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## THE ABUSE OF LAW CLAUSE WITH RESPECT TO VAT

This article presents a problem of the abuse of law clause with respect to VAT that gives rise to numerous disputes between tax authorities and taxpayers. It aims at comprehensively discussing this problem, in the context of the source literature as well as national and EU legislation and case law. The issue presented in this article is important for the operations of enterprises. A principal conclusion is that in each case, tax authorities and administrative courts must examine the transaction and all its aspects in their entirety in terms of their actual nature and objective. This boils down to investigating whether the only objective of a given transaction is to obtain an undue tax advantage, or whether such an advantage is merely gained by an entity “along the way”.

**Keywords:** VAT, abuse of law, administrative judicature, tax authorities, Court of Justice of the European Union.

### 1. INTRODUCTION

As mentioned above, the term “abuse of law” is a broad one and actions covered by this term also include VAT carousel fraud. However, it cannot be determined whether tax fraud constitutes an abuse of law (tax abuse) although, importantly, the abuse of law will not always take the form of a tax fraud or carousel fraud (Mudrecki, 2018).

It needs to be indicated that the abuse of law clause was introduced to the VAT Act, with effect from 15 July 2016, by way of an Act of 13 May 2016 amending the act – Tax Code and other acts (Ustawa..., 2016), through adding paragraphs 4 and 5 to Article 5 of the VAT Act (Ustawa..., 2004). In accordance with this regulation, the tax abuse includes such activities as: supply of goods against payment and provision of services on the national territory for consideration; export of goods; import of goods on the national territory; intra-Community purchase of goods against payment on the national territory; intra-Community supply of goods as part of transactions whose objective, despite having met formal conditions established in the provisions of the Act, was fundamentally to achieve tax advantages the granting of which would be contrary to the purpose served by

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the said regulation. In the event an abuse has been established, the activities performed only bring about such fiscal effects that would emerge in the case of recreating a situation that would take place in the absence of activities constituting the abuse of law. Therefore, the activities that account for the abuse of law are lawful, i.e. compliant with the law, only that they are performed for the purpose contrary to the objectives of the tax law.

What is more, it should be mentioned that these regulations were introduced parallel to the general clause on combatting tax evasion in the field of direct taxes, a clause that was included in the Tax Code Act (Gajewski, 2018).

We need to underline that a thorough analysis of problems related to the abuse of law pertaining to VAT requires a comprehensive view of the issue, i.e. not only from the angle of actions undertaken by payers of this tax and decisions of tax authorities, but also in terms of the stance of the doctrine and case-law of administrative courts and CJEU. Although one should agree with a proposition that “profitability of relations with clients is of key importance for conducting and continuing business activity” (Lew, 2016), the relationship between an entrepreneur and tax authorities is no less relevant. Beyond doubt, “every analysis of an actual status conducted in order to determine fiscal effects should also take account of examining the civil and legal effects of the activity put under scrutiny” (Każmierczyk, 2011). The main aim of the article was, therefore, to analyze the extent to which the standards shaping the issue of abuse of law in VAT are clear and understandable for entrepreneurs in terms of the correct fulfillment of tax obligations. When analyzing the issues covered by this article, the authors used the source analysis method, which made it possible to present the regulations shaping these issues in national and EU legislation. It was also necessary to use the dogmatic method, taking into account the views of the doctrine, the jurisprudence of administrative courts and interpretations issued by tax authorities.

## 2. THE ABUSE OF LAW CLAUSE IN THE SOURCE LITERATURE

The discussed issue has become a subject of numerous developments of the doctrine. J. Zubrzycki states (while analysing the decision in the “Halifax” case) that “if an abuse has been defined, then the transactions carried out should be redefined in a manner that allows recreating a situation which would take place if a transaction that constitutes an abuse had not been carried out”. At the same time, he claims that “the decision in the Halifax case is groundbreaking as CJEU for the first time explicitly applied the concept of the abuse of the subjective right in the field of VAT” (Zubrzycki, 2018).

