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Preventing VAT Fraud without Compromising the Competitive Terms of the Internal Market

A study in whether the CJEU interprets the right of Member States to fight VAT fraud under Article 273 VAT Directive without jeopardising the competitive terms of the internal market

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Summary

The consequences of VAT fraud are many and far-reaching. Tax fraud affects the state budget, which in turn has varying consequences, not least on welfare. Tax fraud distorts the competition for the benefit of dishonest traders, as they pay less VAT. Last but not least, tax fraud is also a matter of legitimacy, as it raises questions about how fair the tax system really is.

Accordingly, Member States have both a right and an obligation to fight tax fraud. However, the same measures aimed at preventing tax fraud can compromise the establishment and functioning of the internal market. For instance, if a Member State refuses to deduct input VAT for certain goods in order to combat tax fraud, it will result in companies established in other Member States having a competitive advantage, as they are allowed to deduct input VAT.

The purpose of this paper is to investigate whether the objective of fiscal harmonisation, more specifically the objective of avoiding distortions of competition, pursued by the VAT Directive, is observed by the CJEU when interpreting the right of Member States to combat VAT fraud under Article 273 VAT Directive, having regard to the principles of neutrality and proportionality.

In conclusion, in some aspects the Court has interpreted Article 273 VAT Directive in accordance with the objective of fiscal harmonisation, while in other aspects the interpretation has been contrary to this objective. All things considered, the interpretation of Article 273 allows Member States to distort competition at national and Union level, either by introducing anti-fraud measures having this effect or by not doing enough to prevent VAT fraud. In a worst-case scenario, when making decisions on tax issues, such as choosing the place of establishment for VAT purposes, the decisions are not made on their economic merits by taxable persons but on tax evasion laws. This contradicts the notion of an internal market.

Abbreviations

CJEU	Court of Justice of the European Union
Council	Council of the European Union
EU/Union	European Union
First (VAT) Directive	First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes
PFI Convention	Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests
PFI Directive	Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law
PFI Regulation	Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests
Second (VAT) Directive	Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax
Sixth (VAT) Directive	Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment
TEU	Consolidated version of the Treaty on European Union
TFEU	Consolidated version of the Treaty on the Functioning of the European Union
VAT	Value Added Tax
VAT Directive	Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

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1 Introduction

1.1 Background

The VAT GAP, the difference between expected VAT revenues and VAT actually collected, amounted to EUR 137.5 billion in 2017. The Member States collected 11.2 % less VAT than expected.¹ According to a study, requested by the TAX3 Committee, this amount is the result of VAT fraud and inadequate collection systems, but mostly VAT fraud.² VAT fraud is when a tax rule is deliberately broken in order to illegally obtain a tax advantage.³

The consequences of VAT fraud are many and far-reaching. Tax fraud affects the state budget, which in turn has varying consequences, not least on welfare. Tax fraud distorts the competition for the benefit of dishonest traders, as they pay less VAT.⁴ Last but not least, tax fraud is also a matter of legitimacy, as it raises questions about how fair the tax system really is.⁵

Accordingly, Member States have both a right and an obligation to fight tax fraud. However, the same measures aimed at preventing tax fraud can compromise the establishment and functioning of the internal market. For instance, if a Member State refuses to deduct input VAT for certain goods in order to combat tax fraud, it will result in companies established in other Member States having a competitive advantage, as they are allowed to deduct input VAT. This is contrary to the notion of a functioning internal market. Disparities between the laws of the Member States, aimed at preventing VAT fraud, are liable to create or maintain distortions of competition.

¹ CASE and University of Barcelona, ‘Study and Reports on the VAT Gap in the EU-28 Member States: 2019 Final Report’ (TAXUD/2015/CC/131, Institute for Advanced Studies 2019) <https://ec.europa.eu/taxation_customs/sites/taxation/files/vat-gap-full-report-2019_en.pdf> accessed 9 May 2020 8.

² Marie Lamensch and Emanuele Ceci, ‘VAT fraud: Economic impact, challenges and policy issues’ (Policy Department for Economic, Scientific and Quality of Life Policies 2018) <www.europarl.europa.eu/cmsdata/156408/VAT%20Fraud%20Study%20publication.pdf> accessed 9 May 2020 10.

³ AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 40.

⁴ However, in cases of carousel fraud, the tax evader(s) will even receive reimbursement for input VAT never paid downstream in the supply chain. For a definition of carousel fraud, see Nina Chestney, ‘FACTBOX – How carousel fraud works’ Reuters (London, 20 August 2009) <<https://uk.reuters.com/article/uk-carousel-fraud-britain-factbox-sb/factbox-how-carousel-fraud-works-idUKTRE57J43U20090820>> accessed in 9 May 2020.

⁵ For more information about the implications of tax fraud, see Valerie Braithwaite, ‘Tax evasion’ in Michael Tonry (ed), *The Oxford Handbook of Crime and Public Policy* (Oxford University Press 2011) <www.oxfordhandbooks.com/view/10.1093/oxfordhb/9780199844654.001.0001/oxfordhb-9780199844654-e-16> accessed 9 May 2020.

To ensure the proper functioning of the internal market, it is necessary that the Member States collect the right amount of VAT, no more no less. If a Member State, in the name of preventing tax fraud, collects more VAT than necessary then taxable persons in other Member States will have a competitive advantage as they pay less in VAT. On the contrary, if nothing is done to prevent tax fraud, taxable persons in other Member States will have a competitive disadvantage as they pay more in VAT. Distortions of competition will also occur within that Member State because not everyone commits fraudulent acts. To fight tax fraud without compromising the proper functioning of the internal market and its competitive terms is thus a challenge for Member States.

Luckily, to cope with this challenge, national courts may ask the CJEU about the interpretation of EU law, including the VAT Directive^{6,7}. For instance, according to Article 273 VAT Directive, Member States may impose “obligations which they deem necessary to ensure the correct collection of VAT and prevent evasion”. Does this mean that the Member States may impose any measures they consider necessary to prevent tax fraud, as long as the requirements of Article 273 VAT Directive are met, regardless of the impact on the proper functioning of internal market? According to the wording, the answer is yes. However, according to settled case-law by the CJEU, the answer is no. In reaching this conclusion, the Court used several methods of interpretation, not only the linguistic method. They also applied two principles, namely neutrality and proportionality. This shows the role of the CJEU in preventing tax fraud.

1.2 Purpose

The purpose of this paper is to investigate whether the objective of fiscal harmonisation, more specifically the objective of avoiding distortions of competition, pursued by the VAT Directive, is observed by the CJEU when interpreting the right of Member States to combat VAT fraud under Article 273 VAT Directive, having regard to the principles of neutrality and proportionality.

⁶ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax OJ L347/1 (VAT Directive).

⁷ Consolidated version of the Treaty on the Functioning of the European Union OJ C326/47 (TFEU), art 267.

1.3 Delimitations

Since there are many legal questions related to the purpose of this thesis, some delimitations are necessary. Only Article 273 VAT Directive is analysed in relation to the objective of fiscal harmonisation. There are several articles in the VAT Directive but also elsewhere, both substantive and procedural, relating to the prevention of VAT fraud. For instance, pursuant to Article 394 VAT Directive, Member States may retain anti-fraud measures if these have been implemented by January 1, 1977 and reported to the European Commission before January 1, 1978. According to 395 VAT Directive, in order to prevent tax evasion, Member States may derogate from the VAT Directive after submitting to a procedure laid down in this provision and obtaining unanimous approval from the Council. Furthermore, the EU has adopted two legislative acts of secondary law for the protection of the financial interests of the Union, the PFI Directive⁸ and the PFI Regulation⁹. The PFI Directive aims to protect the financial interests of the Union through criminal law, while the PFI Regulation intends to do the same, but through administrative measures. Protecting the financial interest of the Union includes preventing VAT fraud as there is a direct link between the tax revenue of the Member States and the financial interests of the Union. Member States must contribute with a percentage of the uniform basis of assessment for VAT to the Union.¹⁰ Moreover, as for procedural provisions, there are several provisions aimed at facilitating administrative cooperation between Member States to combat VAT fraud.¹¹ These provisions regulate, inter alia, the exchange of information between Member States and joint audits.

Additionally, the CJEU has independently developed legal grounds for preventing VAT fraud. According to well settled case-law, if a person carries out fraudulent acts himself or should have known that he is participating in tax fraud, he may be denied the right to exempt or deduct VAT.¹² Lastly, according to prevailing opinion and settled case-law, Member States

⁸ Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law OJ L198/29 (PFI Directive).

⁹ Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests OJ L312/1 (PFI Regulation).

¹⁰ Council Decision of 7 June 2007 on the system of the European Communities' own resources (2007/436/EC, Euratom) OJ L163/17 (Council Decision 2007/436/EC), art 2(1).

¹¹ Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax OJ L268/1; Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) No 904/2010 on administrative cooperation and combating fraud in the field of value added tax OJ L348/1.

¹² C-18/13 Maks Pen [2014] ECLI:EU:C:2014:69, paras 22-32; Joined Cases C-131, C-163 and C-164/13 Schoenimport "Italmoda" Mariano Previti (C-131/13), Turbi.com (C-163/13) and Turbo.com Mobile Phone's (C-164/13) [2014] ECLI:EU:C:2014:2455, paras 41-62.

and the EU legislature must comply with the fundamental freedoms enshrined in the Treaties.¹³ Despite the low number of cases dealing with the fundamental freedoms in the area of VAT, the VAT Directive and national VAT legislation relating to the prevention of VAT fraud must be compatible with the fundamental freedoms. Therefore, it is necessary to underline that the ambition of this paper is only to analyse Article 273. Analysing other provisions related to the prevention of VAT fraud is an important but time-consuming endeavor, which is not possible to do within the framework of this thesis. The reader should know that there are other legal grounds for combating VAT fraud, other than Article 273 VAT Directive, which are not analysed in this paper in relation to the objective of fiscal harmonisation. However, to the extent that other provisions affect the interpretation and application of Article 273 VAT Directive, they are also dealt with in this paper.

In line with the purpose of this paper, the focus is on the principles of neutrality and proportionality. At the same time, there are many principles underlying the common VAT system and are applied by the CJEU. Examples of such principles, in addition to neutrality and proportionality, are the principles of conferral and subsidiarity, the general principles of equal treatment and non-discrimination, the principles of legal certainty and legal expectations.¹⁴ Analysing the interpretation of the CJEU, in the light of all these principles, is not possible within the framework of this thesis. Therefore, as regard the interpretation of VAT provisions, the reader should know that the application of other principles than neutrality or proportionality may result in an outcome which relate to the objective of fiscal harmonisation differently.

1.4 Method

In line with the purpose of this paper, Article 273 VAT Directive is analysed in relation to the objective of fiscal harmonisation. First, the wording of Article 273 is analysed. Then, after this is done, the interpretation of Article 273 by the CJEU is analysed. In other words, the paper makes a distinction between legislation and interpretation.

This division between legislation and interpretation provides a greater understanding of the relationship between the Union legislator and the CJEU, and their responsibilities in the field of VAT. For instance, although the wording of a provision may be ambiguous and lead to

¹³ Karoline Spies, 'Fundamental freedoms and VAT: an analysis based on the Credit Lyonnais case' (2017) 6(2) World Journal of VAT/GST Law 100, 107-108.

¹⁴ Ben Terra and Julia Kajus, *A guide to the European VAT Directives* (IBFD 2019) ch 2.

undesirable consequences given the objective of fiscal harmonisation, this issue may be resolved or at least mitigated by the CJEU through their case-law. However, if there is a problem with the legislation, one may reflect on whether it should be resolved by the Court, or the Union legislator. The CJEU has long been accused of judicial activism for their interpretation and frequent use of fundamental principles.¹⁵

Moreover, according to the traditional understanding of the law, the courts does nothing but applying the law.¹⁶ No matter who makes the judicial decision, legally, the result will be the same. The concepts of *de lege lata* and *the lege ferenda* is based on this understanding.¹⁷ However, this view of the law is false, now more than ever. It does not reflect the open texture and indeterminacy of EU law. The CJEU has a margin of discretion, the exercise of which can take many forms, in interpreting and applying norms.¹⁸ To illustrate, since indetermination leave room for competitive interpretation of the law, the Court has the discretion to formulate the possible interpretations and also choose between them. Hence, to highlight the discretion of the CJEU, this paper makes a distinction between legislation and interpretation.

Arguably, the analysis of Article 273 VAT Directive should be divided into legislation, interpretation but also application. The CJEU may not settle national cases, but national courts can.¹⁹ Functionally, following the principles of direct effect and supremacy, national courts can be seen as European Courts.²⁰ National courts are responsible for applying EU VAT law. Applying the VAT provision on tax fraud correctly involves difficulties not only in interpreting VAT provisions, for which the CJEU is primarily responsible,²¹ but also actual circumstances. Different understandings of actual circumstances between national courts may

¹⁵ Jane Reichel, 'EU-rättslig metod' in Maria Nääv and Mauro Zambino (eds), *Juridisk metodlära* (2nd edition, Studentlitteratur AB 2018) 126–127, 131.

¹⁶ Miguel Poiares Maduro, *We the Court: The European Court of Justice and the European Economic Constitution* (Hart Publishing 1998) 16-17.

¹⁷ Eva-Maria Svensson, 'De lege interpretata – om behovet av metodologisk reflektion' [2014] JP 211, 212–215.

¹⁸ Miguel Poiares Maduro, *We the Court: The European Court of Justice and the European Economic Constitution* (Hart Publishing 1998) 16-19. See also Mauro Cappelletti, 'Alternative Dispute Resolution Processes within the Framework of the World-Wide Access-to-Justice Movement' (1993) 56 *The Modern Law Review* 282, 282-283; Per-Anders Forstorp, 'Det juridiska fältet: Critical Legal Studies, Foucault och Bourdieu' (2003) 3 *Tidskrift för litteraturvetenskap* 16; Robert Pålsson, *Hunden klockan tre och fjorton* (Iustus Förlag AB 2005) ch 3; Robert Pålsson, 'Om värderingars roll i rättstillämpningen' [2006] SvJT 258; Moa Bladini, 'Objektivitet i dömandet – på gott och ont?' [2016] SvJT 303.

