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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

The ECJ applied the principle of *fraus omnia corrumpit* (fraud corrupts everything) in the field of VAT for the first time in 2007. On that occasion, the ECJ decided that knowledge of fraud may have the effect that taxable persons lose the right to deduct input VAT. More recently, the ECJ declared in *Mecsek-Gabona* that knowledge of fraud may also have the effect that suppliers of goods lose the right to zero rate cross-border transactions. In this article, the author places the ECJ's decision in *Mecsek-Gabona* in a broader context.

1. Introduction

The judgment of the Court of Justice of the European Union (ECJ) in *Mecsek-Gabona*¹ revolves around the zero rating of, or, in the terminology of the VAT Directive,² the exemption³ for, intra-Community supplies of goods, which was introduced in 1993 as part of the "transitional" VAT regime for intra-Community transactions, following the abolition of the internal tax borders within the European Union.⁴ Twenty years later, that temporary regime has generally been accepted as having acquired a more or less permanent status, albeit that the European Commission started in 2010⁵ a -still ongoing - debate on changing this system.

The ECJ addressed the zero rating of intra-Community supplies of goods for the first time in its judgment

in *Teleos*,⁶ in 2007, and on the zero rating of intra-Community triangular supplies of goods, in its judgment in *EMAG*,⁷ in 2006. The ECJ also addressed the latter issue in 2010, in *Euro Tyre Holding*⁸ and, in 2012, in *VSTR*.⁹ I will discuss these decisions below.

2. Zero Rating – Material Requirements

In its judgment in *Teleos*, the ECJ identified the following material conditions for the application of the zero rate to intra-Community supplies of goods:

- (1) the supplier must transfer the right to dispose of the goods as owner;
- (2) the goods must physically move from one Member State to another, and;
- (3) the person acquiring the goods must have the status of a taxable person (or of a non-taxable legal person "acting as such in a Member State other than that of the departure of the dispatch or transport of the goods").¹⁰

As regards the movement of the goods, the ECJ ruled that the supplier must establish that the goods have been dispatched or transported to another Member State and that, as a result of that dispatch or that transport, the goods must have physically left the Member State of supply.¹¹ In relation to takeaway transactions, where the purchaser has the contractual obligation to arrange for transport of the goods to another Member State, the ECJ held that the supplier is dependent on the transport information it receives from its customer. Under these conditions, the tax authorities cannot require conclusive proof of the transport, which implies that, once the supplier has fulfilled his obligations relating to evidence of an intra-Community supply, Member States cannot hold the supplier liable for VAT if it is discovered afterwards that the goods have not in fact been transported to another Member State. Under the latter circumstances, the supply cannot be zero rated,

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1. HU: ECJ, 6 Sep. 2012, Case C-273/11, *Mecsek-Gabona Kft. v. Nemzeti Adó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága*, ECJ Case Law IBFD.
 2. Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006).
 3. Article 138(1) of the VAT Directive, which corresponds with article 28c(A) of the former Sixth Directive. Under article 169(b) of the VAT Directive, the supplier is entitled to deduct input VAT in relation to the supply.
 4. Council Directive 91/680 of 16 December 1991 supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, OJ L376 (1991), p. 1.
 5. Green Paper of 1 December 2010 on "The future of VAT – Towards a simpler, more robust and efficient VAT system", COM(2010) 695, which was followed by a "Communication of 6 December 2011 on the future of VAT", COM(2011) 851, in which the Commission laid down the priorities and a practical work programme for the coming years. See, in this context, also the findings of the Informal Commission expert group ("Group on the future of VAT"), which can be accessed at http://ec.europa.eu/taxation_customs/index_en.htm.

