COUR EUROPÉENNE DES DROITS DE L'HOMME
EUROPEAN COURT OF HUMAN RIGHTS

FIFTH SECTION

CASE OF "BULVES" AD v. BULGARIA

(Application no. 3991/03)

JUDGMENT

STRASBOURG

22 January 2009

This judgment will become final in the circumstances set out in Article 44 § 2 of the Convention. It may be subject to editorial revision.

In the case of "Bulves" AD v. Bulgaria,

The European Court of Human Rights (Fifth Section), sitting as a Chamber composed of:

Peer Lorenzen, *President,*
Rait Maruste,
Karel Jungwiert,
Renate Jaeger,
Isabelle Berro-Lefèvre,
Mirjana Lazarova Trajkovska,
Zdravka Kalaydjieva, *judges,*

and Stephen Phillips, *Deputy Section Registrar*,

Having deliberated in private on 16 December 2008,

Delivers the following judgment, which was adopted on that date:

PROCEDURE

1. The case originated in an application (no. 3991/03) against the Republic of Bulgaria lodged with the Court on 23 January 2003 under Article 34 of the Convention for the Protection of Human Rights and Fundamental Freedoms ("the Convention") by "Bulves" AD, a Bulgarian joint-stock company set up in 1996 with its registered office in Plovdiv ("the applicant company").

2. The applicant company was represented by Mr M. Ekimdjiev and Mrs S. Stefanova, lawyers practising in Plovdiv.

3. The Bulgarian Government ("the Government") were represented by their Agents, Ms M. Karadjova and Ms M. Kotzeva, of the Ministry of Justice.

4. The applicant company alleged, in particular, that in spite of its full compliance with its statutory VAT reporting obligations, the domestic authorities had deprived it of the right to deduct the input VAT it had paid on a supply of goods received by it, because its supplier had been late in complying with its own VAT reporting obligations. It also argued that this difference in treatment was discriminatory.

5. On 24 November 2005 the Court decided to give notice to the Government of the above-mentioned complaints by the applicant company. It was also decided to examine the merits of the application at the same time as its admissibility (Article 29 § 3).

THE FACTS

I. THE CIRCUMSTANCES OF THE CASE

A. The taxable transaction

6. On 16 August 2000 the applicant company purchased goods from another company ("the supplier").

7. Both companies were registered under the Value Added Tax Act 1999 ("the VAT Act") and the transaction constituted a taxable supply under the said Act.

8. The total cost of the received supply was 21,660 Bulgarian levs (BGN) (11,107 euros (EUR)), of which BGN 18,050 (EUR 9,256) was the value of the goods and BGN 3,610 (EUR 1,851) was value-added tax ("VAT").

9. The supplier issued invoice no. 12/16.08.2000 to the applicant company, which the latter paid in full, including the VAT of BGN 3,610 (EUR 1,851).

10. The applicant company recorded the purchase in its accounting records for the month of August 2000 and filed its VAT return for that period by 15 September 2000.

11. The supplier, on the other hand, did not record the sale in its accounting records for the month of August 2000, but for October 2000, and reported it in its VAT return for the latter period, which it filed on 14 November 2000.

B. The VAT audit

12. On an unspecified date the tax authorities conducted a VAT audit of the applicant company covering the period from 10 February to 31 December 2000. In the course of the inspection a cross-check of the supplier was conducted in order to ascertain whether it had properly reported and recorded the supply in its accounting records. As a result, the above reporting discrepancy was discovered (see paragraphs 10 and 11 above).

13. On 31 January 2001 the "Yug" Tax Office of the Plovdiv Territorial Tax Directorate issued the applicant company with a tax assessment. It refused the applicant company the right to deduct the VAT it had paid to its supplier ("the input VAT"), amounting to BGN 3,610 (EUR 1,851), because the supplier had entered the supply in its accounting records for the month of October 2000 and had reported it for that period rather than for August

2000. The Territorial Tax Directorate therefore considered that no VAT had been "charged" on the supply in the August 2000 tax period, that the applicant company could not therefore deduct the amount it had paid to its supplier as VAT and, furthermore, that it was liable to pay the VAT on the received supply a second time. Accordingly, it ordered the applicant company to pay the VAT in the amount of BGN 3,610 (EUR 1,851) into the State budget, together with interest of BGN 200.24 (EUR 102) for the period from 15 September 2000 to 31 January 2001.

14. The applicant company appealed against the tax assessment on 20 February 2001.

15. In a decision of 26 February 2001 the Plovdiv Regional Tax Directorate dismissed the applicant company's appeal and upheld the tax assessment in its entirety. It recognised that the applicant company had fully complied with its VAT reporting obligations in respect of the received supply, but found that the supplier had failed to enter its invoice in its own accounting records on the date it had been issued, 16 August 2000, and had not reported its VAT-taxable supply for the month of August 2000 as it should have done. It therefore concluded that no VAT had been "charged" on the supply in question and that the applicant company was accordingly not entitled to deduct the input VAT, in spite of the fact that the supplier had subsequently reported the supply for the month of October 2000.

16. The applicant company appealed against the decision of the Regional Tax Directorate on 19 March 2001, arguing that it could not be denied the right to deduct the input VAT solely because of its supplier's belated compliance with its VAT reporting obligations. The applicant company also claimed that the supplier's right to deduct the VAT it had paid to its own supplier had been recognised by its tax office, while the applicant company was being denied that right. In its submissions the applicant company relied, *inter alia*, on Article 1 of Protocol No. 1 to the Convention.

