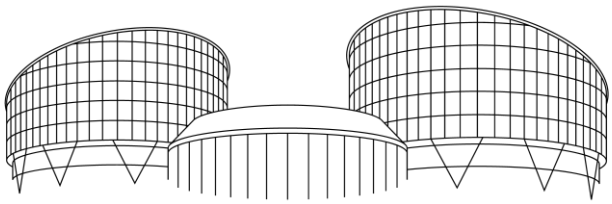

EUROPEAN COURT OF HUMAN RIGHTS
COUR EUROPÉENNE DES DROITS DE L'HOMME

FIFTH SECTION

DECISION

AS TO THE ADMISSIBILITY OF

Applications nos. 26553/05, 25912/09, 40107/09 and 12509/10
by Stefan NAZAREV and Others
against Bulgaria

The European Court of Human Rights (Fifth Section), sitting on 25 January 2011 as a Chamber composed of:

Peer Lorenzen, *President*,
Karel Jungwiert,
Mark Villiger,
Mirjana Lazarova Trajkovska,
Zdravka Kalaydjieva,
Ganna Yudkivska,
Angelika Nußberger, *judges*,

and Claudia Westerdiek, *Section Registrar*,

Having regard to the above applications lodged on 14 July 2005 (application no. 26553/05), on 24 April 2009 (application no. 25912/09), on 23 June 2009 (application no. 40107/09), and on 3 February 2010 (application no. 12509/10),

Having deliberated, decides as follows:

## THE FACTS

The applicant in application no. 26553/05 ("the first application"), Mr Stefan Mihailov Nazarev, is a Bulgarian national who was born in 1931 and lives in Plovdiv. At the relevant time he was a sole trader, registered under the name ET EKIP-3-STEFAN NAZAREV. Under Bulgarian law,

sole traders do not have a distinct legal personality separate from the natural persons in whose name they are registered. The applicant was represented before the Court by Mr M. Ekimdjiev and Ms K. Boncheva, lawyers practising in Plovdiv.

The applicants in application no. 25912/09 ("the second application") are N.D.E. EOOD, a Bulgarian sole-ownership limited liability company established in 2000 with its registered office in Sofia, and Mr Adel Abdo Sarkis, a Bulgarian national who was born in 1957 and lives in Sofia. Mr Sarkis complains both in a private capacity and as managing director and sole owner of the capital of the applicant company, which under Bulgarian law has a distinct legal personality.

The applicant in application no. 40107/09 ("the third application"), Ms Petya Borisova Hasardzhieva, is a Bulgarian national who was born in 1965 and lives in Plovdiv. At the relevant time she was a sole trader, registered under the name ET ELITKOMPLEKS-PETYA BORISOVA. She was represented before the Court by Mr M. Ekimdjiev and Ms K. Boncheva, lawyers practising in Plovdiv.

The applicant in application no. 12509/10 ("the fourth application") is T-Group Bulgaria EOOD, a Bulgarian sole-ownership limited liability company established in 2005 and with its registered office in Plovdiv. It is represented before the Court by Advokatsko Druzhestvo Balkanski & Partners, a law firm with its registered office in Plovdiv.

## A. The circumstances of the case

The facts of the case, as submitted by the applicants, may be summarised as follows.

### *1. The first application - no. 26553/05*

#### (a) The 2001 tax assessment and the appeal proceedings

On 30 March 1994 the applicant obtained a value-added tax ("VAT") registration.

In 1997 the Iztok Tax Office of the Plovdiv Territorial Tax Directorate conducted a VAT audit of the applicant for the period from 1 January to 31 December 1997. The audit ended on 29 January 1998 with a Findings of Fact, which identified a number of irregularities in the VAT compliance of the applicant and proposed that a tax assessment be issued to him. A tax assessment was, however, never issued.

On 12 June 1998 the applicant's accounting records for the 1996 and 1997 fiscal years were stolen. On 15 June 1998 he notified the police and the Iztok Tax Office of the Plovdiv Territorial Tax Directorate of the theft.

In 2001 the Plovdiv Territorial Tax Directorate conducted another VAT audit of the applicant in respect of the period from 1 January 1997 to 30 June 2000.

On 22 June 2001 the Plovdiv Territorial Tax Directorate issued the applicant with a tax assessment ("the 2001 tax assessment") whereby it refused him the right to deduct the VAT he had paid to a number of suppliers ("the input VAT") in 1997, 1998 and 1999. The input VAT whose deduction was refused totalled 51,245.60 new Bulgarian levs (BGN, 26,212 euros (EUR)), on which interest for late payment was also charged in the amount of BGN 58,585 (EUR 29,966).

On 8 August 2001 the applicant appealed against the 2001 tax assessment.

On 21 September 2001 the Plovdiv Regional Tax Directorate upheld the 2001 tax assessment in its entirety. It also noted that in so far as the 1997 VAT audit had not ended with a tax assessment, there was no formal restriction on conducting a second audit in respect of the same period.

On 14 September 2001 the applicant appealed to the courts. In the course of the proceedings the tax authorities failed to present the trial court with the original of the Findings of Fact of 29 January 1998, because they could not find it in their archives. An uncertified copy of the said document was nevertheless presented to the trial court.

In a judgment of 15 June 2004 the Plovdiv Regional Court found partly in favour of the applicant, quashed the 2001 tax assessment in respect of the deductibility of input VAT in the amount of BGN 49,516.97 (EUR 25,392) and upheld the remainder.

On an unspecified date, the Plovdiv Regional Tax Directorate filed a cassation appeal against the judgment of the Plovdiv Regional Court to partly quash the 2001 tax assessment in respect of the deductibility of input VAT in the amount of BGN 49,516.97 (EUR 25,392). In respect of the remainder, the judgment of the Plovdiv Regional Court became final.

In a final judgment of 15 March 2005 the Supreme Administrative Court reversed the judgment of the Plovdiv Regional Court, upheld the part of the 2001 tax assessment that had been quashed by the Plovdiv Regional Court and dismissed the applicant's appeal.

