EUROPEAN COURT OF HUMAN RIGHTS
COUR EUROPÉENNE DES DROITS DE L'HOMME

FIRST SECTION

DECISION

Application no. 31651/08
Alojzy FORMELA
against Poland

The European Court of Human Rights (First Section), sitting on 5 February 2019 as a Chamber composed of:

Linos-Alexandre Sicilianos, *President,*
Ksenija Turković,
Krzysztof Wojtyczek,
Pauliine Koskelo,
Tim Eicke,
Jovan Ilievski,
Gilberto Felici, *judges,*

and Abel Campos, *Section Registrar,*

Having regard to the above application lodged on 3 June 2008,

Having deliberated, decides as follows:

THE FACTS

1. The applicant was represented before the Court by Mr A. Bielewicz, a lawyer practising in Kartuzy. The Polish Government ("the Government") were represented by their Agent, Mr J. Wołąsiewicz, who was succeeded by Ms J. Chrzanowska and by Mr J. Sobczak of the Ministry of Foreign Affairs.

2. The applicant complained that in spite of his having fully complied with his statutory VAT reporting obligations, the domestic authorities had deprived him of the right to deduct the input VAT which he had paid on a supply of goods because his suppliers had not or had been late in complying with their own VAT reporting obligations.

3. On 31 May 2011 the application was communicated to the Government.

A. The circumstances of the case

4. Mr Alojzy Formela, is a Polish national, who was born in 1942 and lives in Gdańsk.

5. At the relevant time he ran a business and was registered as an active taxpayer, both under the general scheme – having been assigned a tax identification number (a "NIP number") – and under the Law of 8 January 1993 on tax on goods and services and excise duty (*Ustawa o podatku od towarów i usług oraz o podatku akcyzowym*; "the VAT Act").

1. Taxable transactions

(a) With supplier K.

6. In 2001 the applicant purchased goods from company K. (hereinafter "supplier K." or "company K."), which had its own NIP number and which was registered as an active VAT payer.

7. The transactions constituted a taxable supply under the VAT Act.

8. Supplier K. issued invoices to the applicant for sales which occurred between January and June 2001 and between August and December 2001. The applicant paid these invoices in full. The net value of the sales in question amounted to 246,911 Polish zlotys (PLN) (approximately 66,732 euros (EUR)) and included PLN 54,315 (approximately EUR 14,679) of VAT.

9. The applicant logged his transactions with supplier K. in his accounting records and retained the originals of the relevant invoices.

10. On unspecified dates he filed his VAT returns for the above-mentioned months with the tax office. The applicant's output VAT (*podatek należny*) in the said tax returns was reduced by his input VAT (*podatek naliczony*) in the amount shown on the relevant invoices from supplier K. (see paragraph 8 above).

11. Supplier K. initially retained the copies of the invoices documenting the above-mentioned transactions with the applicant.

12. On 22 May 2002 supplier K. informed the tax authorities that the invoices in question had been stolen. The company promised to reconstruct all the missing paperwork but failed to do so.

13. In 2003, following a tax audit, company K. was apparently investigated on suspicion of issuing fraudulent invoices.

14. Moreover, it appears that supplier K.'s VAT arrears arising from transactions with the applicant between January and June 2001 and between August and November 2001 – which had been established as a result of the audit – could not be recovered by the State as they had become statute-barred. The relevant VAT arrears for December 2001 have likewise not yet been recovered, given the difficulties in the execution proceedings against supplier K.

(b) With supplier S.

15. In 2002 the applicant purchased services from company S. (hereinafter "supplier S." or "company S.") which, at that time, had been assigned a NIP number but was not registered as a VAT payer.

16. The transactions appeared to constitute a taxable supply under the VAT Act.

17. Supplier S. issued invoices to the applicant for sales which occurred in the months of March and June 2002. The applicant paid these invoices in full. The net value of the sales in question amounted to PLN 12,300 (approximately EUR 3,324) and included PLN 2,706 (approximately EUR 731) of VAT.

18. The applicant recorded his transactions with supplier S. in his accounting records and retained the originals of all the relevant invoices.

19. On unspecified dates he filed his VAT returns for the above-mentioned months with the tax office. The applicant's output VAT in the said tax returns was reduced by his input VAT in the amount shown on the relevant invoices from supplier S. (see paragraph 17 above).

20. Supplier S. recorded all the sales in question in its accounting records and retained the copies of the relevant invoices.

21. Supplier S. failed to file its VAT forms with the tax office before the statutory deadline.

22. On 29 April and 17 May 2004, after having registered as a payer under the 1993 VAT Act, supplier S. voluntarily filed its outstanding VAT forms and paid the tax office the VAT amounts arising from the respective transactions with the applicant.

23. It appears that on 14 May 2004 the applicant read the file relating to the audit of supplier S.'s business which had been completed on 21 May 2003 and which revealed irregular business activities on the part of company S.

2. The applicant's VAT audit

24. On 28 April 2004 the tax authorities decided to conduct a VAT audit of the applicant's business. In the course of this inspection a cross-check of suppliers was conducted in order to ascertain whether they had properly recorded and reported the transactions in question in their accounting records. As a result the following discrepancies were discovered.

(a) Tax assessment regarding transactions with supplier K.

25. In the absence of copies of the invoices recording sales to the applicant between January and June 2001 and between August and December 2001, the tax authority reviewed the VAT forms which had been filed with the tax office monthly by supplier K. The forms disclosed only the total amount of VAT due and did not show the detailed records of each

sale. It was therefore only possible to find out the VAT amount that supplier K. had paid each month but not to establish from which particular transactions the VAT stemmed. In four out of the eighteen months which were checked, company K. declared a lower amount of VAT than that which had been declared by the applicant.

26. In the light of the above findings, the tax authority challenged all the calculations submitted by the applicant with regard to his transactions with supplier K.

27. On 28 October 2005 the tax authority in Kartuzy issued tax assessments for the applicant for the months from January to June 2001 and from August to December 2001. The authority refused the applicant the right to offset the input VAT which he had paid to company K. because the supplier had not kept copies of the invoices and had paid a lower amount of output VAT for four of those months (January, April, June and December 2001).

