



UNIVERSITY OF LEEDS

This is a repository copy of *Italmoda: the birth of the principle of third-party liability for VAT fraud*.

White Rose Research Online URL for this paper:
<http://eprints.whiterose.ac.uk/101748/>

Version: Accepted Version

Article:

De La Feria, R and Foy, R (2016) *Italmoda: the birth of the principle of third-party liability for VAT fraud*. *British Tax Review*, 2016 (3). pp. 270-280. ISSN 0007-1870

This is a pre-copyedited, author-produced version of an article accepted for publication in *British Tax Review* following peer review. The definitive published version, De La Feria, R and Foy, R (2016) *Italmoda: the birth of the principle of third-party liability for VAT fraud*. *British Tax Review*, 2016 (3). pp. 270-280. ISSN 0007-1870, is available online on Westlaw UK or from Thomson Reuters DocDel service.

Reuse

Items deposited in White Rose Research Online are protected by copyright, with all rights reserved unless indicated otherwise. They may be downloaded and/or printed for private study, or other acts as permitted by national copyright laws. The publisher or other rights holders may allow further reproduction and re-use of the full text version. This is indicated by the licence information on the White Rose Research Online record for the item.

Takedown

If you consider content in White Rose Research Online to be in breach of UK law, please notify us by emailing eprints@whiterose.ac.uk including the URL of the record and the reason for the withdrawal request.



eprints@whiterose.ac.uk
<https://eprints.whiterose.ac.uk/>

***Italmoda*: the birth of the principle of third-party liability for VAT fraud**

On the 18th of December 2014, the Court of Justice of the European Union (CJEU) gave its decision in the joined cases *Staatssecretaris van Financiën v. Schoenimport Italmoda Mariano Previt* (Case C-131/13), *Turbu.com BV v. Staatssecretaris van Financiën* (Case C-163/13), and *Turbu.com Mobile Phone's BV v. Staatssecretaris van Financiën* (Case C-164/13). Whilst the questions referred by the Netherlands in relation to the latter two cases were declared inadmissible – in line with the Advocate General's Opinion –¹ the importance of the decision of the CJEU in the former case (hereinafter, *Italmoda*), can hardly be overstated.²

In its conclusions, the Court started by consolidating, and reiterating, previous case-law on the third-party liability for VAT fraud, by holding that the VAT directive must be interpreted as meaning that,³ it is for the national courts to refuse the right of deduction, exemption or refund of VAT concerning an intraEU supply, if it is established objectively that a taxable person knew or ought to have known that the transaction relied on to create the right involved participating in VAT evasion. More significantly, however, the CJEU went on to ruled that those rights may be refused even if the evasion was carried out in another Member State and all formal requirements outlined by the Member State in which the right is being claimed have been adhered to, and – crucially – in the absence of legislation of national legislation establishing third-party liability for VAT fraud. This decision is, therefore, not only important from the perspective of those who may now face the implications of (an arguably) extensive third-party liability for VAT tax fraud, but is mostly because it seems to confirm this test as a new legal principle, with all the legal implications that being such principle carries.

The Road to Italmoda

The discussion on third-party liability for VAT fraud first arose in the context of three UK cases, *Optigen*, *Fulcrum*, and *Bond*,⁴ where HMRC had denied recovery of input tax to three traders, who were not themselves the fraudsters, but had instead been unknowing participants in a carousel VAT fraud scheme, by buying items from a fraudster. HMRC argued that despite the taxpayers being unaware of the carousel fraud, the transactions did not constitute an economic activity for the purposes of VAT, within the meaning of what is now Article 9(1) of the VAT Directive, and consequently did not give rise to the right to deduct of input tax. The cases came in the wake of the introduction of new legislation,⁵ which imposed joint and several liability in respect of tax unpaid in a supply chain.⁶

Whilst initially won by HMRC in the UK lower courts,⁷ the cases were referred to the CJEU on appeal. In its decision, the Court dismissed the argument that the transactions in questions did not constitute economic activities, ruling that each transaction should be considered on its merits.⁸ It then went on to reject third party liability, concluding that, insofar as the taxable person had no knowledge and no means of knowledge of the fraud,⁹ it should be allowed to deduct input VAT, regardless of the existence of prior or subsequent fraudulent VAT transactions in the supply

¹ Opinion of Advocate General Szpunar in Joined Cases C-131/13, C-163/13 and C-164/13, ECLI:EU:C:2014:2217.