¹⁹ TFEU, art 267.

²⁰ Robert Schütze, *European Union law* (2nd edition, Cambridge University Press 2018) 403-404.

²¹ TFEU, art 267.

affect the proper functioning of the internal market.²² To highlight the discretion of national courts, for the same reasons mentioned above, it would be appropriate to divide the analysis into another level, namely application. It would also provide a greater understanding of the relationship between the Union legislator, the CJEU and the Member States in the field of VAT. However, to do this would require me to analyse the national law of at least some Member States, which is not possible within the framework of this paper. To understand, describe and analyse EU VAT law is an important but time-consuming endeavor.²³ Also, the distinction between interpretation and application is far from obvious. According to Article 267 TFEU, the CJEU only has jurisdiction over issues relating to the validity or interpretation of EU law, not the application thereof. It is settled case-law that the CJEU has no jurisdiction to apply EU law.²⁴ Yet, as stated by Davies, “it is well-known that it often delivers judgement so specific that the case is effectively decided, in which it rules unambiguously on matters of fact”.²⁵ Since the CJEU has a broad understanding of interpretation, it is difficult to distinguish between interpretation and application, which is another reason for not dividing the analysis into application as well.²⁶

To analyse the legislation (the VAT Directive), the concept of flexibility is used. This provided a good basis for analysing Article 273 VAT Directive, and its compatibility with the objective of fiscal harmonisation. According to Barnard, there is flexibility in the choice of legislative instruments and within legislative instruments.²⁷ For instance, unlike regulations, directives allow for a degree of flexibility – and thus fragmentation of national laws – by their very nature.²⁸ However, in this paper, the focus is on flexibility within legislative instruments, so called flexibility in implementation. Such flexibility can be of two types: micro- and meso-

²² Pernilla Rendahl, ‘EU VAT and Double Taxation: A Fine Line between Interpretation and Application’ (2013) 41(8/9) *Intertax* 450, 456-458.

²³ See Eleonor Kristoffersson, ‘Comparative studies of national law in the EU harmonized VAT’ (2016) 1 *Nordic Tax Journal* 29.

²⁴ Joined Cases C-28, C-29 and C-30/62 *Da Costa en Schaake NV and Others v Administratie der Belastingen* (C-28/62), *Meijer* (C-29/62) and *Hoechst-Holland* (C-30/62) [1963] ECLI:EU:C:1963:6, 31, 38; C-6/64 *Costa v. E.N.E.L.* [1964] ECLI:EU:C:1964:66, 592-593; C-13/68 *Salgoil v Ministero del commercio con l'estero* [1968] ECLI:EU:C:1968:54, 454, 459; C-320/88 *Staatssecretaris van Financiën v Shipping and Forwarding Enterprise Safe* [1990] ECLI:EU:C:1990:61, para 11.

²⁵ Gareth Davies, ‘The Division of Powers between the European Court of Justice and National Courts’ (2004) 3 *Webpapers on Constitutionalism & Governance beyond the State* 1, 7.

²⁶ For a better understanding of the relationship between the CJEU and national courts, as regards Article 267 TFEU, see Gareth Davies, ‘The Division of Powers between the European Court of Justice and National Courts’ (2004) 3 *Webpapers on Constitutionalism & Governance beyond the State*; Takis Tridimas, ‘Constitutional review of member state action: The Virtues and vices of an incomplete jurisdiction’ (2011) 9(3/4) *International Journal of Constitutional Law* 737.

²⁷ Catherine Barnard, ‘Flexibility and Social Policy’ in Gráinne De Búrca and Joanne Scott (eds), *Constitutional Change in the EU: From uniformity to Flexibility?* (Hart Publishing 2000) 203–213.

²⁸ TFEU, art 288.

flexibility.²⁹ In cases of meso-flexibility, while the provisions are understood to be concrete and do not allow for general derogations, they explicitly exempt one or more Member States from their scope. On the other hand, in cases of micro-flexibility, the legislation provides for a broad degree of substantive discretion or allows for general derogations. For instance, in environmental law, provisions requiring the Member States to promote sustainable development are often characterised by micro-flexibility. Usually, in thinking about harmonisation, the focus is on meso-flexibility. The fewer State parties, the lower level of harmonisation. However, the level of micro-flexibility may also affect the degree of harmonisation, and in this paper the focus is mainly on this latter relationship.

1.5 Material

EU law prevails over national law.³⁰ According to Article 4 TFEU, shared competence applies in the field of VAT.³¹ This competence has been used to harmonise the area of turnover taxes through the introduction of, inter alia, the VAT Directive. According to Article 288 TFEU, the VAT Directive is only binding as to the result to be achieved. However, to guarantee the implementation of directives, the CJEU has, among other things, developed the doctrine of direct effect. If the VAT Directive is implemented incorrectly or not on time, individuals may invoke its provisions in national courts. This presupposes that the invoked provision is clear and precise, unconditional and absolute.³² Since Article 273 VAT Directive does not confer rights on individuals, it has no direct effect. However, when justifying their alleged violation of other provisions having direct effect, Member States invoke Article 273 VAT Directive.³³ Therefore, the VAT Directive is used as material.

The provisions of the VAT Directive aimed at preventing VAT fraud are Articles 11, 19, 80, 131, 158(2), 273, 343, 394 and 395 VAT Directive.³⁴ Only these provisions specifically mention VAT fraud in various forms, such as “evasion” or “possible evasion”. These provisions can be divided into general and specific depending on whether they have a general

²⁹ Gráinne De Búrca, ‘Differentiation within the Core: The Case of the Common Market’ in Gráinne De Búrca and Joanne Scott (eds), *Constitutional Change in the EU: From uniformity to Flexibility?* (Hart Publishing 2000) 138-140.

³⁰ C-6/64 *Costa v. E.N.E.L.* [1964] ECLI:EU:C:1964:66; C-11/70 *Internationale Handelsgesellschaft mbH v Einfuhrund Vorratsstelle für Getreide und Futtermittel* [1970] ECLI:EU:C:1970:114.

³¹ See also Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 19-22.

³² C-26/62 *Van Gend en Loos v Administratie der Belastingen* [1963] ECLI:EU:C:1963:1; C-148/78 *Ratti* [1979] ECLI:EU:C:1979:110; C-80/86 *Kolpinghuis Nijmegen* [1987] ECLI:EU:C:1987:431.

³³ See, for instance, C-127/18 *A-PACK CZ* [2019] ECLI:EU:C:2019:377, para 26.

³⁴ Arguably, Article 80 VAT Directive is intended to prevent tax abuse and not VAT fraud. For the difference between fraud and abuse, see Chapter 2.

or specific connection to the so-called VAT determination scheme.³⁵ For instance, in accordance with Article 11(1) VAT Directive, Member States may regard a group of related companies as a single taxable person. Since Article 11(1) VAT Directive is related to the concept of taxable person, it is specific. According to Article 80 VAT Directive, in order to prevent tax evasion or avoidance, Member States may adjust the taxable amount if the parties are closely related. Since this provision is related to the concept of taxable amount, it is specific. According to Article 273 VAT Directive, Member State may impose special measures which they deem necessary to prevent evasion. Since these measures can be related to any aspect of the VAT determination scheme, Article 273 is general. Only Articles 273, 394 and 395 VAT Directive are general. Nevertheless, in line with the purpose of this paper, only Article 273 is analysed in relation to the objective of fiscal harmonisation.

According to Article 411(2) VAT Directive, references to repealed (VAT) Directives shall be construed as references to this Directive in accordance with Annex XII. Repealed (VAT) Directives is also used as material.

According to Article 267 TFEU, national courts may ask the CJEU about the interpretation of EU law, such as the VAT Directive. The purpose of the preliminary reference procedure is to guarantee uniformity in the decentralised application of EU law, but also to make it possible for the CJEU to fulfil its task, namely, to ensure that the interpretation and application of EU law is observed.³⁶ According to the principle of sincere cooperation, which is set out in Article 4 TEU³⁷, national courts must interpret EU law in accordance with the interpretation provided by the CJEU.³⁸ Therefore, case-law from the Court is used as material. In line with the purpose of this paper, the selection of case-law is primarily based on whether they include an interpretation of Article 273 VAT Directive. Other cases of significance to the interpretation and application of Article 273 have also been used. All cases relating to Article 273 VAT Directive have been analysed.

1.6 Disposition

The disposition is as follows. In Chapter 2, the concept of VAT fraud is examined. How does VAT fraud relate to the objective of preventing tax evasion, avoidance and abuse? What is the

³⁵ For a more detailed description of the VAT determination scheme, see AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 43-50.

³⁶ Ulf Bernitz, *Europarättens genomslag* (Norstedts Juridik 2012) 82-83.

³⁷ Consolidated version of the Treaty on European Union OJ C326/13 (TEU).

³⁸ Ben Terra and Julia Kajus, *A guide to the European VAT Directives* (IBFD 2019) 36-38.

difference between tax fraud and abuse? Next, in Chapter 3, the functions and fundamental characteristics of VAT are presented. What is the objective of fiscal harmonisation and essential characteristics of EU VAT? Since the CJEU has played an important role in the development of EU VAT law, their methods of interpretation, neutrality and proportionality are also presented in Chapter 3. In Chapter 4, the micro-flexibility of the VAT Directive is analysed in light of Article 273 VAT Directive. In Chapter 5, the interpretation of Article 273 VAT Directive by the CJEU is analysed. Have the challenges identified in Chapter 4, which relates to the relationship between preventing VAT fraud and the objective of avoiding distortions of competition, been resolved or at least mitigated by the Court? Lastly, in Chapter 6, the final remarks are presented.

2 Concept of VAT Fraud

For the purpose of this essay, it is necessary to examine the concept of VAT fraud. The VAT Directive contains several provisions aimed at preventing evasion and avoidance. According to the Court, unlike the concept of tax avoidance, tax evasion involves an element of intent on the part of the taxpayer. However, for VAT purposes, there is no need to differentiate between tax evasion and tax avoidance. The purpose of eliminating distortions of competition requires the prevention of both tax evasion and tax avoidance. It is a matter of effect and not intention.³⁹

Accordingly, in several cases, the CJEU has held that preventing tax evasion, tax avoidance and abuse is an objective recognised and encouraged by the VAT Directive.⁴⁰ To achieve this objective, in addition to ensuring the correct collection of VAT, EU law cannot be relied on for *fraudulent* or *abusive* ends.⁴¹ The prevention of tax evasion relates to the concept of fraudulent acts,⁴² while the general principle of abuse of rights⁴³ relates to the concept of abusive practices.⁴⁴ Tax avoidance is related to the general obligation to ensure the correct collection of VAT.⁴⁵ Therefore, as far as the Court is concerned, tax fraud is the same as tax evasion.

VAT fraud may be regarded as an abuse of tax law; however, an abuse does not necessarily involve tax fraud. VAT fraud is when a tax rule is deliberately broken in order to illegally obtain a tax advantage.⁴⁶ Examples of VAT fraud are under-reported sales, failure to register

³⁹ Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd (C-138/86) and Photographs Ltd (C-139/86)* [1988] ECLI:EU:C:1988:383, paras 20-23.

⁴⁰ C-320/17 *Marle Participations* [2018] ECLI:EU:C:2018:537, para 41; C-712/17 *EN.SA* [2019] ECLI:EU:C:2019:374, para 31; C-273/18 *Kuršu zeme* [2019] ECLI:EU:C:2019:588, para 34.

⁴¹ Joined Cases C-80 and C-142/11 *Mahagében (C-80/11) and Dávid (C-142/11)* [2012] ECLI:EU:C:2012:373, para 41; C-277/14 *PPUH Stehcemp* [2015] ECLI:EU:C:2015:719, para 47.

⁴² The terms fraud and evasion are used as synonyms in the case-law of the CJEU. See, for instance, Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd (C-138/86) and Photographs Ltd (C-139/86)* [1988] ECLI:EU:C:1988:383, para 22; C-574/15 *Scialdone* [2018] ECLI:EU:C:2018:295, para 26 and C-648/16 *Fontana* [2018] ECLI:EU:C:2018:932, para 33.

⁴³ In the 2006 *Halifax* case (C-255/02 *Halifax and Others* [2006] ECLI:EU:C:2006:121), the CJEU explicitly stated, for the first time, that the principle of prohibiting abusive practices also applies in the field of VAT (para 70). However, in light of their previous case-law, this was no surprise. Previously, the Court has been clear that the prevention of abuse is an objective recognised and encouraged by the VAT Directive.

⁴⁴ *Rita de la Feria, The EU VAT System and the Internal Market* (IBFD 2009) 269-274; AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 39-42.

⁴⁵ See Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd (C-138/86) and Photographs Ltd (C-139/86)* [1988] ECLI:EU:C:1988:383, paras 20-23.

⁴⁶ AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 40.

for VAT, misclassification of commodities, VAT collected but not remitted and false claims for credit or refund of VAT.⁴⁷ However, in cases of abuse, no tax rule has been broken but only applied to an artificially created situation, which does not reflect economic reality, in order to obtain a tax advantage. According to settled case-law, in order for abuse to exist, the following criteria must be met:

first, the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the Sixth Directive and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions.

Second, it must also be apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage. As the Advocate General observed in point 89 of his Opinion, the prohibition of abuse is not relevant where the economic activity carried out may have some explanation other than the mere attainment of tax advantages.⁴⁸

The distinction between VAT fraud and abuse is important because the consequences of considering a tax scheme as fraud or abuse differ. In cases of abuse, the transactions must be redefined,⁴⁹ while in cases of VAT fraud the right of deduction or exemption from VAT is denied.⁵⁰

However, in cases where there is neither VAT fraud nor abuse, “taxpayers may choose to structure their business so as to limit their tax liability”.⁵¹ In other words, in choosing between two transactions, taxable persons are not required to choose the one which involves paying the highest amount of VAT. Tax planning should therefore be distinguished from VAT fraud and abuse.