It seems that B. Rogowska-Rajda and T. Tratkiewicz conducted a comprehensive analysis of the question of abuse of law in the context of VAT. They claim that the prohibition of practices that represent an abuse or an abuse of law has been applied by the Court of Justice from the 1970s in several areas and in a manner that has been untypical for these areas (Rogowska-Rajda, Tratkiewicz, 2018). However, the analysis of the Court of Justice’s case-law shows diverse approaches to the prohibition of abuse of law depending on a domain.

According to the authors, there is certainly a conflict between the principle of prohibition of abuse of law and the principle of legality and legal certainty. Based on the decisions of CJEU, they determine that “combatting fraud, tax evasion and potential abuses is on the one hand an objective that is recognised and supported by the Community law, but on the other hand, that law should be precise and its application should be predictable for business entities” (Rogowska-Rajda, Tratkiewicz, 2018). Furthermore, “if a taxpayer

has the right to choose between two transactions, the directive does not impose on them an obligation to choose a transaction that entails the payment of the highest VAT amount. Quite the contrary, the taxpayer has the right to choose a form of their activity that will limit their tax liability. However, the freedom of choice may not legalise solutions representing the abuse of law” (Rogowska-Rajda, Tratkiewicz, 2018). Further in their considerations, the authors argue that “in order to establish the existence of an abuse, a tax authority of a Member State is required to prove the occurrence of two conditions. First of all, certain transactions, despite having met formal requirements established by relevant provisions of the directive and national laws that transpose this directive, have triggered the effect of gaining a financial advantage the granting of which would be contrary to the purpose served by these regulations (an objective condition). Secondly, it should result from all objective factors that the only or principal objective of disputed transactions is to gain a tax advantage (a subjective condition)” (Zubrzycki, 2018).

When analysing the decisions of regional administrative courts from recent years, we need to note that they too make use of the stance derived from the source literature. A frequently quoted opinion of Dominik J. Gajewski, a judge of the Supreme Administrative Court, provides that “it shall not suffice to prove that a given transaction gives rise to a tax advantage or aims at gaining such an advantage, as such an assumption would prejudice the freedom of activity of an entrepreneur. It is therefore necessary to establish that such an advantage is contrary to the objective of Directive 2006/112/EC or the national implementing legislation. In other words, the fact that economic objectives other than gaining a tax advantage are completely a matter of chance is of no relevance to the transaction and fails to provide an appropriate justification. Thus, gaining a tax advantage should constitute an overarching objective of the activities, at the same time excluding or marginalising other economic objectives. A given activity cannot therefore be qualified as an abuse of law, if relevant justification of a given organisational and legal form of an activity or individual activities of an entrepreneur other than gaining a tax advantage is available. A different position would mean endowing tax authorities with excessive discretion as to which objective of a transaction should be determined as dominating and, at the same time, would yield a high level of uncertainty as to the possible selection of business activities made by an entrepreneur” (Gajewski, 2016).

Summing up, from the normative point of view, the principle of abuse of tax law is a situation in which a taxpayer undertakes actions aimed at shaping legal relations, while fundamentally remaining in concert with the literal wording of the VAT Act, in such a manner that enables them to gain beneficial tax effects that would however stand in contradiction with the economic, financial or social objectives resulting from the VAT Act (Drozdek, Machalica-Drozdek, 2018).

### **3. ABUSE OF LAW CLAUSE IN THE CASE-LAW OF ADMINISTRATIVE COURTS**

The principle of prohibition to deduct VAT due to the abuse of law clause in the case-law of administrative courts is based on Article 88(3a)(4)(c) of the VAT Act. However, in its decisions the Supreme Administrative Court additionally pleads that the prohibition on deduction results directly from Article 86(1) in situations where the only objective of a given economic transaction is to gain a tax advantage and where such an activity does not have any other economic justification. Provided, obviously, that such fact has been proven indisputably.

