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UNRELIABLE VAT PAYER

Abstract

This paper explores legal regulation and practical application of an institute of unreliable VAT payer in the Czech Republic. The paper presents the most important conclusions made by the author within his dissertation research. The first aim is to introduce the institute of unreliable VAT payer and a mechanism of its application to foreign readers in order to enable cross-border comparisons with similar tools used in other states. The second aim of the paper is to confirm or disprove a hypothesis that legal regulation of the institute of unreliable VAT payer does not suffer from any serious deficit which would make it impossible to use this tool properly. The author mainly applies analysis, synthesis and description method. The author came to a conclusion that unreliable VAT payer is a functional tool in practice, but it suffers from several fundamental constitutional deficits.

Key words: tax, VAT, tax evasion, Czech Republic, unreliable VAT payer, undefined legal term.

JEL Classification: K34, H26

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1. Introduction

I have been dealing with a topic of unreliability of tax subjects for a long time within my dissertation research. In this paper, I present the most important conclusions I have made so far. In the Czech Republic, an unreliable VAT payer and a later adopted unreliable person are particularly important in this regard. They have been instituted in the law to facilitate a fight against tax evasion, especially in combination with a taxable transaction recipient's liability for an unpaid tax. The number of unreliable tax subjects (unreliable VAT payers + unreliable persons) has been growing continuously since 2014. The importance of these tools significantly increased in 2016, when control statements were instituted in the law [Section 101c et. seq. of the Act no. 235/2004 Coll. (hereinafter also referred to as "the VAT Act")]. The control statements allow tax administrators to easily identify recipients of taxable transactions (potential guarantors for an unpaid VAT) and thus to apply guarantees more often. Currently, by far the most common reason of a taxable transaction recipient's liability for an unpaid VAT is the fact that the provider of the transaction is an unreliable VAT payer[1]. In this regard, it is beneficial to tax administrators if as many tax subjects as possible are classified as unreliable, because in that case an unpaid tax may be collected from guarantors as well. On the contrary, to a VAT payer (and to his business partners) it is not beneficial at all to be marked as unreliable.

The first aim is to introduce the instrument of unreliable VAT payer and a mechanism of its application to foreign readers in order to enable cross-border comparisons with similar tools used in other states. Given that legal regulation of unreliable VAT payer is in force and effective I hypothesize that it does not suffer from any serious deficit which would make it impossible to use this instrument properly. The second aim of this paper is to confirm or disprove this hypothesis. I focus on several aspects of the topic - compliance with EU law, preconditions of application, consequences of application and legal remedies. I mainly apply analysis, synthesis and description method. I am not aware that the topic would be addressed by another author in the Czech Republic.

2. Introduction to the institution of unreliable VAT payer

In the Czech Republic, a so-called unreliable VAT payer has been instituted in the law to facilitate a fight against tax evasion, especially in combination with a taxable transaction recipient's liability for an unpaid tax. Until the end of 2012, a tax administrator could

[1] According to the information requested from the General Financial Directorate, 93.62% of all guarantee calls for unpaid VAT were issued for this very reason in 2019.

punish committing a breach of obligations relating to VAT administration by cancelling the VAT payer's registration. Since 2013, however, every tax subject with a registered office in the Czech Republic whose turnover for no more than the 12 immediately preceding consecutive calendar month exceeds 1,000,000 CZK shall become a VAT payer by the law. Therefore, cancelling the VAT payer's registration is no longer possible. Even if a tax administrator cancelled the registration of a VAT payer who was in breach of his obligations but achieved the required turnover, such a payer would immediately become a VAT payer again. Therefore, from 1 January 2013, payers whose VAT registration cannot be cancelled remain payers, but if they breach their VAT related obligations, they shall be marked as unreliable VAT payers.

According to the explanatory memorandum [Explanatory Memorandum to Act No. 502/2012 Coll., Amending Act No. 235/2004 Coll., On Value Added Tax, as amended, and other related acts.], the institute of unreliable VAT payer is expected to effectively suppress and prevent a spread of fraudulent activities in the field of VAT by enabling the identification of high-risk taxpayers who abuse the VAT system.

The essence of the institute is that in case of breach of certain obligations, the VAT payer shall be marked as unreliable and his name shall be included in a freely accessible "blacklist" on the official website of the Financial Administration of the Czech Republic. Future business partners of the unreliable payer (the recipients of taxable transactions) then will be exposed to the threat of liability for an unpaid tax for such transaction. The classification of a VAT payer as unreliable and the publication of such information in combination with the threat of liability for an unpaid VAT for his business partners means a significant intrusion in the tax subject's rights and causes him a huge competitive disadvantage.

