,²⁴ and in the fourth recital of the VAT Directive.²⁵ Though the origin of the principle of fiscal neutrality is to be found in EU law it is developed by the CoJ.²⁶

Fiscal neutrality of VAT is achieved by charging VAT on each stage of the production and distribution chain and through exercise of the right of deduction, resulting in the burden of VAT being passed on to the final consumer of the service and goods.²⁷ Therefore, through exercising the right to deduct fiscal neutrality for a taxable person is achieved and VAT cumulation and double taxation is prevented. The spirit of the principle of fiscal neutrality is that the right to deduct occurs at the beginning of an economic activity, and even in a scenario

²³ H. Kogels. 2012. "Making VAT as Neutral as Possible". EC Tax Review, p 230.

²⁴ Article 1 of the VAT Directive stipulates that: "The principle of the common system of VAT entails the application to goods and services of a general tax on consumption exactly proportional to the price of the goods and services, however many transactions take place in the production and distribution process before the stage at which the tax is charged. On each transaction, VAT, calculated on the price of the goods or services at the rate applicable to such goods or services, shall be chargeable after deduction of the amount of VAT borne directly by the various cost components."

²⁵ Fourth recital of the VAT Directive stipulates that: "The attainment of the objective of establishing an internal market presupposes the application in Member States of legislation on turnover taxes that does not distort conditions of competition or hinder the free movement of goods and services. It is therefore necessary to achieve such harmonisation of legislation on turnover taxes by means of a system of value added tax (VAT), such as will eliminate, as far as possible, factors which may distort conditions of competition, whether at national or Community level".

²⁶ M.Ridsdal, 2005. "Abuse of rights, fiscal neutrality and VAT", EC Tax Review, p.84.

²⁷ Article 1 of the VAT Directive. See *supra* note 24.

where the economic activity initially intended does not result in any supply of goods or service, the right to the deduct is not lost.²⁸ Therefore it is important to acknowledge that the principle of the fiscal neutrality of VAT precludes limiting the rights of taxable persons to deduct input tax paid.²⁹ On the other hand the right to exercise this right is limited. The CoJ reasoning in the *Halifax* decision made it clear that the right of deduction must be precluded if such a right derives from practise in which the transactions are carried out with the aim to obtain tax advantages without any other economic objective.³⁰ Eventually it allows the conclusion that the principle of fiscal neutrality has a reflection to the principle of the right of deduction.

The application of the principle of fiscal neutrality is aimed at ensuring that all economic activities which are subject to VAT are taxed in a wholly neutral way. In situations where VAT has been levied lawfully once, the principle of fiscal neutrality precludes levying VAT on the same goods or services once more.³¹ Therefore the principle of fiscal neutrality has a reflection on the principle of prohibiting double taxation/tax cumulation.

The principle of fiscal neutrality also precludes that taxable persons carrying out the same economic activities are treated differently for the purposes of levying VAT,³² unless the differentiation is objectively justified.³³ The principle of fiscal neutrality goes as far as precluding the treatment of economically lawful and unlawful transactions differently.³⁴ Exemptions to unlawful transactions can be granted in situations where, owing to special characteristics of certain goods and services, competition between the lawful and unlawful sector is precluded.³⁵ Eventually, it allows the conclusion that the principle of fiscal neutrality has a reflection on the principles of equal treatment³⁶ and on the principle of elimination of distortion in competition, since economic activities in comparable situations must not be treated differently.

Though the principle of fiscal neutrality has been developed by the CoJ, it is a far reaching approach and its significance cannot be underestimated. The *Vogtländische Straßen- Tief und Rohrleitungsbau GmbH* case (hereinafter *VSTR*) shows that requirements for domestic procedural law that derive from the VAT Directive must be set aside, if its compliance goes further than necessary to ensure correct collection of the VAT. (See below section 4.2.1.1.). Nevertheless, this scenario is limited and can't be applied in situations where a taxable person has intentionally participated in tax fraud.³⁷

Interim conclusions

The principle of fiscal neutrality plays a crucial role in ensuring the proper functioning of the VAT system. It does not have constitutional status in the EU, but the effect of this principle is similar. The principle of fiscal neutrality has a reflection on other key principles of the VAT system, and it includes in itself five principles common to the VAT system: the principle of the common system of VAT; the principle of right to immediate deduction; the principle of

²⁸ O.Henkow, 2008. "Neutrality of VAT for taxable persons: a new approach in European VAT?". EC Tax Reviv, p 234.

²⁹ Case C-496/11, *Portugal Telecom SGPS SA*, para 35.

³⁰ Case C-255/02, *Halifax and Others*, paras 74, 75, 85.

³¹ Case C-155/01, *Cookies World*, para 60.

³² Case C - 33/11, *A*, paras 32,48.

³³ Case C-549/11, *Orfey Bulgaria*, para 33.

³⁴ Case C-349/96, *Card Protection Plan Ltd (CPP)*, para 33.

³⁵ Joined cases C-439/04 and C-440/04, *Kittel and Recolta Recycling*, para 50.

³⁶ Case C-643/11, *LVK – 56*, paras 55.

³⁷ Case C - 587/10 *VogtländischeStraßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR)*, para 44.

equal treatment, the principle of elimination of distortion in competition and the principle of prohibiting double taxation/tax. Consequently, the principle of fiscal neutrality together taken with the principle of proportionality allows for the definition of what sort of domestic administrative law and administrative practises can be regarded as being in conformity with EU law and VAT system.

2.4. The principle of effectiveness and equivalence

The principle of effectiveness has been developed by the CoJ and is recognized as a general principle of EU law.³⁸ The principle of equivalence stipulates that domestic procedural law governing actions that safeguard the rights of individuals which derive from EU law must be no less favourable than the law governing similar domestic actions.³⁹ The principle of effectiveness can be looked upon as an expression of the principle of equal treatment.⁴⁰ The principle of effectiveness ensures that domestic law does not render EU law functionally ineffective.⁴¹ It is equally important to acknowledge that the principle of effectiveness is exercised in situations where EU law is open to interpretation. Priority must be given to the interpretation that ensures that EU law maintains its effectiveness.⁴²

The principle of effectiveness is seen as an expression of the generally accepted right to an effective judicial remedy.⁴³ The existence of the principle effectiveness and consequently the right to an effective judicial remedy is found in Article 19 (1) of the TEU:

“[...] Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law.”

Because of an effective judicial remedy, the individual has the right to compensation in situations when a Member State has infringed EU law and caused damages to the individual. Compensation can be granted if the breached EU law confers rights to individual, the breach is sufficiently serious and a direct link can be established between the breach of EU law and the loss suffered by the individual.⁴⁴ The requirements which should be met before compensation for damages suffered can be granted have been developed by the CoJ in the *Brasserie du pêcheur* and *Dillenkofer* case.⁴⁵ Equally important is it to ascertain that the right for effective judicial remedy can be exercised if EU law is breached by Member State national courts.⁴⁶

In the VAT sphere, the principle of effectiveness from the perspective of the effective judicial remedy has been applied by the CoJ in *Reemtsma Cigarettenfabriken* case. The CoJ ruled that the principle of effectiveness ensures that Member States are not allowed to make it impossible or excessively difficult for a taxable person to seek reimbursement of unduly paid VAT. The CoJ concluded that, considering the absence of EU law which would regulate the repayment of unduly paid VAT, this matter falls within the national procedural autonomy of each Member State, and that the principle of effectiveness is not breached if the right to seek

³⁸ T. Tridimas, p.6.

³⁹ Advocate General Sharpston opinion in Case C-663/11, *Scandic Distilleries SA*, para 46.

⁴⁰ M. Dougan, 2004. „*National Remedies Before the Court of Justice: Issues of Harmonisation and Differentiation (Modern Studies in European Law)*”, Oxford University Press, p.53.

⁴¹ Case C-591/10, *Littlewoods Retail Ltd*, para 28.

⁴² Case C-437/97, *EKW and Wein & Co.*, para 41.

⁴³ B. Terra and J. Kajus, p.43.

⁴⁴ A.Eijsden, J. Dam, 2010. „*The Impact of European Law on Domestic Procedural Tax Law: Wrongfully Underestimated?*” EC Tax Review. p. 201.

⁴⁵ Case C-46/93, *Brasserie du pêcheur*, para 74; Case C-178/94, *Dillenkofer*, paras 21,27.

⁴⁶ Case C-224/01, *Köbler*, para 34.

reimbursement can be exercised only via civil law action.⁴⁷ In the VAT sphere, the principle of effectiveness is extensively applied by the CoJ in cases related to national time limits by which the right of deduction of input tax is limited in time⁴⁸ (See section 3.1.). Additionally, the principle of effectiveness in the VAT sphere was applied by the CoJ in the *Halifax* case, when the CoJ concluded that the national court must apply national rules of evidence in such a manner that the effectiveness of EU law is not undermined.⁴⁹

The principle of effectiveness, taken together with the principle of subsidiarity, requires that all domestic authorities and *inter alia* tax administrations must apply EU law as if it was national law. The principle of effectiveness does not go as far as to oblige national courts to apply EU law on its own motion if such action would extend the scope of dispute.⁵⁰

Interim conclusions

The principles of effectiveness and equivalence have a pivotal role when there is a need of interpretation of domestic law in the light of EU law. Furthermore the principle of effectiveness ensures that the rights of a taxable person which stem from EU law are not negatively affected. It can be concluded that the principle of effectiveness and equivalence allows the rendering of domestic laws of the Member States as incompatible with EU law if they either make EU law ineffective or are excessively difficult to exercise. Therefore, on the basis of the principle of effectiveness, efficient protection of EU law can be safeguarded.