17. In a judgment of 21 September 2001 the Plovdiv Regional Court dismissed the applicant company's appeal and upheld the decisions of the tax directorates. It stated as follows:

> "The Court finds that the ... objection of the [applicant company] is ... unsubstantiated. In particular, [the applicant company objected that] it had been the compliant party, while the supplier had not complied with its obligations. The right to ... [deduct the input VAT] arises for the recipient of a [taxable] supply only if the supplier has fulfilled the conditions under section 64 in conjunction with section 55 of the VAT Act. The Act does not differentiate between the parties to a supply transaction as regards compliance; the court cannot therefore introduce such an element into this judgment. "

18. On 26 October 2001 the applicant company appealed to the Supreme Administrative Court.

19. In a final judgment of 24 October 2002 the Supreme Administrative Court concurred with the findings and conclusions of the tax authorities and stated the following:

> "... In this case the non-compliance of the supplier impacts unfavourably on the recipient ..., because the right to recover the [input VAT] does not arise for [the latter] and it does not matter that the recipient of the [taxable] supply [acted] in good faith and [was] compliant..., as this is irrelevant for the [purposes of] taxation. ... There [is] also [no] ... violation of ... Article 1 of Protocol No. 1, because the refusal to recognise the claimant's right to [deduct the input VAT] under section 64 (2) of the VAT Act did not violate its property rights, due [to the fact that] the recognition of its substantive right [to deduct] under section 64 of the VAT Act is conditional on the actions of its supplier and [the latter's] discharge [of its obligations] *vis-à-vis* [the State] budget. ..."

II. RELEVANT DOMESTIC LAW

The VAT Act

(a) General information

20. The VAT Act came into force on 1 January 1999. Although at the time Bulgaria was not a member of the European Union (EU), domestic VAT legislation in many respects followed the provisions of Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes, known as the Sixth VAT Directive, which at the time was the principal basis for the system of value-added tax in the EU.

21. In general, VAT was charged on the price due for a supply of goods or services plus certain costs, taxes and charges not including the VAT itself. Most domestic supplies of goods and services, as well as imports, were subject to the standard rate of twenty percent VAT.

22. VAT was generally reported and paid monthly. Monthly VAT returns had to be filed and monthly VAT payments made by the fourteenth day of the following month.

23. At the relevant time, any person (legal or natural, resident or non-resident) who had a taxable turnover exceeding BGN 75,000 (EUR 38,461) during any preceding twelve-month period was obliged to register for VAT purposes (section 108). Voluntary and optional registration was also possible in certain cases.

24. On 1 January 2007, when Bulgaria became a member of the EU, the VAT Act was replaced by a new act of the same name.

(b) The right to deduct the input VAT

25. At the relevant time the input VAT – the so-called "tax credit" under domestic legislation – was the amount of tax which a VAT-registered person had been charged under the VAT Act for receipt of a taxable supply of goods or services, or for imported goods, in a given tax period, which the person in question had the right to deduct (section 63).

26. During the relevant period and in the context of the present case, where the VAT incurred on supplies exceeded the VAT charged on sales in a given tax period, the excess VAT was first carried forward for a period of six months to offset any VAT debt due in those six months, as well as other liabilities to the State (sections 63 and 77). If at the end of the six-month period the excess VAT, or part thereof, had still not been recovered, the balance was refunded within a further forty-five days (section 77). This period could be extended if the tax authorities initiated a tax audit (section 78 § 7).

27. At the relevant time, section 64 of the VAT Act provided that the recipient of a supply could deduct the input VAT when the following conditions were fulfilled:

(a) the recipient of the supply on which VAT had been charged was a VAT-registered person;

(b) the VAT had been charged by the supplier, who was a VAT-registered person, at the latest on the date of issuance of the VAT invoice;

(c) VAT was chargeable on the supply in question;

(d) the goods or services received were used, were being used or would be used for VAT-taxable supplies; and,

(e) the recipient was in possession of a VAT invoice which met the statutory requirements.

28. Further to the above, in respect of item (b), VAT was considered during the relevant period to have been charged when the supplier:

(1) issued an invoice which indicated the VAT;

(2) recorded the issuance of the invoice in its sales register;

(2) entered the VAT charged in its accounting records as a liability to the State budget; and

(3) declared the VAT charged in its VAT return filed with the tax authorities (section 55 § 6).

III. COMMUNITY LAW

29. At the relevant time, Bulgaria was not a member of the European Union. Accordingly, the *acquis communautaire* was not directly applicable or transposed into domestic legislation. However, as noted above, its domestic VAT legislation in many respects followed the provisions of the Sixth VAT Directive (see paragraph 20 above).

30. Consequently, it is worth mentioning in the context of the present case the following two judgments of the Court of Justice of the European Communities (CJEC), which examine the entitlement of the recipient of a supply to reimbursement of the VAT charged on such a supply in cases of suspected "carousel fraud". This type of fraud, a kind of VAT missing trader intra-Community fraud, occurs when goods are imported VAT-free from other Member States, are then re-sold through a series of companies at VAT-inclusive prices and subsequently re-exported to another Member State with the original importer disappearing without paying over to the tax authorities the VAT paid by its customers.