6. UK: ECJ, 27 Sep. 2007, Case C-409/04, *The Queen, on the application of: Teleos plc and Others v. Commissioners of Customs & Excise*, ECJ Case Law IBFD, ECR I-7797.
 7. AT: ECJ, 6 Apr. 2006, Case C-245/04, *EMAG Handel Eder OHG v. Finanzlandesdirektion für Kärnten (Berufungssenat II)*, ECJ Case Law IBFD, [2006] ECR I-3227.
 8. NL: ECJ, 16 Dec. 2010, Case C-430/09, *Euro Tyre Holding B.V. v. Staatssecretaris van Financiën*, ECJ Case Law IBFD, [2010] ECR I-13335.
 9. DE: ECJ, 27 Sep. 2012, Case C-587/10, *Vogtländische Straßen – Tief und Rohrleitungsbau GmbH (VSTR) v. Finanzamt Plauen*, ECJ Case Law IBFD.
 10. Id., paragraph 70.
 11. Id., paragraph 42.

albeit that the VAT due must not be collected from the supplier. Instead, the purchaser must be held accountable for the unpaid VAT:

(...) once the supplier has fulfilled his obligations relating to evidence of an intra-Community supply, where the contractual obligation to dispatch or transport the goods out of the Member State of supply has not been satisfied by the purchaser, it is the latter who should be held liable for the VAT in that Member State.¹²

Holding the purchaser liable for the unpaid VAT makes sense because the purchaser has caused the VAT liability by not fulfilling his contractual obligation to transport the goods to another Member State. However, this liability lacks a clear legal basis in the VAT Directive.

3. Zero Rating – Formal Requirements

In addition to material requirements for zero rating intra-Community supplies of goods, Member States may set formal requirements. In this respect, the opening sentence of article 28c(A) of the former Sixth Directive¹³ stated:

Without prejudice to other Community provisions and subject to conditions which they shall lay down for the purpose of ensuring the correct and straightforward application of the exemptions [zero rates] provided for below and preventing any evasion, avoidance or abuse, Member States shall exempt [zero rate] (...).¹⁴

However, Member States may not use these formal requirements in a way that would undermine the neutrality of VAT, which is a fundamental principle of the VAT system. In *Collée*,¹⁵ the ECJ held that the principle of tax neutrality requires that the zero rating be allowed if the substantive requirements are satisfied, even if the taxable person has failed to comply with some of the formal requirements; it can only be otherwise if non-compliance with such formal requirements would effectively prevent the production of conclusive evidence that the substantive requirements for zero rating have been satisfied. This reasoning led, in *Collée*, to the conclusion that the supplies of goods were zero rated, although the supplier had failed to comply with the national time limit for producing evidence in this respect. In a similar vein, the ECJ recently held in *VSTR*¹⁶ that the zero rating cannot be refused on the sole ground that the supplier does not provide the VAT identification number of his customer. Member States are allowed to make the zero rating subject to the condition that a supplier provides the VAT identification number of his customer; however, this condition must be disregarded when the material conditions for zero rating are met.

4. Zero Rating Triangular Transactions

The ECJ has delivered various judgments on the zero rating of triangular intra-Community transactions.¹⁷ These are transactions involving three parties (A, B, C); party A sells goods to party B, party B sells the same goods to party C, and the goods are delivered directly from party A to party C, who is located in another Member State. In *EMAG*,¹⁸ the first suppliers (parties A) were located in Italy and the Netherlands, whereas parties B¹⁹ and C²⁰ were both located in Austria. The goods (consignments of soft lead) were transported from Italy and the Netherlands (Member States of departure) directly to the premises of party C in Austria (Member State of arrival). Party B had charged Austrian VAT to party C. However, the Austrian tax authorities argued that both the supplies between A and B and the supplies between B and C were zero-rated intra-Community supplies.

In the course of the subsequent judicial proceedings, the Austrian *Verwaltungsgerichtshof* asked the ECJ whether the intra-Community transport can be attributed to both supplies. If that were possible, the triangular transaction would result in two intra-Community supplies.²¹ The ECJ answered that, if two successive supplies give rise to a single movement of goods, the supplies must be regarded as having followed each other in time, and concluded that the intra-Community transport of the goods can be ascribed to only one of the successive supplies. The other supply must then be considered to be a domestic supply.