² Joined Cases C-131/13, C-163/13 and C-164/13, ECLI:EU:C:2014:2455.

³ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L 347, 11.12.2006, 1–118.

⁴ Joint cases C-354/03, C-355/03 and C-484/03, *Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v Commissioners of Customs & Excise*, ECLI:EU:C:2006:16.

⁵ Valued Added Tax Act 1994 (VATA), s.77A, inserted by Finance Act 2003, s.17.

⁶ G. Richards, "Carousel fraud: absolving the innocent: *Optigen Ltd and others v Commissioners of Customs & Excise*" (2006) *British Tax Review* 2, 147-149.

⁷ *Bond House Systems Limited v Commissioners of Customs & Excise*, [2003] VAT & Duties Tribunals 18100; and *Optigen Ltd v Commissioners of Customs & Excise* [2003] VAT & Duties Tribunals 18112. See the strong-worded criticisms of R. Pincher, "The costs of VAT frauds: *Bond House Systems Ltd and Optigen*" (2003) *British Tax Review* 5, 346–355.

⁸ See n. 4 above, para 47.

⁹ *Ibid*, para 46, 51 and 55.

chain.¹⁰ Particularly strong on its criticism of third party VAT liability was Advocate General Pocias Maduro, who in his Opinion on the case stated:

“The United Kingdom seems to envisage combating carousel fraud – or at least dispensing with the problems it poses – by limiting the scope of the VAT system. To my mind, the Court should not consent to this approach. It would drastically shift the burden of the problem from the tax authorities to the private sector, at the expense of legitimate trade and the proper functioning of the VAT system. Moreover, it would deter Member States from taking appropriate measures against carousel fraud.”¹¹

This initial rejection of third party liability was significantly qualified less than a year later in *Kittel and Recolta Recycling*.¹² Similarly to *Optigen, Fulcrum and Bond*, at stake was the limitation by the Belgium tax authorities of the right to deduct of the acquirer of goods from a potential missing trader fraudster. The decision by the CJEU significantly qualified its previous decision in *Optigen, Fulcrum and Bond*, by introducing a new concept of innocence. It ruled that innocent third parties cannot be made liable for VAT fraud; innocent third parties are those that have not themselves committed the fraud, and have taken every precaution which could reasonably be required of them. A contrario, third party liability for VAT fraud is possible where ‘the recipient tax payer knew, or should have known that the goods were connected with the fraudulent evasion of VAT.’¹³ Whilst ascertaining knowledge of fraud will most likely be a proof issue, the expression “should have known” has raised legal concerns as to its meaning and scope. It is therefore unsurprising that it has been subject to significant scrutiny,¹⁴ and even its translation, from the original judgment in French, questioned.¹⁵

Despite this uncertainty, *Kittel and Recolta Recycling* was a landmark decision, firmly establishing the possibility of third party liability for VAT fraud. Since then there has been a steady – and increasing – stream of cases establishing both the scope of that liability and the burden of proofs elements of it. There have been many cases of VAT fraud after *Italmoda*, with more and more cases concerning fraud decided, or pending before the CJEU. The table 1 below lists the CJEU cases that concerned, directly or indirectly, third party liability for VAT fraud, which in turn are but a fraction of the recent cases concerning VAT fraud and evasion.¹⁶

TABLE 1: CJEU Cases on Third-Party Liability for VAT Fraud

CASE	NAME	MEMBER STATE
C-354/03, C-355/03 and C-484/03	<i>Optigen, Fulcrum and Bond</i>	UK
C-245/04	<i>EMAG</i>	Austria
C-439/04, and C-440/04	<i>Kittel and Recolta Recycling</i>	Belgium
C-384/04	<i>Federation of Technological Industries and Others</i>	UK

¹⁰ For a comment on the perceived impact of these cases at the time see S. Vandenberghe and H.J. Sharkett, “Rights of Taxable Persons Involved in VAT Carousel Fraud from an EU, Belgian and UK Point of View Today and Tomorrow” (2006) *International VAT Monitor* 17(4), 254–263.