31. In its judgment of 12 January 2006 in joined cases C-354/03, C-355/03 and C-484/03, *Optigen Ltd (C-354/03), Fulcrum Electronics Ltd (C-355/03) and Bond House Systems Ltd (C-484/03) v Commissioners of Customs & Excise*: reference for a preliminary ruling from the High Court of Justice (England & Wales), Chancery Division – United Kingdom, European Court Reports (ECR) 2006, page I-00483, the CJEC concluded as follows:

> "Transactions such as those at issue in the main proceedings, which are not themselves vitiated by value added tax fraud, constitute supplies of goods or services effected by a taxable person acting as such and an economic activity within the meaning of Articles 2 (1), 4 and 5 (1) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, as amended by Council Directive 95/7/EC of 10 April 1995, where they fulfil the objective criteria on which the definitions of those terms are based, regardless of the intention of a trader other than the taxable person concerned involved in the same chain of supply and/or the possible fraudulent nature of another transaction in the chain, prior or subsequent to the transaction carried out by that taxable person, of which that taxable person had no knowledge and no means of knowledge. The right to deduct input value added tax of a taxable person who carries out such transactions cannot be affected by the fact that in the chain of supply of which those transactions form part another prior or subsequent transaction is vitiated by value added tax fraud, without that taxable person knowing or having any means of knowing."

32. In a similar judgment of 6 July 2006 in joined Cases C-439/04 and C-440/04, *Axel Kittel v Belgian State (C-439/04) and Belgian State v Recolta Recycling SPRL (C-440/04)* (ECR 2006, page I-06161), the CJEC went on to state the following.

> "Where a recipient of a supply of goods is a taxable person who did not and could not know that the transaction concerned was connected with a fraud committed by the seller, Article 17 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, as amended by Council Directive 95/7/EC of 10 April 1995, must be interpreted as meaning that it precludes a rule of national law under which the fact that the contract of sale is void – by reason of a civil law provision which renders that contract incurably void as contrary to public policy for unlawful basis of the contract attributable to the seller – causes that taxable person to lose the right to deduct the value added tax he has paid. It is

irrelevant in this respect whether the fact that the contract is void is due to fraudulent evasion of value added tax or to other fraud.

By contrast, where it is ascertained, having regard to objective factors, that the supply is to a taxable person who knew or should have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of value added tax, it is for the national court to refuse that taxable person entitlement to the right to deduct."

THE LAW

I. ALLEGED VIOLATION OF ARTICLE 1 OF PROTOCOL NO. 1

33. The applicant company complained under Article 1 of Protocol No. 1 that, in spite of its full compliance with its own VAT reporting obligations, the domestic authorities had deprived it of its right to deduct the input VAT it had paid on the received supply of goods, because its supplier had been late in complying with its own VAT reporting obligations. Moreover, as a result of the refusal to allow the aforesaid deduction, the applicant company had unjustifiably had to pay the input VAT a second time, this time directly into the State budget under the tax assessment, together with interest.

Article 1 of Protocol No. 1 reads as follows:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

A. The parties' submissions

1. The Government

34. The Government stated that the applicant company could have initiated an action against its supplier under the general rules of tort in order to seek compensation for the input VAT it had not been allowed to deduct because of the supplier's failure to comply with its VAT reporting obligations.

35. On the merits, the Government noted that in principle the collection of taxes fell within the ambit of the second paragraph of Article 1 of Protocol No. 1 as it related to measures to control the use of property in accordance with the general interest.

36. They further noted that such measures were legitimate when they were provided for in a statute or other normative act, and considered that a State enjoyed considerable freedom in determining the "laws ... it deems necessary to control the use of property" as provided in the second paragraph of Article 1 of Protocol No. 1 (the Government referred to *AGOSI v. the United Kingdom* 24 October 1986, § 52, Series A no. 108). They also considered that, in so far as most measures for control of the use of property did not involve confiscation, the Convention gave the domestic authorities considerable freedom of action in regulating, based on their own social and economic criteria, the use of private property. Following this line of thought, according to the Government, the Court had stated in its judgment in the case of *Handyside v. the United Kingdom* (7 December 1976, Series A no. 24) that the second paragraph of Article 1 of Protocol No. 1 "sets the Contracting States up as sole judges of the 'necessity' for an interference" (ibid., § 62).

37. The Government stated that a further requirement in order for a measure to be legitimate was for it to be in accordance with the "general interest"; in this respect States enjoyed a "wide margin of appreciation" (they referred to *Tre Traktörer AB v. Sweden*, 7 July 1989, § 62, Series A no. 159).

38. As to the case at hand, the Government noted that it related to a "tax credit", the input VAT which according to section 63 of the VAT Act could be deducted only if the tax had been charged. Accordingly, it related to the right of the applicant company to deduct an amount due in respect of VAT only if specific statutorily defined conditions had been met: (a) an invoice had been issued with VAT included, (b) the invoice had been recorded in the VAT sales register, (c) the supplier had entered the invoice in its accounting records and (d) the supplier had entered it in the VAT return it had duly filed (section 55 § 6). Only when these four conditions were cumulatively met did the right to deduct the input VAT arise, constituting thenceforth a "possession" within the meaning of Article 1 of Protocol No. 1. Hence, only from that moment on could the applicant company claim that there had been interference with its right to deduct the input VAT. In view of the above, the Government considered that the applicant company did not have a "possession" within the meaning of Article 1 of Protocol No. 1 to the Convention which could have been the subject of interference.