28. The authorities also pointed out that in February, March, April, May, June, August, September, October, November and December 2001 company K. had declared a lower amount of VAT than that calculated on the basis of invoices which it had issued to various other business partners. It was therefore concluded that company K. had breached the VAT regulations.

29. Lastly, the tax authority established that the applicant was liable to pay VAT on the received supply. Accordingly, they ordered the applicant to pay VAT arrears into the State budget, together with interest. These VAT arrears included PLN 54,315 (approximately EUR 14,679) of the VAT arising from the impugned transactions with supplier K. The tax authority observed that, generally speaking, a purchaser was liable for any illegal actions on the part of its supplier. They also pointed out that supplier K. had failed to reconstruct the missing copies of the records in question and had not met its obligations under the 1993 VAT Act.

30. The applicant appealed on 30 November 2005. He submitted that all the transactions had been accompanied by VAT invoices issued both as originals and as copies and that he had kept all the originals, thus furnishing proof that the transactions had indeed occurred.

31. He also pointed out that he had fulfilled all his obligations under the 1993 VAT Act, namely that he had paid the VAT when purchasing the goods, had retained the originals of the invoices, and had diligently filed all the VAT forms with the tax office. He also submitted that holding him liable for the mistakes or negligence of his business partners would be against the spirit of the law.

32. On 19 April 2006 the Gdańsk Fiscal Directorate (*Dyrektor Izby Skarbowej*) upheld the relevant first-instance decisions, making reference to section 19 § 1 of the 1993 VAT Act and paragraph 50 (4) 2 and (6) of the Minister of Finance's Ordinance of 22 December 1999 (*Rozporządzenie w sprawie wykonania niektórych przepisów ustawy o podatku od towarów i*

usług oraz o podatku akcyzowym; "the 1999 Ordinance") (see paragraph 62 below).

33. The directorate observed that the applicant had reduced the output VAT by the amount of the input VAT shown on invoices which were not confirmed by copies kept by the supplier. Moreover, it was not possible to verify whether the supplier had properly recorded all the sales as the relevant paperwork had been stolen and not reconstructed. Lastly, in the months of January, April, June and December 2001 the output VAT declared by the supplier had been lower than the input VAT calculated on the basis of the original invoices retained by the applicant. Consequently, it had to be presumed that paragraph 50 (6) did not apply, since the supplier had not recorded the sales.

34. On 5 June 2006 the applicant applied for judicial review. He submitted that there only were four months in which the supplier had declared a lower amount of output VAT than the input VAT which he had declared. Nonetheless, the authorities had used that fact as a justification for challenging all the calculations he had made and for refusing him the right to offset the input VAT in respect of all his transactions with company K.

35. He also stated that he could not be held liable for the absence of the reconstructed paperwork, as that had not been his fault and he had personally shown all the diligence required. And yet, regardless of that fact, he had been obliged to pay the VAT for a second time. He argued that he was being punished not for his own actions but for omissions on the part of the supplier, and he had had no means of forcing the supplier to act in accordance with the law.

36. On 19 December 2006 the Gdańsk Regional Administrative Court (*Wojewódzki Sąd Administracyjny*) upheld the directorate's decision of 19 April 2006, finding that the applicant could not offset the input VAT because the impugned transactions were not confirmed by the supplier's duplicate invoices as required under paragraph 50 (4) 2 of the 1999 Ordinance.

37. On 13 March 2008 the Supreme Administrative Court (Naczelny Sąd Administracyjny) dismissed a cassation appeal lodged by the applicant.

38. The administrative courts found that the decisions had been delivered in compliance with the law as applicable at the material time. They also reasoned that the questions of whether or not the relevant transactions had actually taken place and whether or not the applicant had properly retained all the invoices were irrelevant because the law was very clear in not allowing any exceptions.

(b) Tax assessment regarding transactions with supplier S.

39. On 28 October 2005 the tax authority in Kartuzy issued tax assessments for the months of March and June 2002. They refused the applicant the right to offset the input VAT which he had paid to supplier S.

in March and June 2002 because at the time of effecting the transactions the supplier had not been a registered VAT payer, had not filed its VAT declaration and had not paid the output VAT. The tax authority reasoned that because supplier S. had not been registered, it had not been entitled to issue invoices. Consequently, the invoices which had been issued by it could not serve as a basis for offsetting the input VAT. The authorities concluded that supplier S. had breached the provisions of the 1993 VAT Act and, as a general rule, a purchaser was liable for any illegal actions on the part of its supplier.

40. The tax authority also established that the applicant had been liable to pay VAT on the received supply. Accordingly, they ordered the applicant to pay the VAT arrears into the State budget, together with interest. These VAT arrears included PLN 2,706 (approximately EUR 731) of the VAT stemming from the impugned transactions with supplier S.

41. On 30 November 2005 the applicant appealed against the tax assessment decisions. He submitted that supplier S. had eventually met its obligations by recording all the transactions and paying the outstanding tax. Consequently, the fiscal authorities must have received the same VAT twice over – once from the applicant, following the challenged decisions, and once from the supplier. The applicant also mentioned that those facts must have been known to the tax authority at the time of issuing the tax assessment. He stated that he had fulfilled all his obligations and that holding him liable for the negligence of his contractor would be against the spirit of the law.

42. On 19 April 2006 the Gdańsk Fiscal Directorate upheld the relevant first-instance decisions of 28 October 2005. The directorate concurred with the first-instance authority's reasoning and added that even if the purchaser had acted in good faith, he was still exposed to a risk emanating from the activities of his business partners. The directorate also observed that there was no evidence confirming the argument that supplier S. had filed or corrected the relevant VAT-7 forms or that it had paid that tax.

43. On 5 June 2006 the applicant applied for judicial review, arguing that the tax authorities had based their decisions on Section 50 (4) 2 of the 1999 Ordinance, which was identical to the unconstitutional provision of the 2002 Ordinance (see paragraph 62 below).