3. Legal definition of unreliable VAT payer and unreliable person

Legal regulation of unreliable VAT payer has been instituted in the law with effect from 1 January 2013 as a part of the VAT Act. In particular, the following provisions are relevant:

According to Section 106a (1) of the VAT Act: "*If a payer seriously violates his obligations relating to tax administration, the tax administrator shall decide that such payer is an unreliable payer*".

According to Section 106ab (4) of the VAT Act: "*In a manner allowing remote access, the tax administrator shall publish the fact that the given person is an unreliable payer or unreliable person*".

According to Section 109 (3) of the VAT Act: "*A recipient of a taxable transaction shall be liable for any unpaid tax for such transaction if, at the moment of carrying out the transaction or providing the consideration for such transaction, the fact that the provider of the taxable transaction is an unreliable payer is published in a manner allowing remote access*".

Such legislation suffered a major deficit: An unreliable VAT payer could relatively easily get rid of the status by cancelling his tax registration. As a VAT "non-payer", he could no longer be included in the category of unreliable VAT payers. If he became a VAT payer again, the unreliability status was not restored.

The legislature responded to this deficit by instituting a so-called unreliable person in the law [Section 106aa of the VAT Act, effective from 1 July 2017]. Since then, if the registration of an unreliable VAT payer is cancelled, the payer becomes an unreliable person by the law and, conversely, if an unreliable person becomes a VAT payer, he automatically becomes an unreliable VAT payer. As a result of this amendment, a tax administrator may also mark directly the VAT "non-payer" as unreliable, if his conduct is comparable socially harmful. Such unreliable person shall become an unreliable VAT payer at a moment of his registration as a VAT payer [Explanatory Memorandum to Act No. 170/2017 Coll., Amendment of certain laws in the field of taxes]. The main difference between an unreliable VAT payer and an unreliable person is that the unreliability of a person has no liability consequences for his business partners. This paper primarily explores the institute of unreliable VAT payer, but the conclusions should be, in principle, applicable to unreliable persons as well.

4. Unreliable VAT payer versus EU legislation

Considering the harmonization of VAT at EU level, I first examine whether the Czech legislation of unreliable VAT payer is in accordance with EU legislation. At my request for information, the Ministry of Finance of the Czech Republic informed me that the institute of unreliable VAT payer has not been inspired by any foreign legislation. It is therefore a purely Czech invention.

The Council directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter also referred to as "the Directive") is particularly relevant in regard of the harmonization. The competence to introduce an instrument such as unreliable VAT payer in the national law is based on Article 273 (1) of the Directive, which provides: "*Member States may impose other obligations which they deem necessary to ensure the correct collection of VAT and to prevent evasion, subject to the requirement of equal*

treatment as between domestic transactions and transactions carried out between Member States by taxable persons and provided that such obligations do not, in trade between Member States, give rise to formalities connected with the crossing of frontiers". Thus the Directive allows, in principle, national regulation of such an instrument, provided that the conditions are met. I therefore do not consider the legislation of unreliable VAT payer itself problematic in the context of the EU legislation.

However, as part of my research, I encountered a problem with the Czech legal regulation of a liability of recipients of taxable transactions, which is closely related to the unreliable VAT payer institute. Considering the text of the law [already cited Section 109 (3) of the VAT Act], the taxable transaction recipient's liability has been enacted as a liability without fault. But such a system of strict liability is forbidden by EU legislation.

Although Article 205 of the Directive allows Member States to enact a liability of third persons for payment of VAT in some situations, according to the Court of Justice of the European Union, Member State may make a person jointly and severally liable for the payment of VAT if, at the time of the supply, that person knew or had reasonable grounds to suspect that the VAT payable in respect of that supply, or of any previous or subsequent supply, would go unpaid. Member State may rely on presumptions in that regard, but such presumptions may not be formulated in such a way as to make it practically impossible or excessively difficult for the tax subject to rebut them with evidence to the contrary [CJEU No. C-384/04, Federation of Technological Industries and Others].