2.5. The principles of legal certainty and protection of legitimate expectations

The principles of legal certainty and protection of legitimate expectations forms a part of the EU order and must be respected by EU institutions and Member States when they exercise powers conferred on them by EU law.⁵¹ The principle of protection of legitimate expectation is a corollary of the principle of legal certainty.⁵² The principle of legal certainty ensures that an individual can rely on EU legislation and be certain that its application will be predictable. Individuals must be able to sufficiently and precisely predict the extent of the obligations which EU law imposes on them.⁵³

The principle of protection of legitimate expectation requires public authorities to exercise their powers in a way that individuals can be certain that the authority will act in a way that is compatible with EU law and that by such action EU law will not be affected.⁵⁴ The principle of protection of legitimate expectation is linked with the concept of good faith and requires that individuals be able to rely on actions taken by authorities which require the individual to exercise certain operations. Consequently, the authority cannot later depart from their previous actions if it causes a loss to the individuals.⁵⁵ In the VAT sphere the CoJ applied the principle of protection of legitimate expectation from the perspective of good faith in the *Elmeka* case, the CoJ argued that national tax authorities are obliged to respect the principle of protection of legitimate expectations if actions taken by the tax authorities give a prudent

⁴⁷ Case C-35/05, *Reemtsma Cigarettenfabriken*, paras 37, 39, 42.

⁴⁸ Joined Cases C-95/07 and C-96/07, *Ecotrade*, paras 48, 54; Case C-291/03, *MyTravel plc*, paras 17,18; C-62/00, Case, *Marks & Spencer*, para 34.

⁴⁹ Case C-255/02, *Halifax and Others*, para 76.

⁵⁰ B. Terra and P. Wattel, p 90 - 91.

⁵¹ Advocate General Mazák opinion in Case C-427/10, *Banca Antoniana Popolare Veneta*, para 28.

⁵² B. Terra and J. Kajus, p.43.

⁵³ Case C-395/11, *BLV Wohn - und Gewerbebau*, para 47.

⁵⁴ T. Tridimas, p. 252.

⁵⁵ D. Chalmers, G. Davies and G. Monti. 2010. „*European Union Law*”, Second edition, Cambridge University Press, p.412.

taxable person a reasonable set of expectations.⁵⁶ Equally important is it to acknowledge that the necessity to ensure legal certainty is recognised by the CoJ as a goal pursued by the system of VAT.⁵⁷

Furthermore it is important to acknowledge that the principle of the protection of legitimate expectations precludes legislative amendments which retroactively deprive taxable persons rights enjoyed from an earlier legislation.⁵⁸ (See section 3.1.1.).

The principle of protection of legitimate expectations is not absolute and it has its limitations. It cannot be applied in situations where an individual acts in bad faith or when the transactions involved are related to VAT fraud. This limitation is set with the purpose to ensure proper functioning of the EU VAT system.⁵⁹ Consequently, the principles of legal certainty and protection of legitimate expectations are not obsolete and can be outweighed by the principle of legality.⁶⁰

Interim conclusions

The principles of legal certainty and protection of legitimate expectations, as with the principle of effectiveness and equivalence, serve as means to establish the grounds on which administrative procedural norms and administrative practice in the Member States can be regarded as incompatible with EU law. Consequently, in the VAT sphere principles of legal certainty and protection of legitimate expectations aim to ensure that taxable persons can be sure that they will receive tax treatment as expected.

⁵⁶ Joined Cases C-181/04 to C-183/04, *Elmeke*, paras 32, 35.

⁵⁷ Case C-104/12, *Becker*, para 23.

⁵⁸ Case C-107/10, *Enel Maritsa Iztok 3 AD*, paras 29,38,39.

⁵⁹ Opinion of Advocate General Cruz Villalón in Case C-587/10, *Vogtländische Straßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR)*, para 61.

⁶⁰ U. Bernitz, J. Nergelius, C. Cardner and X. Groussot. 2008. "General principles of EC law in a process of development reports from a conference in Stockholm, 23-24 March 2007, organised by the Swedish Network for European Legal Studies". Kluwer Law International, p 58.

3. DOMESTIC PROCEDURAL LAWS AND VAT DISPUTES IN THE COJ

3.1. National time limits and recovery of unduly paid VAT

For the purposes of this thesis, it is appropriate to examine how the CoJ deals with national procedural law norms that render EU law ineffective or make it difficult to exercise the rights provided to an individual in EU. In the VAT sphere the CoJ has interpreted domestic administrative rules which created time limits for recovery of VAT in situations where a taxable person has unduly overpaid it. Before a conclusion can be reached regarding how the burden of proof must be allocated in VAT disputes in the EU, it is important to examine CoJ decisions from this kind of case line. It is equally important to acknowledge that the VAT Directive does not set time limits for Member States in what time overpaid VAT should be reimbursed to a taxable person. Similarly, the VAT Directive does not directly stipulate how the burden of proof should be arrived at. Consequently situations where a dispute between a taxable person and tax administration involves legality of time limits set for recovery of unduly paid VAT the issues are similar to those in situations when the dispute involves the question how the allocation of the burden of proof should be done between a taxable person and tax administration.

3.1.1. Case C-62/00 - Marks & Spencer I

The *Marks & Spencer I* case dealt with domestic legislation which retroactively shortened a limitation period for repayment of unduly paid VAT. The CoJ applied the principles of effectiveness and protection of the legitimate expectations with the aim to establish the compatibility of domestic procedural law with EU law.

Marks & Spencer, which is a retailer, sold gift vouchers at a price lower than their face value. Afterwards, the vouchers were sold and they were given away to third parties. In December 1990 Marks & Spencer informed their tax administration, maintaining that they should account for VAT not on the face value of the vouchers but on the amounts which they received when they sold them. Consequently, due to the fact that Marks & Spencer initially applied VAT incorrectly, they claimed repayment of VAT which they had overpaid. On 18th July 1996 three-year limitation period came into force, which restricted the time period within which repayment of VAT unduly paid can be reclaimed. Therefore, the tax administration repaid only part of the VAT unduly paid respecting the period which was not affected by the introduction of the force of the three-year limitation period. Marks & Spencer contested the tax administration's decision. In the litigation process the national court considered that the dispute concerned interpretation of EU law and, therefore, referred preliminary questions to the CoJ. In the preliminary questions, the court essentially asked whether legislation which removed, with retrospective effect, the right under the national law to reclaim unduly paid VAT, more than three years before the claim was made, are in conformity with the principle of effectiveness and the principle of protection of legitimate expectations?⁶¹

In the first part of the ruling the CoJ emphasized the principle of effectiveness. The CoJ argued that in the absence of EU rules which would regulate the repayment of national charges wrongly levied, such task lies on the domestic legal system of each Member State. Nevertheless, those domestic procedural law norms, which govern actions for safeguarding

⁶¹ Case C-62/00, *Marks & Spencer*, paras 12-21.

the rights of an individual derive from Community Law and must be in conformity with the principle of equivalence and with the principle of effectiveness.⁶²

The CoJ argued that the three-year limitation period set for recovery of unduly paid VAT by itself does not render virtually impossible or excessively difficult the exercise of the rights conferred by EU law and, therefore, it does not infringe the interests of legal certainty. The time set for application of the recovery of VAT unduly paid must be sufficient to ensure that the right for repayment could be exercised effectively. The legislation, which is not retrospective in scope, complies with this condition. In the dispute the given conditions were not secured, since the reduction in the United Kingdom of the time limits from six years to three years had an immediate effect on all claims made after the date of enactment of the legislation. As a result, such legislation is incompatible with the principle of effectiveness. The fact that the time limits which set restrictions in time for the recovery of VAT unduly paid is by itself compatible with the standards of EU law, does not mean that new time limits do not have to be reasonable and implemented with transitional arrangements, which would ensure an adequate time period after the enactment of the legislation for lodging claims for repayment which persons were entitled to submit under the original legislation.⁶³

The second part of this judgement concerns the application of the principle of the protection of legitimate expectations. The government of the United Kingdom argued that the principle of the protection of legitimate expectations is not relevant in this dispute, since the determination of the administrative procedural rules governing the claims of unduly paid VAT is entirely a matter of the domestic law subjected only to observance of the principles of the EU of equivalence and effectiveness. The CoJ did not agree with this argumentation and ruled that the principle of the protection of legitimate expectations forms a part of the EU legal order and must be observed by the Member States when they exercise the powers conferred on them by the EU directives. Subsequently, the CoJ concluded that a legislative amendment which retroactively deprives a taxable person of a right to a deduction that he has derived from EU law is incompatible with the principle of the protection of legitimate expectations.⁶⁴

Interim conclusions

From the *Marks & Spencer I* case, it can be concluded that the authority to evaluate the compatibility of domestic administrative procedural law norms of the Member States with the principles of EU law lies in the competence of the CoJ. Domestic administrative procedural law does not exclusively belong to the realm of the competence of a Member State if it renders rights which derive from EU law difficult or impossible to exercise. Consequently, domestic administrative procedural law norms can be regarded as incompatible with EU law if they do not comply with the principles of the effectiveness and equivalence, and the principles of legal certainty and protection of legitimate expectations.

3.2. CFREU and domestic procedural law

Marks & Spencer I case makes it clear that domestic legal systems should be able to ensure that an individual is able to enjoy rights which derive from EU law. Article 6 of the TEU specifies that the EU recognises the rights, freedoms and principles set out in the CFREU, and

⁶² Case C-62/00, *Marks & Spencer*, para 34.

⁶³ Case C-62/00, *Marks & Spencer*, paras 36, 38.

⁶⁴ Case C-62/00, *Marks & Spencer*, paras 43 - 46.

the fundamental rights guaranteed by the ECMR. Such protection, as exercised, derives from the constitutional traditions common to the Member States. Pursuant to Article 6 of the TEU, fundamental rights guaranteed by the ECMR are regarded as general principles of EU law. Article 51 of the CFREU governs the application of the CFREU, and pursuant to it, fundamental rights enshrined in the CFREU are addressed to all institutions, bodies, offices and agencies of the EU and to the Member States when they are implementing EU law.

3.2.1. Case C-617/10 – Åkerberg Fransson

The *Åkerberg Fransson* case involved interpretation of the *ne bis in idem* principle in EU law. This principle is enshrined in Article 50 of the CFREU and it provides the right for an individual not to be tried or punished twice in criminal proceedings for the same criminal offence.