39. They further argued that the right to deduct the input VAT was the result of a complex tax relationship between the supplier and the applicant company and that the latter had implicitly consented to a situation whereby

the right to such a deduction depended on the actions of the supplier. This situation, the Government claimed, was widely known, was predictable and applied to all VAT-taxable supplies.

40. The Government also submitted that the domestic authorities had acted in the general interest in order to ensure the collection of taxes and enforce discipline in the tax reporting of transactions. They considered this to have been in conformity with the discretion granted to States under the second paragraph of Article 1 of Protocol No. 1.

41. The Government also considered that, in the event that the Court should find that there had been interference with a conditional possession of the applicant company, this should not be considered to have represented an excessive burden for it, as the amount of VAT had been known and had been fixed at twenty percent. Accordingly, the Government considered that the present case did not amount to an excessive burden imposed on the applicant company but simply to a refusal to allow the input VAT to be deducted.

2. The applicant company

42. The applicant company stated that it could not seek compensation from its supplier under the general rules of tort as they were in a contractual relationship and domestic legislation precluded it from initiating such an action in those circumstances. In addition, it claimed that the supplier's failure to comply with its VAT reporting obligations in timely fashion could not be said to have directly caused it damage, and that the supplier had not enriched himself in any way as a result. The applicant company considered that it was the tax authorities' actions, and their conclusions in the tax assessment as to the repercussions of the supplier's belated compliance, which had caused it damage. Accordingly, it claimed that an action under the general rules of tort against its supplier could not afford it appropriate redress in respect of its complaint under Article 1 of Protocol No. 1.

43. On the merits, the applicant company claimed that the right to deduct the input VAT constituted a "possession" within the meaning of Article 1 of Protocol No. 1 which should be considered to have arisen at the moment it had fully complied with its own VAT reporting obligations. It argued that the fact that recognition of the right to deduct the input VAT was conditional on the compliance of the supplier – a factor which was beyond the control of the recipient of a supply – made the relevant provisions of the VAT Act unpredictable and arbitrary in their application. Accordingly, the applicant company considered that the refusal of the authorities to allow it to deduct the input VAT amounted to a deprivation of its possession, resulting from the fact that the price it had paid to its supplier included BGN 3,610 (EUR 1,851) in VAT. Hence, it had not only lost the amount it had paid to its supplier in respect of VAT but had also had to pay the same amount a second time to the State budget under the tax assessment, together

with interest in the amount of BGN 200.24 (EUR 102). In addition, the applicant company claimed that, as a result of the refusal to allow it to deduct the VAT, the amount it had paid to its supplier as VAT had not been tax-deductible as an expense and had been subject to corporate income tax, which amounted to a further deprivation of its "possessions" within the meaning of Article 1 of Protocol No. 1.

44. Alternatively, the applicant company argued that it had had a legitimate interest in the deduction of the input VAT which also fell within the scope of Article 1 of Protocol No. 1 (the applicant company referred to *Pressos Compania Naviera S.A. and Others v. Belgium*, 20 November 1995, Series A no. 332). In particular, in so far as it had acted in good faith towards its supplier and the tax authorities, had paid the VAT charged by the supplier and had recorded the transaction in its accounting records in timely fashion, it had legitimately acquired a legal expectation that the right to deduct the input VAT would be recognised. The applicant company further claimed that the right to deduct the input VAT constituted an asset in respect of which it had a "legitimate expectation" that it would obtain effective enjoyment of a property right.

45. In view of the above, the applicant company considered that Article 1 of Protocol No. 1 was applicable and that there had undoubtedly been interference with its "possessions" within the meaning of that Article.

46. As to whether the interference had been necessary, the applicant company recognised that it had sought to protect the community's interest in the effective collection of taxes. However, even assuming that the interference with its property rights had served a legitimate aim, the applicant company considered that the interference had not been in the general interest, as the VAT on the supply in question had been paid into the State budget by the supplier with only a slight delay.

47. The applicant company further argued that the interference in question had not been proportionate, as it had failed to strike a fair balance between the demands of the general interest of the community and its own right to protection of its property rights. In particular, although it agreed with the Government that States enjoyed a wide margin of appreciation under the second paragraph of Article 1 of Protocol No. 1 in implementing fiscal legislation, their discretion in that respect could not be considered to be limitless. In that connection it argued that it had had to bear an individual and excessive burden which upset the fair balance that had to be maintained between the demands of the general interest of the community and the requirements of the protection of the right of property. In particular, although the applicant company had complied with its VAT reporting obligations fully and in time, because of its supplier's failure to discharge its VAT reporting obligations in the same manner (a) it had still been denied the right to deduct the input VAT of BGN 3,610 (EUR 1,851); (b) it had then been ordered to pay the VAT of BGN 3,610 (EUR 1,851) a second

time, but this time to the State budget; (c) it had additionally been ordered to pay interest of BGN 200.24 (EUR 102) on that amount; (d) the VAT it had paid to its supplier had not been recognised as a tax-deductible expense and corporate income tax had then been charged on it; (e) it had incurred additional court fees and expenses in challenging the tax assessment; (f) it had thus been unduly and severely sanctioned for an infringement by the supplier, which had in fact discharged its VAT reporting obligations, but with a slight delay; and (g) general uncertainty had arisen in the fiscal affairs of the applicant company because all its VAT supplies could similarly be compromised by the failure of a supplier to discharge its VAT reporting obligations. Moreover, the applicant company would have no knowledge of this until such time as the tax authorities refused to recognise the right to deduct the input VAT relating to a particular transaction.