Thus, it seems that the Czech legislation is in conflict with EU legislation in this regard. Nevertheless I believe this conflict can be overcome by euro-conform interpretation of the provisions of Section 109 (3) of the VAT Act. In order to meet the requirements set by the Court of Justice of the European Union it is necessary for a tax administrator to perform a so-called knowledge test (Did VAT payer know or should have known or could have known about tax evasion?) even though the law does not explicitly state it. In case of a negative result of the knowledge test, the liability of the recipient of the transaction shall not arise. The Supreme Administrative Court has already reached the very same conclusion, while interpreting the provisions of Section 109 (2) of the VAT Act, which applies to the liability of recipient of a taxable transaction for unpaid VAT in a case the payment for taxable transaction is provided by cashless transfer to a foreign bank account [SAC No. 5 Afs 78/2017-33].

5. Criteria for a VAT payer's unreliability

It is clear from the text of Section 106a (1) of the VAT Act that the unreliable VAT payer institute should be used in case of a serious violation of obligations relating to tax administration. However, it is not clear at all which obligations are to be involved. The term "serious violation of obligations relating to tax administration" is an undefined legal term, and neither the law nor any other legal regulation mentions any of its characteristics. This is an undesirable phenomenon, as the legislature should ensure that certain characteristics are mentioned in the laws or in implementing regulations [Hendrych, Fiala 2009: 217-218; or SAC No. 5 Afs 151/2004-73].

According to the explanatory memorandum [Explanatory Memorandum to Act No. 502/2012 Coll., Amending Act No. 235/2004 Coll., On Value Added Tax, as amended, and other related acts.], the term shall be defined by a statement of the General Financial Directorate, because such a method of unifying interpretive practise enables an operative response to practical knowledge. To the legislature, it seemed unsuitable and "perhaps even unconstitutional" to supplement the characteristics of an unreliable payer in the form of an implementing legal regulation by the Ministry of Finance. On the other hand, the legislature has evaluated the actually adopted legal regulation as constitutionally compliant. He even considers it to be strengthening the legal certainty of taxpayers.

This argument seems absurd to me. If it is unsuitable and "perhaps even unconstitutional" to supplement the characteristics in the form of an implementing legal regulation, then the more it must be unsuitable and unconstitutional to supplement the characteristics in the form of non-legal (or semi-legal) regulation such as statement of the General Financial Directorate.

Nevertheless, the General Financial Directorate has published a document entitled "Information of the GFD on the application of Section 106a of the VAT Act (unreliable VAT payer) and related provisions", dated 19 December 2017, No. 101/13-121002-506729, as amended by fourth amendment No. 137801/17/7100-20118-012287 (hereinafter also referred to as "the Information"), which has a form of an internal normative instruction. The document currently includes four amendments, which have significantly expanded its original content. The information as amended by the fourth amendment contains an exhaustive list of nine very specific situations which are considered to be serious violations of a VAT payer's obligations by the General Financial Directorate. These situations include committing of various tax delicts consisting in a breach of payment related or payment not related obligations, or a combination of both.

The above-mentioned situations include various breaches of obligations resulting in, for example, an assessment of a tax in accordance with aids, rejection of a tax deduction, issuing a securing order [more information to the institute of securing order at Balcar 2019, Securing Order], or an additional tax assessment. The situations where a tax subject does not provide required assistance to a tax administrator or where he has a cumulated VAT arrears in a certain value are also included. Committing any of these delicts results in issuing the decision on unreliability of the VAT payer.

An analysis of all the situations would go far beyond the scope of this paper, so in this regard I refer to my previous research [Balcar 2019, Právní povaha institutu nespolehlivého plátce DPH: 43-58]. To exemplify, I present just one of the situations: "*The public interest on proper VAT collection is jeopardized, as there are recorded cumulative VAT arrears at the payer in the minimum value of 500,000 CZK without tax attribution during the period of at least three consecutive calendar months. These cumulative VAT arrears arose from tax liabilities assessed or additionally assessed after 1 January 2013, and this situation persists at the moment of the issuance of a decision on the unreliable payer*" [The Information of the General Financial Directorate]. This one is a typical example of a breach of payment related obligation.

This situation is particularly interesting because in the original Information the limit of committing the delict (the limit of jeopardizing the public interest) consisting of the value of cumulative arrears was set at 10 million CZK. However, later the limit has been reduced to 500,000 CZK by the third amendment to the Information. Such significant reduction has naturally resulted in a massive increase of tax debtors to whom the situation applies, and consequently also in a significant increase of number of unreliable VAT payers.

