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Some Recent Cases from the European Court of Human Rights

This article examines some recent cases of the European Court of Human Rights on various indirect and direct tax matters. The two cases discussed here relate to the denial of VAT input tax deductibility, where the supplier has failed timely to pay over the VAT, and the repercussions of the Yukos affair in Russia.

Disallowance of Input VAT and the Innocent Trader

There is a good example of the interplay between EC law, on the one hand, and the European Convention on Human Rights (hereinafter: the Convention), on the other, in the recent decision of the European Court of Human Rights (ECtHR) of 22 January 2009 in the case of *Bulves AD v. Bulgaria*.[1] This case concerned the disallowance under Bulgarian domestic legislation of input VAT where the trader in question was completely innocent and had no control over its supplier. The case dates from 2000 and so pre-dates Bulgaria's accession to the European Union. Nevertheless, the ECtHR cited in its judgment the decisions of the European Court of Justice (ECJ) in *Optigen Ltd* and the related cases[2] and *Axel Kittel* and the related cases.[3] Bulgaria adopted a VAT on 1 January 1999, similar in many respects to that operating in the European Union.

The background facts were straightforward. On 16 August 2000, the applicant company purchased goods from another company at a cost of BNG 21,660 (approximately, EUR 11,100) which included an amount of BNG 3,610 (approximately, EUR 1,850) as VAT. The supplier issued an invoice dated 16 August 2000, showing the VAT, which the applicant company paid in full. The applicant company recorded the purchase in its VAT return for the month of August 2000, which it filed by 15 September 2000. Its supplier (for reasons that were not explained in the case) did not, however, record the sale in its accounts until October 2000 and only paid over the VAT with its VAT return for that month. As a result of a VAT audit, the Tax Office cross-checked with the supplier and discovered the reporting discrepancy. Consequently, they issued the applicant company with a tax assessment for the amount of VAT, BNG 3,610, plus interest. The applicant company appealed against the tax assessment, but its appeal failed in the Bulgarian domestic courts on grounds that, in accordance with the Bulgarian legislation, deductibility of input VAT was conditional on the supplier having paid the VAT in the period for which deduction was sought.[4]

The applicant company appealed to the ECtHR alleging a violation of Art. 1 of the First Protocol in that it had been denied the peaceful enjoyment of its possessions. The applicant company's case was based on its contentions that it was completely innocent, that it had complied fully with the VAT legislation, that it had no control over its supplier and no reason to believe the supplier had not paid over the VAT, and that it should not be denied the deduction of the input VAT on the grounds of failure of the supplier to account properly.

The ECtHR first confirmed that the applicant company had at least a legitimate expectation of being able to deduct its input VAT and this amounted to a "possession" within the meaning of Art. 1 of the First Protocol. Denial of the deduction constituted an interference with the possession and the consequent question was whether this interference could be justified by the government. This required a "fair balance" to be struck between the demands of the general interest of the community and the protection of the company's fundamental rights as well as a reasonable relationship of proportionality between the means employed and the aims pursued. The ECtHR considered that the general interest of the community was in preserving the financial stability of the VAT system and curbing any fraudulent abuse. The Court noted the applicant company paid the VAT twice, once on payment of the original invoice (which was eventually paid over to the State), and once again on the tax assessment. There was, therefore, no negative effect on the State budget. There was also no indication of any involvement by the applicant company in any fraudulent abuse. Accordingly, the ECtHR concluded as follows:

> [1]. Considering the timely and full discharge by the applicant company of its VAT reporting obligations, its inability to secure compliance by its supplier with its VAT reporting obligations and the fact that there was no fraud in relation to the VAT system of which the applicant company had knowledge or the means to obtain such knowledge, the Court finds that the latter should not have been required to bear the full consequences of its supplier's failure to discharge its VAT reporting obligations in timely fash-

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1. Application number 3991/03.
2. ECJ, 12 January 2006, Joined 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*.
3. ECJ, 6 July 2006, Joined Cases C-439/04 and C-440/04, *Axel Kittel v. Belgian State* and *Belgian State v. Recolta Recycling SPRL*.
4. It appears from the ECtHR judgment that, in addition to the assessment to pay the VAT (which the company had already paid once to the supplier), the applicant company was unable to deduct the full cost of the goods in its corporate income tax computation.