⁴⁷ Michael Keen and Stephen Smith, ‘VAT Fraud and Evasion: What Do We Know, and What Can be Done?’ (2006) 59(4) National Tax Journal 861, 865-868.

⁴⁸ C-255/02 Halifax and Others [2006] ECLI:EU:C:2006:121, paras 74-75; C-419/14 WebMindLicenses [2015] ECLI:EU:C:2015:832, para 36; C-273/18 Kuršu zeme [2019] ECLI:EU:C:2019:588, para 35.

⁴⁹ C-255/02 Halifax and Others [2006] ECLI:EU:C:2006:121, para 94.

⁵⁰ C-624/15 Litdana [2017] ECLI:EU:C:2017:389, para 32.

⁵¹ C-255/02 Halifax and Others [2006] ECLI:EU:C:2006:121, para 73; C-425/06 Part Service [2008] ECLI:EU:C:2008:108, para 47; C-103/09 Weald Leasing [2010] ECLI:EU:C:2010:804, para 27. See also C-419/14 WebMindLicenses [2015] ECLI:EU:C:2015:832, para 42.

3 Functions and Fundamental Characteristics of EU VAT

3.1 The Objective of Fiscal Harmonisation: Achieving an Internal Market

For the purpose of this essay, it is necessary to clarify the objective of fiscal harmonisation. In clarifying the objective of fiscal harmonisation, I assume the perspective of the Union legislator.

In accordance with the principle of conferred competence, if the EU adopts a legal act without or on the wrong legal basis, the act can be declared invalid by the CJEU on the ground of lack of competence.⁵² As regards the choice of legal basis, the CJEU has established two requirements. First, the choice must be based on objective factors that are available for judicial review, such as the aim and content of the legal act. Second, the legal basis used shall be required by the main or predominant purpose of the legal act.⁵³ Therefore, to clarify the objective of fiscal harmonisation, the institutional grounds for harmonising turnover taxes is useful. The legal basis for harmonising turnover taxes is now Article 113 TFEU.⁵⁴ According to Article 113:

The Council shall [...] adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

The phrase “to avoid distortion of competition” was introduced only after the harmonisation of VAT for reasons of clarity. The legislative powers conferred upon the Union is thus limited by the concept of an internal market⁵⁵. Legislative acts, such as regulations or directives, must be intended to improve the conditions for the establishment and functioning of the internal market. They cannot only aim to regulate the internal market.⁵⁶ What does ‘the establishment

⁵² TFEU, art 263.

⁵³ David Langlet and Said Mahmoudi, *EU Environmental Law and Policy* (Oxford University Press 2016) 123.

⁵⁴ C-144/13 VDP Dental Laboratory and Others [2015] ECLI:EU:2015:116, para 60.

⁵⁵ According to Article 26 TFEU, the internal market shall “comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties”. However, this definition is ambiguous and falls short in explaining the meaning of the internal market as a legal concept. The meaning of the internal market is subject to intense controversy. For more about the internal market as a legal concept, see Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 6-11 and Stephen Weatherill, *The Internal Market as a Legal Concept* (Oxford University Press 2017) 1-14.

⁵⁶ C-376/98 Germany v Parliament and Council [2000] ECLI:EU:C:2000:544, para 83.

and functioning of the internal market' mean? While the former concerns obstacles to free movement,⁵⁷ the latter addresses distortions of competition resulting from disparities between national laws.⁵⁸ The distortions must be *appreciable*.⁵⁹ All in all, the Union legislator may only rely on Article 113 TFEU to eliminate obstacles to free movement or appreciable distortions of competition resulting from disparities between national laws.

Accordingly, as regards the common VAT system, the predominant objective of fiscal harmonisation is to eliminate obstacles to free movement and distortions of competition, which is confirmed by the Preamble of the First (VAT) Directive⁶⁰ and the CJEU.⁶¹

However, the elimination of obstacles to free movement and distortions of competition is not the only reasons for harmonisation in 1967. Before the harmonisation of turnover taxes, only France had a VAT, while the other Member States had cascade systems. Preparatory works show that these cumulative, multi-stage turnover taxes had major disadvantages. For instance, when goods are exported, they must be relived of the tax burden. Failure to do so will reduce the competitiveness of European companies in international trade. With cumulative taxes, it is almost impossible to calculate the exact amount of the tax burden on a product, as this amount depends on the number of stages in the supply chain. Moreover, since the tax amount depends on the number of stages in the supply chain, cumulative turnover taxes encourage vertical integration of enterprises. VAT does not have these disadvantages.⁶² Taxing services is also easier with VAT, and that was considered a great advantage.⁶³ For these reasons, in April

⁵⁷ In the 2000 Tobacco Advertising case (C-376/98 Germany v Parliament and Council [2000] ECLI:EU:C:2000:544), the CJEU held that this ground could be used to facilitate but not prohibit trade. For instance, in view of the trend in national legislation towards greater restriction of tobacco products, the CJEU held that a prohibition on advertising such products in periodicals, magazines and newspapers is necessary to eliminate future obstacles to the free movement of press products. However, as regards advertising on other products, such as posters and parasols, a prohibition will “in no way help to facilitate trade” concerning these products (paras 96-101).

⁵⁸ Robert Schütze, *European Union law* (2nd Edition, Cambridge University Press 2018) 555.

⁵⁹ C-376/98 Germany v Parliament and Council [2000] ECLI:EU:C:2000:544, paras 106-107.

⁶⁰ First Council Directive 67/227/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes OJ 71/1301 (First VAT Directive).

⁶¹ C-475/03 Banca popolare di Cremona [2006] ECLI:EU:C:2006:629, para 19; C-475/17 Viking Motors and Others [2018] ECLI:EU:C:2018:636, para 30.

⁶² Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 48-50; AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 10.

⁶³ Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 50.

1967, the Council established the common VAT system through the adoption of the First VAT Directive and Second VAT Directive⁶⁴.

Still, as the Member States were given a high level of discretion under the First and Second Directives, the national VAT legislation adopted by them differed substantially. Disparities between the VAT laws of the Member States were considered liable to create significant distortions of competition. Although it was clear that these must be eliminated, it was not until 1977 that the Council adopted a new directive, the Sixth (VAT) Directive⁶⁵. The Second VAT Directive was repealed. The discretion left to the Member States was thus greatly reduced.⁶⁶ Arguably, the main reason for adopting this directive is not the elimination of distortions of competition, but something more practical. In 1970, the Council decided that every Member States must contribute to the Union with a percentage of the uniform basis of assessment for VAT. To ensure that each Member States carries a proportional burden, national VAT legislation must not differ substantially within the Union. This underlined the importance of further harmonising the VAT, which the Council did seven years later through the Sixth Directive.⁶⁷ In 2006, the Council adopted the VAT Directive, thus replacing the First and Sixth Directive, for reasons of clarity and rationalisation. Compared to the Sixth Directive, the VAT Directive contains few material changes.⁶⁸ As regards EU VAT, the main legislation is now the VAT Directive.

All in all, the objective of fiscal harmonisation is to eliminate obstacles to free movement of goods and services, appreciable distortions of competition, cascading effects, difficulties in international trade and establish a common basis of assessment for VAT.⁶⁹

⁶⁴ Second Council Directive 67/228/EEC of 11 April 1967 on the harmonisation of legislation of Member States concerning turnover taxes - Structure and procedures for application of the common system of value added tax OJ 71/1303 (Second VAT Directive).

⁶⁵ Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment OJ L145/1 (Sixth VAT Directive).

⁶⁶ Rita de la Feria, *The EU VAT System and the Internal Market* (IBFD 2009) 53-56.

⁶⁷ See C-539/09 *Commission v Germany* [2011] ECLI:EU:C:2011:733, para 75 and the cited case-law.

⁶⁸ AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 12-16.

⁶⁹ These objectives are not separate but interlinked. To illustrate, in the 1982 Hong Kong case (C-89/81 *Hong-Kong Trade* [1982] ECLI:EU:C:1982:121), the CJEU held that the purpose of eliminating distortions of competition meant that similar goods should bear the same tax burden whatever the length of the production and distribution chain (para 6). This suggests that cascading turnover taxes are contrary to the objective of avoiding distortions of competition.

3.2 Essential Characteristics of EU VAT

According to settled case-law by the CJEU, under Article 401 VAT Directive, the maintenance or introduction of taxes, duties, or charges are prohibited if they display the *essential characteristics of VAT*.⁷⁰ The purpose of this provision is to prevent Member States from circumventing the harmonisation of VAT by introducing new turnover taxes. This raises the question of what the *essential characteristics of VAT* are. According to the Court, VAT has the following four characteristics:

- It applies generally to transactions relating to goods and services.
- It is proportional to the price charged by the taxable person for goods and services.
- It is charged at each stage of the supply chain.
- Taxable persons have the right to deduct the VAT paid upon acquired goods and services used for the taxed transactions of the taxable person.⁷¹

This is confirmed by Article 1 VAT Directive. VAT is a general tax on consumption as opposed to a specific tax. VAT is proportional to the price charged by the taxable person. For instance, if the VAT rate is 25 %, the tax amount is 25 % of the price before the tax. VAT is an all-stage tax and thus charged at every stage of production and distribution chain. Taxable persons have the right to deduct the VAT paid upon acquired goods and services used for the taxed transactions of the taxable person. The right of deduction is a fundamental principle of the common system of VAT. The deduction system is intended to relieve the trader entirely of the tax burden.⁷²

Note that, in order to ensure the notion of VAT as a tax on consumption, it is important to maintain the essential characteristics of VAT. For instance, if the taxable amount is not the consideration actually received or if the right of deduction is refused, the VAT is effectively not a tax on consumption but on economic activity. This is contrary to the objective of fiscal harmonisation, which is to avoid the disadvantages of a cascading turnover tax. This is an

⁷⁰ C-437/97 EKW and Wein & Co. [2000] ECLI:EU:C:2000:110, paras 19-23; C-101/00 Tulliasiamies and Siilin [2002] ECLI:EU:C:2002:505, paras 105-106; C-308/01 GIL Insurance and Others [2004] ECLI:EU:C:2004:252, para 31; C-475/03 Banca popolare di Cremona [2006] ECLI:EU:C:2006:629, para 27; C-475/17 Viking Motors and Others [2018] ECLI:EU:C:2018:636, paras 26-27; C-185/18 Oro Efectivo [2019] ECLI:EU:C:2019:485, paras 20-21.

⁷¹ C-437/97 EKW and Wein & Co. [2000] ECLI:EU:C:2000:110, para 22; C-475/03 Banca popolare di Cremona [2006] ECLI:EU:C:2006:629, para 28; C-475/17 Viking Motors and Others [2018] ECLI:EU:C:2018:636, para 39; C-185/18 Oro Efectivo [2019] ECLI:EU:C:2019:485, para 23.

⁷² C-329/18 Altic [2019] ECLI:EU:C:2019:831, paras 26-27 and the cited case-law.

important aspect as many Member States, in order to prevent VAT fraud, undermine the essential characteristics of VAT under Article 273 VAT Directive. To illustrate, in the 2019 A-PACK case,⁷³ in the interest of preventing VAT fraud, Czech Republic refused to reduce the taxable amount, in cases of total or partial non-payment, if the debtor is no longer a taxable person. Hence, the essential characteristics of VAT and the notion of VAT as a consumption tax are important aspects in the context of preventing VAT fraud.

3.3 The CJEU in the Field of EU VAT

The CJEU has played an important role in the development of EU VAT through their extensive case-law. The interpretative methods used by the CJEU, as well as the principles of neutrality and proportionality are presented below. The purpose of this is to contribute to a better understanding of the Court's reasoning in Chapter 5.

3.3.1 Interpretative Methods

The methods employed by the CJEU in their interpretation of EU legislation, including the VAT Directive, are described as literal, contextual and teleological. Despite common beliefs, there is no clear hierarchy between these methods. In fact, in many cases, these different methods are applied simultaneously or balanced against each other.⁷⁴

The literal method of interpretation aims to clarify the meaning of an article based on its wording. To illustrate, in the 2019 Oro Efectivo case, the CJEU held that an “interpretation of [Article 401] leads to the conclusion that, in view of the negative condition in the expression ‘cannot be characterised as turnover taxes’, the maintenance or introduction by a Member State of taxes, duties or charges is authorised only on condition that they cannot be assimilated to a turnover tax”.⁷⁵ According to the contextual method, in interpreting an article, consideration should not only be given to its wording but also context.⁷⁶ The provision, which is subject to interpretation, is regarded as part of a whole. For example, in several cases, the CJEU has stated that since VAT is a general tax on consumption, the exemptions from VAT should be interpreted *strictly*.⁷⁷ The CJEU are primarily known for applying the teleological

⁷³ C-127/18 A-PACK CZ [2019] ECLI:EU:C:2019:377.

⁷⁴ Eleonor Kristoffersson and Pernilla Rendahl, *Textbook on EU VAT* (2nd edition, Iustus Förlag AB 2019) 28–31.

⁷⁵ C-185/18 Oro Efectivo [2019] ECLI:EU:C:2019:485, para 21.

⁷⁶ See C-433/08 Yaesu Europe [2009] ECLI:EU:C:2009:750, para 24 and the cited case-law.

⁷⁷ C-449/17 A & G Fahrschol-Akademie [2019] ECLI:EU:C:2019:202, para 19 and the cited case-law.

method. Maduro, former Advocate General, refers to two different levels of teleological interpretation used by the Court.⁷⁸ Usually, in thinking about the teleological method, the focus is on the what Maduro calls the teleological level of interpretation. According to this method, in interpreting an article, the focus is on its purpose. However, in the interpretation of an article, the Court also applies the metateleological level of interpretation by focusing on the telos of the legal context in which this provision forms part of.