6. Decision on unreliability of a VAT payer

A VAT payer who fulfils the characteristics of at least one of the situations described in the Information shall be marked as unreliable by a decision of a tax administrator. What does it actually mean for the VAT payer?

The payer shall be included in the list of unreliable VAT payers (kind of blacklist), which is freely accessible on the official website of the Financial Administration of the Czech Republic. Taxpayer's potential business partners will probably not want to make business with someone who is officially considered unreliable. Such a status is strongly defamatory and, I believe, it evokes a fraud. Potential business partners of an unreliable VAT payer would also be exposed to the threat of liability for an unpaid tax. It may be reasonably

assumed that if they have the choice to do business with an unreliable VAT payer, or on similar conditions with someone else, they will choose the second option. Marking a VAT payer as unreliable and the publication of such information, combined with the threat of liability, means a significant intrusion with the property and personal rights of the tax subject, as it causes him a huge competitive disadvantage which may even lead to his bankruptcy or to an economic demise.

Considering the consequences of the unreliable VAT payer institute, the key question is: What is the legal nature of this institute? Is it a sanction or even a punishment? The answer to this question is crucial, as the application of special legal principles typical for a criminal law, such as *nullum crimen sine lege* (in the case of unreliable VAT payer, the requirement of *nullum crimen sine lege certa* is particularly relevant), *ne bis in idem* or a prohibition of retroactivity depends on it.

According to the explanatory memorandum [Explanatory Memorandum to Act No. 502/2012 Coll., Amending Act No. 235/2004 Coll., On Value Added Tax, as amended, and other related acts], the institute of unreliable VAT payer is meant to be "*not only repressive but also preventive measure*". The same explanatory memorandum also expressly states that the classification of a tax subject as unreliable and the publication of that information is a sanction.

The Supreme Administrative Court, which is the highest authority in a field of the interpretation of tax laws in the Czech Republic, has not yet ruled on the question of the legal nature of the unreliable VAT payer. The court just stated that it is questionable whether such a decision constitutes a punishment within the meaning of the Charter of Fundamental Rights and Freedoms of the Czech Republic and the Convention for the Protection of Human Rights and Fundamental Freedoms [SAC No. 8 Afs 71/2018-38].

The question of the legal nature of the decision on unreliability of a VAT payer has already been ruled several times at administrative courts of the first instance (regional courts). However, the case law of these courts is not consistent. In some cases, courts have stated that the decision on unreliability is a punishment [RC in Praha No. 10 Af 81/2016-49; RC in Brno No. 29 Af 66/2016-36; RC in Brno No. 30 Af 21/2016-39], in some cases that it is neither a punishment nor even a sanction, but just a "measure" [RC in Plzeň No. 30 Af63/2016-48; RC in Ostrava No. 22 Af 152/2017-36]. So it is definitely worth following how the Supreme Administrative Court will deal with the question.

The public defamatory status of a tax payer in combination with the threat of liability for an unpaid VAT for his business partners surely means a significant intrusion in the property

and personal rights of the VAT payer. If it leads to a bankruptcy or even to an economic demise of the tax payer, it is, in my view, a far more serious consequence than an imposition of most of other punishments. According to the European Court of Human Rights, the severity of an imminent sanction is one of the criteria for defining a criminal offense [ECHR No. 14939/03, Zolotukhin v. Russia], therefore, in my opinion, the decision on unreliability should be considered a punishment within the meaning of the Charter of Fundamental Rights and Freedoms of the Czech Republic and the Convention for the Protection of Human Rights and Fundamental Freedoms.

7. Statistics

I believe the importance of a legal institute is determined, among other things, by the frequency of its use. The more often the legal instrument is applied in practice, the more attention should be paid to it. Therefore, I compiled some basic statistics on numbers of unreliable tax subjects in the Czech Republic.

A VAT payer is marked as unreliable formally - by a decision of a tax administrator within the meaning of Section 101 et seq. of the Act no. 280/2009 Coll. (hereinafter also referred to as “the Code of Tax Procedure”). The following overview shows how many decisions on unreliability of a VAT payer and unreliability of a person were issued each year:

Table 1. Number of decisions on unreliability of tax subjects

Year	2013	2014	2015	2016	2017	2018	2019
Number of issued decisions on unreliability of a VAT payer	0	4	5,201	7,726	9,815	9,436	8,320
Number of issued decisions on unreliability of a person	0	0	0	0	1,516	11,190	8,207

Source: author’s own elaboration based on the data provided by the General Financial Directorate

The data shows that the number of issued decisions on unreliability of a VAT payer was continuously increasing from 2014 to 2017 and since then it has been slowly decreasing. Since 2017, a part of unreliable payers has probably started moving into the category of unreliable persons. From the obtained data it is not possible to find out the number of new

unreliable subjects (VAT payers + persons) in any year, because the data obviously do not consider transfers of tax subjects between the two categories.

