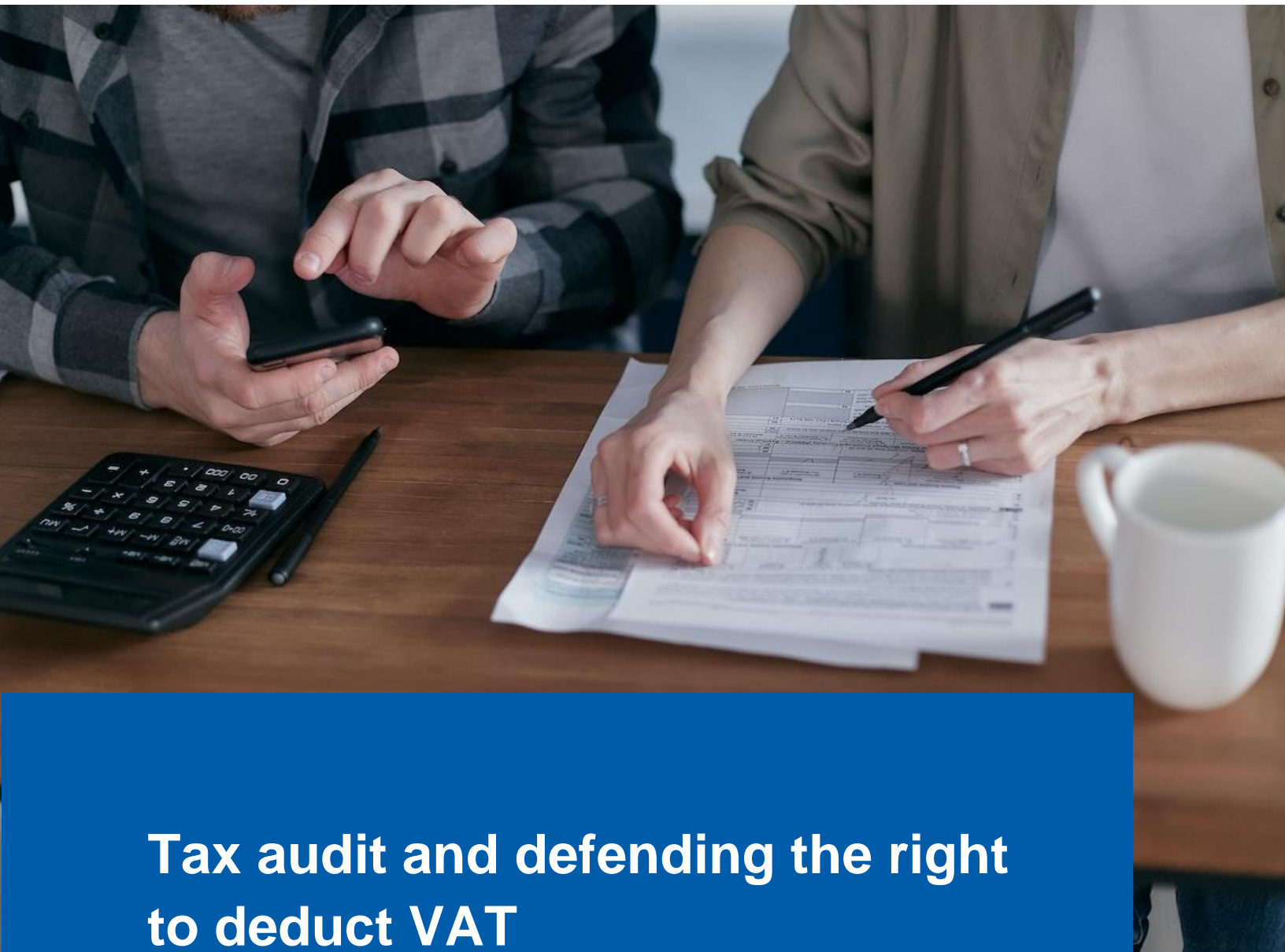


News Flash

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Tax audit and defending the right to deduct VAT

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Can you bear the burden of proof in the tax audit process? A tax audit on VAT can affect any entrepreneur, regardless of whether they are large multinational corporations with various local and cross-border transactions or small and medium-sized enterprises that supply only one type of goods or provide standard services.

A tax audit can make "life" difficult even for honest entrepreneurs whose business is fully compliant with the law. And that's simply because **they can't sufficiently prove the transactions** they've made, or they've chosen the wrong business partner. The burden of proof is on the side of the taxpayer, therefore the entrepreneur should remember in every transaction that the evidence of its real execution must be kept, as it may be needed in the future. **The standard period** for the tax audit on VAT, during which a taxpayer may be investigated, is **almost 6 years**. This represents a relatively long period when considering employee turnover, changes in internal operations, physical storage of documents, etc.

The right to deduct VAT

Small and medium-sized enterprises that have not implemented such detailed internal and control processes can often find themselves in problematic situations, e.g.:



related to the insufficient verification of the business partner



or insufficient supporting documentation.