However, the question remained of how the transport of the goods must be ascribed to one of the two successive supplies. The ECJ answered this question in *Euro Tyre Holding*²² and reaffirmed its conclusions in *VSTR*.²³

In *Euro Tyre Holding*, a Dutch company of that name (party A), sold goods (car tyres) to a Belgian company (party B), which then sold the goods to another Belgian company (party C). Party B collected the goods at the premises of party A and transported them directly to party C in Belgium. These transactions attracted the attention of the VAT authorities because it appeared that not all participants had met their VAT obligations. The Dutch tax authorities reasoned that the intra-Community transport of the goods had to be ascribed to the supplies between parties B and C. These supplies were then zero rated intra-Community supplies and party A's supplies would be subject to VAT in the Netherlands. The *Gerechtshof* (Court of Appeal) of Den Bosch upheld this reasoning. However, the *Hoge Raad der Nederlanden* (Dutch Supreme Court) was not convinced that, under the given circumstances,

12. *Teleos*, paragraph 67.
13. 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 (1977).
14. The same provision, which can be found in article 131 of the current VAT Directive, also applies to other zero rates, with the exception of that laid down by article 28c(E) of the former Sixth Directive and those laid down by articles 155 to 166 of the current VAT Directive.
15. ECJ, 27 Sept. 2007, Case C-146/05, *Albert Collée, as full legal successor to Collée KG v. Finanzamt Limburg an der Lahn*, ECJ Case Law IBFD, [2007] ECR I-7861.
16. *Supra* n. 9.

17. See also: S. Maunz & H. Marchal, *Zero Rating Cross-Border Triangular Transactions under EU VAT*, 23 Intl. VAT Monitor 5 (2012), Journals IBFD, and J.J.P. Swinkels, *Zero Rating Cross-Border Supplies of Goods under EU VAT – Triangular Takeaway Transactions*, 23 Intl. VAT Monitor 6 (2012), Journals IBFD.
18. *Supra* n. 7.
19. The ECJ referred to the intermediate Austrian party as “K GmbH”.
20. *EMAG Handel Eder OHG* was the final customer.
21. *Verwaltungsgerichtshof*, 26 May 2004, EU 2004/0001 (99/14/0244).
22. *Supra* n. 8.
23. *Supra* n. 9.

the transport of the goods must be ascribed to the second supply in the chain, and asked the ECJ to clarify the matter.

In its judgment, the ECJ noted that the former Sixth Directive did not contain a general rule on whether an intra-Community transport carried out by or on behalf of the intermediate party B,²⁴ must be ascribed to the first or to the second supply, and held that, in the case at hand, the collection of the goods from the warehouse of party A by a representative of party B must be regarded as the transfer of the right to dispose of the goods to B.

According to the ECJ, the transport of goods can only be ascribed to the first supply (to the effect that the subsequent supply is subject to VAT in the Member State of arrival) if the following conditions are met:

- C received the “power to dispose of the goods” in the Member State of arrival;
- A had received confirmation from B that the goods were to be transported to another Member State; and
- A had received B’s VAT identification number which was issued to B by the Member State of arrival.

Based on the above conditions, party A could rely on the information received from his customer, party B. However, the customer could also have provided information that would have had the effect that party A’s supply would no longer be zero rated:

However, after the transfer to the person acquiring the goods of the right to dispose of the goods as owner, the supplier effecting the first supply might be held liable to VAT on that transaction if he had been informed by that person of the fact that the goods would be sold on to another taxable person before they left the Member State of supply and if, following that information, the supplier omitted to send the person acquiring the goods a rectified invoice including VAT.²⁵

The ECJ thus constructed a regime under which, depending on the information that he provides to his supplier, party B has the power to ascribe the transport of the goods to either the first or the second supply.²⁶ Party B’s power only exists if party C receives the right to dispose of the goods in the Member State of arrival, i.e. after the intra-Community transport by B. If B had already transferred the right to dispose of the goods to party C in the Member State of dispatch, the intra-Community transport could only be ascribed to the second supply, and the first supply would then be subject to VAT in the Member State of departure.

In *VSTR*, the ECJ reproduced the line of reasoning it had developed in *Euro Tyre Holding* in relation to a triangular transaction involving *VSTR*²⁷ (party A) in Germany, a US company (AIT,²⁸ party B) and a Finnish company (party C). *VSTR* had sold two stone crushers “ex works” to AIT and AIT arranged for the transport of the machines

24. The ECJ referred to party B as “the person who, as the first person acquiring the goods and as the second supplier, was involved in both supplies.”

25. *Supra* n. 8, paragraph 36.