¹¹ ECLI:EU:C:2005:89, at para 43.

¹² Joint cases C-439/04 and C-440/04, *Axel Kittel v Belgian State* and *Belgian State v Recolta Recycling SPRL*, ECLI:EU:C:2006:446.

¹³ *Ibid*, para 61. Discussed in L Howard, ‘Input Tax’ (2013) *VAT Digest* 95 Jan/Feb, 4-21.

¹⁴ See K. Rahman and I. Roxan, “*Mobilx Ltd (In Administration) and others v HMRC*: is this the end of fraudulent evasion of VAT?” (2010) *British Tax Review* 5, 492-500; and M Schofield, “*S&I Electronics Plc v HMRC* and the State of MTIC VAT Fraud” (2015) *British Tax Review* 5, 663-678.

¹⁵ *Universal Enterprises Ltd v HMRC* [2015] UKUT 311 (TCC) (Upper Tribunal) at paras 36-37; and *Lifeline Europe Ltd v HMRC* [2014] UKUT 135 (TCC) (Upper Tribunal) at paras 57-61.

¹⁶ See overview in R de la Feria, ‘Anti-Tax Fraud Policy: Tackling Fraud Proportionally and Effectively’ (2015) *Durham Law School Research Briefing* 23.

C-409/04	<i>Teleos and Others</i>	UK
C-146/05	<i>Collée</i>	Germany
C-285/09	<i>R</i>	Germany
C-430/09	<i>Euro Tyre</i>	Netherlands
C-499/10	<i>Vlaamse Oliemaatschappij</i>	Belgium
C-587/10	<i>VSTR</i>	Germany
C-80/11	<i>Mahagében</i>	Hungary
C-273/11	<i>Mecsek-Gabona</i>	Hungary
C-285/11	<i>Bonik</i>	Bulgaria
C-324/11	<i>Gábor Tóth</i>	Hungary
C-18/13	<i>Maks Pen</i>	Bulgaria
C-163/13	<i>Turbu.com</i>	Netherlands
C-131/13	<i>Italmoda</i>	Netherlands
C-492/13	<i>Traum</i>	Bulgaria
C-123/14	<i>Itales</i>	Bulgaria
C-159/14	<i>Koela-N</i>	Bulgaria
C-277/14	<i>PPUH Stehcemp</i>	Poland
C-24/15	<i>Plöckl</i>	Germany
C-576/15	<i>Maya Marinova</i>	Bulgaria

Whilst an analysis of each of these cases is outside the scope of this note, some of these are particularly significant, paving the way for the decision in *Italmoda*. A year after the decision in *Kittel and Recolta Recycling*, the CJEU released its judgment in *Federation of Technological Industries*, another case referred by the UK courts.¹⁷ The Court started by confirming that third party liability is possible, if principles of legal certainty and proportionality are met, but it can only be applied to persons who, at the time of the supply, knew or had reasonable grounds to suspect that some or all VAT would go unpaid. It then went on to set out the basic principles underpinning the burden of proof on third party liability for fraud, by stating that a person is presumed to have reasonable grounds for suspecting that this is the case if the price paid was less than the lowest price that it might be reasonably expected to be paid for those goods in the free market, or less than the price paid on previous supplies of similar

¹⁷ Case C-384/04, *Commissioners of Customs & Excise and Attorney General v Federation of Technological Industries and Others*, ECLI:EU:C:2006:309.

goods; this presumption is rebuttable, however, if proof is presented that the low price paid is attributable to other circumstances.¹⁸