Therefore, the statistics of the number of registered unreliable VAT payers and persons as of a certain date, e.g. always as of 31 December, are more relevant. However, the General Financial Directorate refused to provide me with this data, so I can only rely on unofficial sources.

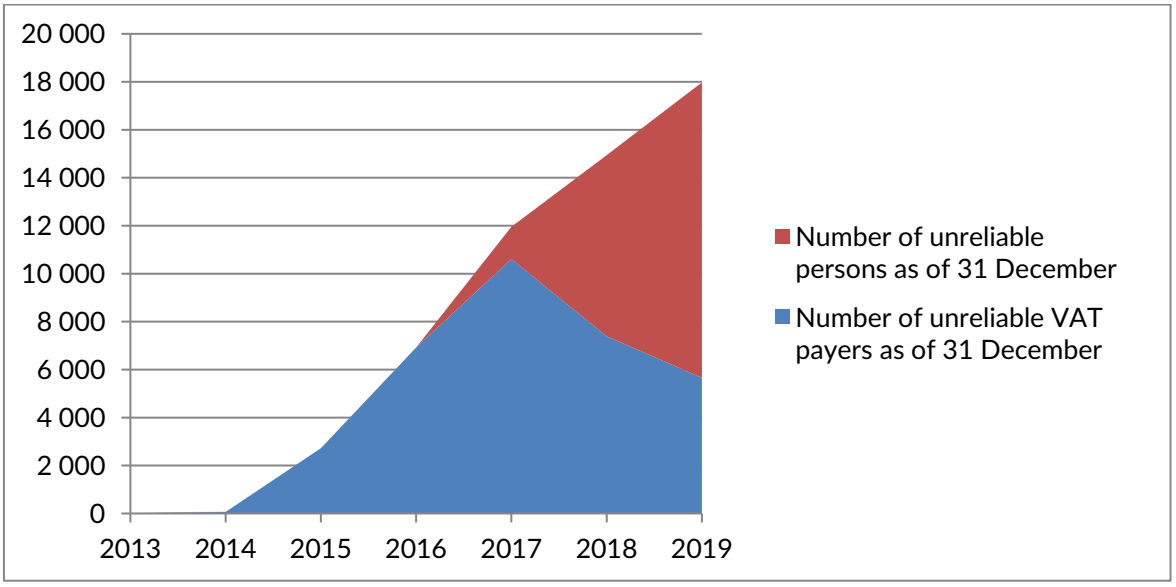
Table 2. Number of unreliable tax subjects

Year	2013	2014	2015	2016	2017	2018	2019
Number of unreliable VAT payers as of 31 December	9	67	2,722	6,921	10,613	7,385	5,656
Number of unreliable persons as of 31 December	0	0	0	0	1,340	7,554	12,318
Number of unreliable VAT payers and unreliable persons as of 31 December	9	67	2,722	6,921	11,953	14,939	17,974

Source: author's own elaboration based on the data from the website bisnode.cz

The above-mentioned data are projected into the following graph. Apparently, although the number of registered unreliable VAT payers has been decreasing since 2017, the number of unreliable tax subjects (VAT payers + persons) continues to grow as the number of unreliable persons increases.

Graph 1. Number of unreliable tax subjects in time



Source: author's own elaboration based on the data from the website bisnode.cz

8. Legal remedies

If a tax subject considers the decision on his unreliability incorrect or unlawful, he may challenge it, in particular, by an ordinary legal remedy, which is an appeal [Section 109 et seq. of the Code of Tax Procedure]. The appeal period is only 15 days, which is halved compared to the general appeal period. The reason for the shortening is the effort to speed up the decision-making process. Also, contrary to the general rules, an appeal against a decision on unreliability of a VAT payer has a suspensive effect, which may, however, be excluded by a tax administrator for reasons worthy of special consideration [Brandejs, 2017: Sec. 106a]. Based on the data on appeals resolved at the Appellate Financial Directorate, I calculated their success rate:

