

Neutrality and Proportionality in VAT: Making Sense of an (Apparent) Conflict

Marco Greggì*

Neutrality and proportionality are two features of the European VAT that often come into play when judiciary is requested to rule on alleged frauds to the tax. According to the well settled case law of the European Court of Justice (ECJ) the right to deduct VAT can't be granted when such a fraudulent operation occurs. In the *EN.SA.* case, to the opposite, the Court rules that neutrality is to be preserved even when the operation invoiced did not actually take place, if very specific circumstances are met: namely, that no loss for the national budget occurred, that the company invoiced was not actually planning to erode its tax liability for VAT purposes and that the non-existent operation was simulated for other commercial purposes (not directly affecting the tax due). This conclusion is made possible making the principles of proportionality (and reasonableness) to prevail over a mechanical application of the tax that would otherwise prevent the right to deduct the tax charged.

Keywords: VAT, neutrality, proportionality, reasonableness, fraud, carousel, invoice, administrative sanction.

I PRELIMINARY REMARKS

The *EN.SA.* case¹ that was recently decided by the European Court of Justice (ECJ) was a battleground upon which VAT principles such as neutrality and proportionality as well as the need for a more robust contrast to VAT fraud have been tested simultaneously in an unprecedented way.² In the eyes of the superficial reader, the outcome of the judgment would sound surprising as the court ultimately allowed a business to deduct input VAT even if it was charged in a non-existent operation. This understanding is not entirely accurate.

The court rather observed that the prohibition to deduct VAT as charged for non-existent (arguably fraudulent) transactions is a conundrum of the neutrality principle³; yet, neutrality *per se* is not a dogma of VAT implementation, and it must be interpreted consistently with the principle of proportionality in a delicate balance of the two.⁴ Therefore, there could be situations just like this one in which the neutrality must be re-engineered in

a way to make the entire VAT system more consistent with this goal to allow a deduction that would otherwise be denied.

This may occur only in selective situations. First of all, the non-existent operation for which the invoice has been issued must not be fraudulent in its nature. Secondly, no loss should occur for the national budget.

The application of the principle of neutrality also has consequences on fines that are imposed for an alleged violation.⁵ As a general rule, none of the European directives provide unambiguous guidelines on how infringements should be penalized (both with administrative or criminal sanctions). Nonetheless, it is common understanding that consequences of violations must be proportional to the breach of the law and imposed in a manner that does not violate the neutrality principle.⁶

Yet, while these findings appear to be reasonable and sound, it is quite challenging to understand how this delicate balance between proportionality and reasonableness can be achieved. The theoretical point is that,

Notes

* Professor of Tax Law at the University of Ferrara, Italy. This research has been developed in the framework of a project supported by the European Commission (2017-1-LI01-KA203-000088). Email: marco.greggi@unife.it.

¹ ECJ 8 May 2019, Case C-712/17 *EN.SA. srl*, ECLI:EU:C:2019:374.

² A. van Doesum et al., *Fundamentals of EU VAT Law* (Kluwer 2016).

³ *EN.SA.* (C-712/17), *supra* n. 1, ss 24 and 25.

⁴ *EN.SA.* (C-712/17), *supra* n. 1, s. 33. See R. de La Feria, *The EU VAT System and the Internal Market*, Doctoral Series Vol. 16, 249 (IBFD 2009).

⁵ R. J. F. Gordon, *EC Law in Judicial Review* 300 (Oxford University Press 2007).

⁶ They must also be consistent with the principle of effectiveness. See recently M. Rodriguez-Berejo, *The ECJ's Taricco Saga on VAT Fraud: The More There Is of Mine, the Less There Is of Yours?*, 30(2) *Int'l VAT Monitor* 70 (2019).