48. Hence, the applicant company considered that the severe pecuniary and non-pecuniary consequences it had suffered, despite having acted in complete conformity with the law, were evidence of the inadequacy and disproportionate nature of the State interference.

B. Admissibility

49. The Government claimed that the applicant company could have initiated an action against its supplier under the general rules of tort in order to seek compensation for the input VAT it had not been allowed to deduct because of the supplier's failure to comply with its VAT reporting obligations (see paragraph 34 above). They did not submit any domestic case-law to support their assertion that this was a viable alternative which could have afforded redress to the applicant company. The Court observes in this regard the position of the applicant company and its claim that such an action was not available to it under domestic legislation (see paragraph 42 above).

50. The Court recognises that where the Government claim non-exhaustion, they bear the burden of proving that the applicant has not used a remedy that was both effective and available at the relevant time. The availability of any such remedy must be sufficiently certain in law as well as in practice (see *Vernillo v. France*, 20 February 1991, § 27, Series A no. 198). In so far as the Government failed to show that the suggested remedy was both effective and available at the relevant time by providing examples of domestic judgments, the Court finds that it cannot be considered that the applicant company failed to exhaust the available domestic remedies by not having initiated an action against its supplier under the general rules of tort.

51. In any event, the Court notes that the applicant company appealed against the tax assessment issued against it, presented its arguments before the domestic courts and afforded them the opportunity to prevent or put

right the alleged violation of Article 1 of Protocol No. 1. Hence, it exhausted the available domestic remedies in respect of the complaint submitted to the Court.

52. Accordingly, the Court finds that this complaint is not manifestly ill-founded within the meaning of Article 35 § 3 of the Convention. It further notes that it is not inadmissible on any other grounds. It must therefore be declared admissible.

C. Merits

1. Existence of a possession within the meaning of Article 1 of Protocol No. 1

53. The Court reiterates its established case-law whereby an applicant can allege a violation of Article 1 of Protocol No. 1 only in so far as the impugned decisions related to his "possessions" within the meaning of that provision. "Possessions" can be either "existing possessions" or assets, including claims, in respect of which the applicant can argue that he or she has at least a "legitimate expectation" of obtaining effective enjoyment of a property right. By way of contrast, the hope of recognition of a property right which it has been impossible to exercise effectively cannot be considered a "possession" within the meaning of Article 1 of Protocol No. 1, nor can a conditional claim which lapses as a result of the non-fulfilment of the condition (see *Kopecký v. Slovakia* [GC], no. 44912/98, § 35, ECHR 2004-IX; *Prince Hans-Adam II of Liechtenstein v. Germany* [GC], no. 42527/98, §§ 82 and 83, ECHR 2001-VIII; and *Gratzinger and Gratzingerova v. the Czech Republic* (dec.) [GC], no. 39794/98, § 69, ECHR 2002-VII).

54. The Court observes that in the present case the right to claim a deduction of input VAT arose for the applicant company when the VAT it had incurred on purchases exceeded the VAT it had charged on sales. In order to take advantage of its right to deduct, the applicant company fully complied with its own obligations under the VAT Act: (a) it paid the VAT on the supply on the basis of the VAT invoice issued by its supplier; (b) it entered the supply in its accounting records for the month of August 2000; and (c) it reported it in its VAT return for that period. Thus, the applicant company did everything that was within its power, under the applicable legislation, in order to attain the right to deduct the input VAT.

55. The Court notes, however, the Government's argument that this was not sufficient to create an entitlement for the applicant company to deduct the input VAT on the supply in question, because not all the conditions of section 63 of the VAT Act had been met (see paragraph 38 above). In particular, after the tax authorities conducted a cross-check of the supplier they established a reporting discrepancy which led them to conclude that no

VAT had been charged on the supply in the August 2000 tax period, and they refused to recognise the applicant company's right to deduct the input VAT (see paragraphs 12 and 13 above). Accordingly, the right to deduct the input VAT did not constitute an "existing possession" of the applicant company.

56. The Court further notes the Government's argument that by entering into a contractual relationship with the supplier, which inevitably had tax consequences for both parties, the applicant company had implicitly consented to a situation whereby the right to deduct the input VAT depended on the actions of the said supplier (see paragraph 39 above). The Court observes, however, that the rules governing the VAT system of taxation – including the conditions for registration, charges, recharges, exemptions, deductions and reimbursements – are exclusively set and regulated by the State. Hence, as a result of the rules imposed by the State the applicant company had limited or no choice as to whether and how it would participate in the VAT system of taxation. Likewise, in respect of the supply in question, the applicant company, as a VAT-registered person, did not have a choice in respect of the applicable VAT rules. It therefore cannot be considered that by entering into a contractual relationship with its supplier it had consented to any particular VAT rules that might subsequently have had a negative effect on its tax position.