#### (b) Grounds for refusing the applicant the right to deduct input VAT

After the theft in 1998 the applicant did not reconstitute his accounting records for the affected years by contacting and obtaining from his suppliers copies of the stolen invoices and receipts. As a result, when the Plovdiv Territorial Tax Directorate conducted the second VAT audit in 2001 they applied Article 109 § 2 (1) to (10) of the Tax Procedure Code to assess the tax position of the applicant (see Relevant domestic law and practice below). In the course of the said tax audit the authorities examined the

records that the applicant did present and also performed cross-checks of most of the suppliers from which he claimed to have received supplies.

In the 2001 tax assessment the Plovdiv Territorial Tax Directorate refused the applicant the right to deduct input VAT on the grounds that (a) some of his suppliers did not have a valid VAT registration or (b) he had failed to present them with VAT invoices or copies thereof, evidencing that he had received VAT chargeable supplies.

In finding partly in favour of the applicant, the Plovdiv Regional Court in its judgment of 15 June 2004 considered that the tax authorities had correctly applied the procedure for assessing the applicant's tax position in view of the missing accounting records. However, it considered that the information contained in the Findings of Fact of 29 January 1998 should be considered as evidence of the applicant's VAT compliance status for the 1997 fiscal year in respect of those suppliers that the tax authorities had not cross-checked. The Plovdiv Regional Court therefore quashed the 2001 tax assessment as it related to such suppliers and in respect of the supplies that the applicant had received from two suppliers which it considered had valid VAT registrations.

In its final judgment of 15 March 2005 the Supreme Administrative Court found that the Findings of Fact of 29 January 1998 cannot be considered as evidence of the applicant's VAT compliance status for the 1997 fiscal year, and also found that the tax authorities had correctly applied the procedure for assessing the applicant's tax position in view of the missing accounting records, which the latter had failed to reconstitute. It therefore upheld the part of the 2001 tax assessment that had been quashed by the Plovdiv Regional Court and dismissed the applicant's appeal.

### *2. The second application - no. 25912/09*

#### (a) Background

On 8 July 2004 the applicant company executed a notary deed with another company (“the seller”) for the purchase of land and an unfinished three-storey building situated on it. The purchase price was BGN 650,000 (EUR 332,480) of which BGN 50,000 (EUR 25,575) was for the land and BGN 600,000 (EUR 306,905) for the unfinished building. The applicant company paid the price of the land on the day of the notary deed and agreed to pay the remainder before 31 December 2004.

On 8 September 2004 the applicant company executed a notary deed with a third party for the sale of a quarter share of part of the unfinished three-storey building – a café situated on the ground floor – together with the corresponding share of the land on which the building was situated.

On 28 October 2004 the applicant company obtained a VAT registration.

On 11 and 22 November 2004 the seller issued two VAT invoices to the applicant company for the unfinished three-storey building for a total of

BGN 600,000 (EUR 332,480), plus VAT in the amount of BGN 100,000 (EUR 51,282). The seller and the applicant company reported the transfer of the unfinished three-storey building in the November 2004 VAT reporting period and the latter claimed a deduction of the input VAT of BGN 100,000 (EUR 51,282) it had paid on the transaction.

**(b) The 2005 tax assessment and the appeal proceedings**

On 21 December 2005 the Vitosha Tax Office of Sofia Territorial Tax Directorate issued the applicant company with a tax assessment ("the 2005 tax assessment") whereby it refused the right to deduct the input VAT of BGN 100,000 (EUR 51,282) that the applicant company had paid under the two invoices from 11 and 22 November 2004 for the purchase of the unfinished three-storey building.

On 21 December 2005 the applicant company appealed against the 2005 tax assessment.

On 20 March 2006 the National Revenue Agency upheld the 2005 tax assessment.

On 11 April 2006 the applicant company appealed to the courts.

In a judgment of 6 March 2008 the Sofia City Court dismissed the appeal of the applicant company and upheld the 2005 tax assessment.

On an unspecified date the applicant company lodged a cassation appeal against the judgment of the Sofia City Court.

In a final judgment of 4 November 2008 the Supreme Administrative Court dismissed the applicant company's appeal, but on slightly different grounds from those relied on by the Sofia City Court (see following section).

**(c) Grounds for refusing the applicant company the right to deduct input VAT**

In its decision of 20 March 2006 the National Revenue Agency considered that the VAT-chargeable supply for the transfer of the unfinished three-storey building had been effected, for the purposes of VAT taxation, on 8 July 2004 when the transaction had been registered with a notary. Thus, the VAT invoice in respect of the transaction had had to be issued within five days of that event and the VAT had had to be charged, reported and paid to the State budget in respect of the July 2004 VAT reporting period. In so far as that had been done belatedly in the November 2004 VAT reporting period, it found that no right to deduct the input VAT arose for the applicant company.

In its appeal of 11 April 2006 the applicant company argued that although the notary deed had been executed on 8 July 2004 it included two separate transactions – one for the purchase of the land and one for the unfinished three-storey building. While the first had been fully settled on the day of the notary deed, the second had only been concluded when the

purchase price of the unfinished three-storey building had been paid in November. In so far as the sale of land did not amount to a VAT chargeable supply, no VAT invoices had been issued nor reported in the July 2004 VAT reporting period. As the parties had contracted that payment of the price of the unfinished three-storey building would be made on a later date, the seller had issued VAT invoices in respect of it on 11 and 22 November 2004 which the applicant company had duly paid. Thus, the applicant company considered that the VAT chargeable supply in respect of the unfinished three-storey building had not arisen on 8 July 2004, but on 11 and 22 November 2004 when the seller had issued the VAT invoices.