Table 3. Appeal success rate

Year	2013	2014	2015	2016	2017	2018	2019	In total
Number of appeals	0	4	79	142	202	178	125	730
Number of reviewed decisions	0	3	44	149	161	156	162	675
Number of successful appeals (decision reversed, changed or returned to the first instance)	0	0	3	3	9	10	25	50
Number of unsuccessful appeals (appeal dismissed)	0	3	41	146	152	146	137	625
Appeal success rate (in %)	-	0.00	6.82	2.01	5.59	5.77	15.43	7.41

Source: author's own elaboration based on the data provided by the General Financial Directorate

Obviously the Appellate Financial Directorate has dismissed the majority of appeals. It needs to be emphasized that the Appellate Financial Directorate is not an independent authority, but is subordinate to the General Financial Directorate, whose statements are binding for it. That is why a reversion or a change of a challenged decision within the appeal proceedings may not be expected, if the decision of a tax administrator is in accordance with the statement of the General Financial Directorate (even a bad one). The above-mentioned success rate of appeals should therefore only apply to decisions that were in violation of the Information, so I consider the statistics on judicial reviews overall more relevant.

In the Czech Republic, a decision of an administrative authority (including tax administrators) may be contested by an administrative complaint. The complaint is

inadmissible if the complainant has not exhausted ordinary remedies in the procedure before. The defendant (respondent) is an administrative authority which has made the last instance decision (in a case of unreliable VAT payer it is always the Appellate Financial Directorate). The contested decision shall be reviewed and may be revoked by court as unlawful or for procedural faults [Section 65 et seq. of the Act No. 150/2002 Coll., the Code of Administrative Justice].

Table 4. Success rate of tax subjects at courts

Year	2013	2014	2015	2016	2017	2018	2019	In total
Number of complaints	0	0	0	12	8	17	7	44
Number of successful complaints at courts of first instance	0	0	0	0	0	3	3	6
Number of unsuccessful complaints at courts of first instance	0	0	0	0	0	9	3	12
Number of successful cassation complaints by the Appellate Financial Directorate	0	0	0	0	0	0	1	1
Number of successful cassation complaints by tax subjects	0	0	0	0	0	0	2	2
Total success of tax subjects at courts	0	0	0	0	0	3	4	7
Total success of tax subjects at courts in % (total success rate)	-	-	-	0.00	0.00	17.65	57.14	38.89

Source: author's own elaboration based on the data provided by the General Financial Directorate

The chart above shows that in 2013-2019, at courts of administrative justice, the Appellate Financial Directorate defended 11 out of 44 decisions on unreliability while 7 out of 44 were revoked by courts. The rest of cases (26 out of 44) has not been resolved yet. The success rate of tax subjects (unreliable VAT payers) at administrative courts is 38.89 % so far. However, the case law of the Supreme Administrative Court will be crucial in this regard. The Supreme Administrative Court has not yet dealt with the issue of the unreliable VAT payer and most of proceedings have not yet been finally resolved.

A tax subject may also challenge a final decision of a tax administrator by an extraordinary remedy: a petition to permit the reopening of the proceedings. The reopening of proceedings may also be ordered as a mean of supervision. Another supervisory mean is an order by a closest superior tax administrator to review the decision. However, in cases of decisions on unreliability, these remedies are actually not used in practise very often -

there are only very few cases in total [more information to the legal remedies at Balcar 2020: 38-46].

There is also another – very specific – option for an unreliable VAT payer to get rid of the unreliability status. An unreliable payer may request a tax administrator to issue a decision stating that he is no longer unreliable. The tax administrator shall issue such decision, provided that the unreliable VAT payer does not seriously violate his obligations relating to tax administration for a period of at least a year. If the unreliable payer does not fulfil the condition, the tax administrator shall decline the request. An unreliable payer may file the request no earlier than after the expiration of one year from the day of the full force and effect of the decision: a) that he is unreliable, b) by which the tax administrator dismissed a request for the issuance of a decision stating that they are not unreliable, or c) that the group of which they were members is an unreliable payer [Section 106ab of the VAT Act].