Another UK referral resulted in the first of several cases concerning the scope of third party liability for VAT fraud, and in particular whether it could apply to a supplier of goods to a potential fraudster, through the denial of the exemption usually applicable to intra-EU sales. The case was *Teleos and Others*,¹⁹ and it concerned a document which formed the evidence that the goods had reached their destination in another Member State.²⁰ On the evidence that the document was false, the supplier was subsequently denied an exemption despite the fact that they themselves had not been involved in the fraudulent activity. The Court explicitly denied third party liability in this case, but implicitly accepted the extension of the scope of this liability to cases concerning the denial of the right to exemption of intra-EU supplies, by referring to traders who ‘took every reasonable measure in [their] power’ to avoid VAT fraud.²¹ Further guidance then came in the *R* case,²² which concerned an intra-EU supply of goods where at the time of supply, the supplier deliberately concealed the identity of the true purchaser to enable that purchaser to evade VAT. The CJEU ruled that if the supplier knew that the goods formed part of a VAT fraud, liability was possible, and exemption could consequently be denied.²³ The decision caused immediate controversy, not least for being perceived as the express extension of that in *Kittel and Recolta Recycling*.²⁴ There was, however, a key difference: *R* did not concern third party liability, but someone who was in fact involved in the fraud.²⁵ It was therefore questionable whether suppliers, who were not themselves involved in the fraud, could still be held liable for the VAT fraud potentially committed by their acquirers.

Express confirmation came only in 2012 in *Mecsek-Gabona*.²⁶ The Court stated in that case that a Member State may refuse to grant a VAT exemption to an intra-EU supply “provided that it has been established that [the vendor] knew or should have known that the transaction which it carried out was part of a tax fraud committed by the purchaser, and that it had not taken every reasonable step within its power to prevent its own participation in that fraud”. The scope of third party liability for VAT fraud had been thus extended, to include those who sell goods to potential fraudsters, through denial of the right to exemption of intra-EU supplies.²⁷ Whilst at the time this extension may have appeared to the casual onlooker – or even the attentive expert – as a small legal step, in reality it was a massive one, substantively extending the scope of that liability.

Indeed, there are fundamental differences between making a person who acquired a good from a fraudster liable, by denying the right to deduct input VAT, and making someone who supplied a good to a potential fraudster liable, by denying the right to exemption. Both constitute instances of what is known as responsabilisation of third parties for crime, a phenomenon which has been identified as part of a general trend towards crime control starting in the

¹⁸ Ibid, para 47.

¹⁹ Case C-409/04, *The Queen, on the application of Teleos plc and Others v Commissioners of Customs & Excise*, ECLI:EU:C:2007:548.

²⁰ S. Nathoeni and W. de Wit, “VAT Exemptions of Intra-Community Supplies of Goods: State of Play after VSTR” (2013) *EC Tax Review* 2, 100-105.

²¹ See n 19 above, paras 66 to 68.

²² Case C-285/09, *Criminal proceedings against R*, ECLI:EU C:2010:742.

²³ Ibid, para 55.

²⁴ See R.T. Ainsworth, “A perfect storm in the EU VAT: *Kittel*, “*R*” and *Marc*” (2012) *Boston University School Law Working Paper* 12-22, May 2012; and M.G. Phillips, “Lessons on VAT: The *R* Case in the ECJ” (2012) *Tax Notes International* 66(5), 443.

²⁵ See n. 22, para 18.

²⁶ Case C-273/11, *Mecsek-Gabona Kft v Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága*, ECLI:EU:C:2012:547.

²⁷ R. Wolf, “*Mecsek-Gabona*: The Final Step of the ECJ’s Doctrine on Reliance on EU Law For Abusive or Fraudulent Ends in the Context of Intra-Community Transactions” (2013) *International VAT Monitor* 5, 280-286.

late 20th century,²⁸ and it is now widespread, in particular within financial crime, such as money laundering.²⁹ However, denying deductibility to the acquirer of goods constitutes responsabilisation for a crime which has already occurred, committed in the same country that is now denying the right to deduct input VAT, not paid as output. On the contrary, denying VAT exemption of intra-EU supply to the supplier of goods amounts to responsabilisation for a crime which has not yet occurred, and committed in another country, namely the Member State where the presumed fraudster was supposed to account for VAT on the intra-EU acquisition. Both these elements imply a fundamental expansion of those which can be made liability for VAT fraud, which should, at the very least, be acknowledged as such.

The above legal developments regarding third party liability for VAT fraud are both continued in, and underlie the CJEU decision in *Italmoda*.