In its judgment of 6 March 2008 the Sofia City Court concluded that the execution of the notary deed on 8 July 2004 amounted to a VAT chargeable supply in respect of the unfinished three-storey building, that VAT invoices in respect of it should have been issued within five days and that the transaction should have been reported in the July 2004 VAT reporting period. The Sofia City Court relied on section 25 (1) of the VAT Act, which stated that a VAT-chargeable event arises on the earlier date of the (a) the date on which a property right is transferred or (b) the date on which full or partial payment is made. It therefore concluded that in so far as the property rights to the unfinished three-storey building had been transferred on 8 July 2004 the parties' undertaking to pay the purchase price at a later date did not postpone the date of the VAT-chargeable event, and the transaction should have been reported in the July 2004 VAT reporting period rather than in the November 2004 reporting period. Accordingly, as the transaction had been erroneously reported by both the seller and the applicant company, no right to deduct the input VAT arose for the latter.

In its final judgment of 4 November 2008 the Supreme Administrative Court dismissed the applicant company's cassation appeal on slightly different grounds from those relied on by the Sofia City Court. It also found that the VAT-chargeable event was the transfer of the property rights to the unfinished three-storey building on 8 July 2004, but noted that the applicant company did not have a VAT registration at the time so, in any event, it would not have had the right to deduct the input VAT in that reporting period. However, at the time of its VAT registration in October 2004 the applicant company could have requested that the tax authorities recognise its right to deduct the input VAT on the transaction under a special procedure applicable to VAT transactions effected prior to obtaining a VAT registration. In so far as the applicant company had failed to make such a request, no right to deduct the input VAT on the supply in question prior to its VAT registration arose.

### *3. The third application - no. 40107/09*

#### (a) The 2006 tax assessment and the appeal proceedings

On 21 February 2006 the Plovdiv Territorial Tax Directorate issued the applicant with a tax assessment ("the 2006 tax assessment"). It refused the applicant's right to deduct input VAT she had paid on, *inter alia*, five supplies dating from 2003 which totalled BGN 8,680 (EUR 4,439), on which interest for late payment was also charged in the amount of BGN 3,071.74 (EUR 1,571).

On 28 March 2006 the applicant appealed against the 2006 tax assessment.

On 18 May 2006 the Plovdiv section of the National Revenue Agency upheld the 2006 tax assessment in its entirety.

On 20 October 2006 the applicant appealed to the courts.

In a judgment of 4 March 2008 the Plovdiv Regional Court dismissed the appeal and upheld the 2006 tax assessment.

On 24 April 2008 the applicant lodged a cassation appeal against the judgment of the Plovdiv Regional Court.

In a final judgment of 22 December 2008 the Supreme Administrative Court dismissed the applicant's appeal. It found that the applicant had failed to show, both during the audit conducted by the tax authorities and during the court proceedings, that the supplies in question had ever actually been received by her, which was sufficient ground for refusing the right to deduct the VAT paid under the issued invoices, irrespective of whether they had been properly accounted for by her suppliers.

#### (b) Grounds for refusing the applicant company the right to deduct input VAT

In the course of the audit conducted by the tax authorities, the Plovdiv Territorial Tax Directorate noted that the supplies in question had been provided for marketing, advertising, agency and intermediary services. They examined the accounting records of the applicant, performed cross-checks of the suppliers in question, and obtained further clarifications and submissions from the parties. As three of the suppliers were not found at their registered tax addresses, the authorities instead examined and relied on their tax dossiers, which are held by the tax authorities. Notably, these three suppliers were registered at the same address.

In the 2006 tax assessment the Plovdiv Territorial Tax Directorate refused the right to deduct the input VAT on the five supplies from 2003 because the applicant's suppliers had failed to present the requisite proof for assessment of their tax liabilities, including evidence that they had actually carried out the supplies in question. In particular, the tax authorities found that the suppliers lacked the necessary know-how as well as the technological and human resources to provide the contracted services, while

the applicant could not remember what specific services she had received from each of them. In addition, the applicant failed to provide copies of all the contracts underlying the transactions in question, the marketing reports and the results of the agency and intermediary services allegedly received.

In her appeal to the courts the applicant argued that the cross-checks conducted on her suppliers were not carried out in conformity with the applicable procedure, which allegedly predetermined their lack of success, and that the tax authorities had come to the wrong conclusions on the basis of the records and documents in their possession.

In its judgment of 4 March 2008 the Plovdiv Regional Court found certain procedural deficiencies in the cross-checks performed by the tax authorities and in some of their assessments concerning the availability of technological and human resources by some of the suppliers, but did not consider them significant enough to negate the overall conclusions that it had not been shown by the parties that the services had in fact been provided. In particular, it noted that irrespective of whether the suppliers had properly recorded and reported the supplies in question, the applicant had failed to provide the requisite proof that the transactions in questions had ever been affected, that all the underlying contracts for the services existed, and that the invoiced services had ever been received by, for example, presenting marketing reports, brochures or advertising materials produced as a result of these transactions. Finally, the court noted that the three missing traders were all located at the same address and all purported to provide the same type of advertising and marketing services, proof of which the applicant had failed to present to the tax authorities.

In its final judgment of 22 December 2008 the Supreme Administrative Court also found that the applicant had failed to show, both during the audit conducted by the tax authorities and during the court proceedings, that the supplies in question had actually ever been received by her and that there had, therefore, been VAT-chargeable supplies within the meaning of the VAT Act of 1999. It noted that this was sufficient ground to refuse the right to deduct the input VAT paid under the issued invoices, irrespective of whether they had been properly accounted for by her suppliers.

### *4. The fourth application - no. 12509/10*

#### (a) The 2008 tax assessment and the appeal proceedings against it

On 28 January 2008 the Sofia City Territorial Tax Directorate issued the applicant company with a tax assessment (“the 2008 tax assessment”). It refused, *inter alia*, the applicant company's right to deduct the input VAT it had paid to three suppliers of services in 2007 in the amount of BGN 1,526,810 (EUR 780,976), on which interest for late payment was also charged. The supplies in question were for construction works undertaken

by the suppliers to complete seven buildings that the applicant company was constructing.

On an unspecified date the applicant company appealed against the 2008 tax assessment.

On 5 June 2007 the Sofia Office of the National Revenue Agency upheld the 2008 tax assessment in respect of the refusal to authorise deduction of the input VAT.