3.3.2 Neutrality

The EU VAT system shall ensure the highest level of neutrality. Neutrality is derived from Article 113 TFEU and Article 1(2) VAT Directive. Despite being a fundamental principle of EU VAT law,⁷⁹ neutrality is not a rule of primary law but a principle of interpretation. Thus, it cannot determine the validity of secondary law, such as the VAT Directive and its provisions.⁸⁰ The principle of neutrality functions as an interpretative tool with a multi-faceted face.⁸¹ Moreover, the essence of neutrality can manifest itself through other principles, for example the principle of uniform application⁸² and right of deduction.⁸³ It is a principle with many corollaries.

Neutrality is a relative principle. It refers to whether one certain VAT effect is neutral compared to another.⁸⁴ However, in order to assess whether there is neutrality in a particular case, the Court often takes its point of departure in the objective of fiscal harmonisation and essential characteristics of VAT. According to Doesum, Kesteren and Norden, neutrality has an economic and legal aspect.⁸⁵ The economic aspect of neutrality, referred to as *system*

⁷⁸ Miguel Poiars Maduro, 'Interpreting European Law: Judicial Adjudication in a Context of Constitutional Pluralism' (2007) 1(2) European Journal of Legal Studies 1, 5.

⁷⁹ C-454/98 Schmeink & Cofreth and Strobel [2000] ECLI:EU:C:2000:469, para 59.

⁸⁰ C-334/14 De Fruytier [2015] ECLI:EU:C:2015:437, para 37; C-40/15 Aspiro [2016] ECLI:EU:C:2016:172, para 31; C-573/15 Oxycure Belgium [2017] ECLI:EU:C:2017:189, para 32. Arguably, this is only true to form. To illustrate, in determining the validity of secondary law, such as Council Decisions under Article 395 VAT Directive which allows a named Member State to derogate from the VAT Directive, the substance of neutrality can still determine the validity of secondary law. However, since the principle of neutrality cannot formally determine the validity of secondary law, the Court speaks in terms of, for example, the principle of the right of deduction (see, for instance, C-17/01 Sudholz [2004] ECLU:EU:C:2004:242).

⁸¹ Eleonor Kristoffersson and Pernilla Rendahl, *Textbook on EU VAT* (2nd edition, Iustus Förlag AB 2019) 31.

⁸² According to the principle of uniform application, in order to avoid Member States interpreting the concepts of EU law differently and thus circumventing the harmonisation of VAT, it is up to the Court to define the concepts laid down in the VAT Directive. For example, where this principle has been applied, see C-264/14 Hedqvist [2015] ECLI:EU:C:2015:718, para 33.

⁸³ Rita de la Feria, 'EU VAT principles as interpretative aids to EU VAT rules: the inherent paradox' [2016] Oxford University Centre for Business Taxation Working Paper No. 16/03 6, 7.

⁸⁴ Eleonor Kristoffersson and Pernilla Rendahl, *Textbook on EU VAT* (2nd edition, Iustus Förlag AB 2019) 31.

⁸⁵ AD van Doesum, Herman van Kesteren and Gert-Jan van Norden, *Fundamentals of EU VAT LAW* (Kluwer Law International BV 2016) 36–39.

neutrality, entails that the VAT should be proportional to the actual price charged by the taxable person for goods or services (VAT excluded). This means that VAT should not encourage vertical integration of enterprises, create cascading effects or result in double or non-taxation. The Court has, in several cases, used the essence of system neutrality to interpret EU VAT law.⁸⁶ This aspect of neutrality is mainly related to the essential characteristics of VAT. The trader, as a tax collector on behalf of the State, must be relieved entirely from the burden of VAT. The legal aspect of neutrality, referred to as *legal neutrality*, is a reflection of the principle of equal treatment in the field of VAT.⁸⁷ This principle precludes taxable persons who are in competition with each other from being treated differently for VAT purposes. Legal neutrality has also been used by the Court on numerous occasions.⁸⁸ Legal neutrality is mainly related to the objective of avoiding distortions of competition.⁸⁹

As shown, the principle of neutrality is a vehicle for achieving the objective of fiscal harmonisation and maintaining the essential characteristics of VAT. The use of neutrality is a mixture of the contextual and teleological approach to EU VAT law by the CJEU.

3.3.3 Proportionality

Proportionality is derived from the laws of the Member States,⁹⁰ and is a general principle of EU law.⁹¹ Since proportionality is not only a principle of interpretation but also primary law, it can determine the validity of secondary law, such as the VAT Directive.⁹² Like many other

⁸⁶ See, for instance, C-454/98 Schmeink & Cofreth and Strobel [2002] ECLI:EU:C:2000:469; C-29/08 SKF [2009] ECLI:EU:C:2009:665, para 56.

⁸⁷ C-38/16 Compass Contract Services [2017] ECLI:EU:C:2017:454, paras 21-39; C-308/16 Kozuba Premium Selection [2017] ECLI:EU:C:2017:869, para 43.

⁸⁸ See, for instance, C-566/16 Vámos [2018] ECLI:EU:C:2018:321, para 48; C-145/18 Regards Photographiques [2019] ECLI:EU:C:2019:668, para 36; C-715/18 Segler-Vereinigung Cuxhaven [2019] ECLI:EU:C:2019:1138, paras 35-37; C-211/18 Idealmed III [2020] ECLI:EU:C:2019:168, para 41.

⁸⁹ C-481/98 Commission v France [2001] ECLI:EU:C:2001:237, para 22.

⁹⁰ Grainne de Búrca, 'Proportionality and Subsidiarity as General Principles of Law' in Ulf Bernitz and Joakim Nergelius (eds), *General Principles of European Community Law* (Kluwer Law International 2000) 95-96.

⁹¹ Joined Cases C-177 and 181/99 Ampafrance and Sanofi [2000] ECLI:EU:C:2000:470, para 42 and the cited case-law.

⁹² In Joined Cases C-177 and C-181/99 Ampafrance and Sanofi [2000] ECLI:EU:C:2000:470, the CJEU found that Council Decision 89/487/EEC – which allowed France to introduce a special measure derogating from now Article 176 VAT Directive – invalid for lack of proportionality. The French measure to combat tax evasion and avoidance was not proportionate. Moreover, in C-17/01 Sudholz [2004] ECLI:EU:C:2004:242, the CJEU examined the validity of Article 2 of Council Decision 2000/186/EC which allowed Germany to introduce a special measure derogating from now Article 27 and 68 VAT Directive. In assessing whether Article 2 – which restricts the right of deduction – infringes the substantive requirement of Article 395 VAT Directive, the CJEU found that Article 2 is not disproportionate in view of its purpose to combat tax evasion and simplify the procedure for collecting VAT.

general principles of EU law, the actual meaning and scope of proportionality is not codified, neither in TFEU nor TEU. Nowadays there is Article 5(4) TEU. However, according to settled case-law, the principle is much wider in both scope and meaning than implied by Article 5(4) TEU.

Proportionality is a balancing principle used to determine whether an interest or right recognised by the legal order is excessively restricted. According to Advocate General Trstenjak, in the 2011 *Commission v Germany* case, proportionality requires that the measure be appropriate, necessary and reasonable in order to attain the objective pursued. A measure is *appropriate* to ensuring attainment of the objective pursued if it genuinely reflects a concern to attain it in a consistent and systematic manner. A measure is *necessary* if, from among several measures which are appropriate for meeting the objective pursued, it is the least onerous for the protected interest. An *unreasonable* restriction exists where, despite its contribution to attaining the legitimate objective pursued, the measure results in excessively strong interference in the protected interest.⁹³ Usually, the application of proportionality consists in the Court taking the following steps:

first, identifying what legally protected right or interest is at stake; secondly, identifying the extent to which this right or interest has been interfered with or restricted; thirdly, identifying the reason (the purported justification) for its restriction, whether for the protection of another right or public interest etc., and if so what weight is to be given to that other interest.⁹⁴

As regards this paper, the rights or interests at stake relates to the objectives and principles of the VAT Directive, while the purported justification is the prevention of VAT fraud. To what extent can the objectives and principles of the VAT Directive be restricted in the prevention of VAT fraud? The tension between the objectives and principles of the VAT Directive, on the one hand, and the objective of preventing tax VAT fraud, on the other hand, results from the fact that anti-fraud measures often affects people not involved in fraud. This lack of precision is necessary for the measures to be effective. The alternative, which is to investigate VAT fraud in each case, is neither administratively possible nor cost-efficient.

⁹³ C-539/09 *Commission v Germany* [2011] ECLI:EU:C:2011:733, Opinion of General Advocate, paras 91-92, 126-127 and the cited case-law.

⁹⁴ Grainne de Búrca, 'Proportionality and Subsidiarity as General Principles of Law' in Ulf Bernitz and Joakim Nergelius (eds), *General Principles of European Community Law* (Kluwer Law International 2000) 97.

4 Analysis of Article 273 VAT Directive

As shown in Chapter 3, the objective of fiscal harmonisation is preventing distortions of competition, eliminate obstacles to free movement of goods and services, avoid cascading effects, difficulties in international trade and establish a common basis of assessment for VAT. However, in line with the purpose of this paper, the focus is on the competitive terms of the internal market and thus the objective of avoiding distortions of competition.

Disparities between the laws of the Member States are liable to create or maintain distortions of competition. Hence, in order to prevent distortions of competition, Member States have harmonised the area of turnover taxes, now through the VAT Directive. Usually, in thinking about harmonisation, the focus is on meso-flexibility. Since all Member States are bound by the VAT Directive, there is “full harmonisation” in terms of meso-flexibility. However, the degree of harmonisation is also affected by the level of micro-flexibility. In this chapter, the micro-flexibility of the VAT Directive is analysed in light of Article 273. According to Article 273:

Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers.

The option under the first paragraph may not be relied upon in order to impose additional invoicing obligations over and above those laid down in Chapter 3.

Article 273 is a general derogation from the VAT Directive. Despite not explicitly authorizing derogations from the VAT Directive, such as Article 395 VAT Directive, measures introduced under Article 273 are effectively derogations.⁹⁵ Therefore, as a starting point, the VAT Directive is characterised by a high level of micro-flexibility. However, the introduction of special measures under Article 273 is subject to substantive restrictions. The level of

⁹⁵ See, for instance, C-188/09 Profaktor Kulesza, Frankowski, Józwiak, Orłowski [2010] ECLI:EU:C:2010:454; C-101/16 Paper Consult [2017] ECLI:EU:C:2017:775.

micro-flexibility – and thus the impact on the objective of fiscal harmonisation – must take these restrictions into account.

Before taking these restrictions into account, note that Article 273 VAT Directive is optional and not mandatory. Member States *may* introduce anti-fraud measures. The optional nature of Article 273 may have a distortive effect on competition at national and Union level. As referred to above, in order to ensure the proper functioning of the internal market, Member States must collect the right amount of VAT, no more no less. If nothing is done to combat VAT fraud, taxable persons in other Member States will have a competitive disadvantage as they pay more in VAT. Distortions of competition will also occur within that Member State because not everyone commits fraudulent acts. Those who manage to commit VAT fraud pay less in VAT compared to their competitors.

The first restriction is that Member States may only introduce measures under Article 273 to ensure the correct collection of VAT and prevent evasion. However, the meaning of evasion is not included in the VAT Directive. In the absence of legal guidance, Member States may adopt an extensive or, for them, favorable interpretation of evasion. If Member States interprets the concept of tax evasion differently or extensively, anti-fraud measures introduced by them may compromise the competitive terms of the internal market.

Second, under Article 273 VAT Directive, Member States may impose measures “which they deem necessary” to ensure the correct collection of VAT or prevent evasion. According to the wording, the measure need not be necessary. Member States may introduce any measures *they* deem necessary. Having this margin of discretion enables Member States to act contrary to the objective of fiscal harmonisation when preventing VAT fraud.

Thirdly, as regards Article 273 VAT Directive, anti-fraud measures are subject to “the requirement of equal treatment as between domestic transactions and transactions carried out between Member States”. Arguably, despite its wording, this requirement does not prevent Member States from discriminating between domestic and intra-Union transactions. Usually, in EU law, requirements of equal treatment are for the protection of intra-Union transactions.⁹⁶ Hence, intra-Union traders can demand equal treatment but not domestic traders. Such an interpretation of equal treatment is clearly liable to distort competition to the disadvantage of domestic transactions. In preventing VAT fraud, the Member State may

⁹⁶ See, for instance, C-86/78 Peureux [1979] ECLI:EU:C:1979:64, para 32.

impose measures only on domestic traders which may, in one way or another, affect their ability to compete with other taxable persons.

Nevertheless, there are restrictions in Article 273 VAT Directive compatible with the objective of fiscal harmonisation. Anti-fraud measures adopted under Article 273 may not include additional invoicing obligations over and above those laid down in Chapter 3 VAT Directive. Directive 2001/117/EC introduced this restriction in Article 22(8) of the Sixth VAT Directive, now Article 273 VAT Directive, as the invoicing obligations have now been harmonised.⁹⁷ Invoices enable tax authorities to carry out checks and buyers to prove, if necessary, the right of deduction.⁹⁸ This restriction means that Member States may not impose additional invoicing obligations, under Article 273 VAT Directive, to carry out controls and thereby prevent VAT fraud. Invoicing obligations are liable to compromise the right of deduction. The right of deduction is an essential characteristic of VAT. In order to avoid cascading effects, on the basis of Article 273, this restriction is important. Moreover, while this requirement does not relate to the objective of avoiding distortions of competition directly, if Member States were allowed to impose additional invoicing obligations, thus compromising the right of deduction, the competitive terms of the internal market could be jeopardised indirectly. In other words, not allowing Member States to derogate from Chapter 3 reduces the legal possibilities of Member States to distort competition. Furthermore, anti-fraud measures adopted under Article 273 VAT Directive may not, in trade between Member States, give rise to formalities connected with the crossing of frontiers. Hence, the prevention of VAT fraud may not result in tax borders or other psychological barriers. This relates to the objective of eliminating obstacles to free movement of goods and services.