Åkerberg Fransson was accused of having provided falsified information in his tax returns. Due to this, the treasury lost revenue which included income tax and VAT. Åkerberg Fransson was also accused of making false employer declarations of income tax contributions. The Public Prosecutor's Office considered the tax offences as serious since they were related to large amounts of unpaid tax. Thus, such conduct formed a part of criminal activity committed systematically on a large scale. On the same basis which led to criminal proceedings against Åkerberg Fransson, in the framework of administrative proceedings, the tax authorities ordered him to pay a tax surcharge. Åkerberg Fransson did not challenge the decision of the tax administration.⁶⁵

The referring court, in preliminary questions, essentially asked whether in the situation against Åkerberg Fransson, where two processes were brought (administrative process and criminal process) - does it breach the principle of *ne bis in idem* if both proceedings were based on the same conduct – falsification of information? The CoJ reasoned that pursuant to 51 (1) of the CFREU, Member States, when they implement EU law, must take into account the requirements of the fundamental rights enshrined in the CFREU. Therefore, domestic legislative acts must be in conformity with the fundamental rights guaranteed by the CFREU. Under Articles 2, 250 (1) and 273 of the VAT Directive, the Member States are obliged to take all legislative and administrative measures appropriate for ensuring collection of all the VAT due within its territory and for preventing evasion. Article 325 of the TFEU obliges the Member States to counter illegal activities affecting the financial interests of the EU. Article 4 (3) of the TEU stipulates that a Member State is obliged, for purposes of preventing evasion, to provide for proper collection of VAT to ensure that all legislative and administrative measures within its territory are appropriate. Hence, the processes brought against Åkerberg Fransson were related to falsified information in his VAT returns, therefore the question referred by the national court involved the interpretation of EU law and, subsequently, falls in the competence of the CoJ.⁶⁶

The CoJ reasoned that the CFREU does not preclude the Member States from imposing, for the same acts of non-compliance with declaration obligations in the field of VAT, a combination of tax penalties and criminal penalties. Nevertheless, Article 50 of the CFREU precludes the Member States from bringing repeated criminal proceedings against an individual in respect of the same conduct. Before it can be concluded whether the action brought against an individual breaches the principle of *ne bis in idem*, it is necessary for the

⁶⁵ Case C-617/10, *Åkerberg Fransson*, paras. 12, 13.

⁶⁶ Case C-617/10, *Åkerberg Fransson*, paras. 17, 25 - 30.

national court to provide three criteria for this purpose: the first is the legal classification of the offence under national law, the second one is the nature of the offence, and the third one is the nature and degree of severity of the penalty.⁶⁷

Furthermore, the CoJ argued that if the domestic law norms are in conflict with the rights guaranteed by the CFREU, national courts are obliged to apply provisions of EU law and give full effect of those provisions. In situations where it is necessary, national courts are obliged to exercise their jurisdiction in such a way that a national court on its own motion should refuse to apply any conflicting national legislation. CoJ indirectly referred to the principle of effectiveness and reasoned that any provision of domestic law or any administrative or judicial practice which might impair the effectiveness of EU law should be set aside. Last, but not least, it is important to note that the CoJ concluded that the ECMR does not constitute a legal instrument formally incorporated in EU law and, therefore, is not applicable until the EU has not acceded to ECMR.⁶⁸

Interim conclusions

It can be concluded that domestic administrative procedural law can be regarded as incompatible with EU law if it does not comply with the general principles common to EU law, especially the principles of effectiveness and equivalence as well as the principles of legal certainty and protection of legitimate expectations. The judgement in *Åkerberg Fransson* has more far reaching consequences than the judgement in *Marks & Spencer I*. The protection of fundamental rights that derive from the CFREU today are in practice safeguarded by CoJ if such dispute in essence fulfils the condition by being related to EU law. The CoJ conclusions are not limited by the principles common to the EU, but additionally include interpretation of the domestic procedural law norms in the light of fundamental rights guaranteed by the CFREU. It follows that in the VAT sphere, prohibition to render EU law ineffective applies to the domestic administrative and judicial practise as well, if that domestic practice by nature renders EU law ineffective.

⁶⁷ Case C-617/10, *Åkerberg Fransson*, paras. 34, 35.

⁶⁸ Case C-617/10, *Åkerberg Fransson*, paras 44 - 46, 48.

4. EVIDENCE AND THE ALLOCATION OF BURDEN OF PROOF IN VAT DISPUTES

4.1. Background

Detailed rules of evidence and rules which would divide the burden of proof between a taxable person and tax administration at the EU level do not exist. Article 178 (b) of the VAT Directive stipulates that for the purposes of deduction in respect of transactions carried out by a taxable person and treated as supply of the goods or services, the taxable person must comply with the formalities laid down by each Member State. The same procedural autonomy pursuant to Article 131 of the VAT Directive applies to transactions that are VAT exempt. It implies that the allocation of the burden of proof in VAT disputes is governed each Member State's by procedural law norms separately. This means that Member States are free to design their own rules of evidence to the extent that they do not render EU law ineffective. Moreover, rules regarding evidence and the allocation of the burden of proof must comply with the general objective of the EU to combat VAT fraud.

4.2. Evidence

Despite the procedural autonomy of Member States some indications of what information can be regarded as evidence is to be found in the VAT Directive and Implementing Regulation. Taxable persons, before they can exercise the right of deduction pursuant to Article 178 (a) of the VAT Directive, must hold a properly drawn invoice. In respect of the importation of goods pursuant to Article 178 (e) of the VAT Directive, a taxable person must hold an import document specifying him as a consignee or importer. Consequently, it can be concluded that invoices and import documents can be regarded as necessary evidence, before the right to deduct can be exercised. Aiming to ensure proper functioning of the VAT system, chapters 5 and 6 of the VAT Directive obliges a taxable person to submit a VAT return and recapitulative statements stating relevant information which is necessary to calculate the amount of VAT to be paid VAT. Therefore, it allows the conclusion that information provided by the taxable person in his/her VAT return and recapitulative statement can be regarded as evidence if it is consistent with an invoice.⁶⁹ Moreover, it can be concluded that the VAT Directive sets ground requirements for evidence which a taxable person is obliged to provide before the right of deduction can be exercised.

In addition to the VAT Directive, the Implementing Regulation contains several rules of evidence applied in specific circumstances. Pursuant to Article 39 of the Implementing Regulation for the purpose of determining the place of supply for short-term hiring of means of transport a contract between the parties involved can serve as evidence. Moreover, Article 51 of the Implementing Regulation stipulates that for the application of the exemption stipulated in Article 151 of the VAT Directive an exemption certificate set out in Annex II of the Implementing Regulation serves as evidence. Article 18 (3) (a) of the Implementing Regulation stipulates that a certificate, which is issued by a competent tax authority which validates that the acquirer of services established outside the EU has the capacity of a taxable person, serves as evidence. This certificate must state that acquirer of the services is engaged in economic activity.

⁶⁹ It is important to recognize that departure from the formal requirements of the invoice is accepted and the right of deduction can be exercised in the scenario when the taxable person, before the tax authority has made its decision, has submitted a corrected invoice to the tax authority and provided the relevant evidence about occurrence, nature and amount of the transactions concerned. See Case C-271/12, *Petroma Transports and Others*, para 34.

On the 18th December 2012, the Commission proposed to amend the Implementing Regulation as far as it regards the place of supply of services,⁷⁰ by introducing rules of evidence for the identification of customer location related to short-term hiring of transport and electronically supplied services.⁷¹

For the purpose of identifying where the customer is established or has his permanent address or usually resides, at least two separate pieces of evidence, which are not contrary to each other, have to be provided.⁷² Therefore, it allows the conclusion that it is possible that more precise rules regarding evidence on the common system of VAT will be introduced in the Implementing Regulation in future.

Therefore it can be concluded that the VAT Directive stipulates indications that imply which information can be regarded as evidence in VAT disputes. The Implementing Regulation contains a minor amount of rules which are devoted to evidence. In overall Member States have a wide discretion to lay down domestic rules of evidence and exercise their national administrative practice in the VAT sphere.

4.2.1. CoJ case law and evidence

It is clear that in the VAT field some rules related to evidence are included in EU law. Nevertheless, due to the procedural autonomy of each Member state and the lack of scrutiny of the rules of evidence at the level of EU law, the rules of evidence are different across the Member States. Consequently, it is an obligation of a national court to carry out verification of evidence and access all relevant facts and circumstances in VAT disputes according to rules of evidence in national law.⁷³ In the absence of rules of evidence in domestic law general practice established must be taken in to account.⁷⁴ In VAT disputes all of the intentions of the taxable person must be supported by objective evidence.⁷⁵ Despite of the significant role of evidence in VAT disputes, the CoJ case law does not indicate which evidence taken together can be regarded as objective evidence. Nevertheless, occasionally the CoJ has indicated which evidence cannot be regarded as decisive evidence. For example, when a taxable person carries out intra-Community supply of goods, the VAT return submitted by the person who acquired goods declaring intra-Community acquisition of the goods cannot be regarded as decisive evidence for the fact that the goods concerned have left the territory of the Member State where transportation of the respective goods had begun⁷⁶ (see section 4.3.3.1). Additionally, the fact that a business partner's VAT identification number was removed from the VAT register retroactively (after the supply was carried out) cannot serve as decisive evidence⁷⁷ (see section 4.3.3.2). Consequently, it can be concluded that the concept of objective evidence differs depending on the national practise of each Member State and from the subject of each dispute. It is equally important to acknowledge

⁷⁰ Proposal for a COUNCIL REGULATION amending Implementing Regulation (EU) No 282/2011 regarding the place of supply of services. 2012. COM (2012) 763 final, p.15.