As the **Court of Justice of the EU** has emphasized several times in its case law, the right of taxable persons to deduct input VAT already paid on goods they have acquired or services they have received from output VAT is a basic principle of the common VAT system and the right to deduct tax is an inseparable part of the VAT mechanism, and in principle cannot be limited.

Principle of neutrality

This **principle of neutrality** requires that a VAT deduction is granted if the substantive requirements are met. In practice, this means demonstrating that:



the delivery of the goods or service occurred as declared on the invoice that the taxpayer has at the disposal,



a tax liability really arose by this delivery,



and also, that the taxpayer, as a buyer, used the purchased goods and services for their own taxable transactions.

The sanction in the form of an absolute denial of the right to deduct VAT is disproportionate if there was no tax evasion.

Tax audit process

The ideal tax audit scenario is as follows:

- **both parties involved** (customer and their supplier) **communicate with the tax administrator, confirm the real execution of the transaction,**
- **the customer can prove with relevant evidence the actual purchase of goods or services** as declared on the invoice,

- and last but not least, **the taxpayer can demonstrate the fact that they subsequently used this input for their taxable output.**

As a result, the doubts of the tax administrator are eliminated, and the tax audit ends without a finding.

When does the tax administrator not have to admit the right to VAT deduction?

The problem arises when transactions in which suppliers did not fulfill their obligations become the subject of tax control. For example, a supplier **does not submit a tax return and control statement or does not pay the tax**, and then becomes uncontactable.

These are situations where the supplier:

- **does not report the respective supply,**
- **reports it in a lower amount,**
- **he does not communicate with the tax administrator** to explain these actions, which in fact raises doubts on the side of the tax administrator about the real existence of this taxable supply and at the same time significantly complicates the customer's position in defending their right to deducted input VAT.

In such cases, which in practice are increasing more and more, the tax administrator tries not to recognize the right to VAT deduction to the customer, instead of recovering the unpaid tax from the supplier. Most often, the tax administrator argues that the actual supply of goods or services did not take place at all, or that it was not carried out in the manner declared by the supplier on the invoice.

Burden of proof in tax proceedings

In order for the taxpayer to avoid the refusal of the right to VAT deduction, **the taxpayer must bear the burden of proof and sufficiently demonstrate that they actually received the goods or services as declared on the invoice** and used them for their taxable output. However, this is usually problematic due to the lack of evidence on the customer's side. Customers often provide only invoices, which does not satisfy the tax administrator, and they do not have other evidence proving the respective delivery.

It is therefore important that every customer approaches this issue with proper attention and makes sure that they also have **other evidence** at their disposal, such as:



signed delivery notes and acceptance protocols,



transport documents, work schedule, orders, contracts,



email communication with the supplier,



record from the attendance system if the service is delivered at the customer's premises, etc.

Often, VAT evasion actually occurred on the side of this uncontactable supplier or at an earlier stage of the business chain, but this fact itself, or other doubts about the supplier and subcontractors at an earlier stage cannot lead to the rejection of the right to VAT deduction.

However, the tax administrator, in its decisions refusing the right to VAT deduction, often questions **the credibility of the supplier** resulting from their:

- inaccessibility,
- insufficient material,
- or personal equipment, etc.

However, if it is proven that goods or services were actually delivered between the customer and their supplier, the right for VAT deduction cannot be rejected only on the basis that the tax administrator considers this transaction to be irrational from an economic point of view, or that the supplier or some of the subcontractors did not fulfill their tax obligations at an earlier stage of the chain. In such a case, the tax administration is obliged to prove, based on all the circumstances and findings, that the given customer knew or could have known that they were participating in a transaction infected by tax evasion. Only when this is properly proven, the tax deduction should not be granted.

How can an entrepreneur avoid the rejection of the right to VAT deduction?

The task of the entrepreneur claiming the VAT deduction, is in the case of a tax audit to **demonstrate that they approach the selection of their suppliers with appropriate care and prudence.**

This may mean, for example:

- communicating and concluding contracts only with authorized persons,
- verifying business partners in publicly available registers,
- ensuring sure that the given supplier is able to deliver the goods or services as ordered, etc.

Verifying your business partners, as well as obtaining and keeping evidence of the actual delivery is undoubtedly time-consuming and administratively demanding, but entrepreneurs should definitely not underestimate these steps. They can thus avoid the time-consuming proving process during the tax audit and, last but not least, the financial consequences, which can even be devastating for small entrepreneurs.

If you are interested in setting up control processes tailored to your company, so that a possible future tax audit does not catch you off guard, we would be glad to offer you our consulting services. Our experience in the field of tax audits will help you identify and reveal weak spots in your processes, and our specific measures will help you reduce the risk of negative findings in the tax audit process. If you find this interesting, do not hesitate to contact us at slovakia@accace.com.

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