44. On 19 December 2006 the Gdańsk Regional Administrative Court upheld the decision of 19 April 2006, finding that the applicant could not offset the input VAT for the impugned transactions with supplier S. because at the relevant time the latter had not been registered as a VAT payer and hence had not been entitled to issue invoices within the meaning of paragraph 50 (4) 1 (a) of the 1999 Ordinance. It also reasoned that the tax authorities had performed an audit covering a certain period and had verified the existence and the contents of the documents, all of which was required of them under the applicable law. Any later events could not

therefore be of any relevance. Lastly, the court also reiterated that a buyer could seek compensation from a dishonest business partner by means of a civil law action.

45. The applicant appealed, arguing, *inter alia*, that the impugned decisions legitimised double taxation and the unjust enrichment of the State Treasury because supplier S. had also paid the VAT in question – a fact which had not been disclosed by the first and second-instance authorities. The applicant also submitted that the civil remedy against a business partner had not been available to him in respect of S. as the latter had paid the VAT arrears with interest prior to the tax decision of the first-instance authority.

46. On 13 March 2008 the Supreme Administrative Court dismissed a cassation appeal lodged by the applicant. It held that the basis for invalidating the applicant's right to offset input VAT was the fact that the VAT invoices had been issued by an entity which could confer no such entitlement in view of the lack of its VAT registration at the time of the transactions. Consequently, the question of whether the applicant's supplier had or had not paid the tax in question was irrelevant for the case at hand.

(c) Financial consequences for the applicant

47. The Government submitted that on 13 December 2005 the tax authority in Kartuzy had granted the applicant the right to pay the impugned VAT arrears and interest in ten instalments. On an unspecified date the applicant completed the payment of the tax with interest. The 2005 decision and the copies of payment slips have not been submitted to the Court.

48. After the completion of the tax proceedings, the applicant did not rectify his tax return for personal income tax.

B. Relevant domestic law and practice

1. General provisions on VAT

49. At the relevant time, VAT was regulated by the general Tax Act of 29 August 1997 (*Ordynacja podatkowa*), which is still in force, by a series of specific laws such as the VAT Act – which was in force from 5 July 1993 until 1 May 2004 – and by the 1999 Ordinance, which was in in force from 1 January 2000 until 26 March 2002. The 1999 Ordinance was repealed by the Minister of Finance's Ordinance of 22 March 2002 on the implementation of the provisions of the law governing tax on goods and services and excise duty (*Rozporządzenie w sprawie wykonania niektórych przepisów ustawy o podatku od towarów i usług oraz o podatku akcyzowym* (hereinafter the "2002 Ordinance"), which was in force from 26 March 2002 until 1 May 2004.

50. VAT had to be paid by any person (legal or natural, resident or non-resident) who had had a taxable turnover exceeding EUR 10,000 during the preceding taxing year (Section 14 of the VAT Act).

51. It was charged on the price payable for a supply of goods or services plus certain costs, taxes and charges, but not including the VAT itself. Most domestic supplies of goods and services were taxable at the standard rate of twenty-two per cent VAT (Section 18 of the VAT Act).

52. VAT was generally to be reported and paid monthly. Monthly returns had to be filed with the tax office and monthly payments made by the twenty-fifth day of the following month (Section 10 of the VAT Act).

53. Taxpayers were obliged to register as "VAT payers" with the tax office prior to effecting their first taxable sale or service (Section 9 (1) of the VAT Act). The tax office was under a duty to confirm the registration application and to assign a NIP number, unless the taxpayer had already been allocated one prior to his VAT registration (Section 9 (2) of the VAT Act).

54. Under Section 32 of the VAT Act, taxpayers had a duty to issue an invoice confirming the sale of goods, the date of the transaction, the price of each item before tax, the value of the sale, the amount of tax payable, and data concerning the taxpayer and the supplier. Paragraph 36 of the 1999 Ordinance in turn provided that registered VAT payers who had a NIP number were entitled to issue VAT invoices.

55. VAT invoices, including those issued by a supplier, had to indicate the buyer and seller's NIP numbers (Section 9 (8) of the VAT Act and paragraph 37 of the 1999 Ordinance). Information on a supplier's status as a VAT payer was not shown on the invoice.

56. At the material time, a VAT-registered buyer could verify whether or not his supplier was a registered and active VAT payer by seeking such information by telephone or, more formally, by applying to a local tax authority under Section 9 (9) a of the VAT Act, for a certificate to this end, which was to be issued within seven days.

57. Between 1 January 2003 and 1 May 2004, the VAT Act contained Section 32 (a) (added by amendment), under which a buyer could file with its supplier a written inquiry about the latter's VAT status. The supplier had a duty to produce the original or a notarised copy of its VAT registration (Section 32 (a) 1). In the event the supplier did not comply with its VAT reporting obligations, the buyer could avoid further tax sanctions if it had confirmation that it had sent such a written inquiry to the supplier but had not received the requested information in reply (Section 32 (a) 3).

Section 32(a) of the VAT Act, in so far as relevant, read as follows:

> "1. Upon receipt of a written request from a buyer of goods or services, a taxpayer issuing a VAT invoice has a duty to: ...
>
> 2. provide [the buyer], in connection with the sale of goods to the buyer:

a) [with] access to accounting ledgers ..., and

b) [with] copies of VAT declarations, in the part thereof documenting their filing in the period during which the [supplier] was under a tax obligation

..."

58. VAT payers were under an obligation to retain both the original and the duplicate invoices for a period of five years (paragraph 52 of the 1999 Ordinance).

59. Output VAT (podatek należny) is an ad valorem tax charged on the selling price of taxable goods or services, and is payable by the customer (buyer). Input VAT (podatek naliczony) is an *ad valorem* tax charged on the receipt of a taxable supply of goods or services, in a given tax period, and which a VAT-registered customer (buyer) can, under certain conditions, offset against its output tax.