On an unspecified date the applicant company appealed to the courts, claiming that the tax authorities had applied the relevant tax legislation erroneously and had committed various procedural violations.

In the course of the court proceedings the Sofia City Administrative Court commissioned, at the request of the applicant company, at least two expert reports to assess the findings of the 2008 tax assessment.

By a judgment of 29 December 2008 the Sofia City Administrative Court upheld the 2008 tax assessment in respect of the deductibility of the input VAT.

On an unspecified date the applicant company lodged a cassation appeal against the judgment of the Sofia City Administrative Court. It claimed that the first-instance court judgment was wrong and that there had been various procedural violations.

By a final judgment of 3 August 2009 the Supreme Administrative Court upheld the judgment of the Sofia City Administrative Court in its entirety.

**(b) Grounds for refusing the applicant company the right to deduct input VAT**

Under the 2008 tax assessment, as upheld by the National Revenue Agency and the courts, the applicant company was refused deduction of the input VAT it had paid to the three suppliers of services in 2007, because there was no VAT-chargeable supply within the meaning of the VAT Act of 2007.

In the course of the audit carried out of the applicant company, the authorities visited the construction sites to evaluate the type of construction works performed and their level of completion. They also carried out cross-checks on the suppliers. Although initially they were not found at their registered addresses, after further searches and notifications by the authorities representatives of the suppliers came forward and produced some of the records and documentation that had been requested of them. The authorities then evaluated the construction equipment and materials available at the suppliers, their know-how to perform such services and the human resource capabilities at their disposal. In addition, they performed cross-checks of companies from whom construction equipment had allegedly been rented and of individuals who had allegedly carried out the work. A detailed evaluation of the various construction works carried out was also undertaken and an assessment made of whether they could have

been carried out by the three suppliers. As a result, the authorities concluded that the three suppliers lacked the material, technological and human resources capability to provide the services on the dates on which they were allegedly received by the applicant company. In particular, they were found to lack the necessary construction equipment, machines, tools, materials and facilities to deliver the services in question and also lacked qualified workers who could have done the work. Separately, the tax authorities found that the suppliers had invoiced for services which were outside the scope of the construction works allegedly received by the applicant company. In respect of some of the construction works, the tax authorities also established that they had been invoiced months after the work had been done. Lastly, the authorities acknowledged that construction services had been received by the applicant company in the course of the completion of its sites, but considered that it had not been proven that they had been carried out by the suppliers in question and that these transactions amounted to VAT-chargeable supplies which gave the applicant company the right to deduct the input VAT.

On the basis of the above findings, the commissioned expert reports and the submissions of the parties, the courts carried out a similar detailed analysis of the services provided and the capabilities of the suppliers to provide them. They reached identical conclusions to those of the tax authorities and found that the three suppliers lacked the material, technological and human resources capacity to do the work.

## B. Relevant domestic law and practice

### *1. VAT legislation 1993-99*

#### (a) VAT Act 1993

The general principles in the VAT Act 1993 regarding the chargeability and reporting of VAT as well as the right to deduct input VAT are similar to those of the VAT Act 1999, as summarised in the *Bulves AD v. Bulgaria* judgment (no. 3991/03, §§ 20-28, 22 January 2009).

Under the VAT Act of 1993, the input VAT, known as "the tax credit" under domestic legislation, was the amount of VAT which a taxable person had been charged on goods or services received under a chargeable transaction or from import of goods or services (section 24 (1)).

In addition, section 24 of the VAT Act 1993 provided, as relevant, the following:

> "(2) The right to [deduct input VAT] arises when the following conditions are met:
>
> 1. the [taxable] person to whom tax is charged is registered under the Act on the date the tax invoice ... is issued;

2. the tax on the chargeable transaction is charged by a [taxable] person registered under the Act on the date it is performed...;

3. the transaction on which the tax is charged is chargeable on the date it is performed...;

...

5. the imported goods or the goods or services received under a chargeable transaction were used, are being used or will be used for performing chargeable transactions...;

6. the recipient has a tax invoice ... which has been recorded in his accounting records."

Section 25 of the VAT Act 1993 further provided, as relevant, the following:

"(1) The right to [deduct input VAT] arises in respect of the tax period during which the tax invoice ... is received, which [has] to have been recorded in the [taxable] person's accounting records, but is exercised after the expiry of that tax period by including it in the [said period's tax] return.

(2) The right to [deduct input VAT] does not arise if the tax invoice ... was issued before the date of registration under the Act."

**(b) Regulation for Implementing the VAT Act 1993**

The relevant part of section 68 of the Regulation for Implementing the VAT Act 1993, as in force up to 1999, provided the following:

"In the event of loss of the original tax invoice the [taxable] person may exercise its right to [deduct the input VAT] if, instead of the invoice,, it presents the following documents:

1. a photocopy of the issuer's copy of the [original invoice], certified by [the latter] with a date and seal;

2. a certificate from the tax office where the issuer of the lost document is registered, stating that the tax indicated therein has been charged ..."

In 1999 the Regulation for Implementing the VAT Act 1993 was replaced by a new Regulation for Implementing the VAT Act 1999.

*2. VAT legislation 1999-2006*

**(a) VAT Act 1999**

The relevant provisions and the background to the VAT Act 1999 have been summarised in the judgment of *Bulves AD*, cited above, §§ 20-28).

The VAT Act 1999 also provided the following in respect of the date of the chargeable event and the chargeability of VAT:

**Section 25**

"(1) The chargeable event within the meaning of the Act shall occur on the earlier of the following two dates:

1. the date of transfer of the right of ownership or other real property right to the goods...;

2. the date of payment (full or partial advance payment). ...

(3) the date of occurrence of the chargeable event:

1. The tax under the Act shall become due for chargeable transactions and the [taxable] person shall be obliged to charge it;

2. The right not to charge tax on exempt transactions shall arise."

**Section 26**

"In the following cases, the date of the chargeable event shall be assumed to have occurred:

1. in cases where goods are provided under a contract for transfer of ownership with a deferring condition or term, if there is no preliminary (full or partial) payment – the date of fulfilment of the condition or expiry of the term upon which in normal circumstances the right of ownership would be transferred; ..."