57. In the light of the foregoing, the Court considers that, in so far as the applicant company had complied fully and in time with the VAT rules set by the State, had no means of enforcing compliance by its supplier and had no knowledge of the latter's failure to do so, it could justifiably expect to be allowed to benefit from one of the principal rules of the VAT system of taxation by being allowed to deduct the input VAT it had paid to its supplier. Moreover, only once a claim for such a deduction had been made and a cross-check of the supplier had been conducted by the tax authorities could it be ascertained whether the latter had fully complied with its own VAT reporting obligations. Thus, the Court considers that the applicant company's right to claim a deduction of the input VAT amounted to at least a "legitimate expectation" of obtaining effective enjoyment of a property right amounting to a "possession" within the meaning of the first sentence of Article 1 of Protocol No. 1 (see, *mutatis mutandis*, *Pine Valley Developments Ltd and Others v. Ireland*, 29 November 1991, § 51, Series A no. 222; *S.A. Dangeville v. France*, no. 36677/97, § 48, ECHR 2002-III; *Cabinet Diot and S.A. Gras Savoye v. France*, nos. 49217/99 and 49218/99, § 26, 22 July 2003; and *Aon Conseil and Courtage S.A. and Christian de Clarens S.A. v. France*, no. 70160/01, § 45, ECHR 2007-...).

58. Separately, as a result of the authorities' conclusion that no VAT had been "charged" on the supply in the August 2000 tax period and of their refusal to recognise the applicant company's right to deduct the input VAT, the latter was ordered to pay the VAT on the supply a second time, together

with interest, to the State budget (see paragraph 14 above). In addition, the applicant company's first payment of VAT on the supply, which it had made to its supplier, was purportedly no longer recognised as an expense for corporate income tax purposes. This in turn increased the applicant's taxable base for the tax year in question, with the result that it had to pay higher corporate income tax than it would allegedly have paid otherwise. These amounts, which the applicant company incurred as a result of the authorities' refusal to allow it to deduct the input VAT, unquestionably constituted possessions within the meaning of Article 1 of Protocol No. 1.

2. Whether there was interference and the applicable rule

59. The Court reiterates that the authorities denied the applicant company the right to deduct the VAT it had been charged by and had paid to its supplier, because the latter had been late in complying with its VAT reporting obligations. This was in spite of the authorities' recognition of the fact that the applicant company had fully complied with its own VAT reporting obligations (see paragraphs 15 and 19 above). Moreover, as a result of the foregoing, the authorities ordered the applicant company to pay all the VAT due on the supply, together with interest, which in turn apparently led to the applicant company having a higher liability for corporate income tax for the tax year in question.

60. The Court notes that the applicant company complained that it had been deprived of its possessions, a situation which fell to be examined under the second sentence of the first paragraph of Article 1 of Protocol No. 1. It is true that interference with the exercise of claims against the State may constitute such a deprivation of possessions (see *Pressos Compania Naviera S.A. and Others*, cited above, § 34). However, as regards the payment of a tax, a more natural approach is to examine the complaint from the angle of control of the use of property in the general interest "to secure the payment of taxes", which falls within the rule in the second paragraph of Article 1 of Protocol No. 1 (see *S.A. Dangeville*, cited above, § 51, and *National & Provincial Building Society, Leeds Permanent Building Society and Yorkshire Building Society v. the United Kingdom*, 23 October 1997, § 79, *Reports of Judgments and Decisions* 1997-VII). The Government argued in favour of this characterisation (see paragraph 35 above).

61. The Court, however, considers that it may not be necessary to decide this issue, since the two rules are not "distinct" in the sense of being unconnected, are only concerned with particular instances of interference with the right to peaceful enjoyment of property and must, accordingly, be construed in the light of the principle enunciated in the first sentence of the first paragraph. The Court therefore takes the view that it should examine the interference in the light of the first sentence of the first paragraph of Article 1 of Protocol No. 1 (see *S.A. Dangeville*, cited above, § 51).

3. Whether the interference was justified

62. The Court reiterates that according to its well-established case-law, an instance of interference, including one resulting from a measure to secure payment of taxes, must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. The concern to achieve this balance is reflected in the structure of Article 1 of Protocol No. 1 as a whole, including the second paragraph: there must be a reasonable relationship of proportionality between the means employed and the aims pursued.

63. However, in determining whether this requirement has been met, it is recognised that a Contracting State, not least when framing and implementing policies in the area of taxation, enjoys a wide margin of appreciation, and the Court will respect the legislature's assessment in such matters unless it is devoid of reasonable foundation (see *Sporrong and Lönnroth v. Sweden*, 23 September 1982, § 69, Series A no. 52; *National & Provincial Building Society, Leeds Permanent Building Society and Yorkshire Building Society*, cited above, § 80; and *M.A. and 34 Others v. Finland* (dec.), no. 27793/95, 10 June 2003).

64. Accordingly, the Court cannot fail to exercise its power of review and must determine whether the requisite balance was maintained in a manner consonant with the applicant company's right to "the peaceful enjoyment of [its] possessions", within the meaning of the first sentence of Article 1 of Protocol No. 1 (see *Sporrong and Lönnroth*, cited above, § 69; *Lithgow and Others v. the United Kingdom*, 8 July 1986, §§ 121-22, Series A no. 102; and *Intersplav v. Ukraine*, no. 803/02, § 38, 9 January 2007).

(a) The general interest

65. The Court considers that in the present case the general interest of the community was in preserving the financial stability of the VAT system of taxation with its complex rules regarding charges, recharges, exemptions, deductions and reimbursements. Essential elements of the preservation of that stability were the attainment of full and timely discharge by all VAT-registered persons of their VAT reporting and payment obligations and, ultimately, the prevention of any fraudulent abuse of the said system. In this respect, the Court accepts that attempts to abuse the VAT system of taxation need to be curbed and that it may be reasonable for domestic legislation to require special diligence by VAT-registered persons in order to prevent such abuse.