⁷¹ It has been proposed that the following information serves as evidence: Customers details such as billing address; Internet Protocol address of the device used by the customer; Bank details, place of the bank account used for payment, billing address held by that bank; The Mobile Country Code of the International Mobile Subscriber Identity stored on the Subscriber Identity Module (SIM) card used by the customer; The location of the residential fixed land line through which the service is supplied to the customer; The place where transport or dispatch of the goods sold via the Internet ends; Registration details of transport hired by the customer; Other relevant information obtained by the supplier. See COM (2012) 763 final, p.15.

⁷² COM (2012) 763 final p.15.

⁷³ Case C-643/11, *LVK – 56*, para 57; Case C-642/11, *Story trans*, para 45.

⁷⁴ Case C-273/11, *Mecsek-Gabona*, para 38.

⁷⁵ Case C-543/11, *Woningstichting Maasdriel*, para 32.

⁷⁶ Case C-184/05, *Twoh International*, para 37.

⁷⁷ Case, C-273/11, *Mecsek-Gabona*, para 65.

that national rules of evidence must be enforced in such a manner that the effectiveness of EU law is not undermined⁷⁸ and other general principles of EU are taken into account.⁷⁹

4.2.1.1. Case C- 587/10 VSTR

The dispute in *VSTR* involved refusal to exempt intra-Community supply of the goods⁸⁰ on the grounds that taxable person could not provide the VAT number of the person acquiring the goods.

A branch of *VSTR* established in Germany in November 1998 sold two stone-crushing machines to Atlantic International Trading Co (hereinafter Atlantic) established in the United States. *VSTR* requested Atlantic to provide its VAT identification number. Atlantic did not have a VAT number, but instead it informed *VSTR* that the goods were to be resold to a company established in Finland and gave the VAT identification number of the company registered in Finland. The goods were collected from Germany with transport contracted by a branch of Atlantic established in Portugal. The goods further were transported to Finland. The customer in Finland declared the intra-Community acquisition of the goods. In the end the goods were subject to tax in the country where the transportation of goods ended.⁸¹

The tax authorities in Germany argued that the supply between the branch of *VSTR* and Atlantic could not be exempt from intra-Community supply of the goods, since Atlantic was not identified for VAT purposes in the EU, and therefore did not provide *VSTR* with its VAT number.⁸² *VSTR* contested the tax administration decision. The court of first instance dismissed the *VSTR* appeal, and consequently *VSTR* appealed the decision arguing that the decision is contrary to the Sixth Directive, since the exemption granted for intra-Community is rendered conditional on the formal obligation to provide the VAT identification number of the person who acquired the goods.⁸³

The referring court asked the CoJ two preliminary questions. The first question was: does the Sixth directive allow accepting intra-Community supply of the goods as VAT exempt if the taxable person is in capacity to furnish proof that the person acquiring the goods has a VAT identification number? The second question was related to the first question and in essence the court asked does the fact that the person acquiring the goods had its seat outside the EU and was not registered for VAT purposes in any Member state bear any significance in the dispute, and whether it is relevant that taxable person has proved that the person who ultimately acquired the goods submitted a tax return stating intra-Community acquisition, therefor having a valid VAT identification number.⁸⁴

Regarding the VAT identification number the CoJ reasoned that the first subparagraph of Article 28c (A) (a) of the Sixth Directive (now Article 138 (1) of the VAT Directive) stipulates that the person acquiring the goods must be a taxable person acting as such in another Member State. This means that the person which acquires the goods must not necessarily trade under a VAT identification number. Regardless of the fact, the VAT identification number provides proof of the tax status of the taxable person, but it is only a

⁷⁸ Case C-255/02, *Halifax and Others*, para 76.

⁷⁹ Case C-273/11, *Mecsek-Gabona*, paras 36, 38.

⁸⁰ Article 138 of the VAT Directive stipulates that intra-Community supply of goods is exempt of VAT, and Article 169 (b) governs that when the supplier performs intra-Community supply of goods he is entitled to exercise his right of deduction.

⁸¹ Case C - 587/10, *VSTR*, paras 14-17.

⁸² Paragraph 17 c (1) of the Umsatzsteuer-Durchführungsverordnung (Regulation implementing the UStG) sets an obligations on the supplier to provide the VAT identification number of the person acquiring the goods. See Case C - 587/10, *VSTR*, para 13.

⁸³ Case C - 587/10, *VSTR*, paras 18, 19, 20.

⁸⁴ Case C - 587/10, *VSTR*, para 26.

formal requirement which cannot undermine the right of exemption when the substantive requirements for intra community-supply of the goods are fulfilled.⁸⁵

The CoJ argued that it is up to the supplier which performs intra-Community supply of the goods to furnish evidence that all substantive requirements for exempt intra-Community supply of the goods are met. Nevertheless, the national provisions that ensure the correct collection of the VAT aiming to combat VAT fraud must comply with the general principles of EU law and not go further than necessary to attain this objective.⁸⁶

The CoJ concluded that compliance with formal obligation without taking into account the substantive requirements goes further than necessary to ensure correct collection of VAT, and the principle of fiscal neutrality precludes such action in situations where a taxable person is not intentionally participating in tax evasion. The court stated that, despite the fact that Atlantic did not complete any VAT returns in the EU, the fact by itself cannot be constituted as decisive evidence, but it can only be regarded as an indication. Moreover, the fact that the person who acquired the goods is established in a third country does not bear significance. In a scenario where a supplier acts in good faith, has taken all the measures which can reasonably be required of him, is able to prove that substantive requirements for exemption are fulfilled and the goods are subject to tax in the country of destination, then the principle of fiscal neutrality precludes administrative practises by which the exemption is rendered conditionally on the basis that the supplier does not provide VAT identification number.⁸⁷

Interim conclusions

The VSTR case makes it is clear that tax authorities and national courts are obliged to put aside formal obligations of domestic legislation as related to evidence if, on the basis of other objective evidence, it can be concluded that transactions concerned are not related to tax fraud, and all the substantive requirements are fulfilled to exempt intra-Community supply of the goods.

Compellingly the CoJ case law clarifies some limitations regarding the procedural autonomy right of Member States to lay down procedural rules of evidence. This autonomy is limited in such an extent that domestic provisions must comply with the general principles of the EU.

4.3. Burden of proof

EU VAT law does not contain rules which precisely govern how the burden of proof must be allocated in VAT disputes. Nevertheless, some rules indirectly indicate how the burden of proof in VAT disputes must be done. For example, Article 242 of the VAT Directive requires that all taxable persons must keep their VAT related bookkeeping accounts in sufficient detail and ensure that tax authorities can check them. Moreover, Article 244 of the VAT directive obliges a taxable person to store copies of all invoices which he has received, are issued by him, or are issued in his name or behalf of him. Articles 245 and 245 of the VAT Directive empowers tax authorities to request that taxable persons, without undue delay, provide available invoices which they stored due to obligations set in Article 244 of the VAT Directive. (See section 4.3.2.2).

⁸⁵ Case C - 587/10, *VSTR*, para 40.

⁸⁶ Case C - 587/10, *VSTR*, paras 43, 44, 47,51.

⁸⁷ Case C - 587/10, *VSTR*, paras 45, 46, 54, 56-58.

Consequently, it allows, *prima facie* the conclusion that, due to the fact that tax authorities are empowered to check the authenticity of information provided by the taxable person, the obligation to prove if information on invoices and taxable person submitted VAT return is inconsistent or false lies with the tax authority.

In the field of VAT exchange of information between Member States is governed by the Council Regulation (EU) No. 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax.⁸⁸ This regulation supplements Regulation (EC) No.1798/2003⁸⁹ adding provisions to more effectively combat cross-border VAT fraud.⁹⁰ Mentioned Regulations sets the conditions under which Member states are obliged to cooperate with each other to ensure proper collection of VAT.⁹¹ These Regulations on administrative cooperation does not contain any rules regarding burden of proof and neither does they grant any rights to taxable persons, except that a taxable person has rights to acquire information about other taxable persons' VAT identification numbers (see section 4.3.3.1.). Nevertheless, these regulations provide extensive powers to Member States to share and acquire relevant information from each other to ensure proper collection of VAT. Therefore in situations where a taxable person has excessive difficulties to acquire relevant information from its business partner located in another Member state the tax administration could exercise its powers and acquire relevant information.

The Implementing Regulation for certain transactions is more precise when the question of how the allocation of the burden of proof is done arises⁹² Article 3 of the Implementing Regulation sets a general obligation for the supplier to demonstrate that the place of supply of the services stipulated in the first subparagraph of Article 56 (2),⁹³ and Articles 58⁹⁴ and 59⁹⁵ of the VAT Directive is located outside the EU. Moreover Articles 18(1) (b),⁹⁶ 20 and 23⁹⁷ of the Implementing Regulation sets an obligation for the supplier to carry out a reasonable level of verification of the accuracy of the information provided by the customer with the goal to

⁸⁸ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax. OJ L 268, 12.10.2010.

⁸⁹ Council Regulation (EC) No 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax and repealing Regulation (EEC) No 218/92. OJ L 264, 15.10.2003.

⁹⁰ B.Terra and P.Wattel, p. 436.

⁹¹ Council Regulation (EC) No 1798/2003, Articles 1, 57.

⁹² Section 4 of the Implementing regulation contains rules which sets conditions which must be taken into account for the purpose to determine the place of supply for services rendered in accordance to Articles 43 to 59 of the VAT Directive.

⁹³ Article 56 (2) of the VAT Directive refers to hiring, other than short-term hiring, of means of transport to a non-taxable person.

⁹⁴ Article 3 (b) of the Implementing Regulation pursues the obligation set for the supplier to demonstrate that the place of supply for the services which is stipulated in Article 58 of the VAT Directive is outside the EU, it will become applicable on 1st January 2015. The future Article 58 of the VAT Directive refers to telecommunication services, radio and television broadcasting services and electronically supplied services listed in Annex II of the VAT Directive.