2. Offsetting input VAT

(a) Provisions applicable at the material time (prior to Poland's accession to the European Union)

60. The offsetting of input VAT was regulated mainly in Section 19 of the VAT Act and then further in the 1999 and 2002 Ordinances.

61. Section 19 of the VAT Act, in so far as relevant, read as follows:

"1. A taxpayer has the right to reduce output tax by input tax on the purchase of goods and services connected with a taxable sale.

2. Input tax is the sum of taxes detailed on invoices confirming the purchase of goods and services..."

62. Paragraph 50 of the 1999 Ordinance and paragraphs 48 of the 2002 Ordinance, respectively, had the same wording. In so far as relevant, they read as follows:

"1. Invoices and rectification invoices shall be issued in at least two copies, with the originals being forwarded to the buyer and the duplicates remaining with the supplier.

...

3. Only originals of invoices or originals of rectification invoices or their duplicates ... shall constitute a basis for reducing output VAT or for the reimbursement of input VAT

4. In the event that:

1) the sale ... has been documented by means of invoices or rectification invoices:

(a) which were issued by ... an entity not entitled to issue invoices ...,

...

2) a buyer is in possession of an invoice or rectification invoice not confirmed by a duplicate [kept] by the supplier ...

> such invoices ... shall not constitute a basis for reducing the output VAT or reimbursing the input VAT.
>
> ...
>
> 6. Point 4 (2) shall not be applicable in cases where a supplier issuing an invoice or a rectification invoice has recorded the sale detailed on the invoice in his VAT declaration."

63. Likewise, paragraph 51 (1) of the 1999 Ordinance and paragraph 49 (1) of the 2002 Ordinance, respectively, read as follows:

> "1. In the event that the original of the invoice or the original of the rectification invoice has been damaged or lost, at the buyer's request the supplier must re-issue the invoice in accordance with the data appearing on the duplicate."

(b) Domestic courts' practice prior to Poland's accession to the European Union

64. The domestic courts of higher jurisdiction have ruled on several occasions on the provisions regulating the offsetting of input VAT in so far as they did not allow a buyer to offset the tax in cases where a supplier was not entitled to issue invoices or had failed to confirm a taxable transaction by means of its own VAT return or, additionally, by a duplicate invoice.

65. In its judgments of 16 June 1998 (no. U 9/97) and of 11 December 2001 (no. SK 16/00), the Constitutional Court (Trybunał Konstytucyjny) essentially confirmed that unpaid VAT was the liability of the buyer, even if the latter had acted in good faith. It also found that the principle *in dubio pro fisco* – as derived from the provisions governing invoices set out, in almost identical wording, in the subsequent ordinances implementing the 1993 VAT Act – complied with the Constitution.

66. This approach was also confirmed by the Supreme Administrative Court (Naczelny Sąd Administracyjny) in the applicant's own case (judgment of 13 March 2008 (no. I FSK 329/07)), in another case resulting from similar facts (judgment of 24 May 2000 (no. I SA/Wr 2241/97)), and in a series of cases concerning undisputedly fraudulent businesses concluding tax transactions under the law applicable prior to Poland's accession to the European Union (judgments of 24 February 2009 (no I FSK 1700/07), 17 April 2000 (no. III SA 642/99), 22 October 2010 (no. I FSK 1786/09) and 31 January 2012 (no. I FSK 575/11)). The same point of view was also expressed by the Supreme Court (Sąd Najwyższy) in its judgment of 28 January 2014 (no. I CSK 220/13).

67. The above-mentioned judgments all contain the conclusion that a VAT payer could indeed be required to undertake all possible steps to ensure that his or her transactions were not a part of a chain of fraudulent deals on the part of a supplier. In other words, a taxpayer was expected to choose his or her business partners with caution.

68. The judgments also all reiterate that a buyer's right to offset input tax did not arise merely out of the possession of an original invoice because,

as demonstrated by the wording of the relevant provisions, it was the actual input tax and not the declared input tax that could be deducted by a buyer. The right to offset input tax was, rather, the consequence of a legal transaction and the actual realisation of the supplier's tax obligation from the preceding stage of the turnover. Consequently, such a right did not arise if the person issuing the invoice had not confirmed the impugned transaction by means of a duplicate invoice and included it in his or her own VAT declaration.

69. On 27 April 2004 the Constitutional Court delivered a judgment resulting from an application lodged by the Ombudsman under Article 191, read in conjunction with Article 188 of the Constitution (case no. K 24/03).

70. The Constitutional Court made the preliminary observation that despite their similarity, the content of the provisions which had already been subjected to constitutional scrutiny was not identical to that of the constitutional complaint at issue, particularly in view of the changed normative context in the wake of the incorporation of Article 32 (a) into the VAT Act.

71. The Constitutional Court then held that both of the impugned provisions were unconstitutional.

72. The Constitutional Court concluded that Section 32 (a) of the VAT Act was flawed for the following two reasons.

Firstly, the provision was excessively formalistic and rigorous in that it accepted that an original VAT invoice which was not confirmed by the existence of a copy could not serve as a basis for offsetting the input VAT, even taking into consideration an exceptional situation in which the supplier has indicated the VAT obtained from the buyer on its VAT form. To this end, the Constitutional Court observed that a taxpayer should at least have the chance to demonstrate that it had, genuinely and in accordance with the law, paid the VAT to the supplier in the amount indicated on the original invoice. In other words, a taxpayer should be allowed to rebut the presumption of fact that an invoice which is not confirmed by a duplicate in the supplier's possession is a fake. Such rebuttal should be possible by means of tax payer's actions such as tax payment or filing a tax return and also by means of submitting counter-evidence in the course of tax proceedings. Exclusion of counter-evidence by virtue of the impugned provisions led to a preponderance of formal truth and that, in turn, violated the principle of the rule of law.

Secondly, the impugned provisions imposed a disproportionate burden on VAT payers by requiring them to undertake specific due diligence or audit actions and constituted an unjustified interference with their business activities. The court also observed that investigation of a supplier's VAT status and its accounting ledgers did not prove whether or not the supplier had in fact paid the VAT due to the tax authorities. That, in turn, meant that

the aforementioned audit actions were actually intended to help the tax authorities monitor the general compliance with tax law.