In conclusion, the optional nature of Article 273 VAT Directive allows Member States to refrain from combating VAT fraud, thereby passively compromising the competitive terms of the internal market. Moreover, despite the legal restrictions in Article 273, the VAT Directive is characterised by a high level of micro-flexibility. The meaning of evasion is not included in the VAT Directive. The requirements of necessity and equal treatment are open to various interpretations contrary to the objective of fiscal harmonisation. This level of micro-flexibility implies acceptance of derogations that are contrary to the competitive terms of the internal market, and thus the objective of fiscal harmonisation.

⁹⁷ Ben Terra and Julia Kajus, *A guide to the European VAT Directives* (IBFD 2019) 1461.

⁹⁸ Ben Terra and Julia Kajus, *A guide to the European VAT Directives* (IBFD 2019) 1417.

5 Analysis of the interpretation of Article 273 by the CJEU

Due to Article 273, the VAT Directive is characterised by a high level of micro-flexibility. As shown in Chapter 4, this level of micro-flexibility implies acceptance for derogations that interfere with the competitive terms of the internal market. However, as indicated above, the process of harmonisation is an ongoing process and not solely in the hands of the Union legislator but also the CJEU.⁹⁹ The CJEU can harmonise the interpretation and application of VAT provisions through their case-law. This chapter investigates whether the CJEU has resolved or mitigated the challenges to the objective of fiscal harmonisation presented in Chapter 4.

The disposition is as follows. Initially, it is analysed whether - and in what way - the CJEU has dealt with the risk of distortive effects of the optional nature of Article 273 on competition. Next, the interpretation of tax evasion by the CJEU is analysed. Finally, the margin of discretion left to Member States under Article 273, as interpreted by the CJEU, is analysed in relation to the objective of fiscal harmonisation, taking into account the requirement of equal treatment.

5.1 Optional Nature of Article 273 VAT Directive

The CJEU has not changed the nature of Article 273 VAT Directive from optional to mandatory. It is still up to the Member States if they wish to introduce anti-fraud measures under this provision. No Member State has been accused of failing to introduce measures under Article 273, neither by the European Commission nor any other Member State.

However, Member States may have an indirect obligation to introduce anti-fraud measures under Articles 273 VAT Directive. According to settled case-law, Articles 2, 250(1) and 273 of the VAT Directive, read in conjunction with Article 4(3) TEU, imposes an obligation on every Member State to take all legislative and administrative measures for ensuring collection of all the VAT due on their territory and for combating evasion.¹⁰⁰ Thus, if they are not to disregard this obligation, Member States must in some cases impose anti-fraud measures

⁹⁹ See Chapter 1.4.

¹⁰⁰ C-617/10 Åkerberg Fransson [2013] ECLI:EU:C:2013:280, para 25; C-144/14 Cabinet Medical Veterinar Dr. Tomoiagă Andrei [2015] ECLI:EU:C:2015:452, para 25; C-105/14 Taricco and Others [2015] ECLI:EU:C:2015:555, para 36; C-576/15 Mary Marinova [2016] ECLI:EU:C:2016:740, para 41; C-648/16 Fontana [2018] ECLI:EU:C:2018:932, para 33.

under Articles 273 VAT Directive. The 2016 Mary Marinova case may serve as an example of this.¹⁰¹

Mary Marinova (MM), a Bulgarian national, sells food and non-food products by retail. In taking investigative actions against the commercial partners of MM, the Bulgarian tax authorities found that several of them had supplied products and issued invoices to MM. These products could not be found in the business of MM. Finding that MM had accounted neither for the incoming products from the suppliers nor the subsequent sales of these products, the Bulgarian tax authorities concluded that she had concealed the supplies and the revenue. They issued a tax adjustment notice. In determining the taxable amount, the Bulgarian tax authority assumed that the products were sold with a profit margin normally used by MM. The referring court asked the CJEU whether the Member States may presume that MM has subsequently sold the incoming goods to third parties and determine the taxable amount according to the factual information at hand in accordance with rules not included in the VAT Directive.

The CJEU concluded that Articles 2(1)(a), 9(1), 14(1), 73 and 273 of the VAT Directive, having regard to the principles of fiscal neutrality and proportionality, do not preclude such national measures. After expressing the obligation of Member States to take all legislative and administrative measures to combat tax evasion, the CJEU held that VAT fraud, such as concealing supplies and revenue, must not hinder the collection of VAT. The Court further stated that, in light of Article 273 VAT Directive and the obligation of Member States to combat VAT fraud, the national competent authorities must re-establish the situation that would have prevailed in the absence of tax evasion. This suggests that the obligations imposed by the VAT Directive, in conjunction with Article 4(3) TEU, may require the Member States to introduce measures under Article 273 VAT Directive to re-establish the situation that would have prevailed in the absence of VAT fraud. Lack of rules in the VAT Directive, which can be applied to the case of MM directly, does not justify a Member State neglecting its obligation to fight VAT fraud. This shows how Member States may have an indirect obligation to introduce anti-fraud measures under Article 273 VAT Directive.¹⁰²

¹⁰¹ C-576/15 *Mary Marinova* [2016] ECLI:EU:C:2016:740.

¹⁰² For an illustration of the relationship between the obligation of Member States to combat VAT fraud imposed by the VAT Directive, read in conjunction with Article 4 (3) FEU, and Article 273 VAT Directive, see C-566/16 *Vámos* [2018] ECLI:EU:C:2018:321, paras 36-38.

Member States also have an obligation to prevent VAT fraud under provisions other than the VAT Directive. Article 325(1) TFEU requires the Member States to counter fraud and any other illegal activities affecting the financial interests of the EU through effective deterrent measures. That provision has been interpreted as applicable also to VAT fraud.¹⁰³ The reason is the direct link between the VAT revenue of the Member State and the financial interests of the Union. Member States must contribute with a percentage of the uniform basis of assessment for VAT to the Union.¹⁰⁴

The concept of fraud, for the purpose of Article 325 TFEU, is nonetheless not included in neither primary nor secondary EU law. In view of the purpose of giving solid protection to the financial interests of the Union, it is probably a concept of Union law. The definition of fraud does not necessarily correspond to the concept of tax evasion included in the VAT Directive. Useful guidance can be obtained from the definition of fraud contained in the PFI Directive or its predecessor, the PFI convention¹⁰⁵, to which the Court referred in the 2015 *Taricco and Others* case.¹⁰⁶ The definition of fraud, for the purpose of Article 325 TFEU, is nevertheless not necessarily limited to that of secondary law. The concept of tax evasion in the VAT Directive, if it does not correspond to the concept of fraud in Article 325 TFEU, it may still fall within the concept of other illegal activities affecting the financial interests of the EU. This concept is without doubt broader than fraud.¹⁰⁷

My point is that the national legislature may be required to combat VAT fraud under provisions other than the VAT Directive,¹⁰⁸ and thus indirectly be obliged to impose measures under Article 273 VAT Directive. According to settled case-law, the national legislature has the primary responsibility for ensuring compliance with Article 325 TFEU, for instance by amending national law.¹⁰⁹ The case-law on Article 325 TFEU has largely focused on criminal

¹⁰³ C-539/09 *Commission v Germany* [2011] ECLI:EU:C:2011:733, para 72; C-617/10 *Åkerberg Fransson* [2013] ECLI:EU:C:2013:280, para 26; C-105/14 *Taricco and Others* [2015] ECLI:EU:C:2015:555, para 38; C-546/14 *Degano Transporti* [2016] ECLI:EU:C:2016:206, para 22; C-493/15 *Identi* [2017] ECLI:EU:C:2017:219, para 19.

¹⁰⁴ Council Decision 2007/436/EC, art 2(1).

¹⁰⁵ Convention drawn up on the basis of Article K.3 of the Treaty on European Union, on the protection of the European Communities' financial interests OJ C316/49 (PFI Convention).

¹⁰⁶ C-105/14 *Taricco and Others* [2015] ECLI:EU:C:2015:555, para 41. To illustrate, according to Article 1(b) PFI Convention, in respect of revenue, fraud may be any intentional act or omission relating to the use or presentation of false, incorrect or incomplete information, non-disclosure of information in violation of a specific obligation and misapplication of a legally obtained benefit that adversely affects the Union's resources.

¹⁰⁷ C-574/15 *Scialdone* [2018] ECLI:EU:C:2018:295, Opinion of General Advocate, paras 66-67.

¹⁰⁸ See also the PFI Directive and the PFI Regulation.

¹⁰⁹ C-42/17 *M.A.S. and M.B.* [2017] ECLI:EU:C:2017:936, para 41; C-612/15 *Kolev and Others* [2018] ECLI:EU:C:2018:392, para 65.

and administrative penalties for fraud, including VAT fraud. Has the Member State, in the context of its procedural autonomy, taken effective, proportionate and dissuasive measures against VAT fraud as required by Article 325 TFEU?¹¹⁰

However, despite the obligation to combat VAT fraud in order to protect the financial interests of the Union, anti-fraud measures must be compatible with the principles underlying the common VAT system. There are several cases where criminal and administrative measures, adopted by a Member State, whose purpose is to combat VAT fraud have been assessed in light of fundamental principles of EU VAT, such as the principles of neutrality and proportionality, within the framework of the VAT Directive.¹¹¹

5.2 Definition of Tax Evasion

There is no definition of tax evasion in the VAT Directive. This lack of definition may cause Member States to interpret tax evasion differently, thereby introducing derogations contrary to the objective of fiscal harmonisation. Luckily, in the 1988 Direct Cosmetics case, the CJEU dealt with the concepts of tax evasion and avoidance.¹¹²

Two British companies sold products to a price below market value to non-taxable persons who, in turn, sold them to end consumers. No VAT was paid on the difference between the final value of the sale to consumers and the price previously charged. To deal with that form of tax avoidance, the United Kingdom introduced a measure derogating from Article 11 of the Sixth Directive (now Article 73 VAT Directive), under Article 27 of the Sixth Directive (now Article 395 VAT Directive), stating that the taxable amount should be the market value and not the consideration actually received. In appealing a decision on them, according to which the taxable amount is the market value, the two companies held that the British measure was outside the limits of the aims referred to in now Article 395 VAT Directive. By the first question, the London VAT Tribunal wished to know whether Article 395 VAT Directive permits the adoption of a derogating measure, such as that at issue, where the taxpayer carries on business in a certain matter not with any intention of obtaining a tax advantage but for commercial reasons.

¹¹⁰ See, for instance, C-42/17 M.A.S. and M.B. [2017] ECLI:EU:C:2017:936, para 29; C-574/15 Scialdone [2018] ECLI:EU:C:2018:295, para 24; C-310/16 Dzivev and Others [2019] ECLI:EU:C:2019:30, para 23.

¹¹¹ See, for instance, C-259/12 Rodopi-M 91 [2013] ECLI:EU:C:2013:414 and C-712/17 EN.SA. [2019] ECLI:EU:C:2019:374.

¹¹² Joined Cases C-138 and 139/86 Direct Cosmetics Ltd v Commissioners of Customs and Excise (138/86) and Laughtons Photographs (C-139/86) [1988] ECLI:EU:C:1988:383.

The Court held that tax avoidance is a concept of Union law, the definition of which is not determined by the Member States. Moreover, regarding the difference between tax avoidance and evasion, the Court held that, while tax avoidance represents a pure objective phenomenon, tax evasion involves an element of intent on the part of the taxpayer. This distinction is confirmed by the historical background to Article 395 VAT Directive. Unlike the Second VAT Directive, which only refers to fraud, the Sixth VAT Directive mentions in addition the concept of tax avoidance. This means that the Union legislator sought to introduce a new element in relation to the pre-existing concept of tax evasion. This new element is the lack of intent on the part of the taxpayer. Furthermore, as regards the rationale behind preventing tax evasion and avoidance, the CJEU added the following:

That interpretation is in conformity with the principle governing the system of value-added tax according to which the factors which may lead to distortions of competition at national and Community level are to be eliminated and a tax which is as neutral as possible and covers all the stages of production and distribution is to be imposed. The title of the Sixth Directive refers to a 'uniform basis of assessment' of value-added tax. Furthermore, the second recital in the preamble to the directive refers to 'a basis of assessment determined in a uniform manner according to Community rules' and the ninth recital specifies that 'the taxable base must be harmonized so that the application of the Community rate ... leads to comparable results in all the Member States'. It follows that the system of value-added tax is concerned principally with objective effects, whatever the intentions of the taxable person may be.¹¹³

Accordingly, in answering the first question, the Court held that Article 395 permits the adoption of a measure derogating from now Article 73 even where the taxable person acts commercially with no intention of obtaining a tax advantage. In other words, according to the Court, the intention on the part of the taxpayer has no bearing on the application of Article 395 VAT Directive. Recently, this has been confirmed by the CJEU in the 2017 Avon Cosmetics case.¹¹⁴

¹¹³ Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd v Commissioners of Customs and Excise (138/86) and Loughtons Photographs (C-139/86)* [1988] ECLI:EU:C:1988:383, para 23.

¹¹⁴ C-305/16 *Avon Cosmetics* [2017] ECLI:EU:C:2017:970, para 46.

Although the case was about Article 395 VAT Directive, their interpretation of tax evasion may be assumed to apply in relation to Article 273 VAT Directive as well. Nothing indicates otherwise. In fact, in answering the first question, the Court interpreted the concept of tax evasion in the area of VAT without specifically mentioning Article 395.¹¹⁵ In accordance with the principle of uniform application,¹¹⁶ the CJEU held that tax avoidance is a concept of Union law. Based on the Court's approach to the distinction between tax evasion and avoidance, expressed in Paragraphs 20 to 22 of the Judgment, it can be concluded that tax evasion is also a concept of Union law. The CJEU defines tax avoidance in relation to evasion. Furthermore, the objectives underlying the Court's teleological approach, which is to avoid distortions of competition and establish a common basis of assessment, supports the notion that tax evasion is a concept of Union law. Allowing Member States to define tax evasion on their own would compromise these objectives. The risk that Member States interpret the concept of tax evasion differently – thereby compromising the objective of fiscal harmonisation – has thus been resolved by the CJEU.