The Decision in Italmoda

Italmoda was a Dutch company, which acquired computer hardware in the Netherlands and in Germany, and subsequently sold it to Italian business customers. Whilst the goods originating in Germany were shipped directly to Italy, they were purchased using *Italmoda*'s Dutch VAT number. The supplies were exempted in Germany, but the company failed to declare their intra-EU transactions in the Netherlands; and in Italy none of those intra-EU acquisitions were declared by the purchasers concerned, and VAT due in their respect left unpaid. The Italian authorities subsequently refused those purchasers the right to deduct VAT and proceeded to recover the tax due.

In the Netherlands, Dutch tax authorities took the view that *Italmoda* had knowingly participated in activity designed to fraudulently evade VAT in Italy. The consequences of this assessment were threefold: it refused the company the right to exemption in respect of the intra-EU supplies effected in that Member State, it refused the right to deduct input tax, and it refused the right to a refund of the tax paid in respect of the goods originating in Germany. The resulting assessments were challenged by *Italmoda*. The action brought by *Italmoda* was upheld at first instance, on the basis that there was no justification for refusing to apply the exemption or the right to deduct VAT, in particular since the tax evasion had taken place in Italy, not the Netherlands, and that *Italmoda* had satisfied all statutory conditions for the exemption to be applied. The case was referred to the CJEU on appeal. The Court was asked in particular the right of deduction should be refused where there has been evasion and the taxable person knew or ought to have known, even if national law does not make provision for a refusal under these circumstances; and, if the first question was answered in the affirmative, whether if all the formal criteria had been met in that Member State – namely the Netherlands – an exemption, deduction or refund could be refused in respect of VAT evasion in another Member State.

On the first question, the Court invoked the principle of prohibition of abuse of law and the decision in *Halifax*,³⁰ in order to assert that 'express authorisation cannot be required in order for the national authorities and courts to be able to refuse a benefit under the common system of VAT, as that consequence must be regarded as inherent in the system.'³¹ It was consequently concluded that:

'it is for the national authorities and courts to refuse a taxable person, in the context of an intra-Community supply, the benefit of the rights to deduction of, exemption from or refund of VAT, even in the absence of provisions of national law providing for such refusal, if it is established, in the light of objective factors, that that

²⁸ D. Garland, *The Culture of Control: Crime and Social Order in Contemporary Society* (OUP, 2002).

²⁹ E. Baker, "The legal regulation of transnational organised crime – Opportunities and limitations" in A. Edwards and P. Gill (eds.), *Transnational Organised Crime* (Routledge, 2003), 183-193.

³⁰ Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise*, ECLI:EU:C:2006:121.

³¹ n. 2, para 59.

taxable person knew, or should have known, that, by the transaction relied on as a basis for the right concerned, it was participating in VAT evasion committed in the context of a chain of supplies.³²

The Court therefore held that third parties could be made liable for VAT fraud or evasion, through the removal of their rights to exemption, deduction or a refund of VAT, even in the absence of national legislation establishing that liability.

Insofar as the second question is concerned, the Court stated by reiterating that, following *Kittel and Recolta Recycling*, when a taxable person knows or should have known that a transaction involved evasion of VAT, that itself constituted fraudulent conduct. It was then highlighted that ‘carousel fraud’ is frequently characterised by requirements being met from the point of view of the Member State in question, whilst the ‘fraudulent nature of those transactions taken together is the consequence of precisely the specific combination of transactions carried out in several Member States.’³³ As such, the Court concluded, there was no objective reason to treat the position differently because the fraud extends to two Member States,³⁴ and a Member State could refuse to exempt, deduct or refund VAT despite the fact that the evasion took place in another Member State.

The New (Sub) Principle of Third-Party Liability for VAT Fraud

The decision in *Italmoda* has very significant theoretical, as well as practical, implications. It has been pointed out that the decision has introduced a principle of extraterritoriality which has significantly strengthened powers to be used against third parties in VAT fraud.³⁵ However, whilst it is true that *Italmoda* confirmed an element of extraterritoriality to third party liability, this element is not new, and had indeed been present since *Mecsek-Gabona*. What is new is the statement that the liability for VAT fraud can arise in the absence of national legislation providing for it, since that liability, as defined by the Court, is inherent to the European legal system – and it is this statement that has transformed third party liability for VAT fraud from a rule, into a principle.