> ion, by being refused the right to deduct the input VAT and, as a result, being ordered to pay the VAT a second time, plus interest. The Court considers that this amounted to an excessive individual burden on the applicant company which upset the fair balance that must be maintained between the demands of the general interest of the community and the requirements of the protection of the right of property.

There has accordingly been a violation of Article 1 of Protocol No. 1.

The case is not only significant because of its citation of ECJ case law, and the similarity to the conclusions reached by the ECJ. It is one of a very small number of cases where the ECtHR has been willing to strike down a provision of domestic tax law as infringing Art. 1 of the First Protocol and where the Court has refused to accept that the provision was within the wide margin of appreciation enjoyed by States in tax matters.

The decision is particularly relevant to countries that have sought to deal with intra-Community, missing trader, VAT fraud by denying to the innocent trader the deduction of VAT where its supplier has failed to pay over that VAT to the State. It should, however, be noted that, in this particular case, the applicant company was unaware of any fraud and was unable to discover any fraud. It is also significant that the supplier did account for the VAT (albeit two months later than it should have done). Whilst the facts are not on all fours with those of missing trader fraud, the judgment points to the unwillingness of the ECtHR to see an innocent and compliant taxpayer penalized for the failings of another person over whom it had no control.

The *Yukos* Case

Given the events that led up to the auction of the assets of the Yukos Group and the eventual liquidation of the holding company, it is not surprising that these events have ended up before the ECtHR. It was also always probable that the dispute relating to the tax affairs of the Yukos Group would end up before the ECtHR. That Court has, in fact, already considered some aspects of the Yukos affair.[5]

The case of *OAO Neftyanaya Kompaniya Yukos v. Russia*[6] raises a host of issues concerning the conduct of the Russian tax authorities and judicial organs. At this stage, the ECtHR was only deciding on the admissibility of the various claims made by the company against Russia. The judgment is unusually long, i.e. 51 pages in total, and much of it is given over to a blow-by-blow account of the events which led from a tax audit of the Yukos Group in December 2003 to the auction of the shares in one of the main operating companies in December 2004 (and the indirect acquisition of those shares by a Russian state-owned entity).

Preliminary objections by the Russian government that the applicant company had been liquidated and that the London-based lawyer acting for the company was no longer authorized to act were rejected by the ECtHR. The Court noted that, if a company placed into liquidation was unable to pursue its claims for breach of the Convention, the protection of corporate rights would be impaired.

The applicant company brought a large number of complaints based on Art. 6 (lack of a fair trial), Art. 1 of the First Protocol (interference with its right to enjoyment of its possessions) taken both by itself and in conjunction with various other articles of the Convention, and Art. 7 (*nulla poena sine lege*). With the exception of a few of the complaints, the ECtHR found that the complaints were admissible, raised serious issues of facts and law under the Convention, and required an examination on the merits. The case will, therefore, proceed to a full examination on its merits.

One point that might be noted is that the original application was lodged in April 2004, but the admissibility decision was only issued on 29 January 2009. Given the large number of issues raised and the complexity of the case it may be some time before a final judgment on the merits is issued. It will be interesting to see whether the ECtHR focuses on a narrow examination of the facts and the compatibility with the Convention or whether wider issues will be considered relating to the alleged political motivation and manipulation of the conduct of the revenue authorities and judicial organs. In some respects, this may prove to be one of the most interesting tax cases that the ECtHR will have to decide.

5. See, for example, the case of *Aleksanyan v. Russia* (application number 46468/06) admissibility decision of 24 January 2008 and the decision of the merits of 16 December 2008.
6. Application number 14902/04 admissibility decision of 29 January 2009.