26. See also R.A. Wolf, *VAT Pitfalls in Intra-EU Commodity Trade*, EC Tax Review 1 (2012).

27. The full name of party A was Vogtländische Straßen-, Tief- und Rohrleitungsbau GmbH.

28. The full name of party B was Atlantic International Trading Company, established in New York.

from the premises of *VSTR* in Germany to its customer in Finland. AIT had provided *VSTR* with the Finnish VAT registration number of its (AIT’s) Finnish customer (party C in the chain). *VSTR* had checked that number and found it to be valid. AIT (party B) had also informed *VSTR* that the machines would be sold to another party before arriving in Finland. Under the principles set forth in *Euro Tyre Holding*, this course of events should imply that AIT had opted to ascribe the intra-Community transport of the goods to the second supply (the supply between AIT and its Finnish customer). However, the referring German court, the *Bundesfinanzhof*, apparently thought that the transport could nonetheless be ascribed to the first supply²⁹ giving the ECJ no option but to answer the referring court’s questions because, in the framework of answering questions on the interpretation of EU law, the ECJ is bound by the factual findings of the referring court. However, if party C had already received the right to dispose of the goods as owner in Germany, the intermediate party’s power to ascribe the transport would cease to exist and the intra-Community transport could not be ascribed to the first supply. Under those circumstances, the transport must be ascribed to the second supply. The ECJ left it to the national court to resolve the dispute in the main proceedings³⁰ and, from that perspective, the findings of the ECJ in *VSTR* do not seem to contradict the ECJ’s earlier findings in *Euro Tyre Holding*.³¹

5. The Right To Deduct and Fraud

In *Kittel*,³² the ECJ was asked to determine whether the practice of the Belgian tax authorities of rejecting claims for a VAT refund in cases of apparent VAT fraud is compatible with EU law. The authorities took the position that transactions involving a missing trader had an unlawful basis and were legally void from the perspective of Belgian civil law. The authorities argued that legally void transactions cannot constitute economic activities or supplies of goods for VAT purposes. Consequently, no VAT was due on such transactions, and no VAT could be deducted in relation to such transactions.

The ECJ rejected this reasoning. According to the ECJ, the fact that a transaction is legally void does not in itself lead to the conclusion that no economic activity or supply of goods takes place.

29. See, in this respect, R.T. Ainsworth, *VAT Triangulation with a US Middleman VSTR*, C-587/10, Boston University School of Law Working Paper 12-55 (14 Dec. 2012), <http://www.bu.edu/law/faculty/scholarship/workingpapers/documents/AMERICANSTRAPPEDINTHEVATUpdated.pdf>.

30. *Editor’s note*: it appears that the *Bundesfinanzhof* based its decision in the main proceedings on a combination of ECJ case law and national VAT law, see *VAT Case Notes*, under Germany, 24 *Intl. VAT Monitor* 5 (2013), Journals IBFD.

31. Joep Swinkels found the observations of the ECJ “confusing”: J.J.P. Swinkels, *Zero Rating Cross-Border Supplies of Goods under EU VAT – Triangular Takeaway Transactions*, 23 *Intl. VAT Monitor* 6 (2012), Journals IBFD.

32. BE: ECJ, 6 July 2006, Joined Cases C-439/04 and C-440/04, *Axel Kittel v. État belge and État belge v. Recolta Recycling SPRL*, ECJ Case Law IBFD, [2006] ECR I-6161.

However, the ECJ did not stop there. It also decided that a national court must refuse deduction of VAT:

(...) where it is ascertained, having regard to objective factors, that the taxable person knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT, and to do so even where the transaction in question meets the objective criteria which form the basis of the concepts of 'supply of goods effected by a taxable person acting as such' and 'economic activity'.³³

A refund of VAT must be refused where a transaction is connected with VAT fraud, provided that "objective factors" lead to the conclusion that the trader was or should have been aware of the fraud. *Kittel* thus marked the introduction of the "knowledge test". Traders can, however, counter a refusal of refund by demonstrating that they had acted with due care:

(...) it is apparent that traders who take every precaution which could reasonably be required of them to ensure that their transactions are not connected with fraud, be it the fraudulent evasion of VAT or other fraud, must be able to rely on the legality of those transactions without the risk of losing their right to deduct the input VAT (...).³⁴

Combining the two conditions leads to the conclusion that the tax authorities can only refuse to make a refund if the applicant passes the knowledge test and has *not* "taken every precaution which could reasonably be required".