I consider such legislation problematic because a lot of practical issues arise during its application. For example, if the unreliable payer miscalculates the period, and instead of one year from the legal force of the decision on his unreliability, requests the status change after one year from its delivery (or from the date stated in the decision), the tax administrator, according to the provision of Section 106ab of the VAT Act, will probably have no choice but to decline the request. Moreover, from the legal force of this declining decision, a new period of one year will begin to run, during which a change of status cannot be successfully requested. Instead of being able to reapply for a change of status after a few days (when one year has actually passed since the decision on the unreliability came into force), the tax subject is practically excluded from economic life for another year due to a marginal mistake. I see no rational reason for such harsh approach. I am convinced that the entire legal regulation of the unreliable payer institute is influenced by the efforts of the Ministry of Finance to permanently eliminate “unreliable” subjects from their business.

9. Constitutional aspects

The most serious problems of the institute of unreliable payer are constitutional deficits of its legal regulation. From the constitutional perspective, two aspects in particular are important. The first of them is a question of the competence of administrative authorities for creating norms and the second is a question of constitutional reservations of the law. These two aspects are closely related.

Regarding the limits of administrative norms-creating, the Constitutional Court of the Czech Republic has already explained that a situation where the law inadmissibly delegates creating norms to an executive body is in conflict with the Constitution - when, for example, a ministry is empowered to adjust something for which the law itself does not set any limits, respectively, which the law does not regulate at all. In such case, it is not a question of implementing the law, but of supplementing it, as the implementing regulation would have to fully define an undefined legal term [Constitutional Court No. Pl. ÚS 23/02].

In that decision, the Constitutional Court stated that in order to ensure the effective exercise of public administration, it is possible and appropriate to leave the adjustment of details to a sub-statutory law that may be changed more operationally. Therefore, the constitutional law of the Czech Republic allows the legislature to authorize executive bodies to issue secondary legislation under certain conditions. However, such legal authorisation must be explicit and the content of the sub-statutory regulation must comply with the law it implements. Such a regulation may be issued only on basis of the law and within its limits. If the legislature resigns from setting the legal framework and blankly authorizes the executive body to determine what the law is, what the rights and duties of persons are, or what the powers and responsibilities of administrative authorities are, then it violates the principle of limited delegation of norm-creating and thus violates the principle of separation of powers in the state [Constitutional Court No. Pl. ÚS 23/02].

This conclusion of the Constitutional Court concerns issuance of sub-statutory legislation. However, the situations which are considered to be serious violations of the VAT payer's obligations are not defined by a sub-statutory regulation, but only by an internal normative instruction (the Information) of the General Financial Directorate which is not binding externally. Thus it is necessary to answer the question whether the given conclusion also applies to the institute of unreliable VAT payer.

The literature on internal normative instructions states that administrative authorities act as creators of law - both formal and material - when issuing secondary legislation. Nevertheless material law is also created by issuing of internal regulations governing activities of subordinate administrative authorities. This is typical for the Ministry of Finance and its subordinate tax administration [Karfíková 2018: 48]. An internal regulation may also guide the interpretation of an undefined legal term in the hierarchy of administration [Hendrych 2016: 54-55]. Such interpretation is called official, internal or officially binding and is based either on an explicit legal provision or on a premise that the issuance of internal normative instructions or guidelines for subordinates is an integral part of management [Gerloch 2013: 132]. However, such interpretation is not and cannot be

generally binding. It is binding only to subordinate bodies and staff, as well as any other internal instruction [Veverka, Boguszak, Čapek 1996: 149].

I therefore believe that the limits defined by the Constitutional Court must be applied to internal regulations as well, and moreover they should be assessed even more strictly in such case, as formally internal regulation is not a source of law.

In this regard it needs to be emphasized that the content of the Information has been changed four times (by amendments) so far. Neither the process of issuing an internal normative instruction nor the form of it are regulated by legal norms, but at most only by another internal regulations, moreover in different departments differently [Veverka, Boguszak, Čapek 1996: 73-74]. While strict legal (or even constitutional) rules apply to the process of changing of legal regulation, no legal norm regulates the process of changing of internal regulation - in this case the issuing of an amendment to the Information of General Financial Directorate. That procedure is probably regulated only by another - not published - internal regulation[2].

By the third amendment to the Information, the General Financial Directorate has lowered the limit of the value of cumulated arrears as a prerequisite for a decision on unreliability of the VAT payer from 10 million CZK to 500,000 CZK. From day to day, the content of the undefined legal term “serious violation of obligations relating to tax administration” has changed dramatically. This change was based neither on the text of the law nor on the case law of courts. The General Financial Directorate made the change completely arbitrarily. I consider this situation to be a textbook case of exceeding the limits of administrative “regulation”. If any law allows it, then such a law itself must be in conflict with the constitutional principles of the rule of law. Otherwise, nothing would prevent the General Financial Directorate from reducing the amount of cumulated arrears even to, for example, 1 CZK due to the fight against tax evasion. In the current situation, the General Financial Directorate actually substitutes the legislature. Considering the consequences of the application of the institute of unreliable VAT payer for tax subjects, I find such a situation unacceptable.