**(b) Regulation for Implementing the VAT Act 1999**

The relevant part of section 88 of the Regulation for Implementing the VAT Act 1999, as in force from 2001 to 2006, provided the following:

"(4) In the event of loss, destruction or theft of the original tax document the [taxable] person may exercise its right to [deduct the input VAT] by informing the regional directorate of the National Revenue Agency where it is registered and by obtaining a photocopy of the issuer's copy of the [original invoice], certified by [the latter] with a date and seal, which it must preserve in its accounting records."

**(c) Tax Procedure Code of 2000**

The relevant part of Article 109 of the Tax Procedure Code 2000 provides as follows:

"(1) The tax authority applies the rate of tax, as stipulated in the applicable law, to the taxable base as determined by the said authority [in the instances] where at least one of the following circumstances exists:

1. a [tax] return has not been filed prior to commencing the audit, in the cases where the tax liability is determined according to a [tax] return;

2. the audit authority establishes facts or circumstances concerning concealed revenue or income;

3. accounts are not kept in accordance with the Accountancy Act, or the accounts kept do not make it possible to ascertain or determine the base for taxation, as well as where the documents have been destroyed other than in accordance with the applicable procedure;

4. counterfeit documents or documents containing false statements have been used in the accounts;

5. documents have been lost, stolen or damaged to an extent that renders them unusable;

6. the taxable person has not been found at the address registered with the tax authorities after a thorough and well-documented search by the tax authorities;

7. during the tax audit the taxable person did not present evidence relevant to the determination of its tax liabilities within the deadline set by the audit authority;

8. the existence of transfer pricing or tax fraud has been established;

(2) The tax authority determines the taxable base for levying direct and indirect taxes in the instances under sub-section (1) after taking into consideration each circumstance of relevance to the taxable person concerned:

1. the type and nature of the activity actually performed;

2. the amounts paid in taxes, customs duties, contributions and other public receivables;

3. bank account transactions and balances;

4. official documents containing accurate data;

5. rental costs for the real estate where the activity is performed, in whole or in part, in rented properties;

6. the commercial significance of the place where the activity is performed;

7. capital and the market price of acquired properties at the time of acquisition;

8. gross revenue/income (turnover);

9. the number of people employed to perform the activity, the size of the workforce;

10. contracts concluded by the taxable person in connection with the activity;

11. the difference between the raw and other materials supplied and those used in production;

12. aggregated data on the profit obtained or, respectively, the revenue or income of other persons performing the same or a similar activity under the same or similar conditions;

13. pricing and other conditions of the transactions concluded for the purposes of tax evasion, including data about such transactions between parties related ... to the [audited] taxable person;

14. the usual cost of living, maintenance, education and medical treatment, as well as travel, *per diem* and accommodation expenses for travel within the country or abroad;

15. supplies received and provided, as well as the exercised right to [deduct input VAT];

16. other evidence which may serve to determine the tax base.

(3) The circumstances under paragraphs (1) and (2)(1-16) shall be indicated in the tax assessment.

(4) In cases under paragraph (1) the tax authority shall determine the taxable base for the relevant tax period for which the circumstances have been established, while in the case of paragraph (1)(6) they shall do so for the period determined in the order for the tax audit to be initiated.

(5) Other than in instances under paragraph (1), if the assets and the financial state of the taxable person for the appropriate tax period do not correspond to the declared and/or received revenue, income, the sources of forming the proprietary capital or the free financing for the commercial activity, the tax authority, after an analysis under paragraph (2), levies [tax on] the undeclared profits and income in accordance with the applicable law.

(6) When the tax authority discovers that there are circumstances under paragraphs (1) or (5), it informs the taxable person that it will determine the taxable base in accordance with this section and provides it with a time-limit within which it can present documents or submit an opinion.

(7) The situation outlined in a tax assessment prepared under this section shall be considered true until proven otherwise in the course of appeal proceedings.

(8) [In the process of] assessing the circumstances under paragraphs (1) or (5), taxable persons are obliged to declare their assets and all their sources of income, including their participation in bodies having a management or supervisory role in respect of juridical persons ...

(9) [In the process of] assessing the circumstances under paragraphs (1) or (5) the tax authority shall take precautionary measures to secure all claims at the time it makes the notification under paragraph (6). The imposed security measures are subject to appeal under the same procedure as for tax assessments.

(10) Disposing of attached or distrained property or receivables can be made with the permission of the tax authority which imposed the measure.

On 1 January 2006 the Tax Procedure Code was replaced by the Tax and Social Security Procedure Code.

### *3. VAT legislation 2006 to present day*

#### (a) VAT Act 2007

On 1 January 2007 the VAT Act 1999 was replaced by an Act of the same name, which transposed into national legislation the then current EU legislation in the sphere of VAT. Similar to its predecessors, its sections 68 to 81 contain detailed provisions outlining the conditions and procedures for deductibility of input VAT, which, as they relate to the circumstances of the present case, are not materially different from the preceding VAT Acts summarised above.

#### (b) Tax and Social Security Procedure Code of 2006

Articles 105 to 134 of the Code provide for a detailed procedure for assessment of the tax and social security contributions due from a taxpayer and envisage, in certain circumstances, the possibility of reassessing the tax position of a taxpayer. In particular, it provides the following:

**Article 122**

"(1) The revenue authority applies the rate of tax, as stipulated in the applicable law, to the taxable base as determined by the said authority according to the procedure established by Paragraph (2) where at least one of the following circumstances exists:

1. a [tax] return has not been filed prior to commencing the audit, in the cases where the tax liability is determined according to a [tax] return;

2. there is reason to believe that revenue or income has been concealed;

3. fake documents or documents containing false statements have been used in the accounts;

4. accounts are not kept or are not presented according to the Accountancy Act, or the accounts kept do not make it possible to determine the basis for taxation, as well as where the documents necessary for determination of the basis for levying of taxes or for determination of the compulsory social insurance contributions have been destroyed according to a procedure other than the applicable one;

5. the documents necessary for determination of the basis for levying of taxes are missing or are damaged to an extent that renders them unusable;

6. the data and information necessary for determination of the basis for the levy of taxes cannot be obtained because the auditee has not been found at the registered address referred to in Article 28;

7. the revenue, income, the sources of proprietary capital or free financing for the commercial activity of the auditee as declared and/or received do not correspond to the property and financial status of the auditee for the audit period.