As regards the loss of the right to deduct, the ECJ referred to the principle that "Community law cannot be relied on for abusive or fraudulent ends".³⁵ The right to deduct is apparently derived from EU law. Furthermore, knowingly participating in a trade chain tainted by VAT fraud apparently amounts to fraud itself. As the ECJ put it in *Kittel*:

In the same way, a taxable person who knew or should have known that, by his purchase, he was taking part in a transaction connected with fraudulent evasion of VAT must, for the purposes of the Sixth Directive, be regarded as a participant in that fraud, irrespective of whether or not he profited by the resale of the goods.³⁶

The ECJ consistently applied the "Kittel doctrine" in its later decisions but limited its scope in 2012, in *Mahagében*.³⁷ In *Kittel*, the ECJ referred to a "transaction connected with the fraudulent evasion of VAT", which seems to imply that the fraud may have been committed anywhere in the supply chain. In *Mahagében*, the ECJ limited

the loss of the right to deduct in the event of fraud committed by any trader at preceding stages in the supply chain.³⁸

(...) a taxable person can be refused the benefit of the right to deduct only on the basis of the case law resulting from ... *Kittel and Recolta Recycling*, according to which it must be established, on the basis of objective factors, that the taxable person to whom were supplied the goods or services which served as the basis on which to substantiate the right to deduct, knew, or ought to have known, that that transaction was connected with fraud *previously committed by the supplier or another trader at an earlier stage in the transaction*.³⁹ [emphasis added by the author]

Fraud committed by a customer or any subsequent party in the supply chain will therefore, even if the knowledge test is met, not trigger a refusal of a refund. However, as I will explain below, it follows from *Mecsek-Gabona* that, in such cases, the zero rating of intra-Community supplies can be refused.

6. Zero Rating and Fraud

The ECJ answered the question of whether VAT fraud can lead to the refusal to zero rate intra-Community supplies of goods for the first time in the context of the criminal proceedings against *R*.⁴⁰ That case concerned a trader (Mr R) based in Germany who had sold luxury cars to customers (car dealers) primarily in Portugal. According to the ECJ:

Mr R claimed to be entitled to [apply the zero rate] when the goods supplied had actually left Germany, but the invoices and returns which he produced to the tax authorities as evidence of intra-Community transactions were deliberately substantively inaccurate. According to the national court, Mr R concealed in those invoices the identity of the true purchasers in order to enable them to evade payment of VAT due on the intra-Community acquisitions in Portugal.

In the criminal proceedings against Mr R, the German *Bundesgerichtshof* (Constitutional Court) asked the ECJ whether under the given circumstances (in which a supplier knowingly participated in VAT fraud) the zero rating must be refused. Interestingly, the Grand Chamber of the ECJ seems to have dodged this question. Instead, the ECJ referred to the opening sentence of article 28c(A) of the former Sixth Directive (now article 131 of the VAT Directive), according to which Member States must set conditions in order to ensure the correct and straightforward application of the zero rate and to prevent any evasion, avoidance or abuse.

The ECJ held that a Member State may refuse the application of the zero rate "pursuant to its powers under the first part of the sentence in article 28c(A) of the Sixth Directive and for the purpose of ensuring the correct and straightforward application of the zero rates and to prevent any evasion, avoidance or abuse."⁴¹ The ECJ further held that

33. Id., paragraph 59.

34. Id., paragraph 51.

35. Id., paragraph 54. In that context, the ECJ also referred to its judgments in *Kefalas* (E2: ECJ, 12 May 1998, Case C-367/96, *Alexandros Kefalas and Others v. Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasykrotisis Epicheiriseon AE (OAE)*, ECJ Case Law IBFD, [1998] ECR I-2843), paragraph 20; *Diamantis* (E2: ECJ, 23 Mar. 2000, Case C-373/97, *Dionysios Diamantis v. Elliniko Dimosio (Greek State) and Organismos Ikononikis Anasykrotisis Epicheiriseon AE (OAE)*, ECJ Case Law IBFD, [2000] ECR I-1705), paragraph 33; and *Fini* (DK: ECJ, 3 Mar. 2005, Case C-32/03, *I/S Fini H v. Skatteministeriet*, ECJ Case Law IBFD, [2005] ECR I-1599), paragraph 32.