With regard to the constitutional reservations of the law, the crucial issue is the already mentioned legal nature of the institute of unreliable payer. If it represents a punishment, then the legislation of the institute of unreliable VAT payer probably is in conflict with the principle of *nullum crimen sine lege certa* [cf. Article 39 of the Charter of Fundamental Rights and Freedoms]. Moreover, in certain cases tax subjects may also reasonably point to

[2] I had requested for the internal regulation but General Financial Directorate refused to provide it.

breaching the principle of prohibition of retroactivity [cf. Article 40 (6) of the Charter of Fundamental Rights and Freedoms] and the *ne bis in idem* principle [cf. Article 40 (5) of the Charter of Fundamental Rights and Freedoms], since at least some of the situations which are considered to be serious violations of the VAT payer's obligations consist in a commission of a tax delict, which is penalised by other means of law as well (typically penalty, interest on arrears or various fines).

Even if marking a tax payer as unreliable did not constitute a punishment (but only a sanction of a non-criminal nature), the legislation would be in conflict with the general reservation of the law, which states that the power of the state may be asserted only in cases and within the limits set by law and in a manner determined by law [Article 2 (2) of the Charter of Fundamental Rights and Freedoms]. In other words, all executive authorities must have limits set by law for their norm-creating and executive competences so that they may be considered constitutionally conform and without arbitrary exercise of power [Wagnerová, Šimíček, Langášek, Pospíšil 2012: 86-90].

And moreover, in my opinion, the current legal regulation of the unreliable VAT payer does not respect either the reservation of law, which states that any limits placed on fundamental rights and freedoms may be governed only by law under conditions set by the Charter of Fundamental Rights and Freedom [Article 4 (2) of the Charter of Fundamental Rights and Freedoms] in connection with the constitutional protection of good reputation [Article 10 (1) of the Charter of Fundamental Rights and Freedoms] or in connection with the constitutional protection of right to engage in enterprise [Article 26 (1) of the Charter of Fundamental Rights and Freedoms].

10. Conclusions

The institution of unreliable VAT payer is an interesting tool which represents a functional solution to a situation where it is not possible to cancel a VAT payer's registration. However, its legal regulation suffers from several serious constitutional deficits. There are no criteria specified for issuance of a decision on unreliability in the VAT Act. Application of Section 106a (1) of the VAT Act depends on the interpretation of the undefined legal term "serious violation of obligations relating to tax administration". The legislature has left the General Financial Directorate to interpret what is meant by this term in its internal normative instruction. Therefore, the General Financial Directorate may not only set the criteria for a decision on unreliability of VAT payer, but it can also change them arbitrarily. This has already happened when the limit of the value of the accumulated arrears, as a

precondition for issuance of decision on unreliability, was reduced from 10 million CZK to 500,000 CZK by the General Financial Directorate. It naturally resulted in a massive increase of tax debtors to whom the situation applies, and consequently also in a significant increase of number of unreliable VAT payers. I believe that, in the current situation, the General Financial Directorate actually substitutes the legislature inadmissibly. Another fundamental problem is that the legal regulation does not provide an answer to the question of whether a decision on unreliability of a VAT payer is a punishment or not. The answer to this question is crucial, as the application of special legal principles typical for a criminal law, such as nullum crimen sine lege, ne bis in idem or a prohibition of retroactivity, depends on it. I assert that these issues cause a conflict with constitutional law, especially with the constitutional reservations of the law and with the limits of competence of administrative authorities for creating norms.

I believe I have managed to introduce the institute of unreliable VAT payer and a mechanism of its application coherently to foreign readers. The hypothesis that the institute of unreliable VAT payer does not suffer from any serious deficit that would make it impossible to use this instrument properly has been disproved. I am convinced that if the institute is to be preserved, it needs to be changed. An inspiration for such a change may be sought in foreign legal regulations. This paper could enable such a seeking within a cross-border cooperation, which would allow to make comparisons with similar tools used in other states. I therefore believe that both aims of this paper were met.

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