Whilst Article 205 of the VAT Directive allows Member States to introduce national measures establishing third party liability for payment of VAT,³⁶ the Article merely provides Member States with an option, and as such it lacks the unconditionality which is a precondition to direct effect.³⁷ Moreover, even if that were not the case, direct effect affords individuals the right to invoke a provision in the directive, but as *Italmoda* pointed out in its submission, the directive cannot of itself impose obligations on an individual and be relied on as such, by the Member State, against that individual.³⁸ Unsurprisingly, therefore, Article 205 was not invoked by the CJEU in its decision as the basis for the assertion that third party liability for VAT fraud may arise in the absence of national legislation; instead the Court sought to justify the refusal of rights, which compounds that liability, as a reflection of “the principle that rules of EU law cannot be relied on for abusive or fraudulent ends as the application of those rules cannot be extended to cover abusive, let alone fraudulent, practices”.³⁹ Indeed, from a constitutional perspective, only a principle has the legal force to remove rights and grant liability in the absence of concrete rules.

Whether the Court regards third party liability for fraud as an autonomous principle, a sub-principle of the principle of prohibition of abuse of law, or both as sub-principles of a wider principle, is unclear from the decision. There

³² Ibid, para 62.

³³ Ibid, para 67.

³⁴ Ibid, para 65.

³⁵ M Sutich and P Centore, ‘Denial of a right and extraterritoriality: strengthening the fight against tax fraud’ (2015) *World Journal of VAT/GST Law* 4 2, 101-109.

³⁶ The Article was invoked by the UK in *Federation of Technological Industries*, as the basis for the joint and several responsibility provision set out in section 77A of the VATA 1994.

³⁷ Case 26/62, *NV Algemene Transporten Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, ECLI:EU:C:1963:1.

³⁸ See n. 2, para 55. See, inter alia, judgments in joint cases C-397/01 to C-403/01, *Pfeiffer and Others*, EU:C:2004:584, para 108; and case C-555/07, *Küçükdeveci*, EU:C:2010:21, para 46.

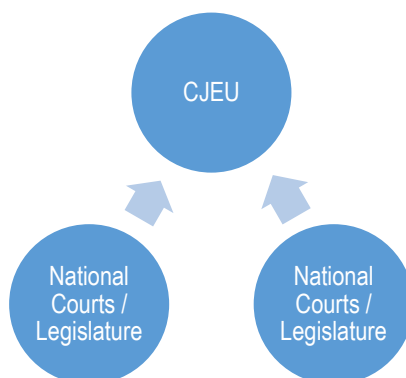
³⁹ See n. 2, para 56.

are, however, clear similarities on the development of these two principles, or sub-principles. Whilst the confirmation of the existence of the principle of prohibition of abuse of law only came in *Halifax*, the genesis of the principle go back 30 years before that decision, to *Van Binsbergen*,⁴⁰ afterwards developed through various cases,⁴¹ until a test was finally set out in *Emsland-Starke*,⁴² sparking the referral of several VAT cases, including *Halifax*.⁴³ Looking to the decisions concerning third party liability for fraud, clear parallels can be drawn between those, and key decisions in the development of the principle of prohibition of abuse: similarly to *Van Binsbergen*, the genesis of the (sub-)principle of third party liability for fraud can be traced back to *Optigen, Fulcrum and Bond; Kittel and Recolta Recycling*, like *Emsland Starke*, introduced the test; and *Italmoda*, similarly to *Halifax* confirms the existence of a principle.

This process of creation and development of principles of EU law has been designed before as one of reverberation.⁴⁴ Like a sound wave, the reverberation of principle development progressively spreads outward throughout the EU and the national legal orders. And like the motion of a wave, there is not only radiating movement, but multi-directional movement back and forth, which for our purposes, means both between the EU judicial arm and the courts and legislatures of the Member States (vertically), and between courts and legislatures of different Member States amongst themselves (horizontally). Table 2 provides an illustration of the reverberation process through its different stages.