36. Id., paragraph 56.

37. HU: ECJ, 21 June 2012, Joined Cases C-80/11 and C-142/11, *Mahagében Kft v. Nemzeti Adó és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága and Péter Dávid v. Nemzeti Adó- és Vámhivatal Észak-alföldi Regionális Adó Főigazgatósága*, ECJ Case Law IBFD.

38. See also R.T. Ainsworth, *Mahagében KFT & Péter Dávid. Re-Directing the EU VAT's Perfect Storm*, Boston University School of Law, Public Law Research Paper 12-35 (July 2012).

39. *Supra* n. 37, paragraph 45.

40. DE: ECJ, 7 Dec. 2010, Case C-285/09, *Criminal proceedings against R*, ECJ Case Law IBFD, [2010] ECR I-12605. See also H. Kogels, *The R Case and Its Impact on the Destination Principle*, 24 Intl. VAT Monitor 3 (2013), p. 152, *Journal* IBFD.

41. ECJ judgment in *R* (*supra* n. 40), paragraph 49.

EU law did not prevent Member States from treating the issue of irregular invoices as amounting to tax evasion and from refusing to apply the zero rate in such cases. National legislation could thus lead to a situation in which the application of the zero rate is refused even though the conditions for zero rating under EU law are met. The principle of proportionality did not lead to a different conclusion:

As regards the principle of proportionality, it must be observed that this does not preclude a supplier who participates in tax evasion from being obliged to pay the VAT subsequently on his intra-Community supply, inasmuch as his involvement in the evasion is a decisive factor to be taken into account in an assessment of the proportionality of a national measure.⁴²

In *R*, the ECJ also hinted at situations in which Member States *must* refuse the application of the zero rate, irrespective of their national legislation:

However, with regard to particular cases in which there are genuine reasons to assume that the intra-Community acquisition corresponding to the supply at issue might escape payment of the VAT in the destination Member State, notwithstanding the mutual assistance of and administrative cooperation between the tax authorities of the Member States concerned, the Member State of departure is, in principle, required to refuse the supplier of the goods the application of the zero rate and to require that supplier to pay the tax subsequently in order to ensure that the transaction in question does not escape taxation altogether.⁴³

The ECJ did not specifically refer in this context to *Kittel* and related case law. However, the ECJ reiterated the principle that EU law cannot be relied on for abusive or fraudulent ends:

Furthermore, the finding [that, in circumstances such as those at issue in the main proceedings, the Member State of departure of the intra-Community supply may refuse the application of the zero rate] is not called into question by the principles of fiscal neutrality or legal certainty, or by the principle of the protection of legitimate expectations. Those principles cannot legitimately be invoked by a taxable person who has intentionally participated in tax evasion and who has jeopardized the operation of the common system of VAT.⁴⁴

In this context, the “abusive ends” consisted of the intentional participation in tax evasion and thus jeopardizing the EU VAT system. Such perpetrators cannot rely on any principle of EU law to protect them against taxation. Member States are then free to refuse the application of the zero rate while disregarding legitimate expectations and possible double taxation. Member States *may* outlaw free riders on VAT fraud. In *Mecsek-Gabona*, this line of reasoning led to the conclusion that Member States *must* refuse the zero rating of intra-Community supplies of goods.

7. Mecsek-Gabona – Beaten Track

Mecsek-Gabona Kft was a Hungarian company which was active in the wholesale supply of cereals, tobacco, seeds and fodder. In 2009, it entered into a contract with Agro-Trade Srl (“Agro-Trade”), an Italian company, for the sale of rapeseed. Agro-Trade would pick up the goods and arrange for transport to Italy (intra-Community takeaway trans-

action). Prior to the transport, Agro-Trade gave Mecsek-Gabona the registration numbers of the vehicles that were to pick up the goods. After the vehicles had been weighed, the quantities of the goods purchased were entered on CMRs⁴⁵ and the carriers presented the transport documents to Mecsek-Gabona, which photocopied the first copies of the completed CMRs. The serial numbers of the 40 CMRs, which were consecutive, were returned to Mecsek-Gabona by post from Agro-Trade’s address in Italy. Shortly after issuing the related sales invoices, Mecsek-Gabona checked Agro-Trade’s VAT number and found it to be valid.