73. Lastly, the Constitutional Court found that paragraph 48 (4) 2 of the 2002 Ordinance regulated the legal consequences of a situation which was already the subject of a higher-ranking provision, namely Section 32a of the VAT Act. That was considered to breach the prohibition of repeating or reformulating content regulated by an act of law in a lower-ranking ordinance.

74. The Constitutional Court also expressly noted that the judgment referred to did not have any retroactive legal effect and that the unconstitutionality of the impugned provision did not constitute a basis for claiming return of the tax which had been assessed by means of a final decision of the tax authority or paid under the provision in question.

(c) Current domestic law and practice

75. The VAT Act and the 2002 Ordinance were repealed on 1 May 2004, when Poland joined the European Union.

76. The offsetting of input VAT is now regulated by Sections 86-88 of the Law of 11 March 2004 on tax on goods and services (Ustawa o podatku od towarów i usług; hereinafter "the new VAT Act").

77. Under the current binding provisions, input VAT is calculated on the basis of the original invoices held by the taxpayer (Section 86 § 2 (1)). Tax authorities are entitled to check whether accounting records correspond with the transaction in question (Section 87 § 2b). To this end, the authorities can seek additional evidence.

78. Since June 2015 a VAT-registered buyer can check whether or not his supplier is registered as an active VAT payer by means of an automated search in the State internet database called "Tax Portal".

(d) European Union Practice

79. Although at the relevant time Poland was not a member of the European Union (EU), domestic VAT legislation in some respects followed the provisions of Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes, known as the Sixth VAT Directive, which at the time was the principal basis for the system of value-added tax in the EU.

The Court of Justice of the European Union (CJEU) has issued several rulings concerning non-compliance with this directive in the context of carousel frauds or other situations involving a trader (that is to say a supplier) who, having incurred liability for VAT, failed to discharge that liability with the tax authorities.

In all such cases the CJEU has held, essentially, that transactions which were not themselves vitiated by VAT fraud but which formed part of a chain of supply in which another prior or subsequent transaction had been

vitiated by such fraud – without the trader (that is to say the buyer) who was engaged in the first transactions knowing or having any means of knowing - constituted supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2(1), 4 and 5 (1) of the Sixth Directive. Moreover, the right of a taxable person carrying out such transactions to deduct input VAT could not be affected by the fact that, in the chain of supply of which those transactions formed part, another prior or subsequent transaction was vitiated by VAT fraud without that taxable person knowing or having means of knowing (Joined cases C-354/03, C-355/03 and C-484/03, *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v. Commissioners of Customs and Excise,* 12 January 2006).

Similarly, in a later case referring to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, the CJEU ruled that the relevant provisions of that directive must be interpreted as precluding a national practice whereby the tax authority refuses a taxable person the right to deduct, from the value added tax which he is liable to pay, the amount of the value added tax due or paid in respect of the services supplied to him on the grounds that the issuer of the invoice relating to those services, or one of his suppliers, acted improperly, without that authority establishing, on the basis of objective evidence, that the taxable person concerned knew, or ought to have known, that the transaction relied on as a basis for the right to deduct was connected with fraud committed by the issuer of the invoice or by another trader acting earlier in the chain of supply (*Mahagében kft v. Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága (C-80/11) and Péter Dávid v. Nemzeti Adó-és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága* (C-142/11), 21 June 2012).

3. Legal remedies

(a) Action under the law on liabilities

80. Articles 415 et seq. of the Civil Code (Kodeks Cywilny), which entered into force in 1964, provide for liability in tort. Under this provision, anyone (including a legal person) who through his or her fault causes damage to another is required to remedy such damage. The burden of proving the damage and the causal link lies with the plaintiff (Article 6 of the Civil Code). Under Articles 445 § 1 and 448 of the Civil Code the court may award to the injured person an appropriate sum in pecuniary compensation for the material and non-material damage suffered.

81. Article 355 § 2 of the Civil Code provides that in a business context a debtor must act with professional due diligence. And under Article 361 § 1 of the same code, any person who has a duty to pay

compensation is liable only for the ordinary effects of his or her actions or omissions which caused the damage.

82. Article 442^1 of the Civil Code sets out limitation periods for civil claims based on tort. This provision, in its current version, reads, in so far as relevant, as follows:

> "1. A claim for compensation for damage caused by a tort shall lapse after the expiration of three years from the date on which the claimant learnt or, having ensured due diligence, could have learnt of the damage and of the person responsible for it. However, this time-limit may not be longer than ten years following the date on which the event causing the damage occurred."

83. The Constitutional Court, the Supreme Administrative Court and the Warsaw Regional Administrative Court expressed a general proposition that a buyer who was not entitled to offset his input VAT because of fraud or a lack of diligence on the part of his or her supplier could seek compensation from that supplier by means of a civil law action (see the judgments of the Constitutional Court of 16 June 1998 (no. U.9/97) and of the Supreme Administrative Court of 13 March 2008 delivered in the applicant's own case (no. I FSK 329/07), of 24 May 2000 (no. I SA/Wr 2241/97), of 29 July 2007 (no. I FSK 105/05), and the judgment of the Warsaw Regional Administrative Court (Wojewódzki Sąd Administracyjny) of 7 May 2004 (no. III SA 539/03)).

(b) Claim for return of overpaid personal income tax (PIT)

84. Under Section 22 (1) of the Law of 26 July 1991 on personal income tax (Ustawa o podatku dochodowym od osób fizycznych), deductible expenses are ones that are incurred in order to achieve an income or protect a source of income. Section 23 (43) of the same law provides that VAT does not constitute a deductible expense unless it is input VAT of a kind which, under the VAT provisions, cannot be the subject of offsetting.

COMPLAINTS

85. The applicant complained under Article 1 of Protocol No. 1 to the Convention about the tax authorities' refusal to recognise his right to have input VAT deducted on account of his suppliers' failure to provide evidence that they had complied with their own VAT obligations.

