

**The European Court of Justice held that : - The deduction of VAT cannot be refused, in principle, because of irregularities committed by the issuer of the invoice**

Under the VAT directive<sup>1</sup>, undertakings may, as a general rule, deduct the amount of input VAT which they have already paid at the time of acquiring goods or services necessary for their activities. In order to be able to exercise that right of deduction, they must hold an invoice duly drawn up for the supply of those goods or services.

Hungarian and United Kingdom law requires taxable persons to act with all due diligence in order to satisfy themselves as to the propriety of transactions which give rise to VAT.

*Case C-80/11*

Mahagében kft, a Hungarian undertaking, sought to deduct from the amount of tax for which it was liable the tax which it had paid to its supplier for the delivery of various quantities of acacia logs. The supplier issued invoices for the delivery of those goods and paid to the public exchequer the VAT which Mahagében had paid to it. Mahagében, in turn, exercised the right to deduct.

However, during an inspection at the premises of the supplier, the Hungarian tax authority established, inter alia, that the quantity of acacia logs held by the supplier, according to the accounting data, at the time of the sales made to Mahagében had been insufficient to fulfil the orders invoiced to Mahagében. As it took the view that the invoices submitted by Mahagében did not reflect the genuine circumstances of those deliveries, the tax authority refused Mahagében the right to deduct VAT. The tax authority also criticised Mahagében on the ground that it had failed to satisfy itself as to the status of its commercial partner and had failed to check whether that partner had complied with its statutory obligations in respect of VAT.

The Baranya Megyei Bíróság (Regional Court, Baranya, Hungary), before which the action has been brought, asks the Court of Justice whether the deduction of VAT may be refused in the case where the invoices on the basis of which the deduction is sought are formally correct but where, according to the tax authority, the company concerned did not satisfy itself as to the propriety of the conduct of the invoice issuer.

*Case C-142/11*

Mr Dávid carried out, under a works contract and through subcontractors, a variety of construction works. He wished to deduct the VAT which he had already paid to the subcontractors; the Hungarian tax authority, however, refused to allow him to deduct that tax because of the improper acts of those sub-contractors.

In its judgment delivered today, the Court points out, firstly, that the right to deduct provided for by the directive, being an integral part of the VAT scheme, may not, in principle, be limited. The question whether the VAT payable on the prior or subsequent transactions relating to the goods or services concerned has or has not been paid to the public exchequer is irrelevant to the right of the taxable person to deduct input VAT.

However, the Member States may refuse to allow the right to deduct where it is established, on the basis of objective evidence, that that right is being relied on for fraudulent or abusive ends. That will, in particular, be the case where the taxable person to whom were supplied the goods or services constituting the basis for the right to deduct knew, or ought to have known, that that transaction was connected with fraud previously committed by the supplier or by another trader at an earlier stage in the transaction. The Court finds that it is for the tax authority to establish that the taxable person was aware, or ought to have been aware, of the existence of such fraud.

Next, the Court examined the taxable person's obligations to satisfy himself as to the propriety of his commercial partner's conduct. The Court points out that, where there are indications pointing to irregularities or fraud, a trader could be obliged to make enquiries about another trader in order to ascertain the latter's trustworthiness. **However, the tax authority cannot, as a general rule, require the taxable person wishing to exercise his right to deduct VAT to satisfy himself that there were no irregularities or fraud at the level of the traders operating at an earlier stage of the transaction.**

**It is for the tax authorities to carry out the necessary inspections of taxable persons in order to detect VAT irregularities and fraud and to impose penalties on the taxable person who has committed them. Consequently, those authorities cannot transfer their own investigative tasks to taxable persons and refuse the latter the right to deduct if they do not carry out those tasks.**

Finally, in the present cases, the Court found that, according to the information from the national courts including the United Kingdom, the transactions relied on as a basis for the right to deduct were in fact carried out and that the corresponding invoices include all the information required by the directive, with the result that the substantive and formal conditions required for the creation and exercise of the right to deduct are fulfilled. Furthermore, the Court points out that the orders for reference do not indicate that the parties to whom the invoices were addressed themselves acted unlawfully by, for instance, filing false returns or issuing improper invoices.

In those circumstances, the Court's reply is that **the directive precludes the practice of the Hungarian and United Kingdom tax authority** of refusing to allow a taxable person to deduct VAT paid because of improper acts on the part of the issuer of the invoice which forms the basis on which deduction is sought, and in the absence of proof that the taxable person was aware, or ought to have been aware, of fraud committed earlier in the chain of supply. Likewise, **the directive precludes a national practice** whereby the tax authority refuses the right to deduct on the ground that the taxable person did not satisfy himself that his commercial partner was in compliance with his statutory obligations, in particular with regard to VAT, or on the ground that the taxable person did not have in his possession, in addition to the invoice, other documents capable of demonstrating that his commercial partner had acted with propriety, even though the taxable person was not in possession of any material justifying the suspicion that irregularities or fraud had been committed within that partner's sphere of activity.

**For further information and TAX issues contact Monty Jivraj of Jeffrey Green Russell Solicitors on +44 207 339 7000 or Email - [MIJ@jgrlaw.co.uk](mailto:MIJ@jgrlaw.co.uk).**