

Due diligence will protect the taxpayer from questioning the right to deduct VAT

In the recent years we have been witnessing an increasingly fierce battle between the Ministry of Finance and Economic Development and the so-called carousel frauds committed in order to extort Value Added Tax. Unfortunately, honest taxpayers often fall victims to this war, who are refused the right to deduct the input VAT due to the fact that their business partner (a supplier, the party which issues the invoice) is suspected of involvement in a tax evasion process by issuing the so-called dummy invoices. Luckily the taxpayer is able to successfully defend against questioning their right to deduct VAT on condition that when selecting business partners and executing transaction they acted in good faith and ensured professional due diligence.

DUMMY INVOICES

Tax authorities refuse taxpayers the right to deduct input VAT from invoices issued by entities which are suspected of involvement in the so-called carousel fraud. The authorities do not question the actual execution of the transaction itself (provision of goods or services actually occurred). Normally the problem is that the party which issued a particular invoice is an entity other than the actual seller, i.e. a front-man (the so-called bogus enterprise) used to hide other entities involved in the carousel fraud. The total value of the output VAT from invoices issued in the carousel is not paid to the budget, the actual seller and front-man often simply vanish hence questioning the right to deduct VAT on the side of the buyer is often the only possibility to cover the diminished budgetary receivables. It is the probability more and more often resorted to by tax authorities.

In the eyes of tax authorities, a dummy invoice is also one which accompanied a real transaction yet with the participation of entity other than the issuer of the invoice in question, which is usually the front-man who hides the actual seller from the buyer.

Tax authorities refuse taxpayers to deduct VAT from such dummy invoices claiming that the taxpayer knew or should have known that by purchasing goods or services they are a part of a transaction (or a transaction chain) connected with the VAT-related crime.













Tax authorities' effective questioning of the right of the taxpayer to deduct the input VAT, apart from the obligation to return the previously deducted amount with interest, may result in burdening the taxpayer with additional, severe penalties in the form of VAT sanctions (even at the level of 100% of the deducted VAT) as well as penal and fiscal sanctions.

DUE DILIGENCE

Fortunately administrative courts more and more often take the side of honest taxpayers highlighting that the refusal of the right to deduct VAT if the transaction has actually been executed is possible only on the condition that tax authorities prove that the taxpayer knew or should have known that by purchasing specific goods or services they are involved in a tax fraud. This requires verification if the taxpayer, when executing a particular transaction, acted in good faith and ensured professional due diligence.

Each case should be judged individually taking into account the character of the transaction itself as well as the circumstances around it. However, the problem lies in defining which actions taken by the taxpayer when executing a specific transaction will confirm that they have ensured due diligence and will provide successful defence against questioning the right to deduct VAT from particular invoices in case of an audit.