THE LAW

A. Alleged violation of Article 1 of the Protocol No. 1 to the Convention

86. The applicant complained that, in spite of having fully complied with his statutory VAT reporting obligations, the domestic authorities had deprived him of the right to offset the input VAT which he had paid on a supply of goods received by him because the two suppliers in question had either not complied, or had been late in complying, with their own VAT reporting and payment obligations. The above complaint relates to the transactions with company K. which took place between January and June 2001 and between August and December 2001, and those with company S. in June and August 2002. The applicant argues that there was a breach of his property rights as provided for in Article 1 of Protocol No. 1 to the Convention, which reads as follows:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

1. Government's preliminary objections

87. The Government raised two preliminary objections as to the admissibility of the application. They argued firstly that the case was incompatible *ratione materiae* with the provisions of the Convention and secondly, that the applicant had not exhausted the domestic remedies available to him.

(a) The Parties' submissions on incompatibility *ratione materiae*

88. In the Government's view, the applicant had not acquired the right to deduct the input VAT because, so long as his suppliers had not complied with their VAT reporting obligations, he could not himself be considered as having complied with the statutory conditions for the VAT deduction. Consequently, he did not have "possessions" – even within the meaning of a "legitimate expectation" – which would be protected under Article 1 of Protocol No. 1 to the Convention. To this end, the Government argued that the right to offset the input VAT was the result of a complex tax relationship between the applicant and his suppliers, whom he had chosen freely. Moreover, the rules on offsetting were widely known, foreseeable and applied equally to all VAT payers. Lastly, the Government referred to the judgment of the Polish

Constitutional Court of 16 June 1998 (no. U 9/97), which reaffirmed that the right to deduct input VAT arose only if the supplier had paid VAT and that the risk – if a dishonest business partner was chosen – lay with the purchaser of the goods or services in question.

89. In particular, with regard to supplier S., the applicant had not demonstrated due diligence by checking his supplier's tax status and its credibility.

90. The applicant submitted essentially that he had complied with all of his VAT reporting and payment obligations.

(b) The Parties' submissions as to the exhaustion of domestic remedies

91. The Government also argued that the applicant had failed to exhaust the domestic remedies available at the material time.

92. The applicant argued that by appealing against the impugned tax decisions all the way up to the Supreme Administrative Court, he had satisfied the requirement of the exhaustion of domestic remedies.

(c) The Court's assessment

93. The Court observes at the outset that it has already examined a similar issue of the applicability of Article 1 of Protocol No. 1 to the Convention (see *"Bulves" AD v. Bulgaria*, no. 3991/03, 22 January 2009; *Business Support Centre v. Bulgaria*, no. 6689/03, 18 March 2010; *Nazarev v. Bulgaria* (dec.), nos. 26553/05, 25912/09, 40107/09 and 12509/10, 25 January 2011; *Atev v. Bulgaria* (dec.), no. 39689/05, 18 March 2014 and *Euromak Metal Doo v. the Former Yugoslav Republic of Macedonia*, no. 168039/14, 14 June 2018).

94. In particular, in the case of *"Bulves"* AD, the Court held that the applicant company could claim a legitimate expectation that it would be allowed to deduct the input VAT which it had paid to its supplier and, hence, had a "possession" within the meaning of Article 1 of Protocol No. 1, in so far as (i) it had complied fully and within the time-limit with the VAT rules set by the State (had paid the VAT on the supply on the basis of the VAT invoice issued by its supplier, had entered the supply in its accounting records, and had reported it in its VAT return for the relevant period), and (ii) had had no means of enforcing compliance by its supplier and no knowledge of the latter's failure to comply (see *"Bulves"* AD, cited above, §§ 54- 57).

95. There is no dispute as to the fact that, in the instant case, in respect of the transactions with either supplier, the applicant paid the VAT when purchasing the goods or services, retained the original invoices and diligently filed all the VAT forms with the tax office. On the other hand, because the tax status of each supplier and the shortcomings in their tax obligations importantly differed, the Court will examine the Government's

objection *ratione materiae* separately in respect of the applicant's transactions with S. and with K.

(i) Transactions with supplier S.

96. The Court thus notes that the domestic tax authorities and the courts established that supplier S. had not had a valid VAT registration and had therefore not been entitled to issue VAT invoices for his transactions with the applicant (see paragraphs 15, 22, 39, 44 and 46 above).

97. Unlike the Bulgarian tax law from the *Bulves* era, the applicable Polish provisions on VAT were clear, firstly, that a taxable transaction and the issuing of VAT invoices could have only been carried out by a registered VAT payer (see paragraphs 53 and 54 above) and, secondly, that invoices issued by an entity not entitled to do so, did not constitute a basis for input VAT offsetting (see paragraph 62 *in fine*).

98. Moreover, the Court finds that, unlike in the case of *"Bulves" AD*, the domestic authorities undertook a thorough review of the relevant circumstances, free from arbitrariness, which resulted in a finding that there had been a failure on the part of the applicant to meet relevant statutory requirements for entitlement to VAT deduction.

99. Lastly, the Court duly notes that the State provided legal and practical means for taxpayers such as the applicant to check the VAT status of their business partners (see paragraph 56 above). It is clear that merely obtaining confirmation of VAT registration did not ensure further compliance by the suppliers with their remaining VAT reporting, filing and payment obligations. Inquiring about VAT status could nevertheless diminish such risks and could therefore be perceived as a sign of the diligence to be ordinarily exercised between business partners. This is regardless of the fact that, as in the circumstances of the instant case, the invoices on the basis of which the applicant carried out his transactions appear to have contained accurate and complete information about the supplier and the amount of VAT levied on the services which were being sold (see, in contrast, *Atev*, cited above, § 22). On this point, the Court considers that duly completed invoices - which had to show the NIP number but no information about a supplier's VAT registration (see paragraphs 54 and 55 above) – could not, as such, provide buyers with any grounds for suspecting tax fraud on the part of a supplier. However, it cannot be ignored that, under the applicable law, only VAT-registered taxpayers were entitled to issue such invoices (see paragraph 54 above), on pain of depriving a buyer of his or her right to offset input VAT (see paragraphs 60-62 above).