Additionally, the CJEU interprets the concepts of tax evasion and avoidance in light of the objective of fiscal harmonisation, if not also the essential characteristics of VAT, which are referred to as the “principle governing the system of value-added-tax” in the 1988 *Direct Cosmetics* case.¹¹⁷ Whether there is intent has no bearing on whether the competition is distorted. Intent has also no impact on the objective of establishing a common basis of assessment. It is a matter of effect and not intent. The purpose of combating VAT fraud is generally to avoid loss of tax revenue. Nevertheless, in dealing with the concepts of tax evasion and avoidance, the CJEU does not at all mention the loss of tax revenue. Moreover, on numerous occasions, in cases concerning Article 273 VAT Directive, the CJEU has held that EU law does not prevent Member States from considering fiscal conduct that prevents the correct collection of VAT and thus compromises the proper functioning of the internal market as tax evasion.¹¹⁸ The definition of tax evasion is based on the objective of fiscal harmonisation. Therefore, from an EU perspective, the rationale behind fighting VAT fraud is not primarily to avoid loss of tax revenue. Based on the Court's reasoning, the rationale

¹¹⁵ Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd v Commissioners of Customs and Excise* (138/86) and *Loughtons Photographs* (C-139/86) [1988] ECLI:EU:C:1988:383, paras 22-23.

¹¹⁶ See n 82.

¹¹⁷ Joined Cases C-138 and 139/86 *Direct Cosmetics Ltd v Commissioners of Customs and Excise* (138/86) and *Loughtons Photographs* (C-139/86) [1988] ECLI:EU:C:1988:383, para 23.

¹¹⁸ C-332/15 *Astone* [2016] ECLI:EU:C:2016:614, para 56; C-576/15 *Mary Marinova* [2016] ECLI:EU:C:2016:740, para 39; C-159/17 *Dobre* [2018] ECLI:EU:C:2018:161, para 41.

behind combating VAT fraud is to achieve the objective of fiscal harmonisation. VAT fraud compromises the competitive terms of the internal market. It also prevents the establishment of a common basis of assessment. Hence, VAT fraud must be prevented.

This relates to the obligation of Member States to collect the right amount of VAT. Intent on the part of the taxpayer is irrelevant. If the Member State collects less VAT than prescribed, for example by not preventing VAT fraud, taxable persons in other Member States will have a competitive disadvantage as they pay more in VAT. Distortions of competition will also occur within that Member State because not everyone commits fraudulent acts. On the other hand, if the Member State collects more VAT than prescribed, taxable persons in other Member States will have a competitive advantage as they pay less in VAT. In both cases, there will be distortive effects on the competitive terms of the internal market, which is contrary to the objective of fiscal harmonisation. It is all about collecting the right amount of VAT. Hence, VAT fraud must be prevented.

5.3 Margin of Discretion

According to Article 273 VAT Directive, to ensure the correct collection of VAT and prevent evasion, Member States may impose obligations which they deem necessary. This has been interpreted by the Court as the Member States having a margin of discretion regarding the means of achieving the correct collection of VAT and preventing fraud.¹¹⁹ Disparities between the laws of the Member States, aimed at preventing VAT fraud, are nonetheless liable to create or maintain distortions of competition. If each Member State has its own measures to combat VAT fraud, it may lead to differences in compliance costs between companies in the different Member States, which in turn affect their ability to compete in the internal market. Admittedly, in exercising this margin of discretion, it is settled case-law by the CJEU that Member States must observe EU law and its principles, such as the principles of neutrality and proportionality,¹²⁰ but that does not *in itself* prevent Member States from introducing different anti-fraud measures. For instance, in the 2006 FTI case, the CJEU held that, while imposing joint and several liability to pay VAT cannot be based on Article 273, Member States may require taxable persons who are joint and several liable under Article 205

¹¹⁹ C-534/16 BB construct [2017] ECLI:EU:C:2017:820, para 21; C-566/16 Vámos [2018] ECLI:EU:C:2018:321, para 38; C-648/16 Fontana [2018] ECLI:EU:C:2018:932, para 35.

¹²⁰ C-566/16 Vámos [2018] ECLI:EU:C:2018:321, para 41.

VAT Directive to provide security for the payment of VAT.¹²¹ Not all Member States have introduced such a measure.

That being said, in what way does the interpretation of Article 273, read in the light of the principles of neutrality and proportionality, relate to the competitive terms of the internal market?

5.3.1 Neutrality

The principle of neutrality, which functions as an interpretative tool with a multi-faceted face, is used by the CJEU to solve many legal issues relating to VAT.¹²² When it comes to combating VAT fraud, the principle of neutrality operates in two different situations in the context of Article 273. The distinguishing factor is the uncertainty about the existence of VAT fraud. If the measure introduced refers to a situation where it is established that the taxable person has committed VAT fraud, in determining whether the measure is precluded by the neutrality of VAT, the concept of legal neutrality is decisive. If the measure introduced concerns a situation where there is uncertainty about the existence of VAT fraud, in determining whether the measure is precluded by the principle of neutrality, a balance is made between the concept of system neutrality and the interest of preventing fraud. The legality of such a measure is determined by the principle of proportionality. Is it proportionate to limit the neutrality of VAT in the interest of preventing VAT fraud? However, in this section, I examine the use of neutrality in cases where the taxable person has been involved in VAT fraud.¹²³

As regards legal neutrality, it is a reflection of the principle of equal treatment in the field of VAT. This principle precludes taxable persons who are in a comparable situation and thus in competition with each other from being treated differently for VAT purposes.¹²⁴ Accordingly, in the 1998 Goodwin case, the Court held that the principle of neutrality precludes "a generalized differentiation between lawful and unlawful transactions, except where, because of the special characteristics of certain products, all competition between a lawful economic sector and an unlawful sector".¹²⁵ Does this mean that the principle of neutrality precludes

¹²¹ C-384/04 Federation of Technological Industries and Others [2006] ECLI:EU:C:2006:309.

¹²² See Chapter 3.3.2.

¹²³ In the next section, I examine the use of neutrality in cases where the existence of VAT fraud is uncertain, given that compatibility with neutrality presupposes that the measure is also proportionate.

¹²⁴ C-566/16 Vámos [2018] ECLI:EU:C:2018:321, para 48.

¹²⁵ C-3/97 Goodwin and Unstead [1998] ECLU:EU:C:1998:263, para 9.

Member States from treating tax evaders differently for VAT purposes? In the 2016 *Mary Marinova* case, the CJEU held that the principle of neutrality cannot be relied upon successfully by a taxable person who has committed VAT fraud, such as concealing supplies and revenue. In other words, according to the Court, fraudsters are not in a situation comparable to that of taxpayers who comply with their tax obligations. Since they are not in a similar situation, they can be treated differently for VAT purposes. Therefore, the national measure imposed by Bulgaria under Article 273 to re-establish the situation that would have prevailed in the absence of VAT fraud does not undermine the neutrality of VAT.¹²⁶ Thus, neutrality does not prevent Member States from restoring the competitive terms of the internal market by collecting the right amount of VAT from tax evaders.

Moreover, in cases where the taxable person is involved in VAT fraud, the Court applies the concept of legal neutrality to the exclusion of system neutrality.¹²⁷ The case-law on Article 273 VAT Directive deals almost exclusively with Member States restricting the right of deduction to combat VAT fraud.¹²⁸ Many Member States are introducing formal requirements aimed at ensuring the correct collection of VAT and combating VAT fraud, which taxable persons must comply with to fully exercise the right of deduction. For instance, in the 2010 *Profaktor* case, Poland required taxable persons to retain accounting records by using cash registers. Otherwise, the deductible amount is reduced by 30 %.¹²⁹ In the 2017 *Paper Consult* case, Romania denied the right of deduction for goods and services acquired by suppliers that have been declared inactive by the tax authorities. Taxpayers whose improper fiscal conduct prevents the detection of irregularities in the collection of VAT is declared inactive by the tax authorities. The declaration of inactivity is public and accessible on the internet to any taxable person.¹³⁰ Note that they refer to situations where there is uncertainty about the existence of VAT fraud. Not using cash registers or buying from suppliers that have been declared inactive does not necessarily involve VAT fraud.¹³¹ These are examples of formal requirements, the purpose of which is to fight VAT fraud, for exercising the right of deduction.

¹²⁶ C-576/15 *Mary Marinova* [2016] ECLI:EU:C:2016:740, para 49.

¹²⁷ See Chapter 3.3.2.

¹²⁸ See, for instance, C-188/09 *Profaktor Kulesza, Frankowski, Józwiak, Orłowski* [2010] ECLI:EU:C:2010:454; C-284/11 *EMS-Bulgaria-Transport* [2012] ECLI:EU:C:2012:458; C-332/15 *Astone* [2016] ECLI:EU:C:2016:614; C-101/16 *Paper Consult* [2017] ECLI:EU:C:2017:775; C-159/17 *Dobre* [2018] ECLI:EU:C:2018:161; C-533/16 *Volkswagen* [2018] ECLI:EU:C:2018:204; C-664/16 *Vădan* [2018] ECLI:EU:C:2018:933; C-712/17 *EN.SA.* [2019] ECLI:EU:C:2019:35.

¹²⁹ C-188/09 *Profaktor Kulesza, Frankowski, Józwiak, Orłowski* [2010] ECLI:EU:C:2010:454.

¹³⁰ C-101/16 *Paper Consult* [2017] ECLI:EU:C:2017:775.

¹³¹ C-101/16 *Paper Consult* [2017] ECLI:EU:C:2017:775, para 56.

At the same time, in accordance with the concept of system neutrality, the VAT should be proportional to the actual price of goods and services. This means that the collection of VAT must not result in cascading effects. When cascading, VAT is not based solely on the actual price of goods or services, but also on VAT from previous stages. Accordingly, in several cases, the CJEU has held that the right of deduction is an integral part of the common system of VAT and may, in principle, not be limited.¹³² National measures aimed at combating VAT fraud introduced under Article 273 may not have the effect of systematically undermining the right of deduction and thus the neutrality of VAT.¹³³ The principle of neutrality requires deduction of VAT to be allowed if the substantive requirements found in Article 168(a) VAT Directive¹³⁴ are satisfied, even if the taxable person has failed to comply with some formal requirements¹³⁵. Does this mean that the principle of neutrality precludes Member States from restricting the right of deduction to prevent VAT fraud?

On numerous occasions, the CJEU has held that the principle of neutrality cannot be invoked by taxable persons who have been involved in VAT fraud. Taxpayers who have committed VAT fraud are not in a situation comparable to that of taxpayers who have complied with their tax obligations. For instance, in the 2016 *Astone* case, the Court found that fiscal conduct that prevent the correct collection of VAT and thus compromise the proper functioning of the internal market may be regarded as tax evasion by Member States and in such cases, deductions for input VAT may be denied. In this case, the taxable person had failed to file a VAT return, keep accounting records and register the invoices issued and paid.¹³⁶ Article 273 of the VAT Directive, having regard to the principle of neutrality, does therefore not prevent Member States from refusing the right of deduction for taxable persons involved in VAT fraud. The concept of legal neutrality is applied to the exclusion of system

¹³² C-332/15 *Astone* [2016] ECLI:EU:C:2016:614, para 44; C-518/14 *Senatex* [2016] ECLI:EU:C:2016:691, para 37.

¹³³ C-332/15 *Astone* [2016] ECLI:EU:C:2016:614, para 49; C-101/16 *Paper Consult* [2017] ECLI:EU:C:2017:775, para 50.

¹³⁴ As regards the substantive requirements, the person wishing to exercise the right of deduction must be a taxable person, the goods or services relied on for the right of deduction must be used by the taxable person for the purpose of his taxed transactions and those goods or services must have been supplied by another taxable person as inputs (C-518/14 *Senatex* [2016] ECLI:EU:C:2016:691, para 28).

¹³⁵ As regards the formal requirements for exercising the right of deduction, pursuant to Article 178(a) VAT Directive, the taxable person must hold an invoice drawn up in accordance with Articles 220 to 236 and 238 to 240 VAT Directive (C-518/14 *Senatex* [2016] ECLI:EU:C:2016:691, para 29).

¹³⁶ C-332/15 *Astone* [2016] ECLI:EU:C:2016:614, paras 56 and 58. See also C-159/17 *Dobre* [2018] ECLI:EU:C:2018:161, paras 40-41.

neutrality by the CJEU when assessing whether a measure is precluded by the principle of neutrality in cases where the taxable person is involved in VAT fraud.

Taxable persons who have previously failed to fulfill their tax obligations may be treated differently by Member States to prevent VAT fraud without violating the principle of neutrality. In the 2017 BB construct case, to ensure the correct collection of VAT and prevent VAT fraud, Slovakia had allowed the tax directorate to require a taxable person, who presents a risk of unpaid taxes owing to its links with another legal person who has tax debts, to provide a guarantee for a period of 12 months.¹³⁷ The Court held that taxpayers who have not complied with their tax obligations, in particular their obligations to register for VAT, are not in a comparable situation with taxpayers who comply with their obligation to register. Therefore, according to CJEU, the principle of neutrality does not preclude a tax authority from requiring a taxable person to provide a guarantee, which can amount to EUR 500,000, at the time of registration for VAT purposes, if the director of which was formerly the director of another legal person which had not complied with its tax obligations.¹³⁸ This suggests that taxable persons who have a history of committing VAT fraud may be treated differently by Member States to prevent VAT fraud.