⁹⁵ Article 59 of the VAT Directive refers to following services; transfers and assignments of copyrights, patents, licences, trade marks and similar rights; advertising services; the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information; obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this Article; banking, financial and insurance transactions including reinsurance, with the exception of the hire of safes; the supply of staff; the hiring out of movable tangible property, with the exception of all means of transport; the provision of access to a natural gas system situated within the territory of the Community or to any network connected to such a system, to the electricity system or to heating or cooling networks, or the transmission or distribution through these systems or networks, and the provision of other services directly linked thereto; telecommunications services; radio and television broadcasting services; electronically supplied services.

⁹⁶ Article 18 of Implementing Regulation sets requirements which must be met before the customer established within the Community can be regarded as taxable person in situation where he has not yet received an individual VAT identification number.

⁹⁷ Article 20 of the Implementing Regulation sets the conditions which have to be taken into account by the supplier of services if the supply of services falls within the scope of Article 44, and consequently is taxed outside the Member State, where the supplier of the services is established. Similarly Article 23 of the Implementing Regulation refers to services stipulated in Articles 56 (2), 58 and 59 of the VAT Directive and sets the requirement to collect information before the supply of services can be taxed at the place where acquirer of the services is established or, in the absence of an establishment, the location of his permanent address or the place where he usually resides.

determine the place of supply for the services provided. Additionally Article 22 of the Implementing Regulation sets an obligation for the supplier of the services to examine the nature and use of the service provided with the purpose to identify the place of the customers fixed establishment to whom the service is provided.

Therefore it allows the conclusion that in these specific situations the Implementing Regulation sets obligations for the supplier of the services to collect evidence before they can exercise the right of deduction. This indicates that in a VAT dispute the initial burden to prove that the information submitted in the VAT return is borne by the taxable person.

Despite the fact that some indirect indications related to evidence and the burden of proof can be found in the VAT Directive, it is clear that the VAT Directive specifies that Member States have procedural autonomy to lay down national rules of evidence and rules which state how the allocation of the burden of proof is done in VAT Disputes. Regardless of the procedural autonomy conferred to Member States in specific situations the Implementing Regulation directly deals with the allocation of the burden of proof and evidence in the VAT sphere.

The Implementing Regulation is adopted according to Article 397 of the VAT Directive together with Article 291 (2) of the TFEU. These legal rules confer power to the Council to adopt measures which are necessary to implement the VAT Directive. The goal of the Implementing Regulation is to lay down rules which implement the VAT Directive. The second and fourth recitals and Article 1 of the Implementing Regulation stipulate that the legal rules included in the Implementing Regulation seek to ensure a unified interpretation of the VAT Directive law norms when divergences of the application of these norms have arisen or are about to arise across the EU. Consequently it allows the conclusion that the legality of the rules related to evidence and allocation of the burden of proof included in the Implementing Regulation can become questionable, since the VAT Directive pursues to confer the right to lay down rules of evidence and the allocations of the burden of proof to the Member States. The Implementing Regulation widens the scope of the VAT Directive, since it limits the procedural autonomy of Member States to lay down procedural rules of evidence and rules regarding the allocation of the burden of proof conferred to them by the VAT Directive.

4.3.1. Allocation of the burden of proof in Latvia

The complexity of domestic procedural rules regarding the allocation of the burden of proof can be illustrated with the approach used in Latvia. Legal proceedings in the field of the taxation in Latvia are regulated by Administrative Procedure Law.⁹⁸ In addition to the Administrative Procedure Law, some of the procedural law norms are included in the Law on Taxes and Fees.⁹⁹ The Law on Taxes and Fees is regarded as a law which designates the tax and fee system in Latvia. The Law on Taxes and Fees regulates the collection and recovery of taxes, the liability of the taxable persons and tax authority. Additionally, it contains rules which regulate the appeal procedures for decisions made regarding tax and fee issues. The Administrative Procedure Law and the Law on Taxes and Fees define the functions, rights and obligations of the tax authority and the taxable person.

The Administrative Procedure Law sets the role of the obligations related to the allocation of the burden of proof for both sides involved in tax disputes. Article 59 (4) Administrative

⁹⁸ Administrative Procedure Law, Republic of Latvia. (Administratīvā procesa likums) 25.10.2001. Ziņotājs, Nr.23, 13.12.2001.

⁹⁹ Law on Taxes and Fees, Republic of Latvia. (Likums par Nodokļiem un nodevām). 02.02.1995. Ziņotājs, Nr.7, 13.04.1995.

Procedure Law stipulates that a taxable person is obligated to provide evidence or inform the tax administration about facts which are at its disposal that are important in the case. Nevertheless, the main obligation to acquire information lies on the tax administration.¹⁰⁰ The Tax authority is obligated to set out evidence upon which the conclusions of the tax administration are based and the grounds on which basis the evidence provided by the taxable person has been rejected. The Tax Authority is allowed to base their decision on the grounds of the Constitution, laws, Cabinet Regulations or binding regulations of local governments, norms of international law or EU law and general principles of law. The Tax Authority can use arguments, which have been expressed in court judgments and legal literature as well as other special literature.¹⁰¹

After the tax authority's decision is finalised the tax authority is forbidden from providing additional evidence that is not mentioned in the case beforehand. Judges who hear tax disputes in administrative procedure are obligated to determine the true facts in the case on their own motion. They are empowered with the right to collect evidence on their own initiative. The right to collect evidence on one's own motion is based on the principle of objective investigation. Regardless of the fact that Administrative courts are bound by the principle of objective investigation, the taxable person has an active role in the litigation process as well, he is obligated to participate in collecting evidence according to his capacity.¹⁰²

Article 38 of the Law on Taxes and Fees stipulates that if a taxable person does not agree with the amount of the tax payments assessed by the tax authority, evidence regarding the amount of the tax payment shall be provided by the taxable person. This legal norm is in conflict with the Administrative Procedure Law. The rules Administrative Procedure Law may be violated in cases where the evidence provided by the administration in its decisions is not sufficient, and the conclusions of the tax authority are based on assumption but not on the basis of objective facts. In such a situation, the taxable person can be obliged to provide sufficient evidence by himself to disprove the tax administration's decision, since Article 38 of Law on Taxes and Fees is regarded as *lex specialis* in all tax related disputes.

The Administrative Court adjudicating the tax disputes often refers to Article 38 of the Law on Taxes and Fees. Since the litigation process in VAT disputes almost always touches upon the question of distribution of the burden of proof between the parties, a large number of judgements from the Supreme Court are available. The main idea behind the rulings of the Supreme Court is that in situations where the taxable person does not agree with the conclusions of the tax administrations, then, in the light of Article 38 of the Law on Taxes and Fees, the burden of proof is shifted to taxable person.¹⁰³ The Supreme Court interprets Article 38 of the Law on Taxes and Fees in such a way that the taxable person should have the capacity to disprove the evidence provided by the tax administration in order to safeguard the right to deduct input tax paid.¹⁰⁴

¹⁰⁰ Administrative Procedure Law, Republic of Latvia, Article 59 (1) (2).

¹⁰¹ Administrative Procedure Law, Republic of Latvia, Articles 67(3) (4). (5).

¹⁰² Administrative Procedure Law, Republic of Latvia, Articles 107 (4) and 150 (3).

¹⁰³ Case SKA-166/2010, 15.03.2010. Supreme Court, Republic of Latvia, para 9.

¹⁰⁴ Case SKA-53/2007, 21.02.2010. Supreme Court, Republic of Latvia, para 6.2.2.

Interim conclusions

Therefore it allows the conclusion that in Latvia the burden of proof in VAT disputes is initially allocated to the tax administration, but after the final tax administration's decision the tax liability increases which shifts the burden of proof to the taxable person.

4.3.2. Allocation of the burden of proof in other EU Member States

In Austria the tax authority generally bears the burden of proof. The tax authority is required to investigate all relevant facts in order to levy taxes. On the other hand, the taxable person has an obligation, on request of tax authority, to cooperate and to provide all necessary facts and to dispel doubts which could lead to tax liability.¹⁰⁵ In Belgium the burden of proof is allocated to the party which invokes facts. Therefore, the tax authority bears the burden to conclude that the information provided by the taxable person is incorrect. Nevertheless, the burden of proof in Belgium can be shifted to the taxable person if it does not comply with the obligation to cooperate with the tax administration.¹⁰⁶ Also in Finland, tax authorities generally bear the burden of proof related to facts which constitutes the basis for the tax claim, and, from other side, the taxable person bears the burden of proof to show circumstance alleviating or eliminating tax claims. This approach is governed by the principle that the burden of proof rests with the party with the easiest access to the information concerned.¹⁰⁷ A similar approach is exercised in Spain. Moreover, in the Spain the burden of proof is allocated by the principle that the party which wishes to make a claim must prove underlying facts. Nevertheless in disputes involving abuse of law, the burden of proof can be shifted to the taxable person.¹⁰⁸ In France, as well as in Belgium, the burden of proof can be used as a penalty if the taxable person does not comply with its obligations, in such situations the burden of proof is shifted to the taxable person. In France the burden of proof lies with the party with the easiest access to the relevant information.¹⁰⁹ Similar to the situation in Latvia, in Portugal courts hearing tax disputes are obliged to investigate all the facts in the case on their own motion. In Portugal, in VAT related disputes where the right of deduction is called into question, the burden of proof is shifted to the taxable person.¹¹⁰

Interim conclusions

The examples of the allocation of the burden of proof in Belgium, Finland, Spain, France and Portugal do not include all relevant aspects of the domestic approaches exercised, but nevertheless they suggest that a number of different methods are exercised across the EU. Therefore it can be concluded that, due to the procedural autonomy of each Member State to design their own procedural rules, the burden of proof rules across the EU differ.

¹⁰⁵ J.Heinrich, 2011. „The Burden of Proof in Tax Matters”, National report - Austria. EATLP, p.1, 2, 5. [Electronic]: Available: [http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20Austria%20\(2\).pdf](http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20Austria%20(2).pdf) Download date 26.05.2013.