100. The Court is therefore of the opinion that, in the particular context of VAT, buyers such as the applicant could be expected to make use of the relatively straightforward verification mechanism which was put in place by the State.

101. In view of these elements, the Court finds that the applicant did not have a "legitimate expectation" to be allowed to deduct VAT and, consequently, what is at stake with regard to his transactions with supplier S. cannot be seen as a "possession" within the meaning of Article 1 Protocol No. 1.

102. Accordingly, this part of the application is incompatible *ratione materiae* with the provisions of the Convention within the meaning of Article 35 § 3 (a) and must be rejected in accordance with Article 35 § 4.

(ii) Transactions with supplier K.

103. The Court observes that the shortcomings on the part of supplier K. were of a different nature and it might be considered that, similarly to *Bulves*, the applicant had no means of knowing of K.'s failure to comply with his reporting and payment obligations (see, *"Bulves" AD*, cited above, § 57 with further references).

104. The Court, nevertheless does not consider it necessary to examine this part of the Government's objection *ratione materiae* or their plea of inadmissibility on the grounds of non-exhaustion of domestic remedies, because the application, in so far as it relates to the applicant's transactions with supplier K. is in any event inadmissible for the reasons stated below.

2. Remainder of admissibility assessment in respect of transactions with supplier K.

(a) The Parties' submissions

105. The Government argued that there had been no interference with the applicant's right to the peaceful enjoyment of his possessions. Moreover, they submitted that the authorities had acted lawfully and in the general interest in order to ensure the collection of taxes and enforce discipline in tax reporting. The regulation of taxes was at the State's discretion and was justified by the second paragraph of Article 1 of Protocol No. 1 to the Convention. The regulations which were challenged by the applicant reflected the fundamental principle of VAT, namely that a supplier must pay the tax arising out of any sales invoice issued. Only then can the buyer deduct the corresponding VAT from his output tax. These regulations had both preventive and deterrent effect and had been adopted in order to curtail the issuing of invoices documenting non-existent transactions. In this sense, they sought to minimise the risk of dishonest practices on the part of suppliers wishing to evade the payment of taxes.

106. The Government emphasised that, in the present case, supplier K. had not reconstructed his accounting records. Consequently, it had not recorded the transactions in relation to which the applicant claimed a right of deduction nor had it reported them in its own tax returns.

107. Moreover, supplier K. had not paid any of the tax liabilities arising from the impugned transactions with the applicant, which further justified even more the intervention of the tax authorities in the applicant's case.

108. The Government further submitted that, unlike the Bulgarian authorities in *Bulves*, the Polish authorities had undertaken a thorough review of the relevant circumstances before coming to the conclusion that the applicant had failed to exercise the special diligence required of VAT-registered persons in choosing their business partners.

109. The Government wished to reassure the Court that after Poland's accession to the European Union the VAT law had been harmonised with the European Union law. Consequently, the prohibition on offsetting input VAT when an invoice had been issued by an entity unauthorised to do so had been repealed.

110. The Government also argued that the applicant could have lodged a civil action against his suppliers seeking compensation for the damage caused by their failure to comply with their VAT obligations.

111. Lastly, the Government argued that the applicant had not borne excessive financial consequences in view of the fact that his turnover was PLN 1,627,268 (approximately EUR 407,000) for 2001 and PLN 1,245,594 (approximately EUR 311,400) for 2002. The applicant had not ceased his business activity as a result of the tax arrears imposed. Moreover, he had been authorised to pay – and indeed paid – the disputed liability over time, in installments. The Government then presented various figures showing the importance of VAT as one of the main sources of income in Poland's State budget.

112. The applicant complained in substance of a violation of Article 1 of Protocol No. 1 in that, in spite of having fully complied with his own VAT reporting obligations, the domestic authorities refused him the right to offset the input VAT which he had paid on a received supply of goods because his suppliers had not complied, or had been late in complying, with their own VAT reporting and payment obligations. Moreover, as a result of the refusal to allow the aforementioned deduction, the applicant had unjustifiably had to pay the input VAT a second time, plus interest, this time directly into the State budget in accordance the tax assessment decision. The applicant submitted that, altogether, he had paid PLN 110,000 (approximately EUR 27,500) in tax with interest.

(b) The Court's assessment

113. Assuming that the instant case falls to be examined under the second paragraph of Article 1 of Protocol No. 1 to the Convention, as the alleged interference at stake was clearly aimed at "securing the payment of taxes", the Court reiterates that although the State has a wide margin of appreciation in the field of taxation, an instance of interference must strike a "fair balance" between the demands of the general interest of the

community and the requirements of the protection of the individual's fundamental rights (see *Gasus Dosier und Fördertechnik GmbH v. the Netherlands*, 23 February 1995, §§ 59-60, Series A no. 306-B; *Khodorkovskiy and Lebedev v. Russia*, nos. 11082/06 and 13772/05, § 870, 25 July 2013 and *Euromak*, cited above, § 42). In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised (see, *Atev*, cited above, § 28). The Contracting States have a wide margin of appreciation when passing laws for the purpose of securing the payment of taxes (see *Atev*, cited above, § 29).

114. The Court notes that the alleged interference in question was lawful and pursued a legitimate aim in the public interest: namely to secure the payment of the VAT (*Bulves*, cited above, § 65 and *Atev*, cited above, § 27). It remains to be seen if such interference strikes the above mentioned "fair balance".

115. In one of its leading VAT cases, *Bulves*, the Court found that the interference with the applicant's property rights was disproportionate as a result of a rigid interpretation of the relevant legislation by the domestic authorities, in that the refusal of the VAT deduction had been automatic, without adequate review of relevant factors such as (i) the timely and full discharge by the applicant company of its VAT reporting obligations, (ii) its inability to secure compliance by its supplier with its VAT reporting obligations, and (iii) the fact that there was no fraudulent activity in relation to the VAT system of which the applicant company had either any knowledge or the means of obtaining such knowledge (see *Bulves*, cited above, § 71).