TABLE 2: Reverberation Process in Development of New EU Legal Principles

Phase I: Pre-Cognisance



Phase II: From Pre-Cognisance to Cognisance

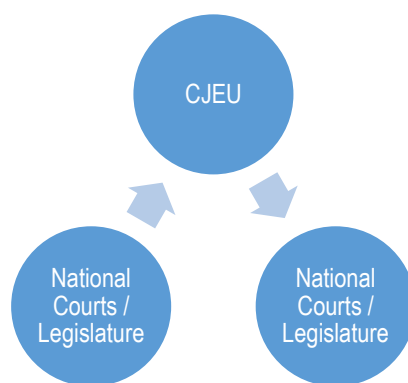
⁴⁰ Case 33/74, *Van Binsbergen v Bedrijfsvereniging voor de Metaalnijverheid*, ECLI:EU:C:1974:131.

⁴¹ For a comprehensive analysis of this case-law see R. de la Feria, 'Prohibition of Abuse of (Community) Law: The Creation of a New General Principle of EC Law through Tax' (2008) *Common Market Law Review* 45, 395-441.

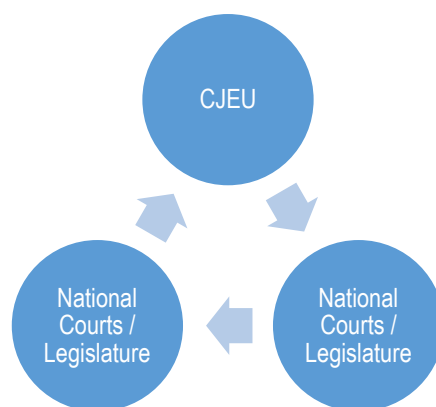
⁴² Case C-110/99, *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas*, EU:C:2000:695.

⁴³ See R. de la Feria, "Giving themselves extra VAT? The ECJ ruling in *Halifax*" (2006) *British Tax Review* 2, 119-123; and R. de la Feria, "GAME OVER' for Aggressive VAT Planning? *RAL v. Commissioners of Customs & Excise*" (2005) *British Tax Review* 4, 394-401

⁴⁴ R. de la Feria, "Introducing the Principle of Prohibition of Abuse of Law" in R. de la Feria and S. Vogenauer (eds.), *Prohibition of Abuse of Law: A New General Principle of EU Law?* (Oxford: Hart Publishing, 2011), xv.



Phase III: From Cognisance to Post-Cognisance



The decision in *Italmoda* marked the beginning of the post-cognisance period. Similarly to what was witnessed after *Halifax*, an intensification of vertical interaction between the CJEU and the courts and legislatures of the Member States can already be witnessed, and the question now arises as to whether horizontal interaction between courts and legislatures of different Member States will also emerge. From a practical perspective what does this mean? What are the practical consequences of *Italmoda*?

The most obvious consequence is the direct applicability of the principle: national courts and tax authorities are obliged to apply it, regardless of the existence of national legislation to that effect, and as a consequence, businesses may see their VAT rights denied if they either acquired, or supplied goods to a fraudster. It also raises the question of whether liability can be extended to other members of the production chain, than have not acquired or supplied directly to the fraudster. As early as 2006, the Belgium tax authorities issued an order to a warehouse-keeper who was deemed joint and severally liable for unpaid output VAT on fuel stored in its warehouse. In a relatively short judgment, the CJEU deemed the Belgium law on which the order had been passed, disproportionate, and thus incompatible with the EU VAT system,⁴⁵ tellingly stating:

“[The VAT Directive] must be interpreted as not authorising the Member States to provide that a warehouse-keeper other than a customs warehouse-keeper is jointly and severally liable for the VAT which is owing on a supply of goods made for valuable consideration, and released from the warehouse, by the owner of the goods who is liable for the tax on those goods, even *where the warehouse-keeper acts in good faith or where no fault or negligence can be imputed to him.*”⁴⁶

⁴⁵ Case C-499/10, *Vlaamse Oliemaatschappij NV v FOD Financiën*, ECLI:EU:C:2011:871.

⁴⁶ *Ibid.*, para 28, *our italics*.