All in all, it is clear that the principle of neutrality cannot be relied upon by persons who have been involved in VAT fraud. Since VAT fraud distorts the competition not only at national but also Union level, this use of neutrality is in line with the competitive terms of the internal market. This applies provided that the taxable person has actually committed or been involved in VAT fraud. There are several cases where the question has been whether the taxable person, in light of the circumstances of that particular case, has committed or is involved in VAT fraud.¹³⁹ It is not uncommon for Member States to accuse taxable persons of being involved in VAT fraud and denying them exemptions or deductions. If a person carries out fraudulent acts himself or should have known that he is participating in VAT fraud, he may be denied the right to exempt or deduct VAT.¹⁴⁰ However, to ensure the neutrality of VAT, the Court has been clear that objective evidence is required that the taxable person has been

¹³⁷ C-534/16 BB construct [2017] ECLI:EU:C:2017:820, para 22.

¹³⁸ C-534/16 BB construct [2017] ECLI:EU:C:2017:820, para 29.

¹³⁹ See, for instance, Joined Cases C-80 and C-142/11 Mahagében (C-80/11) and Dávid (C-142/11) [2012] ECLI:EU:C:2012:373; C-324/11 Tóth [2012] ECLI:EU:C:2012:549.

¹⁴⁰ Joined Cases C-131, C-163 and C-164/13 Schoenimport "Italmoda" Mariano Previti (C-131/13), Turbi.com (C-163/13) and Turbo.com Mobile Phone's (c-164/13) [2014] ECLI:EU:C:2014:2455 and C-18/13 Maks Pen [2014] ECLI:EU:C:2014:69, paras 22-32.

involved in VAT fraud, either knowingly or negligently.¹⁴¹ If the Member State is unable to prove the existence of VAT fraud in an individual case, i.e. if there is uncertainty about the existence of VAT fraud, taxable persons competing with each other may not be treated differently for VAT purposes according to the concept of legal neutrality.¹⁴² The CJEU has maintained neutrality whenever possible and inasmuch as it is possible.

In cases where there is uncertainty about the existence of VAT fraud, in order for the measure not to be precluded by the concept of system neutrality, when this concept becomes relevant in an individual case, the imposed measure must also be proportionate. In other words, for the measure to be consistent with the concept of system neutrality, when this concept becomes relevant in an individual case, it must respect the principle of proportionality. To illustrate, in the 2018 Fontana case,¹⁴³ in the interest of preventing VAT fraud and avoidance, Italy had introduced a measure under which the amount of VAT payable by a taxable person is determined by extrapolation based on sector studies approved by ministerial decree and, accordingly, to make a tax adjustment imposing the payment of an additional sum of VAT. Since the existence of VAT fraud is uncertain in these cases, the Italian measure, in order to be compatible with the principle of neutrality, must also be proportionate. That the amount of VAT payable by a taxable person is lower than it should be according to sectoral studies need not involve VAT fraud. Maybe the taxable person just had a bad year financially. When is an anti-fraud measure consistent with the principle of proportionality?

5.3.2 Proportionality

Normally, when applying the principle of proportionality in the context of Article 273, the CJEU begins by describing the objectives and principles of the VAT Directive at stake. What legally protected right or interest is compromised by the anti-fraud measure introduced by the Member State?

The case-law on Article 273 VAT Directive deals almost exclusively with Member States restricting the right of deduction,¹⁴⁴ the right to exempt intra-Community supplies from

¹⁴¹ C-8/17 Biosafe - Indústria de Reciclagens [2018] ECLI:EU:C:2018:249, para 39 and the cited case-law.

¹⁴² However, as shown in Chapter 5.3.3, the principle of neutrality does prevent Member States from treating domestic traders in a less favorable way than intra-Union traders in the name of preventing VAT fraud, although no one has been proven to have committed VAT fraud.

¹⁴³ C-648/16 Fontana [2018] ECLI:EU:C:2018:932.

¹⁴⁴ See, for instance, C-188/09 Profaktor Kulesza, Frankowski, Józwiak, Orłowski [2010] ECLI:EU:C:2010:454; C-284/11 EMS-Bulgaria-Transport [2012] ECLI:EU:C:2012:458; C-332/15 Astone [2016] ECLI:EU:C:2016:614; C-101/16 Paper Consult [2017] ECLI:EU:C:2017:775; C-159/17 Dobre [2018]

VAT,¹⁴⁵ or refusing to reduce the taxable amount due to post-supply events, such as non-payment by the purchaser,¹⁴⁶ to prevent VAT fraud. Therefore, in most cases, the neutrality of VAT is at stake.

According to the principle of system neutrality, the VAT should be proportional to the actual price of goods and services (VAT excluded). This means that taxable persons should have the right of deduction. Otherwise, the collection of VAT will result in cascading effects. When cascading, VAT is not based solely on the actual price of goods or services, but also on VAT from previous stages. Hence, on numerous occasions, the CJEU has held that the right of deduction is an integral part of the common system of VAT and may, in principle, not be limited.¹⁴⁷ National measures aimed at combating VAT fraud introduced under Article 273 may not have the effect of systematically undermining the right of deduction and thus the neutrality of VAT.¹⁴⁸

It also follows from the principle of system neutrality that the taxable amount must correspond to the consideration actually received for the supplied goods or services, in accordance with Article 73 VAT Directive. Otherwise, the VAT would not be proportional to the actual price of the relevant products. Accordingly, in order to not undermine the neutrality of VAT, the Court has held that national measures under Article 273 VAT Directive may, in principle, not derogate from the provisions in the VAT Directive relating to the taxable amount.¹⁴⁹ For instance, in cases of non-payment by the purchaser, the supplier should have the right to reduce the taxable amount.¹⁵⁰

Moreover, to avoid double taxation contrary to the principle of system neutrality, the Member States are to exempt intra-Community supplies of goods from VAT.¹⁵¹ These transactions are taxed in the Member State of arrival.¹⁵² Double taxation creates cascading effects. In such a

ECLI:EU:C:2018:161; C-533/16 Volkswagen [2018] ECLI:EU:C:2018:204; C-664/16 Vădan [2018] ECLI:EU:C:2018:933; C-712/17 EN.SA. [2019] ECLI:EU:C:2019:35.

¹⁴⁵ See, for instance, C-587/10 VSTR [2012] ECLI:EU:C:2012:592; C-146/05 Collé [2007]

ECLI:EU:C:2007:549; C-563/12 BDV Hungary Trading [2013] ECLI:EU:C:2013:854;

¹⁴⁶ See, for instance, C-337/13 Almos Agrárkúkereskedelmi [2014] ECLI:EU:C:2014:328; C-404/16 Lombard Ingatlan Lízing [2017] ECLI:EU:C:2017:759; C-127/18 A-PACK CZ [2019] ECLI:EU:C:2019:337;

¹⁴⁷ C-332/15 Astone [2016] ECLI:EU:C:2016:614, para 44; C-518/14 Senatex [2016] ECLI:EU:C:2016:691, para 37; C-329/18 Altic [2019] ECLI:EU:C:2019:831, paras 26-27 and the cited case-law.

¹⁴⁸ C-332/15 Astone [2016] ECLI:EU:C:2016:614, para 49; C-101/16 Paper Consult [2017]

ECLI:EU:C:2017:775, para 50;

¹⁴⁹ C-337/13 Almos Agrárkúkereskedelmi [2014] ECLI:EU:C:2014:328, para 38; C-127/18 A-PACK CZ [2019] ECLI:EU:C:2019:337, para 26.

¹⁵⁰ See VAT Directive, art 90; C-588/10 Kraft Foods Polska [2012] ECLI:EU:C:2012:40, para 26.

¹⁵¹ VAT Directive, art 138(1).

¹⁵² VAT Directive, art 2(1)(b).

case, VAT is not based solely on the actual price of the relevant goods in the country of arrival, but also on VAT from previous stages, which is contrary to the principle of system neutrality. Therefore, in order to ensure the neutrality of VAT, Member States should not restrict the right to exempt intra-Community supplies of goods from VAT.¹⁵³

What all these legal presumptions, which follow from the principle of neutrality, have in common is that they intend to relieve the trader, as a tax collector on behalf of the state, entirely from the burden of VAT. In other words, when applying the concept of system neutrality, the CJEU seeks to uphold the notion of VAT as a tax on consumption. The notion of VAT as a consumption tax is thus the interest at stake.

However, in some cases, the legal interest being risked is not the neutrality of VAT. Not all national measures contradict the legal presumptions set by the principle of neutrality relating to, in particular, the right of deduction and the taxable amount. For instance, in the 2013 *Ablessio* case,¹⁵⁴ the referring court asked the CJEU whether the tax authority of a Member States may, in the interest of ensuring the correct collection of VAT and preventing evasion, refuse to assign a VAT identification number solely on the ground that, in the opinion of that authority, the company does not have the resources required to carry out the economic activity declared and that the shareholder of that company previously, on numerous occasions, has sold his shares shortly after obtaining an individual number without conducting economic activity. The essential aim of identifying taxable person is to ensure the proper operation of the VAT system. The interest being risked in this case is thus not neutrality but the proper operation of the VAT system.

After describing the objectives and principles of the VAT Directive at stake, the Court usually states, in one way or another, that preventing VAT fraud is a legitimate interest. Preventing VAT is an objective recognised and encouraged by the VAT Directive.¹⁵⁵ According to settled case-law, Articles 2, 250(1) and 273 of the VAT Directive, read in conjunction with Article 4(3) TEU, imposes an obligation on every Member State to take all legislative and administrative measures for ensuring collection of all the VAT due on their territory and for preventing VAT fraud.¹⁵⁶ However, despite being a legitimate interest, in collecting the right

¹⁵³ See C-146/05 *Collé* [2007] ECLI:EU:C:2007:549, para 23.

¹⁵⁴ C-527/11 *Ablessio* [2013] ECLI:EU:C:2013:168.

¹⁵⁵ C-320/17 *Marle Participations* [2018] ECLI:EU:C:2018:537, para 41; C-712/17 *EN.SA* [2019] ECLI:EU:C:2019:374, para 31; C-273/18 *Kuršu zeme* [2019] ECLI:EU:C:2019:588, para 34.

¹⁵⁶ C-617/10 *Åkerberg Fransson* [2013] ECLI:EU:C:2013:280, para 25; C-144/14 *Cabinet Medical Veterinar Dr. Tomoiagă Andrei* [2015] ECLI:EU:C:2015:452, para 25; C-105/14 *Taricco and Others* [2015]

amount of VAT and preventing fraud, the measures introduced under Article 273 VAT must have as little effect as possible on the objectives and principles of the VAT Directive.¹⁵⁷ They must not go further than is necessary to attain such objectives and must not undermine the neutrality of VAT.¹⁵⁸

In any case, in order for the measure to be necessary and thus compatible with the principle of proportionality, there must be a particular risk of tax evasion or avoidance. For instance, in the 2019 A-PACK case,¹⁵⁹ Czech Republic had introduced a measure aimed at preventing VAT fraud which provides that taxable persons cannot reduce the taxable amount, in cases of total or partial non-payment, if the debtor is no longer a taxable person. The Court found that, in these circumstances, the reduction of the taxable amount does not constitute a particular risk of tax evasion or avoidance. Thus, according to the Court, the measure is not necessary and consistent with the principle of proportionality. That the debtor is no longer a taxable person, for example because that person is subject to insolvency proceedings as in this case, is not an appropriate indication of the occurrence of VAT fraud, which is why I agree with the Court. In the 2018 Pienkowski case,¹⁶⁰ in the interest of preventing tax evasion and avoidance, to exempt supply of goods under Articles 146(1)(b) and 147 VAT Directive, Poland required that a taxable person must have attained a minimum level of turnover in the previous year, or have concluded an agreement with a person authorised to refund VAT to travelers. A failure to comply with these conditions results in the definitive loss for the taxable person of the export exemption even if the requirements of Articles 146(1)(b) and 147 VAT Directive are met. According to the Court, the Polish measure is not necessary as there is no risk of tax evasion or avoidance. If the requirements of Articles 146(1)(b) and 147 VAT Directive are met, the transaction will not be taxed in Poland, so there is no risk of loss of tax revenue for Poland and thus fraud or avoidance. Accordingly, this requirement is precluded by Articles 131, 146(1)(b), 147 and 273 VAT Directive.

In several cases, the Court has held that Member States must employ means which, while enabling them to effectively achieve the objectives pursued by their domestic law, are the

ECLI:EU:C:2015:555, para 36; C-576/15 *Mary Marinova* [2016] ECLI:EU:C:2016:740, para 41; C-648/16 *Fontana* [2018] ECLI:EU:C:2018:932, para 33.

¹⁵⁷ C-672/17 *Tratave* [2018] ECLI:EU:C:2018:989, para 33; C-127/18 *A-PACK CZ* [2019] ECLI:EU:C:2019:377, para 26.

¹⁵⁸ C-183/14 *Salomie and Oltean* [2015] ECLI:EU:C:2015:454, para 62; C-576/15 *Mary Marinova* [2016] ECLI:EU:C:2016:740, para 44;

¹⁵⁹ C-127/18 *A-PACK CZ* [2019] ECLI:EU:C:2019:377.

¹⁶⁰ C-307/16 *Pieńkowski* [2018] ECLI:EU:C:2018:124.

least onerous for the objectives and principles of EU law.¹⁶¹ This suggests that anti-fraud measures, in order to be necessary and thus proportionate, must be as flexible as possible. For instance, in the 2017 Paper Consult case, Romania denied the right of deduction for goods and services acquired by suppliers that have been declared inactive by the tax authorities. Taxpayers whose improper fiscal conduct prevents the detection of irregularities in the collection of VAT is declared inactive by the tax authorities. According to the CJEU, since it is impossible for the purchaser of goods and services to demonstrate that the transactions concluded with the trader declared inactive meets the conditions in the VAT Directive for exercising the right of deduction, this measure goes beyond what is necessary to prevent VAT fraud and collect the right amount of VAT.¹⁶² However, if flexibility compromises the legitimate objectives pursued by domestic law, inflexibility may still be consistent with the principle of proportionality. For instance, in the 2010 Profaktor case, in the interest of ensuring the correct collection of VAT and prevent fraud, Poland required taxable persons to retain accounting records by using cash registers. Otherwise, the deductible amount is reduced by 30 %. The Court considered this measure to be necessary and proportionate despite it being general and applied without exception.¹⁶³ If Poland allows taxable persons to exercise the right of deduction in full by making it possible to demonstrate that the transactions concluded meet the requirements of Article 168 VAT Directive, the objective pursued by that measure, which is to increase the use of cash registers and thereby prevent VAT fraud, would be lost.