116. The Court reaffirmed these considerations as the applicable criteria in subsequent applications (*Business Support Centre*, §§ 21 and 22; *Nazarev; Atev*, §§ 30 and 31; and *Euromak*, § 45, all cited above). The Court will therefore proceed to examine the present case against the *Bulves* criteria.

117. The Court observes that, in the present case, the domestic authorities interpreted the relevant legislation in line with the settled and uniform practice of the domestic courts, including the Constitutional Court (see paragraphs 64-74 above). The respective rulings in the applicant's cases were thus based on the prevalent premise that a VAT payer, even if acting in good faith, was liable for its suppliers' tax omissions and could legitimately be required to undertake all possible steps to ensure that its transactions were not a part of a chain of fraudulent deals on the part of a supplier (see paragraph 67 above).

118. Nevertheless, the tax authorities and the domestic courts in fact examined all the circumstances of the applicant's impugned transactions by means of audits and cross-checks of supplier K.'s VAT forms (see paragraphs 25, 26 and 28 above; comparable with the actions of the Bulgarian tax authorities in *Bulves*, cited above, § 12 and in *Atev*, cited

above, §§ 7 and 8). However, that did not have any bearing on the overriding context of the impugned proceedings, namely the fact that the applicable provisions did not permit any exceptions and automatically rendered the applicant buyer liable for any negligent or illegal actions on the part of his supplier which fell within the scope of paragraph 50 of the 1999 Ordinance (see paragraphs 29 and 38; comparable to *Bulves*, cited above, §§ 17 and 19 and Atev, cited above, § 8 *in fine*).

119. In conclusion, the Court considers that the authorities applied a similar approach towards the applicant as the Bulgarian authorities in the *Bulves* case and in its follow-up, the *Atev* case. More specifically, they failed to attach any particular weight to the applicant's compliance with his own reporting, filing and payment obligations (see paragraphs 30, 31, 35 and 38 above; comparable to *Bulves*, cited above, § 67 and *Atev*, cited above, §§ 31 and 32; and in contrast to *Nazarev*, cited above), his inability to secure compliance by his supplier with its VAT registration or reporting obligations, and the fact that there was no fraudulent activity in relation to the VAT system of which the applicant company had either any knowledge or the means of obtaining such knowledge.

120. On the other hand, although the applicant complied with his own statutory VAT obligations, the Court notes that the legal issue which is at the core of this case is whether the application of clearly established rules of Polish VAT law on the applicant imposed an excessive burden on him which, despite the wide margin of appreciation, would justify this Court finding violation of Article 1 of Protocol No. 1 to the Convention.

121. Moreover, the Court notes the Government's position that fiscal stability, which is undoubtedly of public interest, must be protected by measures directed at ensuring the payment of taxes. Fiscal stability may require a complex system of rules regarding charges, exemptions, deductions and reimbursements aimed at preserving financial stability and the proper collection of VAT (see *Bulves*, cited above, § 65). Similarly in the context of the public interest, the Court is in principle ready to accept a more rigid approach on the part of the authorities towards diligent traders with the aim of securing the collection of taxes (see *Atev*, cited above, § 35). Following its position in the *Atev* case, the Court considers that, in the present case, the rule that any VAT charged must be reflected in the accounting records of the supplier in order for the recipient to have the right to offset the input VAT – despite its stringency and subsequent abandonment (see paragraph 76 above) – fell within the State's margin of appreciation and served as a guarantee of the actual payment of that tax (see, *Atev*, cited above, § 35).

122. In the case at hand, the circumstances which triggered the State's interference with the applicant's rights were essentially the failure on the part of the applicant's supplier of taxable goods and services to act honestly, or at least diligently, in its business relations with the applicant, in

observance of a series of statutory obligations, such as filing duplicate invoices, reconstructing accounting records and reporting the VAT.

123. The supplier's non-compliance with the statutory requirements thus resulted in the impugned tax proceedings and a strict approach on the part of the authorities as far as the applicant was concerned.

124. The Court observes, nevertheless, that the situation was balanced by the existence of a remedy within the framework of civil proceedings for damages, as invoked by the Government, allowing the applicant to seek and obtain compensation from his supplier (see paragraphs 80 - 83 above). In the Atev case, in view of the wide margin of appreciation given to States in the area of taxation matters, that sufficed for the conclusion that a fair balance had been struck between the protection of the applicant's rights and the demands of the general interest (see, *Atev*, cited above, § 36 and in contrast with Euromak, cited above, § 48).

125. In view of all the above considerations, the Court finds that the complaint in respect of the applicant's transactions with K. is manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3 (a) and 4 of the Convention.

B. Alleged violation of Article 6 of the Convention

126. The applicant also complained that the proceedings regarding the tax assessment were unfair, thus breaching Article 6 of the Convention, which provides, in so far as relevant:

> "In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law..."

127. The Court reiterates its case-law, according to which tax disputes fall outside the scope of civil rights and obligations, despite the pecuniary effects which they necessarily entail for the taxpayer (see *Ferrazzini v. Italy* [GC], no. 44759/98, §§ 29-31, 12 July 2001).

128. Since no punitive penalties or surcharges were imposed on the applicant, other than the obligation to pay his reassessed VAT liabilities together with interest for late payment, the proceedings at hand likewise do not fall within the criminal limb of Article 6 § 1 of the Convention (see *Nazarev*, cited above).

129. Accordingly, Article 6 does not apply to the proceedings for challenging the respective VAT assessments. It follows that the applicant's complaint under Article 6 of the Convention is incompatible ratione materiae with the provisions of the Convention within the meaning of Article 35 § 3(a) and must be rejected in accordance with Article 35 § 4.

For these reasons, the Court, unanimously,

Declares the application inadmissible.

Done in English and notified in writing on 28 February 2019.

Abel Campos Registrar	Linos-Alexandre Sicilianos President