The language used by the Court seems to indicate, *a contrario*, that liability would be possible if there was evidence of bad faith, fault or negligence, thus opening the door for the extension of third party liability to other members of the production chain. The new legal principle status of third party liability reinforces this possibility. The question arises in particular as regards intermediaries, who indirectly benefit from fraud, through lower prices, increased markets, etc. Could those benefits now be removed by making them liable for the unpaid VAT, on the basis of the new principle?

There are undeniably significant advantages to making third-parties, including intermediaries, liable for VAT fraud. Tackling fraud can be extremely difficult; this is the case in particular as regards organised fraud, involving criminals in various Member States, or fraud committed by nationals established outside the EU. There are serious costs attached to fraud, so when fraud goes unchallenged, it is not only a loss of revenue impacting upon public finances, but a loss of equal-playing field, impacting on small and medium size enterprises in particular, and indirectly affecting economic growth, as well as future corporate income tax or VAT revenues. Concerns recently expressed in the UK by domestic traders priced out of competition due to outside the EU traders failing to pay VAT, and thus charging much lower prices on goods,⁴⁷ perfectly highlights the problem. Whilst third party liability for fraud cannot address the causes of the problem, namely tackle fraud itself, it addresses the symptoms: not only its revenue costs, since it allows the lost revenue to be collected from a third, easier identifiable person; but in some cases, such as those concerning intermediaries, re-establishing a level playing field, by disincentivating legitimate traders from engaging with fraudsters.

Yet these advantages come at a high cost, as third party liability also carries substantial practical, as well as rule of law, risks.⁴⁸ As noted earlier on in the development of the principle,⁴⁹ *Optigen* and *Fulcrum*, who were in liquidation at the time of the decision of the CJEU, may have been so as a result of HMRC's refusal to repay input tax; anecdotal evidence suggests that innocent traders, primarily small and medium size enterprises, may be forced to stop trading as a consequence of third party liability. In addition, even for those not a risk, third party liability creates uncertainty, which in turn leads to higher compliance costs associated with additional checks of business partners, and a potential bias away from unknown or smaller businesses, in favour, of bigger, well known businesses, creating obstacles to market entrance. Crucially, also, as pointed out by Advocate General Maduro in *Optigen, Fulcrum and Bond*, third party liability for fraud can disincentive fraud tackling, since revenue costs can be addressed via this liability at potentially much lower enforcement costs; yet tackling fraud itself is crucial for reasons of equity, as well as for its links to organised crime.⁵⁰

Globalisation and digitalisation of the economy, and the consequent difficulties in tax enforcement, have probably made the principle of third party liability for fraud an inevitability. Yet, as the CJEU, and national courts and legislatures, move forward in the development of this principle, it is vital that the risks are not forgotten, and that, as all anti-fraud measures, the ethos of the principle is firmly on deterrence, as opposed to revenue gathering. Anti-avoidance, and anti-fraud principles are, by their own nature, trade-offs; carefully defining the scope of the new principle of third party liability for fraud, is crucial if we are to maintain a balance between its undeniable advantages, and its undeniable risks.

⁴⁷ This has been the object of an intense debate in the UK, in particular in the context of the potential liability of internet platforms, such as Amazon and e-Bay. See S Tulett, "Amazon and eBay 'liable' if they ignore VAT fraud", *BBC News*, 1 November 2015; V Holder and G Parker, "Overseas e-retailers face VAT crackdown", *Financial Times*, 22 December 2015; S Bowers, "Tax inspectors raid warehouse containing £500,000 of illegal goods", *The Guardian*, 14 January 2016; V Holder and D Thomas, "HMRC reviews telecoms tax to combat VAT fraud", *Financial Times*, 24 January 2016, and S Bowers, "Amazon and eBay to be held liable for VAT fraud by sellers", *The Guardian*, 16 March 2016.

⁴⁸ This point is explored further in a forthcoming article, R de la Feria, "VAT Anti-Fraud Policy, Third Party Liability, and the Rule of Law".

⁴⁹ G Richards, n 6 above.

⁵⁰ HM Government, *Serious and Organised Crime Strategy*, October 2013.

* Professor of Tax Law, University of Leeds, and a future pupil at Gray's Inn Tax Chambers, respectively.