When considering the question of abuse of law in the light of Article 88(3a)(4)(c) of the VAT Act, it is necessary to address the issue that appears in nearly every related decision of the Supreme Administrative Court. Namely, in line with the established case-law of the Supreme Administrative Court, tax authorities cannot declare invalidity of a given legal act. However, they can decide that for the purpose of Article 88(3a)(4)(c) of the VAT Act, Article 58 and/or Article 83 of the Civil Code (Ustawa..., 1964), shall apply, which obviously is subject to the assessment of the administrative court. This is not contrary to the fact that the provisions on VAT essentially focus on the economic effects of legal acts and events and derive tax liability (or lack of such liability) from them, and they are largely autonomous from the civil law (Baçal, Dominik, Militz, Baçal, 2013).

A ruling that bound these two articles, thus challenging the right to deduct the tax charged, was a decision of the Supreme Administrative Court of 6 July 2011 (I FSK 950/10). In this decision the Court determined that “if it has been established based on objective circumstances that the challenged sale was carried out for a taxpayer who had known or should have known that by purchasing a product they participated in a transaction used to perpetrate fraud with respect to VAT, determination of the inability to exercise the right to deduct a tax results from Article 86(1) of the VAT Act, obviously if it has been indisputably established that the challenged transactions were not carried out as part of regular commercial transactions, but only for the purpose of misusing advantages resulting from that provision, i.e. gaining a financial advantage the granting of which would be contrary to the purpose served by this regulation. The provision of Article 86(1) of the VAT Act should in fact be interpreted as objecting to the taxpayer’s right to deduct VAT charged as part of an invoice, which on the one hand meets formal conditions established by the national legislation, but on the other hand documents a transaction constituting an abuse, i.e. if it has been indisputably demonstrated that gaining a tax advantage represents an principal objective of a given activity instead of if its economic legitimacy (profitability)” (Judgment of the Supreme Administrative..., 2011, I FSK 950/10).

The decision mentioned above is obviously one of the many that address the issue of abuse of law pertaining to VAT, with an ever-increasing case-law body that raises more and more questions included in this domain (The judgments of the Supreme Administrative Court: 2015, I FSK 2/15; 2017, I FSK 2254/15; 2017, I FSK 1669/15; 2019, I SA/Sz 792/18 and others).

As provided in the case-law of the administrative courts, the concept of abuse of law applies to situations where transactions carried out as part of concluded contracts were of a genuine nature, although the authority reconstructs the actual status that is alternative to the existing one and determines fiscal consequences in relation to it.

#### **4. ABUSE OF LAW WITH RESPECT TO VAT IN THE VIEW OF THE COURT OF JUSTICE OF THE EUROPEAN UNION**

It needs to be indicated here that the concept of “abuse of law” was elaborated (defined) in the case-law of the Court of Justice of the European Union (hereinafter CJEU) in the decision issued on 21 February 2006 on Halifax, C-255/02 CJEU.

In the discussed case, Halifax, being a banking enterprise, conducted business activity that was mostly exempt from VAT. The company concluded several agreements with its counterparties related to an investment providing for the construction of “call centres”. The counterparties were Halifax’s subsidiaries. The call centres were supposed to be created in several cities and the mechanism applied by Halifax was similar for all investments.