¹⁰⁶ M. Maus, 2011. „The Burden of Proof in Tax Matters”, National report - Belgium. EATLP, p.1,2, [Electronic]: Available: [http://www.eatlp.org/uploads/public/Answers%20Belgian%20report%20\(2\).pdf](http://www.eatlp.org/uploads/public/Answers%20Belgian%20report%20(2).pdf) Download date 26.05.2013.

¹⁰⁷ O. Ryyänen, 2011. „The Burden of Proof in Tax Matters”, National report - Finland. EATLP, p.1,2,5. [Electronic]: Available: <http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20Finland.pdf> Download date 26.05.2013.

¹⁰⁸ M. Leon, 2011. „The Burden of Proof in Tax Matters”, National report - Spain. EATLP, p.1. [Electronic]: Available: <http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20Spain.pdf> Download date 26.05.2013.

¹⁰⁹ G. Meussen, K.Drüen, B.Leidhammar, G.Marino, 2011. „The Burden of Proof in Tax Matters”, National report - France. EATLP, p.1,2,5. [Electronic]: Available: [http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20France%20\(3\).pdf](http://www.eatlp.org/uploads/public/Burden%20of%20Proof%20-%20France%20(3).pdf) Download date 26.05.2013.

¹¹⁰ N. Garcia and J. Fernandes, 2011. „The Burden of Proof in Tax Matters”, National report - Portugal. EATLP, p.1,8,9. [Electronic]: Available: <http://www.eatlp.org/uploads/public/uppsala/Burden%20of%20proof%20PORTUGAL.pdf> Download date 26.05.2013.

4.3.3. CoJ case law and allocation of the burden of proof

Despite of some indications this thesis made clear that EU VAT law does not contain rules which precisely govern how the burden of proof must be allocated in VAT disputes. Moreover allocation of the burden of proof falls within the procedural autonomy of each Member state. Nevertheless CoJ case law indicates how burden of proof allocations must be done in VAT disputes.

4.3.3.1. Case C-184/05 – Twoh International

In the case *Twoh International* CoJ dealt with the question of the allocation of the burden of proof and the obligation of the tax authorities to gather evidence on the basis of administrative cooperation between tax administrations in the area of VAT. Therefore, the judgement in the *Twoh International* case is directly related to the question how the burden of proof should be allocated in VAT disputes. The case involved interpreting the grounds for applying the authority conferred on tax administration by the Mutual assistance directive¹¹¹ and the Administrative cooperation regulation.¹¹² Despite the fact that both legislative acts have been replaced by now with new ones, the acknowledgments from the judgment in *Twoh International* case are relevant, since the aims for cooperation between Member States remain the same and are not affected by the new legislative acts.

The relevant facts in this case are that the company established in the Netherlands, Twoh International (hereinafter Twoh) supplied computer parts to companies established in Italy. The parties used the “*ex works*” delivery method.¹¹³ Subsequently, Twoh was required to place goods at the disposal of the buyer at a warehouse which was located in the Netherlands. Transportation of the goods to Italy was the responsibility of the buyers. Twoh did not receive from the companies (established in Italy) proof that they declared intra-Community acquisition of the goods. Subsequently, Twoh did not fulfil the obligation required by Netherland’s tax law that a supplier is obligated to prove that the supply of goods was intra-Community by nature.¹¹⁴

The tax administration took the view that Twoh did not demonstrate that the goods had been dispatched or transported to another state. As a result, the tax administration calculated an additional VAT payment for Twoh. Twoh disagreed with that decision and on the basis of the Mutual assistance directive and the Administrative cooperation directive requested that the tax administration gather information from the competent Italian authority to demonstrate that the buyers had declared the intra-Community acquisition of the goods in Italy.¹¹⁵

The national court considered that the dispute involves interpretation of EU law and, therefore, referred the preliminary question to the CoJ. In essence the court asked whether the first subparagraph of Article 28c(A)(a) of the Sixth Directive (now Article 138 (1) of the VAT Directive), in conjunction with the Mutual assistance directive and the Administrative cooperation regulation have be interpreted in a way that, upon request of the taxable person,

¹¹¹ Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct and indirect taxation, OJ L 336, 27.12.1977, now replaced with Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC. OJ L 64, 11.3.2011.

¹¹² Council Regulation (EEC) No 218/92 of 27 January 1992 on administrative cooperation in the field of indirect taxation OJ L 24, 1.2.1992, now replaced with Council Regulation (EU) No 904/2010.

¹¹³ Delivery method (EXW) means that the customer collects goods at the supplier’s premises. EXW is one of the international commercial clauses (‘Incoterms 2010’) drawn up by the International Chamber of Commerce.

¹¹⁴ Case C-184/05, *Twoh International*, paras 15, 16.

¹¹⁵ Case C-184/05, *Twoh International*, paras 17, 18.

the tax authorities of the Netherlands are obligated to seek information from the competent authorities in Italy with an aim to use that information to establish whether the goods had in fact been the subject of an intra-Community supply and acquisition of the goods.¹¹⁶

The CoJ reasoned that the tax administration on the basis of evidence provided by the taxable persons and from their statements is obligated to check whether or not goods have left the territory of the Member state where the transportation or dispatch of the goods began. CoJ reasoned that the Sixth Directive does not contain provision which deals directly with the question regarding what information can serve as objective evidence, since the first part of the sentence in Article 28c (A) of the Sixth Directive (now Article 131 of the VAT Directive) stipulates that it is for Member States to determine the condition under which they will exempt intra-Community supply of the goods. Nevertheless, the domestic provision must comply with the general principles of EU law, especially with the principles of the proportionality and legal certainty. CoJ ruled that when a taxable person seeks derogation or exemption from VAT the burden of providing the necessary proof lies on the taxable person.¹¹⁷

The CoJ held that the legal measures that derive from the Mutual assistance directive and the Administrative cooperation regulation do not confer any rights to individuals other than in obtaining information regarding the validity of the VAT registration number of any specified person. The Mutual assistance directive and the Administrative cooperation regulation do not serve to establish the intra-Community nature of goods, in situations when a taxable person by him or herself is not able to furnish the necessary evidence. Tax administration authority is unrestricted in requesting from a taxable person himself to furnish the proof necessary, and is not obliged to perform enquiries on the basis of the request of the taxable person.¹¹⁸

Last but not least, the CoJ indicated that even if the tax administration of the Netherlands were to request information from a competent authority of Italy and subsequently received confirmation that the buyer had submitted the declaration to the Italian tax authorities confirming intra-Community acquisition of goods, such information by itself cannot serve as decisive evidence capable of establishing that the goods actually left the territory of the Member State where the dispatch or transportation of the goods began.¹¹⁹

Interim conclusions

In *Twoh International* case the CoJ reasoning makes it clear that in VAT disputes when transactions involved are subject to exemptions or derogations from the overall VAT system, the burden of proof lies on the taxable person. In *Twoh International* the burden of proof was allocated to the taxable person because he wanted to benefit from the exemption with the right of deduction provided for intra-Community supply of the goods. The tax administration is not bound by the taxable person's request to perform additional enquiries for the benefit of the taxable person. The Directive 2011/16 on administrative cooperation in the field of taxation and Regulation 904/2010 on administrative cooperation and combating fraud in the field of VAT do not provide rights for individuals receive information except the information regarding the validity of the VAT registration number of any specified person.

¹¹⁶ Case C-184/05, *Twoh International*, para 21.

¹¹⁷ Case C-184/05, *Twoh International*, paras 23-26.

¹¹⁸ Case C-184/05, *Twoh International*, paras 31, 34, 35.

¹¹⁹ Case C-184/05, *Twoh International*, para 37.

Therefore, from the *Twoh International* judgement the question arises whether the conclusions from this case concerning the allocation of proof can be applied when a taxable person performs economic activities purely in a domestic market which is not related to derogations or exemptions from the overall VAT system. Particularly, the facts in this case concern intra-Community supply of goods, the CoJ, in the paragraph 26 of the *Twoh International*, explicitly emphasised that a person who seeks tax treatment which is based on the derogation and exemption from the overall VAT system is obligated to prove that all necessary conditions are fulfilled. Therefore, it allows the conclusion that CoJ reasoning, given in this judgement, is limited to only situations where transactions involve derogations or exemptions.

Equally important is to ascertain that the CoJ acknowledges that the VAT Directive does not contain any rules of evidence related to the intra-Community supply of goods. The CoJ conclusions regarding domestic rules of evidence define that domestic rules of evidence must comply with general principles of EU law. Similarly the VAT Directive does not contain any rules of how the burden of proof must be handled in VAT disputes related to intra-Community supply of goods. This fact did not restrict the CoJ to rule that the burden of proof lies within taxable persons who seek to benefit from it when derogations or exemptions of the overall VAT system is involved. Moreover this conclusion is not based on any EU VAT rules or the general principles of EU law, and consequently undermines the effectiveness of Article 131 of the VAT Directive which confers procedural autonomy to Member States to lay down *inter alia* rules of allocation of the burden of proof.

4.3.3.2. Case C-273/11, Mecsek-Gabona

Mecsek-Gabona, a company established under Hungarian law, concluded a contract with Agro-Trade srl (hereinafter Agro), company established in Italy. Mecsek-Gabona sold to Agro 1 000 tons of rapeseed. Agro undertook to transport the goods to another Member State. The goods were picked up and weighted at Mecsek-Gabona premises. Afterwards the quantities of the goods sold were recorded on CMRs.¹²⁰ Originals of the CMRs remained with the carriers. The serial numbers of the CMRs were returned to Mecsek-Gabona by post from the purchaser's address in Italy. Two invoices were issued, the first invoice was paid by a Hungarian private person, and the second invoice wasn't paid at all. Mecsek-Gabona verified that Agro had a VAT identification number.¹²¹

Hungarian tax authorities, in the course of checking Mecsek-Gabona tax returns, requested information from the Italian tax authorities. Italian tax authorities informed that Agro could not be found at the registered address and that no company with that name had been registered at that address, which was a private residence. Additionally, Agro never paid VAT and its VAT identification number was removed from the register with retroactive effect. On the basis of this information the Hungarian tax authorities concluded that Mecsek-Gabona has failed to furnish evidence that transaction at question was an intra-Community supply of goods.¹²²

Mecsek-Gabona appealed to the court and argued that tax authority's decision must be annulled since Mecsek-Gabona had acted with due diligence, checked the validity of

¹²⁰ Consignment notes drawn up in accordance with the Convention on the Contract for the International Carriage of Goods by Road, signed in Geneva on 19 May 1956.