In the process of checking Mecsek-Gabona’s tax return, the Hungarian tax authorities submitted a request for information to the Italian tax authorities. According to the information returned, Agro-Trade could not be found. No company of that name had ever been registered at the purported business address (a residential property) and Agro-Trade had never remitted VAT. Agro-Trade’s Italian VAT registration number was removed from the register with retroactive effect from 17 April 2009.

The Hungarian tax authorities took the view that Mecsek-Gabona had not succeeded in proving that the transactions at issue were zero-rated intra-Community supplies of goods and assessed it for VAT on those transactions. Mecsek-Gabona appealed and the Hungarian court (the *Baranya Megyei Bíróság*) referred the following questions to the ECJ:

- (1) Is Article 138(1) of Directive 2006/112 to be interpreted as meaning that the supply of goods is zero rated if the goods are sold to a purchaser who is registered for VAT in another Member State at the time when the contract of sale is concluded, and the purchaser has had a clause inserted in the contract of sale for the goods in question under which the right of disposal and the right of ownership are transferred to the purchaser at the time the goods are loaded onto the means of transport, and the purchaser assumes the obligation of transporting the goods to another Member State?
- (2) Is it sufficient, for the vendor to be able to apply the rules relating to zero-rated supplies, for the vendor to satisfy itself that the goods sold are picked up by the foreign registered vehicles and for the vendor to be in possession of the CMRs returned by the purchaser, or must the vendor make sure that the goods sold have crossed the national border and been transported within Community territory?
- (3) Can the categorization of a supply of goods as being zero rated be called into question solely because the tax authorities of another Member State removes the purchaser’s Community tax number from the register with retroactive effect from a date prior to the supply of the goods?

42. Id., paragraph 53.
 43. Id., paragraph 52.
 44. Id., paragraph 54.

45. A CMR is an international waybill based on the provisions of the Convention on the Contract for the International Carriage of Goods by Road (CMR) signed in Geneva on 19 May 1956.

The ECJ decided to deliver its judgment without an Opinion of an Advocate General, thus indicating that these questions did not raise new points of law.⁴⁶ In answering the first two questions, the ECJ referred to the material requirements for the application of the zero rate, as developed in its previous decisions, such as those in *Teleos* and *Euro Tyre Holding*:

In accordance with settled case law, the zero rating of the intra-Community supply of goods becomes applicable only when the right to dispose of the goods as owner has been transferred to the purchaser and the vendor establishes that those goods have been dispatched or transported to another Member State and that, as a result of that dispatch or that transport, they have physically left the territory of the Member State of supply (...).⁴⁷

Member States may determine what constitutes satisfactory evidence, but may not require conclusive evidence that the goods have physically left their territory. With reference to its previous findings in *Teleos* and *Euro Tyre Holding*, the ECJ continued:

The Court accordingly found that, once the vendor has fulfilled his obligations relating to evidence of an intra-Community supply, where the contractual obligation to dispatch or to transport the goods out of the Member State of supply has not been satisfied by the purchaser, it is the latter which must be held liable for the VAT in that Member State.

The ECJ further held that it was for the referring court to assess whether *Mecsek-Gabona* fulfilled its obligations relating to evidence. In this respect (and in reply to the third question referred to it), the ECJ noted that the application of the zero rate cannot be refused solely on the ground that the tax authorities of another Member State have removed the purchaser's VAT identification number from the register with retroactive effect.

8. *Mecsek-Gabona* – Good or Bad Faith

The ECJ's answer to the referring court's first two questions did not result in any new conclusions. However, the Hungarian tax authorities also raised the question of whether *Mecsek-Gabona* had acted in good faith. In its written and oral submissions to the ECJ, the Hungarian government claimed that the company had acted in bad faith. Even though *Mecsek-Gabona* did not know its contracting partner, it had not requested any guarantees from the purchaser of the goods; it had not checked the purchaser's VAT identification number until after the transaction had been concluded; it had not collected any additional information on the purchaser; it had transferred the right to dispose of the goods as owner to the purchaser, while accepting that payment of the original selling price could be deferred; and it had presented the CMRs returned by the purchaser even though they were incomplete.

With regard to the alleged bad faith, the ECJ replied that it had no jurisdiction to check or to assess the factual circumstances of the case before the referring court. The national

court must therefore make an overall assessment of all the facts and circumstances in order to establish whether the company had acted in bad faith. However, the ECJ issued clear instructions as regards the standards by which bad faith must be established and its consequences:

If the referring court were to reach the conclusion that the taxable person concerned knew or should have known that the transaction which it had carried out was part of a tax fraud committed by the purchaser and that the taxable person had not taken every step which could reasonably be asked of it to prevent fraud from being committed, there would be no entitlement to apply the zero rate.