(b) Whether a fair balance was struck between the competing interests

66. Following from the above, it is necessary to assess whether the means employed by the State to preserve the financial stability of the VAT system of taxation and to curb any fraudulent abuse of the system amounted

to proportionate interference with the applicant company's right to peaceful enjoyment of its "possessions".

67. The Court notes once again that the applicant company fully complied with its VAT reporting obligations. In addition, the Court notes that the applicant company's supplier also eventually complied with its VAT reporting obligations, but with a two-month delay. As a result, the supplier either paid the VAT into the State budget or deducted the amount of input VAT it had paid to its own supplier and paid the balance of the VAT to the State budget. Thus, the VAT due on the chain of supplies in question was eventually paid to the State.

68. In view of the above, by 31 January 2001, when the tax authorities refused the applicant company's right to deduct the input VAT on the supply in question, it should have been apparent that there had been no negative effect on the State budget. On the contrary, in the end the State budget in fact received two payments of VAT for the same supply – one from the supplier who had received payment from the applicant company and one from the applicant company itself when it was ordered to pay the VAT together with interest. Accordingly, the refusal to allow the applicant company to deduct the input VAT does not seem, in itself, to be justified by the need to secure payment of the taxes, all of which had been paid, or at least reported, by the supplier by that time, albeit belatedly. The Court notes in this respect the rigid interpretation of the provision on which the authorities relied in refusing the applicant company's right to deduct the input VAT and the absence of any assessment of the overall effect on the State budget of the supplier's belated compliance with its obligations.

69. Separately, the Court notes that the applicant company had absolutely no power to monitor, control or secure compliance by its supplier with its VAT reporting, filing and payment obligations. Accordingly, the Court finds that the applicant company was placed in a disadvantaged position by having no certainty as to whether, in spite of its own full compliance, it would be able to deduct the input VAT it had paid to its supplier, since the recognition or otherwise of the right to deduct was also dependent on the tax authorities' assessment as to whether the latter had discharged its VAT reporting obligations in timely fashion.

70. Lastly, as regards efforts to curb fraudulent abuse of the VAT system of taxation, the Court accepts that when Contracting States possess information of such abuse by a specific individual or entity, they may take appropriate measures to prevent, stop or punish it. However, it considers that if the national authorities, in the absence of any indication of direct involvement by an individual or entity in fraudulent abuse of a VAT chain of supply, or knowledge thereof, nevertheless penalise the fully compliant recipient of a VAT-taxable supply for the actions or inactions of a supplier over which it has no control and in relation to which it has no means of monitoring or securing compliance, they are going beyond what is

reasonable and are upsetting 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 (see, *mutatis mutandis*, *Intersplav*, cited above, § 38).

4. Conclusion

71. 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 fashion, 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.

II. ALLEGED VIOLATION OF ARTICLE 14 OF THE CONVENTION

72. The applicant company alleged a violation of Article 14 of the Convention taken in conjunction with Article 1 of Protocol No. 1. It argued that the domestic VAT legislation was discriminatory because it had deprived the applicant company of its possession with the sole aim of securing payment of the VAT due by another company. It also considered this to be discriminatory because it provided for different degrees of protection for State and private property. The applicant company further alleged that its supplier had been treated differently, since the tax authorities had recognised its right to deduct the VAT it had paid in respect of the supply, while denying that right to the applicant company.

Article 14 provides:

> "The enjoyment of the rights and freedoms set forth in [the] Convention shall be secured without discrimination on any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status."

73. The Government contested the arguments of the applicant company and claimed that the relevant VAT regulations were clear, concise and applied in the same manner to all recipients of VAT-taxable supplies. The Government also noted that the applicant company and its supplier had different roles and occupied different levels in the VAT chain of supply.

Accordingly, any difference in their treatment was justified on that basis and could not be construed as discriminatory.

74. The Court notes that this complaint is linked to the one examined above and must therefore likewise be declared admissible.

75. However, having regard to its finding relating to Article 1 of Protocol No. 1 (see paragraph 71 above), the Court considers that it is not necessary to examine whether, in this case, there has also been a violation of Article 14 of the Convention (see, *mutatis mutandis*, *S.A. Dangeville*, cited above, § 66).

III. ALLEGED VIOLATION OF ARTICLE 13 OF THE CONVENTION

76. The applicant company complained under Article 13, taken in conjunction with Article 14 and Article 1 of Protocol No. 1, that it lacked effective domestic remedies for its Convention complaints and that the domestic courts had not addressed its arguments concerning alleged violations of the Convention.

Article 13 provides:

> "Everyone whose rights and freedoms as set forth in [the] Convention are violated shall have an effective remedy before a national authority notwithstanding that the violation has been committed by persons acting in an official capacity."

77. The Court notes that the applicant company had the right of appeal against the tax assessment, of which it made use. In the course of these proceedings it submitted and argued its Convention complaints before the domestic courts, which examined them, albeit finding against the applicant company. Accordingly, no issue arises under this provision.

It follows that this complaint is manifestly ill-founded and must be rejected in accordance with Article 35 §§ 3 and 4 of the Convention.