Halifax concluded contracts for developing a call centre with an independent developer and construction company, while its rights and obligations were assumed by a subsidiary through an annex. Mutual financial flows took place between the companies as well as new contracts were concluded between them. Those contracts were related to loans, assignments, lease, sublease or investment progress. In the opinion of a court submitting a question for a preliminary ruling to the CJEU, all these agreements were aimed at gaining tax advantages. Therefore, the court formulated questions to be decided upon by CJEU, one of which asked whether transactions carried out by each participant only to gain a tax advantage, in the absence of any independent economic objective, are eligible to VAT as supplies made by or for participants as part of their business activity. Moreover, the question was whether, in line with the abuse of law doctrine elaborated by CJEU, the requests made by applicants to recover the tax charged as a result of given transactions should be rejected. The position communicated by companies in question claimed that the transactions carried out were of a genuine nature. Not only the services provided by independent contractors, but also by entities participating in agreements, had served commercial purposes. Moreover, the companies raised an argument that within the Sixth Directive (Sixth Council Directive..., 1997) system, transactions carried out only for the purpose of gaining a tax advantage and having no other economic objective, account for supplies or services provided by or for participants as part of their business activity, within the meaning of the VAT concept. However, governments of countries interested in the decision argued on the contrary that the transactions which, first, were carried out by each participant only to gain a tax advantage and, second, did not have any other economic objective, did not account for supplies or services provided by participants as part of their business activity.

In examining the abovementioned issues, CJEU determined that the Sixth Directive on the harmonisation of the laws of the Member States relating to turnover taxes, replaced by Directive 2006/112/EC, should be interpreted as objecting to the right of a taxpayer to deduct VAT if transactions that the right derives from constitute an abuse. To be able to establish the existence of an abuse, it is required that given transactions, regardless of the fact that they meet formal conditions provided for in relevant provisions of the Sixth Directive and national legislation transposing that directive, resulted in gaining a tax advantage the granting of which would be contrary to the purpose served by these provisions. Secondly, it should also result from all objective circumstances that the overarching objective of these transactions is to gain a tax advantage.

Following the decision in the Halifax case, CJEU put taxpayer practices in terms of the abuse of law under scrutiny multiple times (CJEU judgment: 2016, C-223/03; 2014, C-589/12; 2014, C-337/13; 2017 C-251/15). However, CJEU had conducted such assessments even before the decision in the Halifax case. One of the decisions dealing with the abuse of law (prior to the Halifax case) was a ruling in the C-63/04 case. The opinion of the Advocate General in the discussed case is particularly interesting. A company constituted under private law erected a building for a university which later became a subject of numerous transactions between the university and other (either directly or indirectly) affiliated entities. The Advocate General determined that those transactions only aimed at deducting tax paid as part of conducting the investment by the university. It was related to the fact that the university essentially performs activities that are exempt from VAT. And, in the words of the Advocate General, although such transactions give an impression of being phony and aimed only at enabling the university to deduct VAT, the investment will nevertheless be covered by the obligation to adjust the deductions made

(for using it for purposes exempt from VAT). Taking that into account, the event of tax exemption that stands in contradiction to the objectives of the Sixth Directive and would have to be adjusted through invoking unwritten rules, such as the prohibition of abuse of law, is not present here. Therefore, it results from the Advocate General's interpretation that the prohibition of abuse of law applies only as a last resort, when the objective assumed by the directive cannot be fulfilled through a relevant interpretation of its provisions.

When analysing the abovementioned decisions of CJEU, we need to remember that Member States, in accordance with the principle of proportionality, must apply measures that enable them to efficiently fulfil an objective consisting in protecting their financial interests, but at the same time these measures must represent the smallest possible threat to the objectives and principles resulting from relevant Community regulations (Mudrecki, 2018).

## 5. CONCLUSIONS

Conclusions that we can draw from this article can be analysed in two ways. Beyond doubt, competences of tax authorities with respect to determining actual substance and significance of transactions carried out by a taxpayer, in particular to determining whether it can be inferred from objective circumstances that the overarching objective of the undertaken actions was to gain tax advantages, derive from the case-law of both national administrative courts and CJEU. To this end, tax authorities may take account of both the nature of such transactions and legal, economic and personal links between entities entering into transactions. If, as a result of the analysis, a conclusion is made that the transactions entered into are phony and aim only (or mostly) to gain a tax advantage, then such legal acts may be deemed an abuse of law. However, as indicated above, a given act cannot be qualified as abuse of law if a different material justification of a given activity or individual activities of an entrepreneur is possible.

The content of this publication is only the private opinion of the Authors.

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