(2) To determine the base for the levy of taxes, the revenue authority shall take into consideration each circumstance of relevance to the person concerned:

1. the type and nature of the activity actually performed;

2. taxes, customs duties, contributions and other public receivables paid;

3. bank transactions and balances on bank accounts;

4. official documents and the documents containing accurate data;

5. the rental costs for the real estate where the activity is performed in whole or in part;

6. the commercial significance of the place where the activity is performed;

7. the capital and the market price of acquired properties at the time of acquisition;

8. the gross revenue/income (turnover);

9. the number of persons employed to perform the activity;

10. the contracts concluded by the taxable person in connection with performing the activity;

11. the difference between the raw and other materials supplied and those used in production;

12. the aggregated data on the profit obtained or, respectively, the revenue or income by other persons performing the same or a similar activity under the same or similar conditions;

13. the pricing and the other conditions of the transactions concluded for the purposes of tax evasion, including data about such transactions between parties related to the auditee;

14. the usual cost of living, maintenance, education and medical treatment, as well as travel, *per diem* and accommodation expenses for travel within the country or abroad;

15. the supplies received or effected, as well as the right to credit for input tax exercised;

16. other evidence which may serve upon determination of the base.

(3) The circumstances covered under Paragraphs 1 and 2 shall be used to justify the audit report.

(4) In the cases under Paragraph 1 the revenue authority shall determine the base for levying of taxes applicable for the relevant period for which the circumstances have been established."

**Article 123**

"(1) In cases under Article 122 § 1 herein, upon determination of the base according to the procedure established by Article 122 § 2 herein, a taxable profit or income shall be presumed to exist until otherwise proven where:

1. the value of the property of the person manifestly substantially exceeds the amount of declared revenue, income, sources of owners' proprietary capital or of free financing, as received thereby;

2. the expenses incurred by the person and by the parties related thereto under Item 3 (a) of § 1 of the Supplementary Provisions herein manifestly and substantially exceed the declared received resources.

(2) The property of other persons shall be considered part of the property referred to in Paragraph 1 if an effective judicial act has established that the said property has been acquired with the funds of the person in respect of whom the circumstances under Paragraph 1 have been established."

Articles 144-161 of the Code provide in detail for the procedure for appeal against findings of the tax authorities in a tax assessment issued to a taxpayer. The appeal is lodged first with the superior revenue authority, whose decision is in turn subject to judicial appeal before the courts. Moreover, at the request of the taxpayer, the enforcement of a decision taken on the basis of a tax assessment can be suspended pending the appeal proceedings (Article 153).

## COMPLAINTS

### The first application - no. 26553/05

The applicant complained under Article 1 of Protocol No. 1 to the Convention that the authorities had refused to allow him to deduct the input

VAT he had paid to his suppliers. He argued that this amounted to an unlawful interference with his possessions because it had primarily resulted from the illogical application of unclear VAT legislation with unforeseeable consequences. Furthermore, the applicant considered that the interference was not proportionate.

The applicant complained under Article 13 that he lacked effective domestic remedies for his complaint under Article 1 of Protocol No. 1. He stressed, in particular, that he had no right to challenge the constitutionality of the VAT legislation before the Constitutional Court.

The applicant complained under Article 6 of the Convention that the court proceedings for challenging the VAT assessment were unfair.

**The second application - no. 25912/09**

The applicants complained under Article 1 of Protocol No. 1 that the authorities had refused VAT deduction on the basis of an erroneous interpretation of the relevant domestic law concerning the date of the chargeable event.

The applicants also complained, relying on Articles 6 and 14 of the Convention, that the proceedings for challenging the VAT assessment were unfair and that the Supreme Administrative Court had wrongly concluded in its judgment of 4 November 2008 that the company had obtained VAT registration subsequent to receiving the VAT chargeable supply.

The applicants complained under Article 13, in conjunction with Article 14 and Article 1 of Protocol No. 1, that they lacked effective domestic remedies for their complaints.

**The third application - no. 40107/09**

The applicant complained under Article 1 of Protocol No. 1 that, in spite of her full compliance with her VAT reporting obligations, the domestic authorities had deprived her of the right to deduct the input VAT she had paid on the services received. She considered her complaint almost identical to that in *Bulves AD* (cited above). In addition, the applicant argued that the interference with her right to property was unlawful because the proceedings against the tax assessment were unfair and the judgment of the Supreme Administrative Court of 22 December 2008 lacked reasoning.

The applicant complained under Article 6 of the Convention that the court proceedings for challenging the VAT assessment were unfair. She claimed that the courts had disregarded important matters such as that the supplies had not been deemed to lack substance at the level of some of her suppliers and that there was an unfair shift of the burden of proof on to her, because the findings of the tax assessment were considered true until proven otherwise.

The applicant complained under Article 13 of the Convention, in conjunction with Article 6 and Article 1 of Protocol No. 1, that she lacked effective domestic remedies for her complaints.

**The fourth application - no. 12509/10**

The applicant company complained under Article 1 of Protocol No. 1 that, in spite of its full compliance with its VAT reporting obligations, the domestic authorities had deprived it of the right to deduct the input VAT it had paid on the services it had received. It considered this complaint almost identical to that in *Bulves AD* (cited above) and argued that the refusal of the domestic authorities amounted to an excessive individual burden which upset the fair balance that must be maintained between the demands of the general interest of the community and the requirements of the protection of the right of property.