By interpreting Article 273 in the light of the principles of neutrality and proportionality, the CJEU seeks to prevent Member States from collecting more VAT than necessary in the name of preventing VAT fraud. Article 273, having regard to the principles of neutrality and proportionality, precludes national measures which are largely fiscal in nature, such as the measure by the Czech Republic in the 2019 A-PACK case. National measures aimed at preventing VAT fraud must be genuine. Member States may only restrict the neutrality of VAT if necessary, to combat VAT fraud or avoidance. The neutrality of VAT cannot be limited, for instance, by refusing to reduce the taxable amount in cases of non-payment, only to increase tax revenue.

¹⁶¹ C-307/16 Pieńkowski [2018] ECLI:EU:C:2018:124, para 34 and the cited case-law.

¹⁶² C-101/16 Paper Consult [2017] ECLI:EU:C:2017:775, paras 33 and 60. See also C-648/16 Fontana [2018] ECLI:EU:C:2018:932, paras 42-45.

¹⁶³ C-188/09 Profaktor Kulesza, Frankowski, Józwiak, Orłowski [2010] ECLI:EU:C:2010:454, paras 27-29.

As referred to above, from an EU perspective, the rationale behind fighting VAT fraud is not primarily to avoid loss of tax revenue. Based on the Court's reasoning, the rationale behind combating VAT fraud is to achieve the objective of fiscal harmonisation. VAT fraud compromises the competitive terms of the internal market. Hence, VAT fraud must be prevented. On the other hand, from a national perspective, the rationale behind preventing VAT fraud is also to increase tax revenue. Therefore, to prevent Member States from collecting more VAT than necessary, such as by restricting the right of deduction, the principles of neutrality and proportionality play important roles. If a Member State, in the name of preventing tax fraud, collects more VAT than necessary then taxable persons in other Member States will have a competitive advantage as they pay less in VAT. To ensure the proper functioning of the internal market, it is necessary that the Member States collect the right amount of VAT, no more no less.

5.3.3 Equal Treatment

According to Article 273 VAT Directive, to ensure the correct collection of VAT or prevent evasion, Member States may impose obligations which they deem necessary. However, these measures are subject to the requirement of equal treatment as between domestic transactions and transactions carried out between Member States by taxable persons. How does this requirement, read in the light of the principles of neutrality and proportionality, relate to the competitive terms of the internal market?

At first glance, this requirement seems to be in line with the competitive terms of the internal market. Taxable persons who are in a comparable situation and thus in competition with each other should be treated equally. Where they conduct their economic activity should not matter. Still, in the 1996 Eismann case,¹⁶⁴ the CJEU held that the requirement of equal treatment only applies to transactions between Member States in requiring that they be treated in the same way as domestic transactions.

According to Italian law, all goods undergoing transport must, during transport, be accompanied by an accompanying document to facilitate fiscal controls. Following the abolition of fiscal controls between Member States on January 1, 1993, the Italian Ministry of Finance stated that this obligation from now on only applies in respect of internal trade and trade with third countries. Eismann sells foodstuffs from door to door and, in doing so,

¹⁶⁴ C-217/94 Eismann Alto Adige v Ufficio IVA di Bolzano [1996] ECLI:EU:C:1996:394.

employs salesmen who go with a lorry loaded with goods intended for sale to the homes of potential private consumers. After an inspection, Eismann was fined by the Bolzano VAT Office for transporting goods without the necessary documents. Eismann brought an action against the decision, arguing that the obligation under Italian law is incompatible with Article 22(8) of the Sixth VAT Directive, now Article 273 VAT Directive. The referring court asked the CJEU whether such an obligation under Italian law is compatible with Article 273 VAT Directive where there is no such requirement in respect of intra-Union trade.

The Court held that, in interpreting EU law, it is necessary to consider the context of the provision and not only its wording. Article 22(8) forms part of Title XVIa of the Sixth Directive whose provisions are essentially intended to regulate intra-Union trade and not trade which takes place within a single Member State. Moreover, the first three recitals of Directive 91/680 show that the main purpose of this directive, which introduced the requirement of equal treatment in Article 22(8), is to complete the internal market, eliminate fiscal frontiers between Member States and abolish fiscal controls at internal frontiers for all intra-Union trade. The purpose is not to harmonise or simplify formalities relating to purely internal transactions. Therefore, Article 22(8) of the Sixth VAT Directive, now Article 273 VAT Directive, does not prevent Member States from introducing formalities for domestic transactions that are stricter than those applicable to intra-Union trade.¹⁶⁵ This interpretation of equal treatment *seems* to have been confirmed by the CJEU in later cases.¹⁶⁶

This means that Member States may impose anti-fraud measures on domestic traders that are stricter than those applicable to intra-Union trade. Member States may even introduce measures only in respect of internal trade. Since these obligations create higher compliance costs for domestic transactions, competition will be distorted to the detriment of domestic traders. Hence, this interpretation of equal treatment is not compatible with the aim of ensuring the competitive terms of the internal market. When interpreting the requirement of equal treatment, the CJEU ignored one of the main purposes behind the harmonisation of VAT, which is avoiding distortions of competition. The CJEU should have considered that the requirement of equal treatment is indeed part of Title XVIa of the Sixth Directive, but also

¹⁶⁵ C-217/94 Eismann Alto Adige v Ufficio IVA di Bolzano [1996] ECLI:EU:C:1996:394, paras 2-4, 8-11 and 15-22.

¹⁶⁶ For instance, in the 2012 Kraft Foods Polska case (C-588/10 Kraft Foods Polska [2012] ECLI:EU:C:2012:40), Poland had introduced a measure under Article 273 VAT Directive that applied only to domestic transactions (para 34). Reduction of the taxable amount requires acknowledgement of receipt of a correcting invoice by the purchaser. The requirement of equal treatment was not mentioned by either Poland or the Court.

the common system of VAT, whose purpose is also to avoid distortions of competition and thus achieve fair competition. In other words, in interpreting Article 22(8) of the Sixth VAT Directive, to avoid distortions of competition, the Court should have applied the metateleological level of interpretation.¹⁶⁷

It follows from the principle of neutrality that taxable persons who are in competition with each other may not be treated differently for VAT purposes.¹⁶⁸ Still, when assessing whether a measure that distinguish between internal and intra-Union trade is precluded by the neutrality of VAT, the CJEU neglect this aspect of neutrality.¹⁶⁹ Instead, in such cases, the Court applies only the concept of system neutrality to the exclusion of legal neutrality. In other words, the principle of neutrality does not prevent Member States from treating domestic traders in a less favorable way than intra-Union traders in the name of preventing VAT fraud, although no one has been *proven* involved in VAT fraud. This is clearly contrary to the competitive terms of the internal market, and thus the objective of fiscal harmonisation.

Compared with measures aimed at persons involved in VAT fraud, however, anti-fraud measures that treat domestic transactions less favorably still have to respect the concept of system neutrality.¹⁷⁰ In addition, all measures introduced under Article 273 VAT Directive must be proportionate.¹⁷¹ As referred to above, by interpreting Article 273 in the light of the principles of system neutrality and proportionality, the CJEU seeks to uphold the notion of VAT as a consumption tax and prevent Member States from collecting more VAT than necessary in the name of preventing VAT fraud.¹⁷² This, on the other hand, is compatible with the competitive terms of the internal market. To ensure the proper functioning of the internal market, it is necessary that the Member States collect the right amount of VAT, no more no less.

¹⁶⁷ See Chapter 3.3.1.

¹⁶⁸ C-566/16 *Vámos* [2018] ECLI:EU:C:2018:321, para 48.

¹⁶⁹ C-217/94 *Eismann Alto Adige v Ufficio IVA di Bolzano* [1996] ECLI:EU:C:1996; C-588/10 *Kraft Foods Polska* [2012] ECLI:EU:C:2012:40.

¹⁷⁰ C-588/10 *Kraft Foods Polska* [2012] ECLI:EU:C:2012:40, para 28.

¹⁷¹ C-566/16 *Vámos* [2018] ECLI:EU:C:2018:321, para 41.

¹⁷² See Chapter 5.3.2.

6 Final Remarks

6.1 Conclusion

The purpose of this paper is to investigate whether the objective of fiscal harmonisation, more specifically the objective of avoiding distortions of competition, pursued by the VAT Directive, is observed by the CJEU when interpreting the right of Member States to combat VAT fraud under Article 273 VAT Directive, having regard to the principles of neutrality and proportionality.

The problems caused by the optional nature of Article 273 VAT Directive have been partially resolved by the CJEU. They have developed an obligation for Member States to take all legislative and administrative measures to ensure the collection of all VAT due on their territory and for preventing fraud. Furthermore, the mandatory provisions intended to protect the financial interest of the Union, such as Article 325 TFEU, have been interpreted as applicable in the field of VAT. In fact, however, no Member State has been accused of failing to prevent VAT fraud, neither by another Member State or the European Commission. The obligations imposed by the VAT Directive and Article 325 TFEU to prevent VAT fraud have no action-directing function. They have a justifying function. The obligations are relied on by Member States and the CJEU to justify measures already introduced. The risk of Member States not preventing VAT – and thus collecting less VAT than necessary – is still considerable.

The CJEU has held that tax evasion is a concept of Union law, the definition of which is not left to the Member States. The risk of tax evasion being interpreted differently or extensively has thus been resolved by the CJEU. Moreover, from an EU perspective, the rationale behind preventing VAT fraud is to achieve the objective of fiscal harmonisation. This is line with ensuring the competitive terms of the internal market.

The CJEU has interpreted Article 273 VAT Directive as allowing Member States a margin of discretion regarding the means of achieving the correct collection of VAT and preventing fraud. Thus, when preventing VAT fraud, different Member States may introduce different measures. Difference in the costs of compliance distorts competition at EU level. Admittedly, in exercising this margin of discretion, Member States must comply with, *inter alia*, the principles of neutrality and proportionality. Thus, in spite of the wording of Article 273, Member States are not entitled to impose every measure they deem necessary. However,

Article 273 VAT Directive, having regard to the principles of neutrality and proportionality, does not prevent Member States from imposing different anti-fraud measures *in itself*, as illustrated by the 2006 FTI case.

When it comes to preventing VAT fraud, the principle of neutrality operates in two different situations in the context of Article 273 VAT Directive. The distinguishing factor is the uncertainty about the existence of VAT fraud. If the measure introduced refers to a situation where it is established that the taxable person has committed VAT fraud, in determining whether the measure is precluded by the neutrality of VAT, the concept of legal neutrality is decisive. This means that the principle of neutrality does not prevent Member States from treating taxpayers who have committed VAT fraud differently from taxpayers who comply with their tax obligations. Therefore, it is possible for Member States to treat tax evaders differently to mitigate the effects of VAT fraud by collecting the right amount of VAT, such as in the 2016 Mary Marinova case. This also allows taxpayers who have a history of not fulfilling their tax obligations to be treated differently for VAT purposes to prevent VAT fraud. If the Member State is unable to prove the existence of VAT fraud in an individual case, i.e. if there is uncertainty about the existence of VAT fraud, taxable persons competing with each other may not be treated differently for VAT purposes according to the concept of legal neutrality. This is in line with the competitive terms of the internal market.

If the measure introduced concerns a situation where there is uncertainty about the existence of VAT fraud, in determining whether the measure is precluded by the neutrality of VAT, a balance is also made between the concept of system neutrality and the interest of preventing VAT fraud. The legality of such a measure is determined by the principle of proportionality. In doing this, the CJEU seeks to prevent Member States from collecting more VAT than necessary in the name of preventing VAT fraud or avoidance. This is in line with the competitive terms of the internal market. To ensure the proper functioning of the internal market, it is necessary that the Member States collect the right amount of VAT, no more no less.

The requirement of equal treatment, read in the light of the principle of neutrality, has been interpreted as not precluding Member States from imposing anti-fraud measures on domestic transactions that are stricter than those applicable to intra-Union trade. Thus, the risk of Member States distorting competition to the detriment of domestic traders remains, contrary to the objective of fiscal harmonisation. These measures, on the other hand, must still respect

the concept of system neutrality and be proportionate, which helps to ensure the notion of VAT as a consumption tax and precludes Member States from collecting more VAT than necessary.

In conclusion, in some aspects the Court has interpreted Article 273 in accordance with the objective of fiscal harmonisation, while in other aspects the interpretation has been contrary to this objective. All things considered, the interpretation of Article 273 allows Member States to distort competition at national and Union level, either by introducing anti-fraud measures having this effect or by not doing enough to prevent VAT fraud. In a worst-case scenario, when making decisions on tax issues, such as choosing the place of establishment for VAT purposes, the decisions are not made on their economic merits by taxable persons but on tax evasion laws. This contradicts the notion of an internal market.

6.2 Further Research

Article 5(3) TEU, which expresses the principle of subsidiarity, states that

in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.

Since shared competence applies in the field of VAT, the principle of subsidiarity must be observed.¹⁷³ In the continuum between the obligations to, on the one hand, ensure the functioning of the internal market and, on the other hand, observe the principle of subsidiarity, where may the VAT provisions on tax fraud be situated? To not violate the principle of subsidiarity, the Member States must, first, be unable to ensure the proper functioning of the internal market by themselves. As shown, in terms of ensuring the competitive terms of the internal market, the interpretation of Article 273 VAT Directive leaves a lot to be desired. Moreover, the purpose of ensuring the proper functioning of the internal market must, second, be better achieved at Union level. This would be an interesting subject for further research.

¹⁷³ TFEU, art 4.

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