¹²¹ Case C-273/11, *Mecsek-Gabona*, paras 15-19.

¹²² Case C-273/11, *Mecsek-Gabona*, paras 21-23.

purchaser's VAT identification number and received CMRs from the purchaser's address in Italy. Moreover, Mecsek-Gabona argued that they could not have had any knowledge of the fact that the Italian tax authority had removed Agro identification number from its VAT register with retroactive effect. Italy's national court considered that an interpretation of Article 138 of the VAT Directive is necessary and therefore referred three preliminary questions to the CoJ. The first and second question inquires if Article 138 of the VAT Directive precludes to refuse an exemption with right to deduct input VAT situation when:

- the right to dispose goods as owner passes to the purchaser in the Member state where the vendor is established, while the purchaser is established in another Member state and at the time of the transaction had a valid VAT registration number, and the purchaser undertook the responsibility to transport the goods to another Member state;
- the vendor furnishes evidence in the form of CMRs and confirms that the goods sold have been picked up by foreign-registered vehicles.

With the third question the national court asked if the vendor may be refused VAT exemption for intra-Community supply of goods on the grounds that the tax authority of another Member State has removed the purchaser's VAT identification number from the register with retroactive effect.¹²³

CoJ argued that it is the responsibility of the vendor to provide evidence that the title of goods has been transferred and that the goods have been dispatched to another Member state. Identically like in *Twoh International* the CoJ concluded that if the mentioned conditions are not fulfilled, the right to deduct input VAT can be refused. However, CoJ emphasized that even if the taxable person has fulfilled the obligations concerning evidence, the right to deduct can be made conditional upon taxable person's good faith. Consequently the right of deduction can be denied if on the basis of objective evidence it is established that the taxable person knew or should have known that the transaction, which it had carried out, was part of a tax fraud committed by the purchaser. Regarding the question if the evidence provided by Mecsek-Gabona can be sufficient to benefit from exemption the CoJ concluded that it falls outside competence sphere, since the VAT Directive does not contain rules about evidential proof. CoJ stressed that the obligation set for a taxable person to furnish evidence must be determined in the light of national law and general practice established in respect of similar transactions. When national courts apply domestic rules they are obliged take in to account the general principles of EU law and in particularly, the principles of legal certainty and proportionality.¹²⁴

Regarding the third question the CoJ concluded that it would be contrary to the principle of proportionality if the right to deduct input VAT would be dependent on the fact that the purchaser's VAT identification number was removed from the register with retroactive effect.¹²⁵

Interim conclusions

The CoJ conclusions in *Mecsek-Gabona* case summarise that in situations when the taxable person has furnished evidence to benefit from exemption granted for intra-Community supply

¹²³ Case C-273/11, *Mecsek-Gabona*, paras 24, 27.

¹²⁴ Case C-273/11, *Mecsek-Gabona*, paras 31-33, 36-38, 45, 51, 53, 54.

¹²⁵ Case C-273/11, *Mecsek-Gabona*, paras 63 - 64.

of goods these rights can be rendered conditional upon good faith. In order to deny the right to deduct the tax authority bears the burden of proof to provide evidence that the taxable person knew or should have known that the transaction, which it had carried out, was part of a tax fraud committed by the purchaser.

4.3.3.3. Joined cases C-80/11 and C-142/11 *Mahagében and Dávid*

The joined cases *Mahagében and Dávid* are related to the interpretation of the domestic practise exercised to combat VAT avoidance and evasion pursuant to Article 273 of the VAT Directive from the perspective of the allocation of the burden of proof.

C-142/11 *Dávid*

The relevant facts in the *Dávid* case were that Mr. Dávid undertook to carry out various construction works. However, Mr. Dávid did not carry out all construction work by himself, he used a subcontractor Mr. Máté. Mr. Dávid paid remuneration to Mr. Máté on the basis of the certificate of completion of the work. After tax inspection, the tax administration concluded that Mr. Máté did not have any employees or equipment to carry out the work with respect to the invoices that were issued to Mr. Dávid. Mr. Máté reissued invoices to his father-in-law who also did not have any employees. Moreover, his father-in-law did not fill out any tax returns at the tax year at issue. In the light of those circumstances, the tax authorities concluded that on the basis of invoices issued by the subcontractor it was not possible to establish that the economic transaction detailed in them had taken place. Though the tax authorities did not contest the fact that construction work was actually carried out, it was impossible, for VAT purposes, to ascertain which contractor carried them out. Because of those inconsistencies, the tax administration concluded that Mr. Dávid did not act with necessary due diligence. In addition to the mentioned construction work, Mr. Dávid had undertaken to carry out another construction work where he used a different subcontractor, which at the time of tax inspection was already in liquidation. Due to the liquidation of the subcontractor it was not possible to acquire relevant documents, because it was impossible to contact the former representative and the liquidator did not have possession of relevant information. Similar to the first situation, tax administration took the view that Mr. Dávid did not act with due diligence because he did not provide evidence which would have proven that the subcontractors had the resources necessary to carry out the construction work. On the basis of above mentioned facts tax administration refused Mr. Dávid the right of deduction and imposed a fine for late payment.¹²⁶

Mr. Dávid brought an action before the court and argued that he was satisfied with the construction work carried out by the subcontractors. Moreover he maintained that the economic activity indeed took place, and that he had checked the status of the invoice issuer and therefore he cannot be held liable for any irregularities on the part of the subcontractor in situations where it is not proven that he knew or should have known that he acted improperly. The national court was unsure whether Mr. Dávid had right to deduct, therefore it referred three preliminary questions to the CoJ. The first question asked whether the right of deduction can be refused on the basis of strict liability if the issuer of an invoice cannot guarantee that further subcontractors complied with their obligations. The second question, in essence, asked whether the right of deduction can be refused in situations where the tax authority does not dispute that the economic activity detailed in the invoices actually took place and the form of

¹²⁶ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 24-29.

invoice complies with legal rules. The third question was related to the second question, the court asked whether the tax authorities are obliged to prove that a person who seeks to exercise his right of deduction was aware of unlawful conduct exercised by the issuer of the invoice or by the another taxable person upstream of the transaction chain.¹²⁷

The CoJ reasoned that there were no doubts that Mr. Dávid received supplies of services and that they were subsequently used as outputs for the purposes of his taxable transactions. The CoJ concluded that in this dispute all the substantive and formal conditions which derive from the VAT Directive were satisfied, and the order for reference did not indicate that Mr. Dávid acted unlawfully. The CoJ emphasized that the right to deduct can be refused on the basis of objective factors which would establish that Mr. Dávid knew, or ought to have known, that that transaction was connected with fraud previously committed by the supplier or another trader at an earlier stage in the transaction. Consequently, the establishment of a system of strict liability would go beyond what is necessary to preserve the public exchequer's rights. Therefore, the CoJ concluded that Articles 167, 168(a), 178(a), 220(1) and 226 of the VAT Directive¹²⁸ must be interpreted as precluding national practice when tax administration refuses the right to deduct on the grounds that the issuer of the invoices acted improperly without establishing that, on the basis of objective evidence, the fact that Mr. Dávid knew, or ought to have known, that the transaction relied on fraudulent ends.¹²⁹

Case C-80/11 Mahagében

Mahagében regularly bought acacia logs from the supplier Rómahegy-Kertkft (hereinafter Rómahegy). Pursuant to the supply of the goods concerned, Rómahegy issued 16 invoices. Rómahegy paid VAT and declared all the supplies in his tax return, stating that deliveries of the goods took place. Mahagében also declared acquisition of the goods and exercised its right to deduct. During the tax inspection of purchase and deliveries performed by Rómahegy, the tax administration concluded that Rómahegy did not have any reserves of the goods concerned and that the amount of goods purchased was insufficient to fill the orders invoiced to Mahagében. Consequently, on the basis of acquired facts, the tax administration concluded that Mahagében had no right of deduction with respect to those invoices issued by Rómahegy.¹³⁰

Mahagében contested the decision and brought an administrative appeal against the initial decision of the tax administration. The appeal was rejected on the grounds that Rómahegy did not have the quantity of goods indicated on the invoices. Additionally it did not have an appropriate lorry for delivery of the goods nor was any evidence provided which would indicate the price was paid for delivery of the goods. Moreover it was concluded that Mahagében did not act with due diligence since it did not check whether Rómahegy was a taxable person and whether it was in possession of the goods which Mahagében wished to purchase. Mahagében brought an action before the court and argued that it had acted with due diligence and that its role is limited to the obligation to verify that the supplying company had

¹²⁷ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 30-33.

¹²⁸ Article 167 of the Directive stipulates that right to deduct arises at the time when the deductible tax becomes chargeable. According to Article 168 (a) taxable person is entitled to deduct VAT due or paid from the VAT, which he is liable to pay, if goods and services are used for taxable transactions. Article 178 of the VAT Directive governs that for the purposes of deduction taxable person must have a properly drawn invoice. Article 220 (1) of the VAT Directive sets an obligation for taxable person that an invoice is issued, and Article 226 of the VAT Directive details what must be reflected on the invoice.

¹²⁹ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 43,44,45-50.