# THE LAW

## I. THE COMPLAINTS OF MR ABDEL ABDO SARKIS

The Court reiterates that an applicant must be directly affected by the act or omission in issue (see *Amuur v. France*, judgment of 25 June 1996, *Reports of Judgments and Decisions* 1996-III, § 36).

It notes that the individual applicant in the second application (no. 25912/09), Mr Adel Abdo Sarkis, complained both in a private capacity and as managing director and sole owner of the capital of the applicant company, N.D.E. EOOD, which is a sole-ownership limited liability company and has a distinct legal personality under Bulgarian law. However, it was only the property of the applicant company that was allegedly affected by the impugned events. It was only the company which participated as a party to the domestic proceedings, challenging the 2005 tax assessment. In addition, the company has submitted its complaints directly to the Court and has legal standing to act independently in the present proceedings.

Thus, the Court considers that Mr. Adel Abdo Sarkis, the individual applicant in application no. 25912/09, cannot claim to have been directly affected by the alleged violations in issue and that he does not achieve the status of victim by the mere fact of being managing director or sole owner of the capital of the applicant company.

It follows that the complaints in the second application in respect of Mr Adel Abdo Sarkis are incompatible *ratione personae* 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. THE COMPLAINTS OF THE REMAINING APPLICANTS

### A. Article 1 of Protocol No. 1

The applicants complained under Article 1 of Protocol No. 1 to the Convention that the authorities had refused to allow them to deduct the input VAT they had paid to their suppliers.

Article 1 of Protocol No. 1 provides the following:

> "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."

The Court observes that the applications under examination have the same background as the case of *Bulves AD*, cited above.

The applicants claim in essence that the facts and the complaints are very similar to those in *Bulves AD* and on that basis seek a finding of a violation.

#### *1. Recapitulation of the Court's findings in Bulves AD*

In *Bulves AD* the applicant company could claim a legitimate expectation that it would be allowed to deduct the input VAT 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 it had complied fully and in time with the VAT rules set by the State (paid the VAT on the supply on the basis of the VAT invoice issued by its supplier, entered the supply in its accounting records and reported it in its VAT return for the relevant period), had no means of enforcing compliance by its supplier and had no knowledge of the latter's failure to do so.

In these circumstances the authorities' refusal to allow VAT deduction interfered with property rights. While the interference could be seen as concerning control of the use of property to secure the payment of taxes within the second paragraph of Article 1 of Protocol No. 1, the relevant principles were the same as those derived from the general rule of peaceful enjoyment of property enshrined in the first sentence of the first paragraph of Article 1 of Protocol No. 1.

The Court further found that the interference was disproportionate as a result of a rigid interpretation of the relevant legislation by the domestic

authorities, in that the refusal of VAT deduction was automatic and 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 fraud in relation to the VAT system of which the applicant company had knowledge or the means of obtaining such knowledge.

The Court reaffirms the above approach and will apply it to the facts of each of the four applications under examination.

*2. Application of these criteria to the cases under examination*

**(a) The first application**

The Court notes at the outset that the judgment of 15 June 2004 of Plovdiv Regional Court was final in respect of the deductibility of the input VAT in so far as amounts in excess of BGN 49,516.97 (EUR 25,392) were concerned. The applicant lodged his application with the Court on 14 July 2005. It follows that this part of his complaint has been introduced out of time and must be rejected in accordance with Article 35 §§ 1 and 4 of the Convention.

In respect of the deductibility of the input VAT in the amount of BGN 49,516.97 (EUR 25,392), the Court notes that the domestic tax authorities and the courts established that some of the applicant's suppliers did not have a valid VAT registration and that he had not reconstituted his stolen accounting records and had therefore failed to present VAT invoices or copies thereof as evidence that he had received VAT chargeable supplies.

Thus, unlike in the case of *Bulves AD* (cited above), the domestic authorities undertook a thorough review of the relevant circumstances, as a result of which it was established that the applicant had failed to exercise the special diligence required of VAT registered persons by verifying whether his suppliers had a valid VAT registration and, in addition, had failed to present VAT invoices.

In so far as the applicant considers that these findings resulted from an erroneous interpretation of the law, the Court reiterates that its jurisdiction to verify that domestic law has been correctly interpreted and applied is limited and that it is not its function to take the place of the national courts, its role being rather to ensure that the decisions of those courts are not flawed by arbitrariness or otherwise manifestly unreasonable (see, *mutatis mutandis, Anheuser-Busch Inc. v. Portugal* [GC], no. 73049/01, § 83, ECHR 2007-I). In the present case the Court sees no indication of arbitrariness, the applicant's allegation in this respect being completely unsubstantiated.

In these circumstances, in view of the fact that there was a thorough review by the domestic authorities, 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, it is unclear whether he had a "legitimate expectation" that he would be allowed to deduct VAT and, consequently, whether what was at stake could be seen as a "possession" within the meaning of Article 1 Protocol No. 1.

In any event, even assuming that the complaints concern a "possession", having regard to the full scope of the review provided by the domestic authorities which resulted in findings of clear omissions imputable to the applicant, the Court finds that the impugned refusal of VAT deduction was a lawful and proportionate measure.

It follows that the complaints under Article 1 of Protocol No. 1 in the first application are manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3(a) and 4 of the Convention.

**(b) The second application**

In the second application, the domestic tax authorities and the courts established that the VAT-chargeable event had occurred on an earlier date than had been reported by the parties to the transaction and that the applicant company had not had a VAT registration at that time in order to claim deductibility of the input VAT. Furthermore, at the time of its VAT registration in October 2004 it had failed to request from the tax authorities recognition of its right to deduct the input VAT on the transaction under the special procedure applicable to VAT transactions effected prior to obtaining a VAT registration.

The Court notes that the applicant company complains mainly about the manner in which the national courts interpreted and applied domestic law in relation to the determination of the date of the chargeable event.

As stated above, in such cases the Court's function is not to take the place of the national courts in interpreting domestic law but solely to ensure that their decisions were not flawed by arbitrariness or otherwise manifestly unreasonable.