IV. APPLICATION OF ARTICLE 41 OF THE CONVENTION

78. Article 41 of the Convention provides:

> "If the Court finds that there has been a violation of the Convention or the Protocols thereto, and if the internal law of the High Contracting Party concerned allows only partial reparation to be made, the Court shall, if necessary, afford just satisfaction to the injured party."

A. Damage

79. The applicant company claimed 3,810.24 Bulgarian levs (BGN) (1,953 euros (EUR)) in respect of pecuniary damage. The amount claimed comprised the value of the input VAT, in the amount of BGN 3,610

(EUR 1,851), and the interest charged to the applicant company by the tax authorities (BGN 200.24 (EUR 102), see paragraph 13 above).

80. The applicant company also claimed EUR 3,000 in respect of non-pecuniary damage stemming, in particular, from the frustration, insecurity and uncertainty endured by its executive director.

81. The Government did not comment.

82. In view of the violation it has found of Article 1 of Protocol No. 1, the Court considers that, as regards pecuniary damage, the most suitable form of reparation would be to award the value of the input VAT (EUR 1,851) that the applicant company was ordered to pay a second time, plus the interest that was charged on the aforesaid amount (EUR 102) (see *S.A. Dangeville*, cited above, § 70). Thus, the Court awards the sum of EUR 1,953 to the applicant company for pecuniary damage.

83. The Court further considers that while the applicant company may have sustained non-pecuniary damage, the present judgment provides sufficient compensation for it (ibid.).

B. Costs and expenses

84. The applicant company claimed BGN 546.61 (EUR 280) in respect of the costs and expenses incurred in the proceedings before the domestic courts. The amount claimed comprised the court fee paid for challenging the decision of the Regional Tax Directorate (BGN 50 (EUR 26)), the court fee paid for appealing against the judgment of the Plovdiv Regional Court (BGN 28 (EUR 14)), its lawyer's fees before the domestic courts (BGN 200 (EUR 102)), and the costs and expenses awarded to the tax authorities (BGN 268.61 (EUR 138)). In support of its claim, the applicant company furnished a decision of 16 January 2001 of the Plovdiv Regional Court awarding BGN 268.61 (EUR 137) in costs and expenses to the tax authorities, a legal-fees agreement with its lawyer and receipts for payment of court fees.

85. The applicant company claimed a further EUR 2,097.80 in respect of the costs and expenses incurred in the proceedings before the Court for fifty-two hours' legal work by its lawyer at an hourly rate of EUR 70 and for postal, photocopying and office supply expenses (EUR 27). The applicant company furnished a legal-fees agreement, an approved time sheet and postal receipts in support of its claim. It requested that the costs and expenses incurred for the proceedings before the Court be paid directly to its lawyer, Mr M. Ekimdjiev, with the exception of the first BGN 500 (EUR 256.41), which it had paid as advance payment.

86. The Government did not comment.

87. According to the Court's case-law, an applicant is entitled to the reimbursement of costs and expenses only in so far as it has been shown that these have been actually and necessarily incurred and were reasonable

as to quantum. In the present case, regard being had to the information in its possession and the above criteria, the Court considers it reasonable to award in full the sums incurred for costs and expenses, which total EUR 2,377.80, of which EUR 1,841.39 is to be paid directly to the applicant company's lawyer, Mr M. Ekimdjiev.

C. Default interest

88. The Court considers it appropriate that the default interest should be based on the marginal lending rate of the European Central Bank, to which should be added three percentage points.

FOR THESE REASONS, THE COURT UNANIMOUSLY

1. *Declares* the complaints under Article 1 of Protocol No. 1 to the Convention and Article 14 of the Convention in conjunction with Article 1 of Protocol No. 1 admissible and the remainder of the application inadmissible;

2. *Holds* that there has been a violation of Article 1 of Protocol No. 1 to the Convention;

3. *Holds* that no separate examination of the complaint of a breach of Article 14 of the Convention taken in conjunction with Article 1 of Protocol No. 1 is necessary;

4. *Holds* that the finding of a violation constitutes in itself sufficient just satisfaction for any non-pecuniary damage sustained by the applicant company;

5. *Holds*
   (a) that the respondent State is to pay to the applicant company, within three months from the date on which the judgment becomes final according to Article 44 § 2 of the Convention, the following amounts, to be converted into Bulgarian levs at the rate applicable on the date of settlement:
      (i) in respect of pecuniary damage – EUR 1,953 (one thousand nine hundred and fifty-three euros);
      (ii) in respect of costs and expenses incurred in the proceedings before the domestic courts – EUR 280 (two hundred and eighty euros);

(iii) in respect of costs and expenses incurred in the proceedings before the Court – EUR 256.41 (two hundred and fifty-six euros and forty-one cents), payable to the applicant company, and EUR 1,841.39 (one thousand eight hundred and forty-one euros and thirty-nine cents), payable into the bank account of the applicant company's lawyer, Mr M. Ekimdjiev;

(iv) any tax that may be chargeable to the applicant company on the above amounts;

(b) that from the expiry of the above-mentioned three months until settlement simple interest shall be payable on the above amounts at a rate equal to the marginal lending rate of the European Central Bank during the default period plus three percentage points;

6. *Dismisses* the remainder of the applicant company's claim for just satisfaction.

Done in English, and notified in writing on 22 January 2009, pursuant to Rule 77 §§ 2 and 3 of the Rules of Court.

Stephen Phillips
Deputy Registrar

Peer Lorenzen
President