¹³⁰ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 15-18.

a VAT registration number and that it was capable of carrying out the transaction concerned.¹³¹

The national court had doubts that the right to deduct VAT can be refused on the grounds that issuer of the invoice did not enter the goods into its bookkeeping accounts and that without the lorry it was unable to deliver the goods. Consequently, the national court referred a preliminary questions to the CoJ and in essence asked whether such administrative practise is proportional and compatible with Article 273 of the VAT Directive and whether the concept of due diligence is compatible with the principles of fiscal neutrality and proportionality. Additionally, the court asked whether Articles 167, 168(a), 178(a), 220(1) and 226 of the VAT Directive¹³² preclude national legislation or practice which requires a taxable person receiving an invoice to verify compliance with the law by the supplier who issued the invoice.¹³³

The CoJ reasoning was similar to the reasoning in the *Dávid* case where it concluded that the right to deduct cannot be refused if taxable person had possession of the goods and a properly drawn invoice confirming that the goods were actually supplied from the supplier indicated on it. The supplies were subsequently used as outputs for the purposes of his taxable transactions. Similar to the *Dávid* case, the CoJ referred to the use of the *knowledge test* and concluded that it must be applied before the right to deduct can be refused. Additionally, the CoJ argued that it is not contrary to EU law to require a trader to act with due diligence to satisfy himself so that the transaction does not result in participation in tax evasion if there are indications of infringement or fraud. Nevertheless, measures of due diligence cannot lead to the situation where the right to deduct is systematically undermined, since it is contrary to the principle of fiscal neutrality of VAT. The CoJ argued that the powers conferred to Member States pursuant to Article 273 of the VAT Directive gives the domestic legal systems a margin of discretion when domestic law is designed to ensure correct levying and collection of VAT and to prevent its evasion. Nevertheless, national measures taken must not go further than is necessary to attain this objective.¹³⁴

It is equally important to acknowledge that the CoJ concluded that tax authorities must not set an obligation for a taxable person, that wishes to exercise its right of deduction, to establish that the issuer of the invoice has the capacity of taxable person, that he was in possession of the goods at issue and was capable to supply them, and that he has satisfied his obligations regarding the declaration and payment of VAT, to satisfy that there are no irregularities or fraud committed by the traders operating at an earlier stage of the transaction. The CoJ concluded that the tax authorities generally carry out the burden of proof and that, in principle, it is the task of the tax authorities to carry out the necessary inspections in order to detect VAT irregularities. Therefore, it is disproportional to ask a taxable person that wishes to exercise its right to deduct to carry out investigation tasks in place of the tax authority. The obligation to carry out the necessary inspections derives from Article 242 which sets a responsibility for the taxable person to keep accounts in sufficient detail, and from Articles 245 and 249 of the VAT Directive which empowers the tax authority to check invoices which the taxable person has stored under Article 244 of the VAT Directive.¹³⁵ (See section 4.3.)

¹³¹ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 19,20.

¹³² See *Supra* note 128.

¹³³ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 21,22.

¹³⁴ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 50, 51,52, 54,55,57, 60.

¹³⁵ Joined cases C-80/11 and C-142/11, *Mahagében and Dávid*, paras 61, 62,65,64

4.3.3.4. Case C-563/11 Forwards V

In the *Forwards V* case, the national court asked the CoJ whether the right of deduction can be denied to a taxable person which did not carry out abusive practise and fulfilled all formal and substantial requirements necessary to exercise its right to deduct, in a situation where the supplier of the goods denies any existence of economic activity and had no capacity to supply the goods concerned.¹³⁶

The CoJ delivered a court order in *Forwards V* case and concluded that disputes which relate to the allocation of the burden of proof can be regarded as *acte éclairé*. The CoJ reasoning was similar to that of the *Mahagében* and *Dávid* cases. In addition to the conclusions given in the *Mahagében* and *Dávid* cases, the CoJ in the *Forwards V* case argued that the burden of proof lies with the tax authorities as well, in situations when irregularities are committed directly by the supplier and consequently the concerned supply is considered not to have actually taken place, therefore, considering it uncertain if the taxable person actually had received the goods or services from the supplier indicated in the invoice.¹³⁷

Interim conclusions

The CoJ reasoning provided in the *Mahagében* and *Dávid* case becomes significant when the question of allocation of the burden of proof in VAT disputes arises. Consequently, the obligation to examine the intentions of the supplier and his compliance with the formal and substantive requirements of the VAT Directive and domestic procedural law cannot be transferred to a taxable person. It becomes clear that in situations when all formal and substantive requirements of the VAT Directive are fulfilled by the taxable person, the burden of proof is allocated to the tax authority. This means that taxable persons must be in possession of a properly drawn invoice and acquired goods or services that were subsequently used as outputs for the purposes of their taxable transactions. Moreover, the burden of proof is assigned to tax authority even in situations when, due to the irregularities in upstream transaction chains, tax authorities have doubts that taxable persons received the goods or services indicated by the taxable person in the invoices, consequently it is disputable that a transaction could actually have taken place. Before the right to deduct can be denied, tax authorities are obliged to apply the *knowledge test*, which in practice means that tax authorities carry out the burden to prove that a taxable person knew, or ought to have known that transactions carried out by the taxable person or other transaction upstream or downstream¹³⁸ of the transaction chain are vitiated by fraud. From the court order delivered in the *Forwards V* case it can be concluded that the allocation of the burden of proof in VAT disputes that do not involve derogations or exemptions from the VAT system is regarded as *acte éclairé*.

It is important to ascertain that the CoJ conclusions in the *Mahagében* and *Dávid* case do not limit the procedural autonomy of Member States to compel taxable persons which seek to exercise the right of deduction to prove and consequently furnish evidence that they were in possession of goods and services indicated in invoices and that the goods and services acquired are or will be subsequently used as taxable outputs when irregularities committed by these taxable person are noticed.

¹³⁶ Case C-563/11, *SIA Forwards V*, para 21.

¹³⁷ Case C-563/11, *SIA Forwards V*, paras 23, 25, 26, 35, 38, 39, 40, 41.

¹³⁸ Case C-285/11, *Bonik*, para 40;

It is not contrary to EU law to require a taxable person to act with due diligence to satisfy himself so that the transaction does not result in participation in tax evasion if there are indications of infringement or fraud. Nevertheless, measures of due diligence cannot be lead to the situation when the right to deduct is systematically undermined. This means that taxable person can be obliged to act with additional precaution but can't be forced to carry out checks of its business partner to ensure that the issuer of the invoice has the capacity of a taxable person, as well as that he was in possession of the traded goods and was capable to supply them and last but not least, that the business partner has fulfilled his obligation to declare the transaction and pay VAT.

Additionally it can be concluded that the CoJ intention to safeguard the right to deduction jeopardises the Member States national practise domain when the burden of proof is allocated to the taxable person or when the method is applied that evidence must be provided by the party who has the easiest access to the information (See section 4.3.). The mentioned problematic of allocating the burden of proof in Member state national practice can arise in scenarios when the right of deduction is refused on the basis that the transaction chain is vitiated by VAT fraud or on the grounds of other irregularities committed by other taxable persons involved in that transaction chain.

Compiling the analysed information in this section of this thesis allows the conclusion that procedural autonomy conferred to Member States to lay down rules which allocate the burden of proof is highly limited. The CoJ has clarified that in situations, where transactions related to derogations or exemptions from the overall VAT system, the burden of proof is allocated to the taxable person. In contrast if the taxable person has provided all necessary evidence, its rights can be rendered conditional on good faith, however in such situations the tax authority bears the burden of proof. At the same time, if transactions performed by the taxable person do not involve any derogations or exemptions from the general VAT system and the taxable person has fulfilled all substantive requirements to exercise the right of deduction, then in general, the burden of proof is allocated to the tax authorities.

5. CONCLUSIONS

The principles common to the EU and specifically the principles of proportionality, effectiveness, equivalence, legal certainty and the protection of the legitimate expectations and the principle of fiscal neutrality play a pivotal role in ensuring proper functioning of the EU VAT system. On the basis of those principles, it is possible to render domestic administrative rules and practises incompatible with the EU VAT system. Moreover in VAT disputes, domestic administrative rules and practise must be set aside if they are in conflict with the fundamental rights guaranteed by the CFREU. Domestic rules and practises of the Member States must ensure the effectiveness of EU law. Member States are obliged to ensure that taxable persons can rely on the belief that they will receive VAT treatment as expected. Due to the general objective set for the EU and its Member States to combat VAT evasion and fraud, the legitimate expectations of taxable persons can be set aside if they intentionally participated in tax fraud, knew or should have known that transactions concerned are vitiated by tax fraud. Measures taken with the goal to achieve this objective must not go further than necessary to attain this objective and, consequently must be in conformity with the principle of proportionality.

Despite of the fact that some rules related to evidence and allocation of the burden of proof can be found in EU VAT rules Member States still have a wide discretion to lay down their own rules of evidence. This procedural autonomy is limited in such an extent that domestic provisions must comply with the general principles of the EU. However, the procedural autonomy conferred to Member States to lay down rules which allocate the burden of proof is highly limited. The CoJ has clarified that in situations when transactions are related to derogations or exemptions from the overall VAT system, the burden of proof is allocated to the taxable person. In contrast if the taxable person has provided all necessary evidence, its rights can be rendered conditional on good faith. In such situations the tax authority bears the burden of proof. At the same time, if transactions performed by the taxable person do not involve any derogations or exemptions from the general VAT system and the taxable person has a properly drawn invoice and the acquired goods and services are used to carry out taxable transactions then the burden of proof is lies with the tax authorities. This method to allocate the burden of proof must be applied even in situations when, due to irregularities in the upstream or downstream transaction chain, the tax authorities are uncertain that the taxable person had possession of the goods or services indicated in the invoice. The interpretation of EU VAT rules given by the CoJ and EU VAT rules themself do not limit the procedural autonomy of Member States to compel taxable persons, which seek to exercise the right of deduction, to prove and consequently furnish evidence that they were in possession of goods and services indicated in the invoices and that the goods and services acquired are or will be subsequently used as taxable outputs when irregularities committed by these taxable person are noticed. Nevertheless, actions taken by the Member States must confer with the principles common to the EU.

It is not contrary to EU law that national procedural rules set an obligation for a taxable person to act with due diligence before they carry out taxable transactions. Those rules must comply with the principles common to the EU, and cannot oblige taxable person to carry out investigational tasks which is in the tax authority's field of competence.

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