	<p>The Ministry of Finance and Economic Development has recently started works on drafting a list of such actions although they have admitted that setting up a single template is difficult due to various circumstances of transactions. The announced list has so far turned into a laconic entry on the Ministry's website, published on 27 June (the entry vanished however few hours after). From practice point of view, this entry pointed out only clear and being matter of common knowledge methods of confirmation, whether the contractor is registered entity and VAT taxpayer. The entry emphasized also obligation of wide-ranging verification of contractors, however without indication of specific verification activities and examples of them.</p> <p>Ensuring professional due diligence when selecting business partners and executing transactions will provide effective protection against questioning the right to deduct VAT, even from dummy invoices issued by a front-man, a member of a carousel fraud.</p>
<p>DEVELOPING AN INTERNAL PROCEDURE</p>	<p>In this context, a key issue for the company will be to work out individual, internal procedures for verification of business partners (goods and service providers) and to supervise the course of transactions, which constitute evidence of ensuring professional due diligence. Individual actions taken by the taxpayer in order to ensure professional due diligence will differ depending on the sector the taxpayer operates in, specifics of a transaction, and a number of individual circumstances which accompany it. Such "details" may play the key roles in a dispute with tax authorities concerning the right to deduct VAT. Nonetheless, based on the analysis of opinions issued by tax authorities and the judicial practice of administrative courts, one is able to select a certain general set of prerequisites which indicate that professional due diligence was ensured by the taxpayer.</p> <p>Examples of actions proving good faith of the taxpayer and their ensuring of due diligence:</p> <ul style="list-style-type: none"> ■ verification of the business partner (excerpt from the National Court Register, confirmation from the Central Registration and Information on Business), ■ verification if the business partner is a VAT-registered entity, ■ a written form of contracts, arrangements, ■ detailed documentation of the course of the transaction, ■ payments via a bank account transfer.
<p>WHAT IF THE AUDIT IS ALREADY IN PROGRESS?</p>	<p>In this situation, it is worth considering the assistance of a professional proxy which will not only provide the company with factual support in contacts with tax authorities, but who will also serve as a specific "buffer" between auditors and the company representatives and employees, which will appropriately extend the time for preparing answers to requests and inquiries from the authorities.</p> <p>Taxpayers often lose disputes with tax authorities related to the right to deduct VAT simply due to inconsistencies and errors in explanations given to tax authorities in various forms during the audit of the company. The errors can frequently be clarified; however it usually takes place during proceedings before the administrative courts, which is connected with the necessity to return the previously deducted VAT and a long-term battle for deducting it again. For many businesses it means significant deterioration of the cash flow and even bankruptcy. Using the assistance of a professional proxy already during the audit may allow for elimination of such errors and avoiding their serious consequences.</p>
<p>PLAYING FOR TIME - VAT RETURNS</p>	<p>Problems with deducting VAT are not always the direct result of questioning the taxpayer's right to deduction - e.g. due to their alleged conscious or unconscious (resulting from failure to ensure due diligence) involvement in a carousel fraud.</p> <p>The procedure of indefinite extension of deadline for VAT return used by tax authorities is equally burdensome for taxpayers. It is worth stressing that it is not uncommon to encounter situations in which, due to some procedural oversights, tax authorities do not keep the legally required form and deadline of the effective extension of the VAT return. Unfortunately, taxpayers are usually completely unaware of this fact which deprives them of the possibility of effective appeal against the actions of authorities and quicker recovery of VAT return. Therefore it is advisable to use the knowledge and experience of a professional proxy also</p>

	<p>in cases of prolonged waiting time for the VAT return.</p> <p>Tax authorities' failure to ensure the legally required form or late delivery to the taxpayer of a decision to extend the deadline for VAT return may result in ineffectiveness of such extension and thus the obligation of VAT return to the taxpayer in the period stipulated by the VAT Act (60 days in general).</p> <p>In such a situation, each delay in receiving such a VAT return gives the right to the taxpayer to demand late payment interest from tax authorities in their full value (and not in the value for the extension fee).</p>				
DUE DILIGENCE AND THE RIGHT TO 0% VAT RATE IN INTRA-COMMUNITY DELIVERY OF GOODS	<p>Ensuring due diligence pays the key role also in disputes with tax authorities concerning the right to apply the 0% VAT rate to intra-community delivery of goods. Here the prerequisites of ensuring due diligence are even stricter hence the appropriate verification of the status of the business partner and supervision over the correct flow of goods outside the territory of Poland to their recipient in another European Union member state are the condition for the application of the preferential VAT rate.</p> <p>In order to apply the 0% VAT rate, it is essential to carefully verify the business partner taking into account if the delivery is made to the buyer who has a correct and valid identification number for intra-community transactions. Due diligence is also key for supervising the course of transporting goods (if the goods actually left Poland to the buyer's country) and for its correct documentation.</p>				
OUR SUPPORT	<ul style="list-style-type: none"> ■ Comprehensive analysis of transactions executed by your company against risk of questioning the right to deduct VAT from purchase invoices or the application of 0% VAT rate in intra-community transactions. ■ Drafting and implementation of internal procedures which confirm ensuring due diligence in executed transactions in order to mitigate the aforesaid risks. ■ Representation of the company in audits, verification procedures, including cases related to the extended deadline for VAT return. ■ Representation of the company in disputes with tax authorities before the administrative courts of all instances. 				
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