Having examined the applicant company's arguments about alleged arbitrariness, the Court finds them unconvincing, in the light of, in particular, the clear text of section 25(1) of the VAT Act of 1999 and the fact that the domestic courts dealt with these arguments in detail and rejected them in reasoned judgments.

In so far as the applicant company may be understood as challenging the legislator's choice to regulate as it did the determination of the relevant date of the chargeable event, the Court reiterates that in framing and implementing policies in the area of taxation Contracting States enjoy a wide margin of appreciation, and the Court will respect the legislature's assessment in such matters, unless it is devoid of any reasonable foundation (see *the National & Provincial Building Society, the Leeds Permanent Building Society and the Yorkshire Building Society v. the United Kingdom*,

judgment of 23 October 1997, *Reports of Judgments and Decisions* 1997-VII, §§ 80-82). In the present case the applicant has not shown that the rules in question were devoid of a reasonable foundation.

It follows that the complaints under Article 1 of Protocol No. 1 in the second application are manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3(a) and 4 of the Convention.

**(c) The third and fourth applications**

In the third and fourth applications, the domestic tax authorities and the courts refused deductibility of input VAT because they came to the conclusion that there had been no VAT-chargeable supply within the meaning of the VAT legislation in force at the relevant time.

It is significant that these findings were made on the basis of on-site inspections, cross-checks of suppliers, their employees and subcontractors, examinations and assessments of the suppliers' technological and human resources capabilities to provide the services allegedly received and reviews of the results of the said services. Moreover, in those instances where suppliers were not found at their registered addresses the authorities examined their tax dossiers, which were held by the tax authorities. The situation in the third and fourth applications was therefore very different from that which gave rise to a violation of the Convention in *Bulves AD*, where VAT deduction was refused on the basis of a rigid automatic approach without examination of the decisive circumstances.

In so far as the applicants may be understood to be challenging the justification for the checks and inspections undertaken in their case, the Court notes that in the context of deductibility of input VAT, the general interest of the community is in preserving the financial stability of the VAT system of taxation, with its complex rules regarding charges, recharges, exemptions, deductions and reimbursements. Essential elements of the preservation of that stability are the attainment of full and timely discharge by all VAT-registered persons of their VAT reporting and payment obligations and, ultimately, the prevention of any fraudulent abuse of the said system (see *Bulves AD*, cited above, § 65). Accordingly, the Court finds it reasonable that States should have at their disposal procedures established by law which provide for a degree of flexibility in assessing the tax position of taxpayers and for the ability to look through the documentary evidence in the form of accounting records by examining the substance of transactions which are claimed to be VAT-chargeable transactions on the basis of which deductibility of input VAT is claimed.

In the case at hand the domestic authorities followed those procedures fully and exhaustively and they provided the applicants with full opportunities to submit arguments and evidence, including before the courts.

Thus, unlike in the case of *Bulves AD* (cited above), the refusal in the third and fourth applications was subject to full judicial review and was based on reasoned conclusions. Furthermore, in the events complained of in the fourth application the applicable legislation was the VAT Act 2007, which transposed the provisions of Council Directive 2006/112/EC of 28 November 2006 on the common system of value-added tax.

The above is sufficient for the Court to conclude that the complaints under Article 1 of Protocol No. 1 in the third and fourth applications are manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3(a) and 4 of the Convention.

### B. Article 6

All the applicants complained under Article 6 of the Convention that the court proceedings for challenging the respective VAT assessments were unfair. The complaint of the applicant company in the second application of the allegedly erroneous findings and lack of reasoning in the judgment of the Supreme Administrative Court of 22 December 2008 also falls to be examined only under Article 6 § 1, 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..."

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 produce for the taxpayer (see *Ferrazzini v. Italy* [GC], no. 44759/98, §§ 29-31, 12 July 2001).

Considering that no punitive penalties or surcharges were imposed on the applicants, other than the obligation to pay their reassessed VAT liabilities together with interest for late payment, the proceedings at hand also do not fall within the criminal limb of Article 6 § 1 of the Convention (see, *a contrario, Jussila v. Finland* [GC], no. 73053/01, § 29-39, ECHR 2006-...).

Accordingly, Article 6 does not apply to the proceedings for challenging the respective VAT assessments.

It follows that the applicants' complaints under Article 6 of the Convention are 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.

### C. Article 13

The applicants complained under Article 13, in conjunction with Article 1 of Protocol No. 1, that they lacked effective domestic remedies for their complaints. The applicant in the first application (no. 26553/05),

Mr Stefan Mihailov Nazarev, also complained that he had no right to challenge the constitutionality of the VAT legislation before the Constitutional Court, while the applicants under the second application also complained in conjunction with their Article 6 complaints.

Article 13 provides:

> "Everyone whose rights and freedoms as set forth in [the] Convention are violated shall have an effective remedy before a national authority notwithstanding that the violation has been committed by persons acting in an official capacity."

The Court notes that the existence of an actual breach of another provision of the Convention (a "substantive" provision) is not a prerequisite for the application of Article 13 (see *Boyle and Rice v. the United Kingdom*, 27 April 1988, § 52, Series A no. 131, and *Soysal and Others v. Turkey*, nos. 54461/00, 54579/00 and 55922/00, § 50, 15 February 2007). However, even on the assumption that the claim of violation of Article 1 of Protocol No. 1 was arguable for the purposes of Article 13, the Court finds that an effective remedy existed in the form of the full scope of review afforded by the domestic courts, which examined all arguments raised by the applicants on the merits of their complaints.

The Court further reiterates that Article 13 does not guarantee a remedy whereby a law as such can be challenged before a domestic organ (see *M.A. and 34 Others v. Finland* (dec.), no. 7793/95, 10 June 2003, and *K.H. and Others v. Slovakia*, no. 32881/04, § 72, ECHR 2009-... (extracts)).

It follows that the applicants' complaints under Article 13 of the Convention are manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3(a) and 4 of the Convention.

For these reasons, the Court unanimously

*Decides* to join the applications;

*Declares* the applications inadmissible.

Claudia Westerdiek
Registrar

Peer Lorenzen
President