Apparently, the ECJ is of the opinion that the application of a zero rate, or at least the zero rating of intra-Community supplies, is a right derived from EU law. Knowledge or potential knowledge of tax fraud may result in the loss of the entitlement to apply the zero rate to the effect that the intra-Community supply of goods is taxed. However, only fraud committed by the purchaser or any subsequent party in the supply chain is taken into account for this determination. This is quite contrary to the ECJ's finding in *Mahagében* that only possible fraud at preceding stages can affect the right to deduct. It follows from *Mecsek-Gabona* that not the origin but the destination of goods may affect the entitlement to apply the zero rate.

The approach adopted by the ECJ in *Kittel*, *Mahagében* and *Mecsek-Gabona*, which may lead to a loss of the right to deduct or a loss of the entitlement to zero rate intra-Community supplies, is not based on any provision in the VAT Directive or any other written EU legislation. Instead, the ECJ's approach is based on the principle that "Community law cannot be relied on for abusive or fraudulent ends".

9. Transposition into National Law?

The question may arise of whether the tax authorities of the Member States can only rely on the ECJ's doctrines in *Kittel* and *Mecsek-Gabona* if those doctrines have been transposed into national law. Based on the clear wording of the ECJ's judgments, the question should be answered in the negative. However, the principle of legal certainty may also play a role in this context. Under that principle, taxes must have a legal basis. For example, article 104 of the Dutch Constitution provides that taxes imposed by the state must be levied on the basis of an Act of the parliament. However, the current text of the *Wet op de omzetbelasting* 1968 (VAT Act) does not allow the tax authorities to refuse the right to deduct or to apply the zero rate, as required under the ECJ's case law. In this respect, the *Hoge Raad der Nederlanden* (Dutch Supreme Court) recently referred some interesting questions to the ECJ.⁴⁸ The *Hoge Raad der Nederlanden* asked the ECJ whether the right to deduct or to apply the zero rate must be refused if the national legislation does not provide for such refusal.

46. Article 20 of the Protocol (No. 3) on the Statute of the Court of Justice of the European Union states: "Where it considers that the case raises no new point of law, the Court may decide, after hearing the Advocate General, that the case shall be determined without a submission from the Advocate General."

47. *Mecsek-Gabona*, paragraph 31.

48. On 18 March 2013, the *Hoge Raad der Nederlanden* (Dutch Supreme Court) referred the questions to the ECJ in *Staatssecretaris van Financiën v. Schoenimport 'Italmoda' Mariano Previti* (Case C-131/13) and, on 2 April 2013, in *Turbo.com BV v. Staatssecretaris van Financiën* (Case C-163/13) and in *Turbo.com Mobile Phone's BV v. Staatssecretaris van Financiën* (Case C-164/13).

10. Conclusions

In 2007, the ECJ applied the principle of *fraus omnia corrumpit*⁴⁹ (fraud corrupts everything) for the first time in the field of VAT. Since then, it has become clear that knowledge or potential knowledge of fraud may not only affect the right to deduct input VAT, but also the right to zero rate intra-Community supplies of goods. The loss of those rights follows from the principle that EU law cannot be relied on for abusive or fraudulent ends. In its judgments in *Kittel*, *Mahagében* and *Mecsek-Gabona*, the ECJ has developed a regime under which the knowledge test plays a pivotal role. Regarding the right to deduct (or receive a refund), only VAT fraud committed

by the supplier or any preceding party is taken into account and regarding the right to zero rate intra-Community supplies of goods, only fraud committed by the customer or any subsequent party.

The most important question that the ECJ has not yet answered is whether or not Member States must have transposed the ECJ's doctrines into national law. However, that question has already been referred to the ECJ.

Fraud not only leads to corruption but, in the area of VAT, also to interesting case law.

49. This expression was first used by French judges at the beginning of the 19th century as a Latin translation of the principle that "*la fraude fait exception à toutes les règles*", see J. Vidal, *Théorie générale de la fraude en droit français* (Paris, Dalloz 1957).

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